

## Q1 2019 Earnings Call

### Company Participants

- Unidentified Speaker
- Victor Tseng, Investor Relations
- Zheng Huang, Chairman and Chief Executive Officer

### Other Participants

- Alicia Yap, Analyst
- Grace Chen, Analyst
- Joyce Ju, Analyst
- Monica Chen, Analyst
- Natalie Wu Yue, Analyst
- Piyush Mubayi, Analyst

### Presentation

#### Operator

Once again, ladies and gentlemen, thank you for standing by and welcome to the Pinduoduo First Quarter 2019 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 would not like to hand the conference over to our first speaker today Mr. Victor Tseng. Please go ahead, sir.

#### Victor Tseng {BIO 15874718 <GO>}

Thank you, operator. Hello, everyone, and thank you for joining us today. Pinduoduo's earnings release was distributed earlier and is available on our IR website at [investor.pinduoduo.com](http://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. David Liu [ph], Vice President of Strategy. Mr. Huang, will review business operations and company highlights, followed by Mr. Liu, who will discuss financials, they will both be available to answer your questions during the Q-and-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 Securities Exchange Act of 1934, as amended, and as defined in the U.S. 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 U.S. Securities and Exchange Commission. The Company does not undertake any obligation to update any forward-looking statements 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. Zheng, please go ahead.

## **Zheng Huang** {BIO 20683053 <GO>}

Okay. Thank you, Victor, and thanks everyone for joining us, our first quarter 2019 results discussion. I'm happy to report that we kicked-off this year with a strong quarter, thanks to our team's hard work and a strong execution across the Board. I also wish to thank our users for their continued support. As I mentioned in my letter to shareholders, several weeks ago, Pinduoduo is turning four this year. We are still very much a startup. But I'm confident that our young Company will continue to make a significant progress this year, as our new e-commerce model is well aligned with the industry evolution and the best interests of all e-commerce participants. By focusing on benefiting all, putting people first, and in being more open, we keep delivering differentiated value to all the users and the merchants. We will continue to prioritize investments to pay its long-term returns, such as sales and marketing and R&D, at this early phase of our development, to build a long lasting foundation.

Our objective is not only to realize our near-term goal of expanding and a deepening of relationship with our 443 million annual active buyer base. But also, to further strengthen our foundation to achieve our vision of new e-commerce.

Let me begin by sharing with you our key financial and operating metrics for the first quarter. Last 12 months at GMV, ending March 31, 2019 grew 181% year-over-year, to RMB557 billion. On a quarterly basis, our GMV growth surpassed the 21% year-over-year increase in total China online retail sales of physical goods in the first quarter by multiple-folds. This was driven first by a strong increase in annual spending per active user and definitely, by continue to grow in our annual active buyer base.

Annual spending per active buyer grew 87% year-over-year and it reached RMB1,257, as our users became more familiar with our platform, and as we continue to enhance the

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variety and quality of our product collection, it is encouraging to see that our users are coming back more frequently because our -- because of our clear value proposition. I will also make that distinction again, that a value for money doesn't just remain cheap. In the run-up to Chinese New Year, some of the -- our expected hit products, with our lower-tier city users were higher priced items, such as seafood, peppers, cherries and a food processors. At the same time, we have also been adding users from higher-tier cities, will find that they can get products of the quality they are looking for, but at a better price.

And such, our user growth continues to be very broad based, with our annual active buyer base up 50% a year-over-year to 443 million, despite the seasonal impact of the Chinese New Year in the first quarter. MAU increased by 74% year-over-year to reach 290 million. We're pleased to see such a encouraging growth. Our users are market-facet, and as we continue to engage them through fun features, that encourages sharing and exploring, we can get to know them better and keep them engaged on our platform.

Similarly, our strong value proposition continues to attract many merchants to our platform. We have become an important channel for many merchants given our rapid user growth, substantial use of scale and high level of engagement. We have seen increase in our merchants advertising spend, which coupled with our healthy GMV growth contributed to the 228% year-over-year increase in our total revenues to RMB4.5 billion in this quarter.

As our platform continues to scale and our advertising products improve, there would be further room for our merchants advertising ROIs to improve. That said, we will continue to strike a balance between monetization and incentivizing high quality merchants to join us and to provide a better products and services to our users. Our growth depends on the satisfaction of our users. So let me talk about our continues effort to improve their experience. First, where our platform designed for and acceptable to all. Pinduoduo started when a mobile Internet was equally accessible to all. And such, Pinduoduo as a platform has conceived to serve all. We work hard to increase the income of farmers and manufacturers, while providing savings to the urban population. Our faster growth and a sizable user base, across all parts of China is a testament to our differentiated value proposition for all participants after platform.

