Y 2018 Earnings Call

Company Participants

- Christian Arnell, Investor Relations
- Tian Xu, Vice President of Finance
- Zheng Huang, Chief Executive Officer

Other Participants

- Alicia Yap, Analyst
- Grace Chen, Analyst
- Natalie Wu, Analyst
- Piyush Mubayi, Analyst
- Thomas Chong, Analyst

Presentation

Operator

Ladies and gentlemen, thank you for standing by and welcome to the Pinduoduo Fourth Quarter Fiscal Year 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question-and-answer session. (Operator Instructions) I must advise you that this conference is being recorded today, Wednesday, 13th of March 2019.

I would like to hand the conference over to your first speaker today, Mr. Christian Arnell. Thank you. Please go ahead.

Christian Arnell {BIO 22010857 <GO>}

Thank you, Karina. Hello, everyone, and thank you for joining us today. Pinduoduo's earnings release was distributed earlier and is available on the IR website at investor.pinduoduo.com as well as through Globe Newswire services.

On the call today from Pinduoduo are Mr. Zheng Huang, Chairman and Chief Executive Officer; and Mr. Tian Xu, Vice President of Finance. Mr. Huang will review business operations and company highlights, followed by Mr. Xu, who will discuss financials. They will both be available to answer your questions during the Q&A session that follows.

Before we begin, I'd like to remind you that this conference contains forward-looking statements made within the meaning of Section 21E of the US -- of the Securities Exchange Act of 1934, as amended, and as defined in the US Private Securities Litigation

Reform Act of 1995. These forward-looking statements can be identified by terminology such as will, expect, anticipate, future, intend, plans, believes, estimates, targets, going forward, outlook and similar statements. Such statements are based upon management's current expectations and current market operating conditions, and relate to events that involve known or unknown risks, uncertainties and other factors, all of which are difficult to predict, and many of which are beyond the company's control, which may cause the company's actual results, performance or achievements to differ materially from those in the forward-looking statements.

Further information regarding these and other risks, uncertainties or factors is included in the company's filings with the US Securities and Exchange Commission. The company does not undertake any obligation to update any forward-looking statement as a result of new information, future events or otherwise, except as required under applicable law.

It is now my pleasure to introduce Chairman and Chief Executive Officer, Mr. Huang. Mr. Huang, please go ahead.

Zheng Huang {BIO 20683053 <GO>}

Thank you, Christian. And thanks to everyone for joining us on the fourth quarter and full year 2018 results discussion.

2018 was another strong year of growth as we continue to lay the foundation for our long-term development. I would like to start off by thanking our 418.5 million active buyers for their continued trust and supporting us. Our top priority has always been serving our users, since we founded the company. The faster growth of our user base and GMV demonstrates the differentiated value our platform brings to them. That being said, their needs are constantly evolving, which motivates us to keep innovating and improving.

Let me recap our full year 2018 key results. Our last 12 months GMV increased by 3.3 times to RMB471.6 billion. This was driven by one, a net increase of about 174 million annual active buyers, which brings our 2018 annual active buyers base to 418.5 million.

And two, a near doubling of annual spending per active buyer to RMB1,127. The increase in annual spending per active buyer was driven by the increase in order frequency per annual active buyer for about 18 orders a year ago to 28 order -- 27 orders as of December 31, 2018, with the rest driven by the increase in average order value.

Given the increase in both active buyers and active orders -- average orders per active buyer, our order volume expanded to 11.1 billion in a full year of 2018, up from 4.3 billion a year ago, implying average orders of 30.4 million versus 11.8 million a year ago. We view this as an indication of users' growing recognition and a satisfaction with what we have worked hard and it served as encouragement for us to keep delivering for our users.

Simultaneously, with our growing user scale and rising user engagement, our platform is becoming increasingly attractive to merchants. As a result, our active merchant base grew to 3.6 million merchants as of December 31, 2018, from approximately 1 million as of

March 31, 2018. The increasing number of merchants contributed to our full year 2018 revenue growth of 652% year-on-year to RMB13.1 billion, of which majority came from our online marketing services. We first launched our online marketing service in April 2017. Since then, we have continued to roll out different advertising formats to enable merchants to reach out to their target users and to enable ourselves to understand our users better.

We plan to further attract and incentivize high quality merchants to offer better SKUs and services to our users. We offer these merchants incentives from time-to-time through different formats. Even though it might slow down the monetization of the platform in a short run, we believe this effort will benefit our users and enhance the platform in the long-term.

I would like to touch on some of the efforts we have made to satisfy consumers' needs. First, consumers want high quality and affordable products. Last December, we launched our new brand initiative to enable capable manufacturers to design, manufacture, and offer better and more suitable products on our platform. Given the already established user scale and active user interactions, we can leverage our understanding of the users preferences and our demand aggregation capabilities to help these manufacturers decide who to sell to, and what to sell and how to sell.

