FINAL

Bloomberg Transcript

Q1 2020 Earnings Call

Company Participants

- Lei Xu, Chief Executive Officer, JD Retail
- Ruiyu Li, Senior Director of Investor Relations
- Sidney Huang, Chief Financial Officer
- Zhenhui Wang, JD.com, Inc

Other Participants

- Alicia Yap, Analyst
- Eddie Leung, Analyst
- Eddie Wong, Analyst
- Gregory Zhao, Analyst
- James Lee, Analyst
- Jerry Liu, Analyst
- Ronald Keung, Analyst
- Thomas Chong, Analyst
- Tina Long, Analyst

Presentation

Operator

Hello, and thank you for standing by for JD.com's First Quarter 2020 Earnings Conference Call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

I would now like to turn the meeting over to your host for today's conference, Ruiyu Li. Thank you. Please go ahead.

Ruiyu Li {BIO 19135837 <GO>}

Thank you, operator, and welcome to our first quarter 2020 earnings conference call. Joining me today on the call are Mr. Richard Liu, CEO of JD.com; Mr. Lei Xu, CEO of JD Retail; and Mr. Zhenhui Wang, CEO of JD Logistics; Sidney Huang, our CFO; and Jon Liao, our CSO.

For today's agenda, Sidney will discuss highlights for the first quarter 2020 and other management will join the Q&A session.

Before we continue, I refer you to our Safe Harbor statement in the earnings press release, which applies to this call, as we will make forward-looking statements. Also, this call includes discussions of certain non-GAAP financial measures. Please refer to our earnings release, which contains a reconciliation of non-GAAP measures to the most directly comparable GAAP measures. Finally, please note, unless and otherwise stated, all figures mentioned during this conference call are in RMB.

Now I would like to turn the call over to our CFO, Sidney.

Sidney Huang {BIO 20098238 <GO>}

Thank you, Ruiyu. Hello, everyone. Thank you for joining us today. 2020 has been an unprecedented year for all of us. As we mentioned on our last earnings call, JD.com and its heroic 200,000 strong front-line employees have been a unique force in supporting the livelihood of hundreds of millions of consumers, helping them to adapt to a new normal under the social distancing measures and making notable contributions to productive and sustainable society throughout the COVID-19 crisis.

In that process, we also navigated through all the operational difficulties and disruptions resulted from the COVID-19 outbreak and delivered a solid set of financials for our shareholders in the first quarter of 2020. We accomplished many impossible missions by leveraging our unparalleled supply chain and logistics capabilities that were invested over the past 15 years, as well as a strong corporate culture that cares deeply about our front-line employees, who in turn take great care of our valued customers.

Our net revenues grew by 20.7% in the first quarter, ahead of our internal expectations as we ensured the supply and fulfillment of essential products to our consumers amid this tough environment. The strong top line growth was accompanied by even stronger user engagement. Our active customers in the past 12 months reached a total of 387 million, up 25% from a year ago, the highest growth rate in eight quarters with 25 million net additional customers on top of an already strong peak season net addition in the December quarter.

Similar to Q4 last year, over 70% of new customers in Q1 came from lower-tier cities. The lower-tier city customers contributed over 50% of our fulfilled GMV in Q1, which sets a new record. In the meantime, our mobile DAU grew 46% in Q1, the fastest in nine quarters. The level of user activities on our platform notably accelerated as we earned a greater consumer mindshare by being the only fully functioning e-commerce platform with diverse product offerings and superior logistics services immediately after the outbreak. This is further evidenced by our number one internal KPI, the net promoter scores, which reached all time highs across all of our core businesses.

Category-wise, revenue growth of general merchandise accelerated to 38%, the highest growth rate for the past six quarters, driven by our newly integrated omnichannel supermarket business group, growing 47% in the first quarter as well as strong performance from healthcare, cosmetics, and household product categories. Our omnichannel supermarket group basically combines our FMCG, fresh produce, 7Fresh

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

and convenience store business units, most of which were launched and developed from zero in the past six years. By 2019, the revenues of this group reached over RMB115 billion, roughly 20% higher than the revenues of the largest offline supermarket chain in China, making us the largest the retailer for this category in the country. If you consider the fact that most offline supermarkets also sell home products and appliances, our leadership gap will be wider.