Second, while working hard, to better understand and serve our users, more in a mobile Internet era, Pinduoduo bypass the PC era, search based e-commerce model, which was oriented around the product index. Instead, we're putting users first, we try to understand their interest, connections and trust between our users. So we can develop a more holistic view of them as a individuals. This allows us to identify suitable recommendations more efficiently. At this stage, we're just uncovering the tip of the iceberg here. At the complexity of matching large scale dynamic user needs, across a variety of products and the prices is amplified by how user preferences can be further influenced by the actions taken by other users and the social network they are in. Each and every engagement with our users provides opportunities for us to improve and better serve them. We'll continue to devote unwavering focus on this and invest in our big data analysis, machine learning and a distributed AI technologies to capture these opportunities.

Another example of how we continuously improve our services to users is the introduction of our own e-waybill system, which provides greater transparency on order shipments and help us resolve delivery issues more efficiently. This system is now connected to all the major logistics providers in China. Within a short period of time, we have become the seventh largest e-waybill system in China. As I mentioned in a shareholder letter, we will continue to maintain an open-policy, whereby merchants can choose to use an e-waybill system, and we believe that ultimately user satisfaction include a merchant satisfaction as the most important KPI for the whole team.

Third, we'll continue to enhance the shopping experience through affordable quality products and the interactive features. People who are unfamiliar with our platform, sometimes question how products on our platform can be so affordable priced. The differentiation is such that, unlike other platforms with simply bringing offline sales online. We enable merchants to offer lower priced prices by aggregating the collective needs of our users. There is a team purchase model, transforms demand that would be otherwise scattered across different SKUs at a time horizons into demand that is in a single time frame and on fewer SKUs.

Supported by our ability to provide insights into user trends and preferences, we help our merchants better plan and customize their design and the production process, eliminate unnecessary intermediaries, and therefore retain more value. As a result, our merchants are empowered to offer better quality SKUs at a more competitive prices. We'll continue to deepen this value proposition with our C2M initiative, with -- working with more produced -- producers and manufacturers in different industries. The addition to our new brand initiative, which now serves as a wider variety of goods ranging from electronics to glassware, we're also working with over 100 heritage brands from Shanghai, to help them upgrade their product offerings. For instance, Bee and Flower, our hair care brand with over 30 years of history, is narrowing their strong production capabilities with our data insights to develop a new line of products to be sold on Pinduoduo.

At a same time, we'll continue to innovate and launch more interactive features. Take in-app games as an example, we've introduced several new games in January. When users complete certain tasks, such as the browsing, playing with friends or making team purchases, they can unlock additional benefits or access special discount coupons, while the dollar value of such coupon is very small. We introduced unexpected fun and excitement into the shopping journey, and encourage other users to browse through our mall to discover more categories and more products, increasing user satisfaction.

As to how we serve our users, I also want to touch on our commitment to the merchants on our platform. We are committed to help our merchants, be the brands or non-branded merchants. To understand that -- and to understand and serve their targeted customers better. For example, we launched a new brand initiative and a heritage brand initiative to help newcomers develop their own brands and existing heritage brands to gain their popularity among our users. We have invested in sales and the marketing dollars together with these brands to raise their profile and a brand recognition among our users.

As of the end of April, the monthly sales of the heritage brand has grown close to 2.5x. Further, we take IP infringement seriously, and we are making the necessary investments

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to improve our existing systems. This is especially important, when considering the number of merchants and SKUs introduce our platform daily. Apart from working with merchants to create their new brand, we have also partnered closely with both domestic and foreign brands, as well as IP alliances and a public authority to read out IP infringing sellers and the products on our platform. Not only have we taken down over 45 million IP infringement products for our platform in 2018, we have continuously enhanced our algorithms to identify fake goods and problematic merchants allowing us to take swift actions.

Now let's switch gears onto other aspirations as we grow our platform. This past quarter, we launched Duo Duo farms. We are collaborating with local governments and stakeholders from a agricultural value chain to help alleviate poverty in many impoverished rural areas in China. We plan to implement, where 1,000 total farm projects over the next five years.

Our first stop of this project is Baoshan in Yunnan province which is known for its coffee beans. Our goal was to bring good quality coffee beans directly from the source onto our e-commerce platform efficiently. A typical coffee bean distribution chain has at least five layers each adding 30% to 50% of markups. Information system -- information asymmetry throughout the value chain has meant that, the upstream coffee farmers typically receive only about 1% of value within the entire value chain. We have cooperated with the local government to create a new farmer developing model to enable upstream farmers to capture a greater share of the value created.