As part of the first phase, we carefully selected 20 manufacturing partners, out of over 1,000 applications from a variety of industries, spanning paper products -- paper products, kitchenware, and electronics, to name a few. We have Chongqing Baiya, a diaper manufacturer and Chaozhou Songfa, which makes ceramic products. The potential sales volume for our 418.5 million paying users, gives these manufacturers the confidence to plan and streamline their manufacturing process, reduce wastage, and optimize their distribution layers to offer more tailored and a better quality product to our users at more attractive prices.

We can make this happen, because China has already developed world class manufacturing and product design capabilities. As the domestic consumption trend continues to rise, we'll have a great opportunity to help these high quality manufacturers build their own brands and alleviate the pain points they face to better capture this growth opportunity. Namely, one, they have limited direct access to end-users at early stage of their brand development, which would impact their brand recognition and the credibility. Second, they have limited knowledge of what their targeted users want in terms of product features and a price range. And third, they have less business visibility to scale and expand their production and inventory.

Over the past four years, we have built a bridge between these capable manufacturers and users to provide anonymized consumer information product preferences and trends and their timely feedback to help their -- help our manufacturers, grow their business and build brand recognition directly with our users.

As distribution channels and shopping formats change in a shifting media, we believe that a new and reputable brand will emerge in China, of which, many will evolve and become global brands. Pinduoduo is dedicated to enabling our partners to become a significant driving force of the economy.

I'd like to share an example from one of our partner manufacturers Jiaweishi. Jiaweishi is one of the world's leading robot vacuum cleaner OEM for many renowned international brands and has accumulated over 70 international patents. They have a strong technical and manufacturing capabilities, but have low brand recognition among consumers. In electronics, brand recognition is important as consumers tend to equate brands with a certain level of quality, and are hence willing to pay a price premium for more recognized brand as a form of insurance. This would make it difficult for new or less developed brand to gain traction without a huge long-term commitment to marketing spending.

How can we help consumers gain trust with manufacturers or new brands like Jiaweishi and at the same time, help these manufacturers or new brands sell their products in a cost efficient manner. To break through this dilemma, we have started working with Jiaweishi as part of our new brand initiative efforts, where we help our partners understand the needs of our users and better tailor their products in a price range to our platform.

One of the innovative method is transparent manufacturing, where we build the user trust through production live streaming and a greater supply chain traceability. Through our close collaboration, Jiaweishi to-date has sold over 110,000 robot vacuum cleaners on PDD, compared to 900,000 units sold by the biggest robot vacuum cleaner in China in 2018. As a result, manufacturers enjoy better margins while consumers are able to find affordable quality products on our platform. After these early signs of success, we have decided to expand this initiative to over 100 manufacturing partners this year, and 1,000 partners hopefully by the year 2020.

Our continuous efforts in eliminating layers of distribution and efficient -- inefficiencies in agricultural products is another example of offering quality products at better prices. I'm happy to report that in 2018, we sold more than RMB65 billion agricultural products on our platform, majority of which we directly sold and shipped from farms to end-users. To facilitate a greater use of our platform by farmers, we worked with over 62,000 new generation farmers, who are Internet savvy, saw the opportunity in urban farming and moved back to their hometown to explore opportunities. With the help from these new generation farmers, we are developing an algorithm driven system, taking into consideration the farming environment, growing cycle, and a user preference and a demand efficient -- in different regions of China, to help farmers better plan their product selection and farming practice.

As a result, we have connected more than 7 million agricultural households who are now benefiting from our platform. We upgraded their supply chain efficiency and increased their household income. At the same time, we enabled approximately 140,000 rural merchants, including farmers located in national level poverty stricken countries, to sell their agricultural products, generating more than RMB60 billion -- RMB16 billion of income for them. Going forward, we are dedicated to continue our efforts to facilitate rural merchants to offer fresher, cheaper and a better agricultural produce to our users directly.

The above is what we call C2M, consumer to manufacturer; where we fully provide the production sequence. We understand the users needs first and enable upstream providers, be it farmers, manufacturers, et cetera, to produce approximately -- to produce approximate products for our -- appropriate products for our users. This is different from how the current system works, whereby, the upstream producers design, manufacture and sell without necessarily being in tune with the changing needs of their targeted users. It results in unnecessary wastage from poor production and inventory planning, and impacts the efficiency of industry and the society.

As a technology driven company, we strive to first leverage technology to ensure product quality through our stringent merchant and a product screening process. We employ technology, including keyword identification, image filtering, text and a video imagery recognition to strengthen the quality of our platform to continue the important fight against counterfeit and IP infringement.