In addition, our JD Health business unit is also gaming consumer mindshare with quarterly active customers for medicine categories increased by triple digits. Net revenues from JD Health increased 65% year-on-year in the first quarter, surpassing the revenues of the largest offline pharmacy in China.

As I have communicated with many of you, probably every time we spoke in the past, we will secure market leadership across most of our core categories one by one. And these are just two notable examples, while a few others are hidden champions. I'm thrilled that we have achieved quite a few of these milestones before my retirement. It's just a matter of time and the snowball will continue to grow.

For now, our general merchandise sales in Q1 contributed more than 40% of our product revenues for the first time and further strengthened our brand recognition and consumer perception as an everything-store with increasingly broader selections. On the other hand, the electronics and home appliance categories also performed extraordinarily well on a relative basis, growing nearly 10% as compared to a nationwide decline of 21% in the first quarter according to the government data. As we discussed many times in the past, our electronics and home appliance categories can always outperform because our cost structure is 50% lower than our peers, which allows us to provide the best value and best service to the consumers.

Another remarkably resilient metrics is our fulfilled gross margin which stood at 8.3% in Q1 comparable to the same quarter last year. There are a few moving pieces in this metric. But essentially the lower fulfilled gross margin of the omnichannel supermarket business was substantially offset by the incremental gains from procurement economies of scale across all categories, particularly those with market leadership positions. To a lesser extent, it also benefited from less subsidies used for traffic generation to cultivate consumer habit for online grocery shopping, which has probably leapfrogged for one to two years in the past three months. As a result, we are approaching the inflection point of the supermarket business ahead of our original schedule.

Another positive contribution to the fulfilled gross margin was from JD Logistics, where the productivity gains from higher than expected orders more than offset the additional costs from the operational disruptions, higher wages, and staff protective measures. If you look around today, you can probably identify a clear pattern. Those who treat their employees well in the normal times are the most resilient in the time of turbulence.

Besides fulfillment expenses, all other expense ratios declined due to our more disciplined spending amid uncertainties during Q1. Our marketing, R&D, and G&A expense ratios in the first quarter improved 20, 38, and 13 basis points, respectively,

FINAL

Bloomberg Transcript

compared to the same quarter last year. As a result, our non-GAAP operating income increased 65% to RMB3.3 billion and the non-GAAP operating margin was 2.2%, up 60 basis points from the same quarter last year.

On a segment basis, non-GAAP operating income of JD Retail Group increased by 39% to RMB4.5 billion in Q1 with operating margin improving to 3.3%, up 44 basis points from the same quarter last year.

While the margin improvement may surprise some, it is because we have been investing for the newer categories and never tried to optimize our margins. As I mentioned to many of you in the past, the relatively decent margin business has already in there for quite some time. In this quarter, we just narrowed gross margin ahead of schedule for certain categories that are under the investment phase.

Moving to the bottom line, our non-GAAP net income attributable to ordinary shareholders in Q1 was RMB3 billion compared to RMB3.3 billion in the same period last year. The decrease was primarily due to certain one-off gains in Q1 last year. Our free cash flow for the first quarter was negative RMB3 billion, partly due to our early payments or pre-payment to certain supplies to support their operations and secure certain sought-after merchandise.

CAPEX was prudent in Q1 and spending for the development properties was for existing projects. As disclosed, we established a second core fund with GIC in Q1 to dispose another RMB4.6 billion of logistics assets which remain the most resilient real estate asset class regardless of the COVID-19 situation.

On the financial outlook, we expect net revenue growth in the second quarter to be between 20% and 30% on a year-over-year basis, based on accelerating growth in the first half of Q2 and assuming the COVID-19 situation does not create significant unexpected disruption in the remainder of this quarter. We are not in a position to provide any full-year guidance on the bottom line, due to the uncertainties of the pandemic. However, the margin dynamics in our Q1 results may provide some basis for your own assessment on the various development scenarios of the COVID-19.