Our central processing system for agriculture products enables us to utilize information about farmers, locations, logistics, productions and a growing cycle to match the product with end user -- end consumer demand. As of now, we've connected 792 farmers with six of our coffee merchants who purchased 42 tons of raw coffee beans. After processing, these merchants can sell the coffee on our platform at a good price, well below what a consumers typically are presented with -- at retail. Equally important, farmers get paid much higher prices than before. By better mapping, supply and demand we can help farmers increase their income levels and help users enjoy the same products at a more attractive prices. This is a real testimony of our core value of benefiting all.

Since, this is the first quarter of the year, I'd like to add by emphasizing our continued focus on building long-term intrinsic value for our Company. A key part of this equation today is to invest in our users and infrastructure as a faster growing young platform. We're attracting many new users daily, yet from a mind share with them is too limited. Meanwhile, we are on-boarding many new merchants with new products while constantly launching and iterating new features. Therefore it is imperative to proactively create more engagement with our users, so that they can discover what they have to offer.

We believe with each and every good quality engagement, our users will come to trust and rely on Pinduoduo more for their shopping needs. The more our users engage, purchase and interact on our platform, the more they can help us to grow. We as a platform will benefit from the positive network effect and they realize meaningful continuous returns over the long-run. As such, our sales and marketing spend is not

targeted at driving specific GMV growth, in the short-term by rather at building user trust familiarity and a user habits in a mid-to long-term.

Pinduoduo is just serving a very small piece of the growing, RMB30 trillion, total China retail sales market today. I'm confident there is a lot of room for us to grow, with our differentiated value proposition.

Now let me turn to the -- turn the call over to our VP of Strategy, David Liu [ph] with over 15 years of TMT banking experience at Goldman Sachs. David, will take us to our financials in greater detail.

## Unidentified Speaker

Thank you, Colin and hello, everyone. For the March 2019 quarter, we recorded strong results across major operating and financial metrics. Our last 12 month GMV grew 181% over the past year to reach RMB557.4 billion. Total revenues grew 228% year-over-year to RMB4.5 billion, up significantly from RMB1.4 billion a year ago. Our strong revenue growth was driven by our rising GMV and improving monetization rate, despite low seasonality from the Chinese New Year holidays. We derived 87% of our total revenues or RMB3.9 billion from online marketing services. This represents a more than three-fold increase from RMB1.1 billion for the same period last year. Our last 12 months online marketing take rate increased for the six consecutive quarters in a row, to reach 2.6%. Several factors contributed to the growth of our online marketing services revenue.

First of all, we continue to attract more merchants to join and advertise on our platform. The rapid growth in our user base, our traffic volume and GMV, these two strong advertising ROIs for our merchants. Secondly, as our merchants become more familiar with our advertising products and analytics tools, they also become more willing to spend aggressively towards achieving their ROI targets. To give you an example, we introduced a number of new marketing tools this past quarter, including our market trend analysis and keyword trend analysis tools. These tools are designed to help merchants, benchmark their app performance against the industry, and to adjust their investments as appropriate to achieve better results. We have many more features of such a nature planned in our pipeline.

Lastly, we continue to invest in our merchants through Duo Duo University. This is an online program that we launched in July 2018. Over 2 million merchants have access to over 1,300 online courses available to date. These courses aim to help merchants enhance their marketing ROIs on our platform by showcasing best practices and educating them on our new tools and features. The remainder our revenues come from transaction services, of which, commission fees contribute the mass majority. Our transaction services revenue for the quarter grew by 116% year-over-year from RMB276.5 million last year to RMB596.8 million.

Our transaction services revenue growth, picked up this quarter as we adjusted our level of payment processing support to a higher quality merchants. We are pleased to note that despite the gradual reduction in discount, offer to higher quality merchants, we still see a

sustained increase in the proportion of such quality merchants in our merchant base. At the same time, we continue to build our other value added services, that we provide to help our merchants grow their business on our platform.

Moving onto cost, our total cost of revenues increased by 174% from RMB318.7 million in the same period last year to RMB873.3 million this quarter. Our gross margin was 81% this quarter as compared to 77% a year ago. Included in our cost of revenue this quarter is a payment rebate of RMB339.2 million from Tencent. Adjusting for the rebate, our gross profit margin would have been 73%. They increasing our cost of revenues was primarily due to higher costs for cloud services, labor costs associated with our platform operations, customer service and quality control and merchant support services. These expenses can be quite lumpy and do not directly correlate with the increase in our GMV or revenues.