We have enhanced our in-house developed system, which can monitor listings at a scale, and flag suspicious activities, which our quality control team then follows upon. To further strengthen our capability, we plan to expand a quality control team by another 500 staff this year. We're building out both our technical and human capacity as we know that we're -- at our scale, we need to have both of these elements coming together to effectively tackle this issue.

Over the course of 2018, our efforts to fight counterfeit have resulted in a removal of approximately 150 times more product listings that were requested by the infringement complaints. The number of suspected counterfeit goods removed was 4 times greater than those removed in 2017. We took down more than 60,000 stores that was selling infringing products. We have also blocked over 30 million links that were suspected of infringing.

We collaborated closely with our stakeholders and the relevant government agencies to ensure merchants on our platform are compliant with relevant laws and regulations. In 2018, we provided thousands of leads and evidence to regulators related to counterfeit issues. We have now over 1,000 brands working with us to tackle these issues.

Tackling counterfeit is an ongoing process and we will continue to work on it in order to offer quality products users -- quality products users want.

Second, consumers want a greater variety of products. We have observed that consumers in many unreserved parts of China are deprived of products that are available in the first tier and second tier cities. Due to the complex and multilayered offline retail distribution network, many consumers in lower tier cities only have access to a limited selection of products, which are often of inconsistent quality. E-commerce, with the support of a well penetrated logistics network, can fundamentally help consumers in every part of China, have equal access to the same variety and quality products.

With this in mind, we recently introduced a new program called Brand Penetration Plan to bring well recognized brands to the less penetrated areas of China more efficiently. With users trust and familiarity, with our differentiated team purchase model, we can help these brands better reach a broader spectrum of consumers and help them design different marketing strategies to differentiate groups -- to different groups of users.

Since we launched our brand pavilion last August, the orders for branded products have grown steadily, by expanding the reach of branded goods into the under-penetrated areas, which can help to fulfill our users need and without substandard products or even some counterfeited products that take advantage of the limited access and brand knowledge users have in these less developed parts of China. We are currently working with over 100 brand partners such as, Nestle, Vivo, Ditto, Wahaha and Media, to bring them directly to our consumers.

Third, consumers want relevant recommendations, but at the same time, still enjoy the fun of discovery and sharing. These include continued investments in bolstering our technology infrastructure, recommendation algorithms, advertisement platform, and AI capabilities, to name a few.

Pinduoduo has created a differentiated and a personalized approach to e-commerce. We're utilizing distributed AI networks to tailor recommendations for our users through machine learning. Distributed AI is better suited for handling dynamic scenarios with multiple changing inputs, which may also impact the value of other inputs. To contextualize this, we know that for most people, when shopping, they may not have very firm or precise preferences. We might be looking to buy a new jacket for spring, but you may not have a particularly clear idea of what exactly you want until you see some choices presented to you. If a friend recommends something to you that broadly fits your needs and is at an acceptable price point, your inclination to buy that particular item goes up.

Factoring the similarities and differences in terms of users' interests and needs across different categories, and across an expanding network of interconnected user requires a capable AI engine, which can handle this complexity. Our AI engine better understands users' interests and needs and it can adapt and present more targeted recommendations. As we add more users to the network and also gain more data points through the increasing traction with our platform, we can further refine our engine to deliver an even better user experience that keeps up with our users' evolving preferences.

Given the importance of this initiative, we're setting up a technology advisory panel that will be led by our Independent Board Member, Dr. Qi Lu. Dr. Lu has extensive experience in AI and technology field. He is the founding CEO of YC China and Vice Chairman of the Board of Directors of Baidu, and has previously -- and was previously Microsoft's Global EVP leading their Applications and Services group. Together with Dr. Lu and our technology advisory panel, we have to -- we hope to strengthen our technical capabilities. In addition, we'll collaborate with technology research institutions, both domestically and overseas to set up a joint research effort to further drive our distributed AI initiatives.

To recap, 2018 was a strong year with robust growth. It was also an eventful year for this full year order platform. We have learned a lot from our users, partners and our peers.

The management team has worked hard at delivering our values to our users and are determined to continue the efforts.

As we step into 2019, we are more confident in our strategies to further cultivate users' trust and affinity for our brand.

With that, I will hand the call to our VP of Finance, Tian, to walk through our financial results in the quarter. Tian, please.

Tian Xu {BIO 20683100 <GO>}

Thank you, Colin. Hello everyone. Our total revenues in the fourth quarter were RMB5.7 billion, up nearly 5 times from RMB1.2 billion in the same quarter last year. The main drivers of this growth came from our increasing user and GMV scale, and the improvement in our online marketing services overtime. About 90% of our total revenues or RMB5.1 billion were revenues from online marketing services, which increased significantly from RMB887.6 million during the same period last year, and 70% versus the third quarter.