In summary, we are privileged to be in a unique position to leverage on the best of our capabilities, to help the society during the COVID-19 outbreak, including our broad product selection in consumer staple categories and our superior logistics infrastructure. We are confident that we will emerge stronger on the other end, with accelerated user growth, strengthened brand image and expanded consumer mindshare. All of these validate our long-term approach to running our business with the customer centric focus. I'm more confident than ever about our market position in our mid to long-term growth prospects.

This concludes my prepared remarks and we can now move to the Q&A session. Operator?

FINAL

Bloomberg Transcript

Questions And Answers

Operator

Certainly. (Operator Instructions) We have the first question from the line of Ronald Keung from Goldman Sachs. Please go ahead.

Q - Ronald Keung {BIO 15432736 <GO>}

Thank you. Thank you. Richard, Xu Lei, Wang Zhenhui, Sidney, LiaoZong and Ruiyu, I think it's a very strong result and congratulations on the first quarter performance. And with the first quarter we've seen how JD Logistics supply chain and logistics business proved to be exceptionally resilient over COVID. And we've seen that over -- there is over 50% revenue growth for the logistics and others revenue line in the first quarter. So I would like to hear, can management just outline some of the growth drivers and margin outlook for the logistics business in particular? And beyond fulfilling the first-party 1P retail orders, are there any plans to fulfill more of your 3P marketplace and even Jingxi orders and what do we see as other opportunities beyond serving just within the JD Retail Group? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Okay. Thank you, Ronald. So I'll start and then maybe Zhenhui can add on. So the Logistics business enjoyed great brand recognition amid the COVID-19 situation. We were widely recognized by the consumers, but also by the government. We were awarded multiple actually awards across the region. So very, very strong performance. And along with that, we absolutely attracted some new customers during the pandemic, because of the resilience of our operations.

But as B2B business, the impact of the brand enhancement will not come immediately. So there will be lasting effect of that positive impact. But in Q1, we did see pretty strong demand from existing clients and also new customers outside of the JD ecosystem. And as I mentioned earlier, the performance, the productivity of our logistics team was exceptional. In fact, the cost per order reached all-time low during the first quarter, because the order volumes spiked unexpectedly and our team front-line workers, as I highlighted earlier, really I used the term heroic, because not only they were highly productive, but they are also very brave to fulfill the orders for consumers amid a lot of uncertainties.

We of course also provided all the necessary safety measures to protect our employees, who in the end really didn't get harm throughout the pandemic situation. But that additional productivity helped our overall margin in Q1 on a year-over-year basis. And this is a business that's built on scale. So as we continue to grow in scale, our margin won't actually trend better and the business has been positioned to attract external customers. As we mentioned earlier, in Q1, our external revenue actually contributed more than 40% this quarter. So it's another milestone for the Group.

A - Zhenhui Wang {BIO 21020367 <GO>}

(foreign language) This is Wang Zhenhui from JD Logistics. I want to add a few things.

FINAL

(foreign language) And as Sidney just mentioned, the experience, actually including our staff experience is always at the core of our business. And during this very special time, the safety and health of our front-line logistics staff stay as first priority for us to operate. And during this time, we provided over 10 million masks and 70,000 gloves and all kinds of protective gears to our logistics staff to ensure they are working in a relatively safe environment.

(foreign language) And in addition to that, we have bought over 70,000 thermometers and over 10,000 disinfectants, et cetera in all different places to ensure the operational safety in the first place.

(foreign language) And with the epidemic situation getting better, JD Logistics is one of the first and actually in some areas, it's the only logistic company our JD couriers can deliver our product to doors to our customers and this has now fully manifested the trust we have been built among our customers, our communities, and government and this is also very helpful for us to gain more external orders and increase our revenues and services to all our clients. Thank you.

Q - Ronald Keung {BIO 15432736 <GO>}

(foreign language) Thank you Sidney and Mr. Wang.

Operator

Thank you. We have our next question from the line of Alicia Yap from Citigroup. Please go ahead.