We view these expenses as necessary investments to ensure scalability and performance of our platform over the long-term. And we will continue to make such investments throughout the rest of the year. Total operating expenses this quarter were RMB5.8 billion as compared to RMB1.3 billion in the same period last year. Our sales and marketing expenses this quarter increased to RMB4.9 billion as we continued to invest in driving greater brand awareness and user engagement.

On a non-GAAP basis, our sales and marketing expenses as a percentage of our revenue was 103%. This quarter we were one of the sponsors of the CCTV Spring Festival Gala, the biggest annual TV event in China with 1.2 billion viewers and one of the most watched live shows in the world. We held a series of successful online promotions leading up to the TV event. And together, these initiatives helped to spur user downloads and increased brand recognition and engagement. We continue to build on this momentum throughout the quarter and we saw user activity in our platform bounce back quickly, post Chinese New Year. These investment in user engagement helped to stimulate more frequent purchases and drove our annual spending per active user to RMB1,257 and 87% increase from RMB674 for March 2018 quarter.

Not only we continue to see existing users upgrade their consumption behavior on our platform, we have observed some newer users actually making higher value purchases earlier in their life-cycle, when compared to older cohorts. This is a reflection of the improved product selection we have on our platform, and more importantly, it is also a sign that these new users have greater trust and confidence in us. Sales and marketing is an investment, that can create meaningful long-term returns for us. We expect our users to grow with our platform and spend more over time.

At the same time, we would like our users to be informed of our product and services improvements and to try them out more frequently. Sales and marketing is a means for us to incur such activities. That being said, we remain stringent on our ROI of our sales and marketing investments, where the math did not work we have held off and will hold-off from making such marketing investments. We are confident that our investments will pay-off. We'll continue to be optimistic, but disciplined in sales and marketing for the rest of 2019.

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Our general and administrative expenses this quarter were RMB236.1 million, with the increase primarily due to an increase in headcount and share-based compensation expenses. On a non-GAAP basis, our G&A expenses as a percentage of our revenue was 1%. Our research and development expenses were RMB667.1 million this quarter, a significant increase from last year as we invested in hiring the more experienced algorithm engineers and spend more on R&D related cloud services.

On a non-GAAP basis, R&D expenses, excess percentage of our revenue was 12%. As disclosed on our 20-F, we exited 2018 with close to 3,700 staff, with over 50% of them being engineers, involved in product development. We expect to continue investing in our R&D capability this year, and are looking to grow our engineering team by at least 2,000 staff.

We plan to enhance our distributor AI infrastructure and invest in core technologies, that can help us improve our user experience and product quality. We are also in discussions with various universities and research institutes regarding joint research efforts and research center collaboration. Operating loss this quarter, came to RMB2.1 billion compared with a loss of RMB253 million in the same period last year. Non-GAAP operating loss was RMB1.6 billion compared with a loss of RMB240 million in the same period last year. Net loss attributable to ordinary shareholders was RMB1.9 billion this quarter, compared with net loss of RMB281.5 million in the same quarter last year. Basic and diluted net loss per ADS were RMB1.64 compared with net loss per ADS of RMB0.64 during the same period of last year.

Non-GAAP net loss attributable to ordinary shareholders were RMB1.4 billion compared with net loss of RMB267.9 million in the same quarter last year. Non-GAAP basic and diluted net loss per ADS, were RMB1.2 compared with RMB0.6 for the same quarter of 2018. That completes the profit and loss statement for the first quarter. Net cash flow used in operating activities was RMB1.5 billion compared with RMB683.5 million in the same quarter last year, primarily due to an increase in operating expenses.

As of March 31, 2019 the Company had a strong balance sheet with RMB37.2 billion in cash, cash equivalents and restricted cash. Excluding restricted cash we had RMB22.5 billion in cash and cash equivalents. In addition to this amount, we had RMB6.9 billion in short-term investments. As such, we remain confident in our ability to make necessary investments this year and to grow in line with our expectations. The encouraging increase in engagement by our users and merchants signals to us that our new e-commerce ecosystem derived meaningful values from our platform.

We will continue to do what is right for our users and keep differentiating ourselves with our focus on a fun value for money shopping experience.

This concludes our prepared remarks, operator we are now ready for questions.

## Questions And Answers



## Operator

Certainly sir. Ladies and gentlemen we'll now begin the question-and-answer session. (Operator Instructions) We have our first question coming from the line of Grace Chen from Morgan Stanley. Please go ahead.

### Q - Grace Chen {BIO 2548665 <GO>}

Thank you. Thank you for taking my questions. The question is about sales and marketing strategy. I just want to dig a bit further. It would be great, the management to share your plan to increase sales and marketing efficiency and also your strategies, specifically with coupons and -- coupons versus spending. Thank you.