As our annual active buyer base growth and user engagement increase, merchants on our platform benefit from higher traffic and transaction volumes. To capture the sales potential from our growing user base, we are seeing our merchants start to advertise more on our platform in order to improve their exposure. The remainder of our revenues were transaction services revenues. We decided to adopt this name, this quarter, as we not only generate commission fees, but also receive other service revenues related to transactions.

Our transaction services revenue this quarter were RMB591.5 million, more than doubled from RMB291.8 million during the same period last year, and up 49% versus the third quarter. The increase was driven by the growth in our revenue -- in our GMV. Similar to last quarter, we have continued in the fourth quarter with offering through preferential rates to selected high quality merchants. By offering traffic with better pricing and charging a lower transaction services fee to these high quality merchants, what we are doing is to accelerate the process of natural selection, whereby merchants who provide better services and value to our users get more traffic and grow faster.

On the other hand, low quality merchants would find it harder to compete and eventually get weeded out. As such, while our merchant base has expanded rapidly in the past year, we are happy to note that the proportion of high quality merchants on our platform has also increased. In doing so, users visiting Pinduoduo would have a better shopping experience every time they come back. We want every shopping experience on Pinduoduo to be a great one. And for new users in particular, exploring them for better quality merchants goes a long way towards creating a good impression on Pinduoduo and raises their likelihood to return and recommend Pinduoduo to others. Hence, while this stuff dampened the growth of our monetization rate in the near term, we are already seeing some benefit and I'm convinced that this has a good payoff in the long run.

While this investment is motivated by our desire to better serve our users, we believe our merchants also appreciate our long-term approach of partnership. We now have over 3.6 million merchants as of the end of 2018, compared to about 1 million at the end of the first quarter of 2018. Our low fee structure and the growing traffic is very appealing for smaller merchants looking to develop their business online. Quality merchants who have existing online business would also be more attracted to join a platform like ours, which has firm standards and is working hard to improve.

Moving on to cost. Total cost of revenue increased by 281% year-over-year to RMB1.4 billion from RMB374 million in the same quarter of 2017. The increase from last quarter is mainly due to higher costs for cloud services, our call center and merchant support, partially offset by lower payment processing fees charged to us.

Total operating expenses were RMB6.9 billion compared with RMB828.1 million in the same quarter of 2017. In particular, sales and marketing expenses this quarter stepped up meaningfully year-on-year to RMB9 billion, mainly due to an increase in online and offline brand building and promotional efforts as we continue to invest in strengthening our brand awareness and facilitating greater user engagement. This past quarter, we had several successful campaigns around Singles' Day and New Year Countdown TV events that we sponsored.

As Colin shared, we have a unique value proposition for our users and see a sizable opportunity ahead. As such, we will continue to invest to accelerate our growth while adhering to our focus on ROI.

General and administrative expenses this quarter were RMB322 million. This increase was primarily due to an increasing headcount and share-based compensation expenses.

Research and development expenses rose to RMB525 million, primarily due to an increase in headcount and the recruitment of more experienced R&D personnel, as well as an increase in R&D related cloud services expenses. Technology is a key focus and we will continue to expand our technological capability for the long-term growth of our platform. Through investing in our distributed AI infrastructure, we see meaningful opportunities to increase our efficiency and scale faster in the future.

At our core, we are a technology company that always put our users first, where we can make the investment to expand our platform and deliver a better service and experience, we will. As we demonstrate our value to our users and our merchants, our monetization will naturally grow and the operating leverage in our model will become apparent.

Operating loss this quarter was RMB2.6 billion compared with a loss of RMB22.7 million in the same quarter of last year. Non-GAAP operating loss were RMB2.1 billion, an increase from RMB10 million during the same period last year.

In the fourth quarter, net loss attributable to ordinary shareholder was RMB2.4 billion compared with net income of RMB13.6 million in the same quarter of last year. Basic and diluted net loss per ADS were RMB2.16 compared to near -- net earning per ADS of RMB0.04 during the same period of last year.

Non-GAAP net loss attributable to ordinary shareholders rose to RMB1.9 billion compared with net income of RMB26.3 million in the same quarter last year. Non-GAAP basic and diluted net loss per ADS were RMB1.72 compared with RMB0.04 for the same period of 2017. That completes the profit and loss statements for the fourth quarter.

Net cash flow provided by operating activities was RMB5.7 billion compared with RMB5.4 billion in the same quarter last year, primarily due to an increase in our online marketing services revenue. As of December 31, 2018, the company had a strong balance sheet with RMB30.5 billion in cash, cash equivalent and restricted cash.

We adopted ASU 2016-18 in 2018, which requires that a statement of cash flow explains the change during the period, using the total cash, cash equivalents, and the restricted cash. Excluding restricted cash, we had RMB14.2 billion in cash and cash equivalents. We also successfully completed a follow on equity offering in which we raised about $1.2 billion in 2019. On top of our cash balances, we also have another RMB7.6 billion of short-term investments.