Q - Alicia Yap {BIO 15274658 <GO>}

Hi, good evening, management. Congratulation on the strong results and guidance. My questions is, could management elaborate a bit how we should reconcile the strong guidance you provide versus the current macro situation in the consumption sentiment? How much of the outperformances are driven by the consumption stimulus and the consumer wanted to buy more things coming out from the COVID or was that the benefit that we are seeing from the offline to online shift? How sustainable is this strong momentum into the back half of the year? Do you anticipate the demand to be more normalized? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Okay. So I will -- this is Sidney, I will give the first shot and then maybe Xu Lei can add. Yes, so what we have observed is that when the pandemic situation was highly uncertain and social distancing was at the most strict time, there will be a huge spike in orders for fresh products and other daily necessities and as I mentioned earlier, we are now the largest omnichannel supermarket in China. So we are here to benefit from the increasing demand on this category. Essentially people will be cooking at home and so that will increase the overall demand for fresh and supermarket sales, both online and offline.

Bloomberg Transcript

FINAL

And so that will benefit, but it will be somewhat offset by slower growth from the discretionary categories as we have seen. Now that the country is gradually opening up and everyone is resuming to work, we do start to see pent up demand on the slower categories starting in March and particularly in April and May. As I mentioned, we are actually seeing accelerating growth over the past three months. So that is in a relatively good scenario. Our strong categories will start to recover.

And at the same time, because of the cautious measures still being undertaken by the majority of the consumers, for example, you still don't see many people in restaurants. So most people still will cook from home. So that will continue to create higher than normal demand for the supermarket product categories. So it's really depending on the development of the COVID-19 situation, but in either direction, our business, because we are a full category retailer and we cover all the major categories, particularly the consumer staples, so we are in a position to grow regardless. So that would be my take.

A - Lei Xu {BIO 21705778 <GO>}

(foreign language) Xu Lei from JD Retail.

(foreign language) And on the user side, we can see in Q1, the growth rate was very healthy and especially if we see the internal statistics of existing customers and those reactivated customers becoming more active this quarter.

(foreign language) And if you see by the users' recipient address, over 60% of our users are coming from the first and six tier cities and by GMV, they count for over 50% of the overall GMV now.

(foreign language) And we will adopt a number of strategies to develop our user base in the future and first of all to target our lower tier city markets and users, and we call it, our dual-driver system driven by our Jingxi platform and also by our main site based on more precise customer algorithm.

(foreign language) And in terms of the China's income landscape and online retailing, the characteristics of JD users are featured -- a lot of them are middle and high-end users, and a lot of them are household users.

(foreign language) And it is planned that by end of this quarter or early next quarter, we will provide specialized programs to provide more tailor-made services to our middle and high-end users and providing them with more selected products with some paid services.

(foreign language) And as introduced earlier, we have established a new first tier department under JD Retail focusing on the users growth and operations and for this department, they focus on the optimizing of the users' algorithm and their database and assets to do more precise operations and conversion of the new users. And the results in Q1 is pretty effective.

Bloomberg Transcript

(foreign language) And in terms of the categories, actually on our platform, some of the categories have been benefited from the coronavirus situation and some has been badly affected due to supply chains, et cetera, lower than expectation. However, looking at the performance during the main holidays, we do see a rapid growth in the home appliances and fashion apparel segments.

(foreign language) And also I will say a few words about our most important marketing activities, that is 618, in this quarter.

(foreign language) And due to the epidemic earlier this year, we can see that the enthusiasm to participate into our 618 Shopping Festival from our brand partners, merchants and other retailers, online and offline is very high. I think it's the highest in the past 17 years. They are very engaged.

(foreign language) And we also expect that all the major players, the competitors on this market are also very active in preparing for this event.

(foreign language) And as all of you know that 618 was created by JD 17 years ago, this is the 17th 618 event. And by nature, we will take more a center stage in this activity. And so far we have received very positive attention from our customers and also a lot of invitation and investments from the merchants and the brand makers to accompany our way.

(foreign language) If there is not another major outbreak of the coronavirus again, we do think the 618 this year will be a good opportunity for all the merchants and the brand makers to recover and offset their life in Q1.