### A - Zheng Huang {BIO 20683053 <GO>}

Okay, I'll take that one. Well, since last quarter we've quite few questions, surrounding sales and marketing. But, the purpose of sales and marketing spending is really focusing on building greater brand recognition and a developing strong use of engagement. There are two important points, I'd like to make about sales and marketing. We view sales and marketing as a discretionary investment, from which we expect to realize the meaningful long-term value. Second, our sales and marketing investments must meet the strict ROI requirement we set internally.

For the investors who haven't read my letter to shareholders, I strongly recommend to read that, because at this stage although PDD is due -- is off -- it's not small anymore, but it's still early stages. We are still sort of a start-up and we have a larger user base and good user retention and a fairly decent brand recognition. But the brand awareness is not fully cemented in users brand yet. So, at this stage, we actually want to spend the money we earned to increase user awareness and also increase the mind-share of PDD in users mind.

We added a lot of new users in the past year who are still forming their shopping habits on our platform. We have seen our youth, our older cohorts of users spending a few times more than when they joined. So, retaining and cultivating existing users on our platform is all the more important, as well as attracting new users. Over time, we hope Pinduoduo would be the platform, they think of when they want to browse during their schedules times and also when they want to value for money products where they become seasonal users.

So if you will look at our different types of sales and marketing spend. You can see how we are trying to drive towards this goal. First-off for brand advertising, help us to build a brand awareness, whereas online performance advertising increases our traffic exposure and increases the user engagement. And coupon and promotions are designed to encourage repeat usage habits by getting users to engage with us more often and sometimes incentivize the users to try different new features as we constantly improve our product and our features -- and future offerings.

Well, also brand advertising and TV programs sponsorships are designed to reach a wide audience such as the Chinese New Year campaign and a World Cup is meant to raise

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awareness, recognition and a trust of our platform. And third for the online performance advertising and coupons and promotions are more targeted and their effect are monitored on a real time basis. There are number of factors as we calculate ROI, their frequency categories, sharing interactions with other users and also number of new users they bring over, a number of inactive users be reactivated, et cetera. As we measure these over various durations, such as one-day, one-week, three months, et cetera, we do adjust our spending on these channels on a real time basis, once we see ROI on those channel shifts.

Overall, I want to summarize, we're -- because we are very confident of our long-term earning power. So I think at this stage, the best way to use the revenue proceeds is probably to invest in R&D, investing in infrastructure. And also, more importantly invest and use that awareness and brand recognition and also try to cultivate the user behavior in a way that they will choose PDD as their dominant place for shopping and for a lot of the browsing. So sorry for the too long answer, but I'm not sure that it covers all your worries or doubts.

**Q - Grace Chen** {BIO 2548665 <GO>}

All right. Thank you.

**A - Zheng Huang** {BIO 20683053 <GO>}

Thanks.

**Operator**

We have our next question coming from the line of Natalie Wu from the CICC. Please go ahead.

**Q - Natalie Wu Yue** {BIO 18841234 <GO>}

Hi. Good evening, management. Thank you for taking the questions. I have two questions here. The first question is that, we see quite online marketing take rate improvement this quarter. So could management share with us some color on drivers of our monetization ramp-up and how should we think about the trend for monetization for remaining of the year? That's my first question. And my second question, I guess, I have follow-up on our sales and marketing spending. So what's our sales and marketing plan for the full year 2019? Thanks very much.

**A - Unidentified Speaker**

Thank you, Natalie. Let me start with the online marketing services take rate question that you referred to. We really view our online marketing service take rate as a reflection of the value that we bring to our merchants. It is ultimately driven by our user satisfaction and our differentiated value proposition. So we do not focus at this moment on take rate, but instead we focused on improving our SKU offerings to our customers. We focus on customer service, which we believe will lead to more user interactions within the platform and among themselves. This translates into more exposure for our merchants. So as merchants' ROI increases with exposure and sales, they naturally want to spend more on

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our platform. And from a results perspective, we have seen our take rate increase over time.

We're still at a very early stage of monetizing on our platform and we will continue to help merchants serve our users better and make money. But we want to be mindful and we will be mindful on balancing between monetization and growth. For now we'll continue to prioritize growth, but we know that the underlying drivers of monetization remain healthy, as we see our merchant base continuing to expand and our merchants becoming more active in marketing as they become more familiar with our platform.