Looking ahead to 2019, we believe our operational focus and a solid balance sheet will position us well for another year of healthy growth. This concludes our prepared remarks.

Operator, we are now ready to begin the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instruction) Your first question comes from the line of Thomas Chong from Credit Suisse. Please ask your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi. Thanks management for taking my question. I had one question about the competitive landscape. Can management comment about how we should think about the competitive dynamics in this year and the next couple of years ahead? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

Well, we noticed that more and more players are looking at lower tier cities and they're also trying to mimic what PDD is currently doing. But I think the greater emphasis from the competitors actually is good for increasing the size of the pie. And, also I think the greater emphasis given to the lower tier cities by our peers is also helping awaken the underlying demand for consumption that has been dormant in these cities. As a result, the pie expanding and we see healthy consumption growth. As the majority of our users are from these lower tier cities, we have built up our value proposition around the value for money products, delivered in a fun and a social setting. We also stand to benefit more from an expansion of this particular market.

Let me just expand a little bit our value proposition. Our number one priority has always been serving our users and we are constantly working on to reinforce the clear, differentiated value proposition that we offer to our users. One is unbeatable, which is value for money products. And two, is an interactive shopping experience that is fun and makes discovery easy.

We already have some of the innovative products, which demonstrates how to combine the Costco part and the Disneyland part. But it is still in a very early stage, but I guess a lot of our users already have some taste of the -- have already sensed a difference of our platform other -- than other platforms. And this foundation has enabled us to scale rapidly, and you can see that from our strong operating results across various metrics like active buyers, MAU and GMV growth.

We can also see that our users are visiting more frequently and are spending more on our -- spending more on our platform. This is a healthy indication that they are more pleased with what we offer. To increase our hedge, we will continue to invest strategically in R&D and in sales and marketing to enhance our user experience and build our brand as we continue to grow our user base and our users increase their interactions with us, our technology driven by machine learning based on our distributed AI infrastructure can become smarter in serving our users.

As our users get a better experience, they would naturally return more frequently to browse and shop at our platform. At the same time, our greater scale also makes it easier for us to attract the higher quality merchants who can provide excellent products and services. We're already benefiting from this network and this will become stronger as we continue to expand, I believe. We will also continue to be laser focused on the same strategy of building our value propositions and not be distracted by what others are doing, for instance, exploring like categories not so relevant, or trying to monetize too early, trying to introduce finance or services, all those kind of stuff. At this stage, I think we're -- we still have the luxury to be laser focused on the same strategy we are building and just focusing on the users.

With that being said, we do think competition is good for our consumers, at least to receive the better -- best of service in the products. We in fact encourage a fair competition among our merchants, on our platform as it motivates the merchants to constantly improve. Probably that's a little bit of too long answer, but I hope it answers your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Thank you.

Operator

Your next question comes from the line of Grace Chen from Morgan Stanley. Please ask your question.

Q - Grace Chen {BIO 2548665 <GO>}

Thank you for taking my question. My question is about the macro trends and implications on the PDD platform. Could you share with us your observations now versus a quarter ago? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

Yes. These days, a lot of people are talking about macros, but I think we should just focusing on doing the right things ourselves. From our results and operational data, we sense that there is still a lot of pent up consumption demand. I mean, a lot. Our annual spending per average buyer has doubled year-on-year to RMB1,100, even as we continue to add new users. Judging from the momentum we have seen thus far, we believe this number will continue to grow steadily.

According to NBS data, total retail sales of consumer goods in China was up 9% in 2018, whereas, online retail sales of physical goods grew 25%, more than doubling the pace of overall retail. We have a good opportunity to meet this demand by leveraging the deep existing manufacturing capabilities of China's manufacturing base. We believe the demand of value for money goods is substantial and universal, regardless what kind of macroeconomics he has [ph]. And this is not just applicable to any specific group of users. We can work with our merchants to deliver better value for money merchandise to our users, and in so doing nurture further consumption growth.

We're also encouraged by some measures the government has been taken, which we think are business friendly and encourage sustained consumption growth. For instance, the government has raised the threshold for personal income tax exemption, which will benefit lower income groups who also tend to spend more of their disposable income on consumption. And this tax law, I think benefits a lot more of our user base, than let's say the top niche users in Shanghai or in Beijing.

There are also the change of VAT exemption rules. The monthly sales threshold for VAT exemption was also raising early January from RMB30,000 to RMB100,000, which shows the government's support to SMEs. Moreover, the government has cut the corporate income tax rate for small companies from 25% to 20%. And the first RMB1 million in profit is taxed as only -- at only 5%. The government has also been proactive in managing the VAT rates since last year, and is reducing social insurance contribution requirements. And these are signal to us that the government is trying to help small business and strengthen business confidence, which we think will be a huge boost for both merchants and consumers on our platform.