(Foreign Language) Thank you.

Q - Alicia Yap {BIO 15274658 <GO>}

(foreign language) Thanks.

Operator

Thank you. We have the next question from the line of Tina Long from Credit Suisse. Please go ahead.

Q - Tina Long {BIO 21068620 <GO>}

Hi. Thank you, management. Congratulations on the very strong results. I want to follow up on the lower tier penetration, because, now as Mr. Xu Lei just mentioned that we have Jingxi and recently I also noticed that we have or JD Light. And also we do have probably over 10,000 home appliances and 3C stores so those stores in lower-tier cities. And also we sort of gave the first level entry access point of WeChat to Jingxi since late last year. So I want to know, first of all, each apps we just talked about and also, including those offline shops, what kind of product offerings we tend to acquire those lower tier city users? And also the contribution from the newly sort of upgraded access points, how much of our

FINAL
Bloomberg Transcript

FINAL

user contribution actually come from the WeChat after we sort of gave access to Jingxi instead of JD? Yeah, thank you.

A - Lei Xu {BIO 21705778 <GO>}

(foreign language) Let me just share some of our operations and other observations on the lower tier market.

(foreign language) And first of all, in building different shopping scenarios in places we will not rely on any single shopping scenarios. Besides the Jingxi platform, which is targeted to the lower tier customers, we will also use our main sites through algorithms to play a role in expanding our shopping scenarios.

(foreign language) And just to be frankly speaking, for Q1, the Jingxi platform in February and March was affected by both the spring festival and the epidemic situation.

(foreign language) But as you can see on this earnings call's results, on Jingxi platform, the percentage of our users and our GMV are all growing and the rate is also growing very healthy. So, we are also adapting different measures to go down into the lower tier markets.

(foreign language) And with the situation of the epidemic getting better, now the operation of Jingxi has come back to the normal level, the levels that we are feeling comfortable. And in the meantime, we also identified several opportunities with Jingxi to grow. First of all, due to the epidemic impacts, actually a lot of factories who originally produced commodities for exports, now is looking at domestic sales opportunities. And Jingxi can find a good way to collaborate with them to help these factories to transform their business. And at the same time, Jingxi has done a lot of jobs to support the farmers to sell their agricultural produce -- and through live streaming and different ways these, at the same time, it's also the social responsibility we are performing to help the farmers, et cetera.

(foreign language) And another shopping scenarios we have is our offline stores. You have those franchise stores of home appliances, consumer electronics and convenience stores et cetera and all these physical offline stores are playing a very important and positive role for us to go down to the lower tier markets.

(foreign language) And the strength of our various ways to create shopping scenarios, we are also offering our products then to the lower-tier cities through our C2M products and self-owned brands and working with different industrial belts to leverage all kinds of resources and collaborators, the merchants and the makers, et cetera, to meet the need and the tailor the need of the local markets. But only through building different shopping scenarios and making tailor-made products with combined efforts, we can achieve the current accomplishments.

(foreign language) Thank you for your questions.

Bloomberg Transcript

FINAL

Bloomberg Transcript

Operator

Thank you. We have our next question from the line of Jerry Liu from UBS. Please go ahead.

Q - Jerry Liu {BIO 17515547 <GO>}

Hi. Thank you, management. My question is about margins. If we look at the first quarter, margins were -- net margins were quite strong, actually reaching a level we saw throughout 2019 despite COVID and earlier we talked about some of the investment areas, actually maybe improving ahead of schedule. So as we look forward, do we see opportunities where we want to step up reinvestment of some of these profits into other areas or do we want to let margins continue to rise a little bit higher? I know management has talked about this long-term target in the past of maybe even high single-digit margins. So just wanted to get a sense of the appetite for reinvestment or letting the margin come up a little bit. Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, sure, Jerry. This is Sidney. Yes, the plan -- first of all, there are still a lot of uncertainties due to the COVID-19 situation, but clearly we will act on the increasing customer base, the enhanced user engagement. We will definitely continue to invest as we have always done to seize the opportunities. Xu Lei mentioned earlier about June 18 festival, which will be a great opportunity for us to work with brands, work with suppliers to really make up for the lost sales for everyone in Q1 due to the pandemic. So we will be putting our share for sure, not only to drive growth, but also to support the recovery of the overall -- from a society point of view, clearly it's also a great opportunity for us to retain the new customers we acquired and also to be able to continue to build consumer behavior for multiple categories that we have gained so much in the past three months.