#### **A - Zheng Huang** {BIO 20683053 <GO>}

Well, I want to add a little bit to David's answer. Actually, I think, the increase you see right now is just a very small fluctuation. I -- personally I don't encourage our investors to measure the monetization range on a quarter-by-quarter basis, instead you should just look at this on a longer timeframe, at least for a half year or a year on a yearly basis. And for seasonal reasons and our policy exchanges, I mean, platform policy exchanges maybe. This kind of small fluctuation, I think, even you can enroll that and but over the long run I think in terms of monetization we're still at a very early stage, yeah.

#### **A - Unidentified Speaker**

Natalie, I think, you also had a question on the 2019 sales and marketing. Given our fast growth it is very hard for us to give you guidance. We are pleased with the results of our marketing campaign thus far and as we have mentioned a number of times we will continue to make investment as long as we think the expected returns meet or exceed our ROI targets. So we believe we're in a good position to do so, as we see our GMV monetization continue to grow.

#### **A - Zheng Huang** {BIO 20683053 <GO>}

Yeah. I also want to add a few sentences. Basically if the market is good and we're doing a good job, then you should expect us to spend more. With that you may see more deficits. But, if we're doing a mediocre job then probably you will see sort of that will be more in line with a lot of expectations maybe. But internally we do have a very strict metric for every penny we spend and that is really based on carefully calculated ROI of all the marketing campaigns. So that is more based on whether -- since we're treating a lot of the marketing as the investments. So the philosophy will be, yeah, there is a good deal then we'll invest. But if the price is too high, then we'll just refrain from that. So with that mentality in mind, it is pretty hard for us to kind of predict or to precisely calculate how much we will spend, while budgeting, okay?

#### **Q - Natalie Wu Yue** {BIO 18841234 <GO>}

Thank you. Thank you, management.

#### **Operator**

(Operator Instructions) We have the next question coming from the line of Alicia Yap from Citigroup. Please go ahead.

## Q - Alicia Yap {BIO 15274658 <GO>}

Hi, good evening management. Thanks for taking my questions and congrats on solid results. My questions is related to the competitive landscape. So can management share with us, how do you see the impact of potential threat from your pick-up here. Going after more aggressively in growing more new user, right from the lower tier cities. And have you seen any rising difficulty in retaining new user that you acquire over the last few months. And then, in terms of what are some of the measure you'd believe you could be effective to counter the combated -- to counter the competition? And or are you not really worried about the competition? So, any colors on that would be helpful. Thank you.

## A - Zheng Huang {BIO 20683053 <GO>}

Well, for competition, it is a hot topic last quarter, and even it's continuing this month. And I have to say that, the competition we see at this moment and a lot of the actions our competitors have taken for instance like the forced exclusivity in Chinese (inaudible). It's unprecedented, I have to say, but it is becoming more and more interesting. You rightly pointed out that a very important factor is the users. So, if we look at our user base and look at our users the behavior and the retention, I think we're very happy about the current status. And not only it's healthy, but I guess the competition even increased, users kind of engagement and support.

So, of course in the short-run, the competition, especially some of the forced exclusivity, we will have some effect on our merchants in a negative way. But in the long-run I don't see any sustainable measures they can take. And as a side effect of all these negative movements the competitors are doing, we also see some positive side effect. A lot of the merchants and the brands start to realize how important our platform is. So, looking at this in another way, as we grow bigger, the opportunity cost merchants incur by not being on our platform also increases.

Merchants like our users, ultimately want more sales from more channels rather than forcing merchants to go against their best interests. We think a more sustainable way to stay competitive in a long-term is to build up our intrinsic value by focusing on serving our users well. We don't think China e-commerce has to be a zero-sum game. I also, personally write quite a few paragraphs in the letter to shareholders about the recent the competition landscape. I think it will continue like this for quite some time, but the outcome is also predictable I think, but I don't think any brand -- in the long run go against their fundamental interest. And, also if we five years down the road, if there is only one de facto e-commerce platform or kind of circulation system in China, that kind of result I don't think it's acceptable in China and it's unimaginable.

So, if not PDD, there has to be some other large scale new e-commerce platform to exist. So, with that said, I'm also -- I'm participating in this kind of competition, but I'm also observer of this competition. Personally I'm getting more and more intrigued and getting interested in this kind of thing, because I see a very good sign, is that the whole industry, including the larger scale competitor is actually follows a lot of our initiatives. For instance, if we're going to Yunnan and we do the coffee beans and others will follow us and go there and also to buy the coffee beans from farmers. We do new branding initiatives, they

will also do and when we launched Heritage brand initiatives, almost the whole industry followed us.