Lastly, I would also like to add that we're excited about opportunities ahead, as China is right now transforming from an export -- an investment oriented economy to a consumption driven economy. In this process, there will be a new wave of Chinese brands that will increasingly serve the growing domestic consumption demand. We have a series of initiatives to help our merchants to capitalize on this trend and build out their own strong brands.

So with that said, we are fairly confident of the future and we're also confident the measures government has been taking are good for the economy. And we're also confident by the evidence that we have seen of the manufacturing base we have in China. The capacity, the quality of the things those factories are making is actually very good. So although we don't expect everything is happening within one year or two years, but, if we look down the road three years, five years, and even 10 years, I think for sure a lot of new brands will emerge from all these factories and within the China's huge market. Okay. That answers your questions, right?

Q - Grace Chen {BIO 2548665 <GO>}

Thank you.

Operator

Your next question comes from the line of Piyush Mubayi from Goldman Sachs. Please ask your question.

Q - Piyush Mubayi {BIO 1530844 <GO>}

Thank you for taking my question. And congratulations on the numerous milestones you've attained over the last four years. You talked a lot about fighting counterfeits and what you've been able to attain and your initial presentation was very, very clear. What I wanted to follow-up with is, how would you plan to balance the numerous brands on your platform as you continue to grow both the PIN brands and other brands? And do you envisage a scenario where you would need to do a Tmall-Taobao kind of thing as Baba has done over the last couple of years? Or would you be able to balance that on one platform?

My second question is, could you talk through the C2M opportunity in terms of size in particular? And third, very quickly, how would you measure the progress you have made with convincing merchants to bring more SKUs on your platform? Thank you.

A - Zheng Huang {BIO 20683053 <GO>}

So, the -- your last -- second question is C2M, right?

Q - Piyush Mubayi {BIO 1530844 <GO>}

Yes.

A - Zheng Huang {BIO 20683053 <GO>}

So I'll talk about C2M first. I had been thinking about some variant of C2M for couple of years already, even before I found PDD. To bow it down to a sentence, the idea revolves around a concept of connecting the supply and demand end points more closely with each other, and in doing so, improving production, cutting out waste and better serving user needs.

So during our earnings call since last quarter, I talked a lot about how we are helping China's agriculture industry and manufacturing industry. These are many -- there are many examples today of how we have helped these partners achieve greater sales volume through better production and logistics efficiency. We have worked with over 7 million farmers in China and created 600 hit products so far, that have each sold over 100,000 units. In doing so, we have to connect farmers directly with consumers.

We are also applying C2M across more and more industries. As you can see, our new brand initiative partners sell a wide variety of goods, ranging from electronics to ceramics and glassware to mops. As we work with more partners, we believe we can also apply C2M to other industries in the future. In terms of investment in this effort, we already have existing vertical specialized teams in place, who have expertise in different industries that are helping these merchants. This year, we will be adding more specialists to flesh out our business development teams, while working with our new brand initiative partners.

Apart from sharing our industry knowledge and user understanding, we will also give market support such as more favorable placements in the recommendation fees or lower commission rate. We believe this helps to build user satisfaction as they find products with better quality and a price on our platform. And we continue to position -- we'll continue to position ourselves as a partner, offering data and advice to our merchants, and we believe we can achieve meaningful impact in asset-light manner.

With that said, I believe it is still very early beginning of C2M. And I hope our effort in this area will encourage a lot of our competitors to also join our effort to change the supply chain of China, because there are so many manufacturers and they produce like thousands of millions of stuff and serving worldwide, and a lot of them just don't have their own brand. So, this is the very beginning and it will take many years to go. But, there is a huge -- it's going to be a huge wave and going to be a huge trend.

And regarding your first question, you asked about whether we will launch something like Tmall or something like that. I think in some of the interviews with the reporters, I said, we will not launch a thing that is exactly like Tmall. We treat all merchants and brands equally. As long as they are providing the right value and quality, everybody will have equal chance.

Our goal has always been focused on providing our users with a good shopping experience, and a part of that comes from improving our product selection. And in August last year, we launched our Brand Pavilion. It has quickly grown in this sort of span -- short span of time to reach over 700 brands, with a mix of both international and domestic brands, represented by flagship stores and licensed distributors.

We also created an electronics channel to highlight to users the variety of electronic goods we have available on our platform. Since August 2018, we have sold accumulative 600 million units of branded products through both our Brand Pavilion and electronics chain alone. And at the same time, we have also launched new brand initiatives to enable capable manufacturers and merchants to design, manufacture and sell products tailored to users' needs on our platform.

So, all these channels and brand campaigns, I would say, these are the kind of low-hanging fruits and easy-to-do job. But I think our team will not stop here. We will -- the biggest effort will still be innovating the kind of new interactive model, which is suitable for promoting different kinds of brands, and for matching user to brands.