So, I guess, the short answer is, we will, as always, continue to reinvest. We will continue to keep an eye on the margins. As you can see, what we did in Q1, because it is in an uncertain time, we will remain very, very disciplined, but on the other hand, we will never stop investing in our customers. We will never stop investing in improving the user experience and to that end, the investment will always continue.

Q - Jerry Liu {BIO 17515547 <GO>}

Got it. Thank you.

Operator

Thank you. The next question comes from the line of Thomas Chong from Jefferies. Please go ahead.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi, thanks management for taking my questions and congratulations on a very strong set of results. I have a question, it's about our suppliers. We have quite a lot of support to our suppliers to pass through the challenging situations. Can management comment about

FINAL

Bloomberg Transcript

the environment of the suppliers in China? Are we seeing -- how long do you think our suppliers will be back to normal and the support measures that we provide to them, will we step up the efforts, we'll help them passing through the situation or should we expect they will recover in the second half? So, that is more relating to the free cash flow side. Should we expect the free cash flow to turn positive in coming quarters? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Okay, I'll first give us shot. Just on the support to suppliers, it happened mostly in February and maybe in early March when the pandemic was in the most severe situation, when whole country was locked down, but I think fortunately the control was quite effective. So by March, there were very few new cases. So many factories and producers had already started resuming work, especially for essential categories. So from our overall assessment on our suppliers because we work with leading brands across country, the most of them are back to work. Their cash flow has resumed somewhat back to normal. So, to the later part of the quarter, there were more prepayments rather than basically to secure sought-after merchandise and to a lesser extent just to pay payable earlier.

So, I think overall the financial health of the suppliers we work with, they are mostly mid to large suppliers and plant owners. Financially, they are quite sound. There may be -- for a small medium enterprises, there might be issues. So that's why we, for our Jingxi business, for example, Xu Lei mentioned that there were some slowdown, but we are also seeing the activities picking up. So, overall, we are cautiously optimistic.

Now, on our own free cash flow, we do expect it to gradually return to normal, but on the other hand, in -- just stay alert about potential future, W-shape, for example, scenarios then. So, cash flow will remain to be a focus for us as well. Free cash flow should be a function of our overall bottom line, but we do expect free cash flow to perform better than our net profit as we did last year.

Q - Thomas Chong {BIO 21155199 <GO>}

Thank you, Sidney, for the detailed answer and congratulations again.

A - Sidney Huang {BIO 20098238 <GO>}

Thank you.

Operator

Thank you. Your next question comes from the line of Eddie Leung from Bank of America. Please go ahead.

Q - Eddie Leung {BIO 15234642 <GO>}

Hey, good evening, guys. Congratulations on a good quarter amid a difficult time for everyone. I have a big picture question. Given the strategy and aggressive tactics of some of our competitors, so do you see a risk to the industries on long-term margins? If not, why not? Thanks.

FINAL

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, I think we have, as I mentioned in my earlier remarks, we have been as aggressive as we could in our own right. We have been investing heavily in all of the categories. We always strive to provide the best value on top of the best service. So that's why I mentioned also earlier in response to Jerry's question that we will clearly also step up our own investments, given the strong -- relatively strong performance and investing back, basically giving back to our consumers as we always do. And when we do that, we also work with brands and in the joint effort, in those promotional activities and on top of our everyday low price.

So the fundamental driver for our margin, I can't speak for others, the fundamental drivers for our business is from the economies of scale, because as we continue to grow, we can gain more and more procurement benefits. Some are straightforward as rebates, volume basically rebates. Others could be in the form of customized models and private label products. So a lot of those tools will become available once you are the largest retailer in the category. So, we will not be affected by others in the industry, which is a trend that you have been seeing over the past few years, because every year, if you recall, every year there is a reason to believe the competition is stronger. Every year there is a reason the competition become more fierce, so -- but we continue to perform pretty well and with growth now accelerating and margin expanding.