So this kind of phenomenon is also unprecedented and it's also encouraging, because a lot of our initiatives we're doing today is actually not just purely from our economic incentive, a lot of that is for our social responsibility. As a big platform in China we do think we should take social responsibility seriously as our first degree necessity. With that, if we go to the farmers buy coffee beans and that will lead the way for others to buy coffee beans from them. Therefore, those farmers get greatly helped and their income got increased, that is more than welcome and that also shows the value of our platform and this kind of a trend, if they don't change their strategy, I guess we'll continue also, which is very good for the industry and very good for China as well.

And to conclude the answer to your question, I have to point out that China's retail market physical goods retail market, now is already 30 trillion and it is still growing and online e-commerce percentage of the 30 trillion market is also growing. And very likely in the future, online and offline will be mingled together. Therefore, the total market we're in is tremendous. So, we're currently just assuming, a very, very small pile of that, and it is unlikely to be a zero sum game, and very likely the current severe competition will lead to two, three even more very strong companies. Yeah. Thank you.

**Q - Alicia Yap** {BIO 15274658 <GO>}

Thank you.

**Operator**

We have our next question coming from the line of Piyush Mubayi from Goldman Sachs. Please go ahead.

**Q - Piyush Mubayi** {BIO 1530844 <GO>}

Thank you for taking my question. Colin, for a relatively new company, as we approach the one year anniversary of your listing, could you look at areas where PDD has surprised you on the upside and you've done very well? As well as areas where you still need to address, and by that I mean, areas such as your bench at this point of time?

And my second question if I may slip in one, in your sales and marketing spend, could you detail which channels have proven to be those that are very effective on conversion for instance? And related to that, if I look at the magnitude of spend for the sponsorship of the CNY gala [ph]. Should we think of SG&A for the rest of the year based on the 103% of revenue in the third quarter or the 63%, if I exclude the CNY spend based on my estimate? Thank you.

**A - Zheng Huang** {BIO 20683053 <GO>}

Okay, I'll leave the second question to David. For the first question, well, I have to say that we're extremely lucky as a young Company and we have been growing very fast. And we have -- we are born in a good age with this model. One thing that surprised me a little bit

is that, I do see the power of this platform to solve some of the social problems, the existing problems. And I feel very proud of our initiatives and efforts in the agriculture industry, because this is a big area for China, especially meaningful, because there were still more than 300 million people, peasants working on the fields directly excluding the peasants working in the cities, building the houses. So when we've changed agriculture upstream model a little bit, that does improve the efficiency a lot and today with increasing user base and the increasing influence of PDD, I -- and also the increasing intensity of the competition, I gladly to see basically the whole industry start to study our agriculture efforts and trying to put more emphasis and the resources into that area. So that is really good and I feel so happy about that.

One thing that -- the negative surprise, not a big surprise, I guess I had sort of pretty good kind of sort of prepared for that, but it's still when we are in a position which is not understood especially for some of the wrong reporting and those kind of things. When you're in a situation you are misunderstood and cannot stand out to actually explain, that actually presumably makes me a little bit sad, but that's the fact and that's also kind of the lesson we have to learn and have to grow. But with all that said, I think I already feel very fortunate and I think I'm -- the whole team got excited by what we have done, especially when we see the good things happening on a few -- in a few.

## A - Unidentified Speaker

Piyush, in terms of your second question regarding sales and marketing, as you know, we do not give guidance for the full year, because the situation that we are in today remains to be quite dynamic. Not only do the opportunities varies from time-to-time, the pricing of such opportunities also move around. What does not move around really is how we think about ROI in terms of our investment in sales and marketing. So as we think about the spending that we make in sales and marketing, we focus now in particular on responses by our users.

So looking at the promotions and the coupons that you know for example recently we have had some very successful campaign, that generated excitement and sharing and conversion on our platform. So we will continue to assess opportunities as they arise going forward the rest of the year, that we will and you should expect us to remain, continue to remain very disciplined as we think about our return on investment.

## Q - Piyush Mubayi {BIO 1530844 <GO>}

Can I just specifically, should we use 63 or 103 as a thinking point, especially given that CPMs across the industry have pulled back dramatically into the second quarter? And also if I look at certain data points that are getting released by third party vendors that track you, it appears that you had a very strong April and that's why I asked the question is that same spend translating to much more effective growth in the month of April and hence going forward?

## A - Zheng Huang {BIO 20683053 <GO>}

Well, I cannot comment specifically on that, but when you talk about the macro environment in the advertising industry, I don't think that is fully kind of revealed yet, and

it also fluctuates and when it comes to our industry the e-commerce, I think because of the competition is too fairly severe. So I don't think those macro numbers that have significant meaning or significantly useful when you do the calculation. Again regardless what kind of outside macro is, we will just use our internal metric to measure the ROI, just like you are investing while you are following the value investing policy. So it doesn't really matter what the stock price is, you just look at the intrinsic value and the current price, if the prices are good and then you will just buy it.