If we look at Tmall, it's mainly a search engine. It's a brand search. But, PDD is a network of users. So it will be a very different kind of a product interface. I hope we will be able to invent in the future that both create value to the user and also create a new channel and a new type of promotion space for the brands. And actually whether something is branded or unbranded is really not a key distinction we focus on. At the end of the day, does it deliver value to our users, it is whether the user likes it or not, it matters. That is what we're focused on and we do -- what do we do differently from other platforms, is we -- is that we have always been recommending [ph] folks and we are trying to leverage the connection between users.

So yes, so with all these said, I think, we're really not trying to sort of copy yet another Tmall or yet another something else. We are really trying to focus on the users and trying to innovate on a space of combining Costco and Disneyland, and I hope, several years down the road, when we look back, we'll be proud of the kind of innovations we have made.

Q - Piyush Mubayi {BIO 1530844 <GO>}

And can I ask a question on -- with the run rate of GMV growth that we've seen in Q4 and with the end of the year, how do you think about the sort of budgets you want to set aside for sales and marketing into '19 and '20? Just the framework would be helpful for us. Thank you.

A - Tian Xu {BIO 20683100 <GO>}

Hi, Piyush, this is Tian, I can address this sales and marketing issue. Currently, we all know this RMB6 billion is a sizable number. And we did have like Singles' Day event and New Year Countdown event et cetera. And usually the fourth quarter is an important season for e-commerce.

So, if you look into the sales and marketing ROI issue, couple of points on how we think about this. In summary, I would stress this is what we see every dollar spent as an investment, because as Colin mentioned, that we have a unique value for money. We have a unique proposition as a value for money products in a fun and a social setting. And we have a bit over 400 million annual active users. But what we see is there are over 900 million online payment users in China today. And this number is still growing. And these online payment users are definitely potential buyers on Pinduoduo platform. And we want to reach them and we believe that the right combination of sales and marketing and the word of mouth can really help us to realize this opportunity.

On the other side, we are still a very young company with a budding brand. It will take us some time to deepen our mindshare with users and cultivate a strong brand awareness. And we will invest in order to achieve this goal. So, while we continue to be opportunistic with all these investments in sales and marketing, we will keep an eye on how high we spend. We started -- we focus on the behavior of the users. For example, the purchasing frequencies, we see -- you see the 50% of increase in terms of how many times a user by per year. Now it's 27%, 28%. This is kind of an indicator to the return, this is indicator to the lifetime value of a customer required. This is something we are looking to now -- we have been looking into, rather than the pure financial return.

So for each money -- coming back for each dollar we spend, whether it is a TV show or events, traffic acquisition or coupon or promotion, we have different standards of ROI and we keep tracking and monitoring this spending. So you asked about like 2019, we cannot provide the exact number or figure right now. But in general, for the first quarter, we have Chinese New Year. So there is still some spending there, and we will see how it goes with the ROI in our mind. Okay.

Q - Piyush Mubayi {BIO 1530844 <GO>}

Thank you.

Operator

Your next question comes from the line of Alicia Yap from Citigroup. Please ask your question.

Q - Alicia Yap {BIO 15274658 <GO>}

Hi. Thank you. Good evening, management. Thanks for taking my questions. Congrats on solid results. I have questions on the take rate. How should we be thinking about the monetization ramp in the next few quarters, and also overall take rate trend in the next two years? If you could elaborate, what would be the drivers for improving take rate trend? Is that coming from increase at inventory potential or is it more merchants bidding on a higher pricing on the existing inventory? Thank you.

A - Tian Xu {BIO 20683100 <GO>}

Hi, this is Tian. Our monetization efforts are still in the early stage as we only rolled out this product first in the first half of 2017, and we did make some good progress and we believe it will grow steadily as our merchants derive increasing value from our platform. So this -- the past year 2018, our GMV buyer base, both grew dramatically and our active buyer merchant base increased to 3.6 million and many of our merchants have been growing their business on our platform, and more importantly, benefiting from our unique demand aggregation capabilities.

So, what I want to address, here, for example, when we launched this new brand initiative, as Colin mentioned, we received thousands of applications. They wanted to be our first batch of 20 partners to pilot test brand cultivation. And we launched our brand channel last September, another example. Now we have 700 brands participating. So, I mean, the growth of our merchant base and this broad activeness of these merchants wanting to work with us on deeper basis indicate that we have a healthy ecosystem, and deliver meaningful value to our -- to these merchants. So, monetization, we believe, follows after we demonstrate this value to users -- the merchants and we want to be really thoughtful about how we ramp up.

As discussed, I remember last quarter, we continued to prioritize good quality merchants as we want to ensure our users are getting better services and shopping experience on our platform, and the better user experience will draw more users and increase our conversion and drive our GMV growth, which will improve merchant ROI on our platform.