Q - Eddie Leung {BIO 15234642 <GO>}

Thank you very much.

Operator

Thank you. We have our next question from the line of Gregory Zhao from Barclays. Please go ahead.

Q - Gregory Zhao {BIO 18710278 <GO>}

Hi, management. Thanks for taking my question and congratulation to the strong quarter. So a really quick one. So we know large majority of the products are produced by the local manufacturers, but you still have a portion of the products imported from the overseas market. So as the pandemic is still ongoing or I think in the rest of the world, how should we think about the impact to imports and the cross-border business? Thank you.

A - Lei Xu {BIO 21705778 <GO>}

(foreign language) This is Xu Lei.

(foreign language) For JD, our very fundamental and the highly well known categories is our electronics and PC segment.

(foreign language) And for the home and appliances categories, the supply chain was not so heavily affected by this coronavirus, but the flat driver is more from the domestic side

Bloomberg Transcript

FINAL

because these products won't be delivered and installed at doors.

(foreign language) And for the mobile phone category, its development will not be -- the sales will not be heavily affected in the later quarters as well. And some major impacts on these category is the 5G new products will lead. These were planned to be launched in the first quarter has now been postponed to be launched in this quarter. So you will see more new products of 5G phones released in April and May.

(foreign language) And for this IT category, this will have a more impact from the global supply chains, especially, you can see from storage pieces, the supplies and the prices are going up. However, thanks to our market share online, offline on the Chinese market, we will strengthen our collaborations with our brand partners globally and to secure our leading positions against all the odds of the coronavirus.

(foreign language) As for some categories which many of them are from overseas into import, for the Mom and baby products, cosmetics and all of these, their impact in the first -- in the second quarter is not very big, but there is uncertainties on the third quarter and this will mainly depend on the epidemic situation in the manufacturer region. Thank you.

Q - Gregory Zhao {BIO 18710278 <GO>}

Thank you.

Operator

Thank you. We have our next question from the line of Eddie Wong from Morgan Stanley. Please go ahead.

Q - Eddie Wong {BIO 22101818 <GO>}

Thank you, management, for taking my question and congratulations on the great results. So I have a question regarding the advertising and the marketplace revenue. We understand that in the first quarter because of the COVID-19, we have a negative impact on these part of the revenue in terms of revenue growth. So have you witnessed there is a strong recovery, especially in terms of the advertising revenues from external third-party merchant in the second quarter so far. Thank you.

A - Lei Xu {BIO 21705778 <GO>}

(foreign language) This is Xu Lei.

(foreign language) If we see the results in 2019 in the advertising market, it only achieved single-digit growth, but the Internet advertising has given a different share.

(foreign language) And in this Q1, the overall Chinese market advertising revenues is a negative growth and for those brands' advertising is also negative growth.

Bloomberg Transcript

FINAL

(Foreign Language) And what make our JD advertising business different, and first of all, well, our advertising services is highly integrated with branding advertising and sales, because we are very close to the customers' shopping position. And secondly, among all our advertisers, there is a lot of partners from SMEs. However, if you see the absolute value, there is very heavy investments from the large and medium sized companies.

(foreign language) And thanks to all these factors, we have seen ROI for our advertisers and then the merchants are actually growing up. And this in turn has given them a much higher ARPU value. And during this epidemic special period of time JD has become a very important place for those medium and big sized enterprises, especially those brand partners' favorite place to place their advertisements.

(foreign language) And with the COVID situation getting better, we have seen that the SMEs are being more active on the advertising transactions. And the difference that actually has happened is they have even higher requirements on their ROI and among all the Chinese e-commerce platforms and JD is doing a great job in providing ROI. And relatively speaking, I believe for some e-commerce platforms that is not delivering a good ROI result, will have a very great pressure this year.

(foreign language) So overall we are satisfied with the performance of our advertising business performance for Q1. Thank you.