**Q - Piyush Mubayi** {BIO 1530844 <GO>}

Okay. Thank you.

**A - Zheng Huang** {BIO 20683053 <GO>}

Next question?

**Operator**

Shall we move to the next question sir?

**A - Unidentified Speaker**

Yes, move on to the next question.

**Operator**

We have the next question going for the line of Joyce Ju from Bank of America. Please go ahead.

**Q - Joyce Ju** {BIO 20718580 <GO>}

Good evening management, thanks for taking my questions. My question is actually related to cost of revenue. First, may we get more colors on the payment rebate from Tencent this quarter? Is this actually a one quarter event and related to just quarters expenses only or this was actually for a longer historical period? And how shall we expect an implied you know payment costs for this quarter or like for the rest of the year?

Secondly, of course Colin mentioned that this year Company will continue to invest a lot to strengthen the merchant services, which were also related to the cost of the revenue but not directly correlated to the GMV. Could you elaborate more in terms of like what investment will be and how shall we expect the amount or the scale of the investments and how this will affect the gross margin for this year? Thanks.

**A - Unidentified Speaker**

Thank you, for the question. First of all, the question regarding the rebate, the rebate that we receive from Tencent is one-off in nature. I would not say that it is not something we would not expect in the future, but that is based on case by case negotiation and it is not something that we would expect to be seeing every quarter. Secondly, in terms of cost of revenues overall, our costs of revenues have increased over the last few quarters as we

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made investments in cloud services and other -- building out our team to in order to provide better services to our platform.

One of the examples that we can point to, is on the merchant support services such as Duo Duo University. So we are spending a lot of efforts educating our merchants on how to better utilize our platform. And at the moment, we are not charging anything for such services and these are naturally falls into our cost of goods sold, cost of revenues. These investments can be quite lumpy as we mentioned in our earlier script, because we believe that they actually are necessary to support our longer term growth of our platforms. As such, our gross margin may likely to fluctuate between 70% to 80% range depending on the timing of our investment. I would also point out that the first quarter, this quarter is lower, our gross margin on adjusted basis is lower because of the Chinese New Year impact. If you think of it as having the investments against a lower revenue, so hopefully that helps too.

**Q - Joyce Ju** {BIO 20718580 <GO>}

Got it. Yes. Sure, thanks.

## Operator

Thank you. We have our next question coming from the line of Ms. Monica Chen from Credit Suisse. Please go ahead.

**Q - Monica Chen** {BIO 19475581 <GO>}

Hi, good evening management, thank you for taking my question, and congratulations on the strong results. Can management just give us more color on your logistics, your e-waybill initiative? For example what's like the so far the feedback from the merchants? And how do we expect that help us to improve our logistics efficiency over time? Thank you.

**A - Zheng Huang** {BIO 20683053 <GO>}

Okay. So, I'll answer that first and David you can add, if you have something to add. So, I think we've rolled out our e-waybill just in March 2019 and the merchants adoption has been very, very rapid. So although it's only like several months old since it's been -- since it's online, it's already the second largest in China, and probably in the world as well. So, we can do this or we have done this in this rapid fashion, it's because we do have the volume, first of all. And secondly, the merchants and the delivery companies all welcomes another alternative. Actually, this initiative, it is very important for the long-term healthy sustainability and independence of delivery companies. And it is also very important for the merchants.

As for the users, you know without this e-waybill system there are merchants who was trying to fake the mailing address or trying to fix the routes of the delivery or trying to fake the delivery time or something like that. But with this e-waybill system in place, the detection of those kind of misconduct is much easier and the end-to-end information flow is much clearer than before. And it is also a tool against the brushing, it will make



merchant much harder to fake orders, so that they will no longer be able to sort of brushing their orders and create fake orders, so that they can rank up higher. So with all that, I think the launching of the e-waybill system has been pretty successful. The team has been working very hard and the result has been satisfactory at this moment. Thank you.

## Operator

Thank you. Ladies and gentlemen, I would now like to hand the conference back to our speaker to end the call and for any ending remarks.

## A - Victor Tseng {BIO 15874718 <GO>}

Thank you for the call everybody. And we look forward to next quarter's earnings call.

## Operator

Thank you, sir. Ladies and gentlemen, that concludes our conference for today. Thank you for your participation. You may all disconnect now.

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