So, in short, we are very optimistic about our long-term opportunity, but we are holding back a little bit for now. We will continue all the efforts we have done in the past, and monetization or increasing take rate, will naturally be a byproduct of our increasing user growth and increasing user spending. So at the end of the day, we do not manage to achieve, you know, a particular take rate each quarter, we don't do that, nor we satisfy -- sacrifice our user experience for higher monetization. That's pretty much I can provide for the, like say, you asked about two years down the road. Thank you.

Q - Alicia Yap {BIO 15274658 <GO>}

But what about 1Q? If it's just seasonally, should we expect it to continue to trend down a bit because of 1Q seasonally?

A - Tian Xu {BIO 20683100 <GO>}

For the revenue figure, we cannot provide an exact figure right now for 1Q.

Q - Alicia Yap {BIO 15274658 <GO>}

Okay. Thank you.

A - Tian Xu {BIO 20683100 <GO>}

Thank you.

Operator

Your next question comes from the line of Natalie Wu from CICC. Please ask your question.

Q - Natalie Wu {BIO 19852429 <GO>}

Hey. Thanks for taking my question Colin, Tian (inaudible). My question is mainly related towards GMV. I saw your user growth and spending growth pattern is actually quite strong. Just wondering, can you share with US your GMV outlook in 2019? Also longer term, what kind of the GMV level you are targeting at?

On top of that, how do you see the channel take rate, both commission take rate and online marketing take rate in 2019? I mean, since when can we see stabilizing for take rate decline? And also on a full year level, just to give us a rough sense should we anticipate the sales and marketing budget -- I mean, the sales and marketing expenses to grow at similar pace with GMV? Any color on that would be appreciated. Also, lastly just to confirm the gap between your net GMV and gross GMV still remain unchanged, right? Thank you.

A - Tian Xu {BIO 20683100 <GO>}

Alicia, (sic) this is Tian again. In terms of GMV, we believe there's a long runway for growth as consumption continue to increase and more user come onto our platform more often. Our order volume has more than doubled year-on-year. We are fulfilling over 30 million orders on average a day. This is driven on our user base and also higher annual spending per active user. And this annual spending per active user is now like 1,100 more than 1,100, more than double last year. So underlying this growth is a fact that users stay longer on our platform, and they also become more familiar with us, spending steadily increased and we are seeing more user buying more stuff within categories and also broadly across categories as they come to trust our platform. All these are factors to drive our GMV up.

So users are able to see and try products they may not have access to in the past. That's something new. For instance, our data shows that a growing number of users in the lower city -- lower tier cities are starting to explore a more diverse selection of products such as, small luxuries like Jiaweishi and affordable coffee makers, such demand may have been unformed or unmatched in the past, but now they are crystallizing and being fulfilled on our platform.

So in short, we are confident in the growth opportunity in the GMV and would continue to invest and innovate in order to being the most like value for money, quality products with our unique and fun shopping experience to our users.

Your question about commission take rate or other take rate, commission take rate is dependent on the payment processing discount we get. So we have always said it's hard to give guidance, you know, ahead of time because our payment processing discount are -- keep changing. Also, we have this new concept of -- we've adopted this new name transaction services. But for now, we don't -- on top of the commission revenue, we have limited number to report to you, but that also showcase the potential we are providing more transaction related service to our merchants in the coming few years. That's one of the indicator to improve our take rate.

For the gap, you mentioned between the nominal GMV and the payment GMV, it's unchanged. What else?

Q - Natalie Wu {BIO 19852429 <GO>}

And also the sales and marketing budget planning, will that be growing at a similar pace versus GMV in 2019?

A - Tian Xu {BIO 20683100 <GO>}

As I mentioned now, it's not linear or linked to GMV growth. We are more like opportunity driven stuff. If there is opportunity to spend marketing dollar in the market and with positive ROI, it's not necessarily revenue, it could be some other operation indicators, then we will spend money. So I can confirm it's not like linear or linked to GMV growth.

Q - Natalie Wu {BIO 19852429 <GO>}

So, can I add up some question on the sales and marketing spending in the fourth quarter? How much of that is related with the promotional stuff and how much is related with brand advertising or like...

A - Tian Xu {BIO 20683100 <GO>}

In terms of percentages similar to what we provided before, so no big change.

Q - Natalie Wu {BIO 19852429 <GO>}

Got it. Thank you. Very helpful.

Operator

I would like to hand the conference back to today's presenters. Please continue.

A - Christian Arnell {BIO 22010857 <GO>}

Thank you very much for joining today's call. If you have any other questions or concerns or comments, please don't hesitate to reach out to the Pinduoduo IR team. This concludes the call. Have a good night.

Operator

Ladies and gentlemen, this concludes the conference for today. Thank you for participating. You may all disconnect.