Q - Eddie Wong {BIO 22101818 <GO>}

(foreign language) Thank you Xu Lei. Thank you

Operator

Thank you. We have our next question from the line of James Lee from Mizuho. Please go ahead.

Q - James Lee {BIO 15949362 <GO>}

Great. Thanks for taking my questions. Can you give us an update on the state of deregulation for online pharmacy here and to help us understand a little bit how you're working with the government and hospitals to drive the adoption here? And also maybe during your experience of COVID-19, what gives you the confidence that the user behavior that you're seeing will remain and how are you uniquely positioned to take advantage of this category? Thanks.

A - Lei Xu {BIO 21705778 <GO>}

(foreign language) This is Xu Lei. I would like to give you a brief introduction on our JD Health development.

(foreign language) Because of the epidemic outbreak, it gives us opportunity for a faster growth of our JD Health.

Bloomberg Transcript

FINAL

(foreign language) And this is such a young team and young business and they have contributed a lot to the society to fight against the coronavirus. We have been providing -- to ensuring the supplies of all kinds of medical materials and to provide free online telemedicine consultations and through the live streaming to spread the knowledge about the virus, et cetera. So they have really done a great job.

(foreign language) And besides the normal business of providing medicines and drugs, we have also done a lot to provide the health services. We have experienced a explosive growth on the online medical consultation and also we are the first telemedicine platform to provide the coronavirus the nucleic acid testing services, which is very needed for a lot of workers who are waiting for coming back to work.

(foreign language) In terms of our customers, for those young customers, the telemedicine is a very easy thing to get used to and with a COVID situation, it's very helpful for us to be known and used by the senior people over 50, 60 years old.

(foreign language) And on the government policy side, we have seen the opening of the online payment of the medical insurance and this will richly promote the development of telemedicine and online health services.

(foreign language) We've also seen those hospitals and pharmacies and all these related players, they are also actively embracing the Internet.

(foreign language) And the value proposition of JD Health is to leverage our core capacities on supply chains and to provide our health services with our technologies to provide a whole life user services to our customers.

(foreign language) And for the next step, we will continue to strengthen our supply chains on the medicines and drugs and improve our ability on health services.

(foreign language) Thank you.

Q - James Lee {BIO 15949362 <GO>}

And if I could ask a follow-up question maybe to Sidney about the long-term margins of the online pharmacy business, how should we think about that relative to your other categories? Thanks.

A - Sidney Huang {BIO 20098238 <GO>}

So, yeah, so if you look at when we logged into this space, if you look at the offline pharmacy financials, what's interesting is that the sector has roughly 40% gross margin but with very high expense ratio of over 30% and here we actually saw a very similar pattern as our electronics and home appliance business where I mentioned earlier that our expense ratio is 50% lower than the leading offline players and here for healthcare, our expense ratio was also significantly lower, probably 10 percentage point advantage

Bloomberg Transcript

FINAL

versus offline pharmacies. So this also gave us the ability to provide the best value and best service to our consumers.

So that is why our pharmacy business has been quietly growing tremendously over the past few years and it leverages our -- as Xu Lei mentioned, we have the existing customer base, we have the consumer recognition of JD as a trusted platform, which is quite essential for healthcare services. So that trust element, the fulfillment reliability, the speed and our value proposition, meaning, we can provide lowest price, all that combined is a great, great combination and because of our cost structure -- driven by our technology, our cost structure is lower, so we can also have a decent margin for this business. So this is where we are already and we are seeing, as I mentioned, tremendous growth with this fundamental economics basically underline our business model here.

Q - James Lee {BIO 15949362 <GO>}

All right, thanks so much.

Operator

Thank you. We are now approaching the end of the conference call. I will now turn the call over to JD.com's Ruiyu Li for closing remarks.

A - Ruiyu Li {BIO 19135837 <GO>}

Thank you, operator. Thank you for joining us today. Please don't hesitate to contact us if you have any further questions. We are looking forward to talking with you in the coming months. Thank you.

Operator

Thank you for your presentation and today's conference. This concludes the presentation. You may now disconnect. Goodbye.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2021, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

Bloomberg Transcript