Q2 2018 Earnings Call

Company Participants

- Jianwen Liao, Chief Strategy Officer
- Ruiyu Li, Investor Relations
- Sidney Huang, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Alex Yao, Analyst
- Alicia Yap, Analyst
- Eddie Leung, Analyst
- Grace Chen, Analyst
- Jerry Liu, Analyst
- Jin Yoon, Analyst
- John Choi, Analyst
- Natalie Wu, Analyst
- Ronald Keung, Analyst
- Thomas Chong, Analyst
- Tianxiao Hou, Analyst
- Unidentified Participant
- Wendy Huang, Analyst
- Xiaoyan Wang, Analyst

Presentation

Operator

Hello, and thank you for standing by for JD.com's Second Quarter 2018 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. And today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

Ruiyu Li {BIO 19135837 <GO>}

Thank you, operator, and good day, everyone. Welcome to our second quarter 2018 earnings call. Joining me today on the call are: Richard Liu, our CEO; Sidney Huang, our

CFO; and Jon Liao, our Chief Strategy Officer. For today's agenda, Mr. Huang will discuss financial and operating highlights for the second quarter, followed by brief remarks from Mr. Liao. After the prepared remarks, management will be available to answer your questions.

Before we continue, I refer you to our safe harbor statement in the earnings press release, which apply 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 direct comparable GAAP measures. Finally, please note that unless otherwise stated, all the figures mentioned during this conference call are in RMB.

Now I would like to turn the call over to Sidney.

Sidney Huang {BIO 20098238 <GO>}

Thank you, Ruiyu, and hello, everyone. Thank you for joining us today. On today's call, we also have our Chief Strategy Officer, Jon Liao, on the line. I'll discuss our financial performance first and then Jon will discuss recent industry trends and the company's development strategies.

We are pleased to report another quarter of solid top line growth, improving profitability for the core e-commerce business and exciting developments in our smart technology initiatives. For investors to better track the progress of our business, starting this quarter, we will begin providing segment information and a more detailed revenue information on our different business lines on a semiannual basis. I believe the increased disclosure will give investors additional insights into the strength of our core business as well as our strategic initiatives.

During the second quarter of 2018, our net revenues grew 31.2%. In particular, growth from net service revenues was 51% year-on-year, driven by a strong momentum from supply chain management and advertising. In the first half of 2018, our marketplace and advertising revenues grew 37% year-on-year, of which commission income has been negatively impacted by the anticompetitive practice in the industry, particularly in the apparel sector. On the other hand, advertising revenue continued to grow at an encouraging rate as our text-driven advertising products show improving ROI for our brand customers.

Meanwhile, growth from logistics and other service revenues accelerated to 151%, mainly resulting from the robust growth from our supply chain management and technology service revenues. Investing in our third-party logistics service business remained a focus during the quarter. While this continued to impact the gross margin line, I'm pleased to report that loss ratio further narrowed during the second quarter. And we maintained a relatively stable gross margin at the group level.

Non-GAAP gross margin in the second quarter was 13.3% compared to 13.4% in the same quarter last year. If we look at JD Mall, non-GAAP gross margin again showed an improving trend from last year's level, reflecting steady gross margin expansion in our first-party business and fast growth in advertising revenue. Gross margin for the direct sales business improved over 50 basis points on a year-over-year basis in Q2 2018 due to increased economies of scale across all key categories.

During the second quarter, we continued to invest heavily in R&D and technologies, which we believe will drive JD's long-term growth. Our R&D expenses totaled RMB2.8 billion or 2.3% of total revenue, up approximately 60 basis points from the same quarter last year, mainly due to the continued investment in top R&D talent and the technology infrastructure to further enhance our capabilities in smart consumption, smart supply and smart logistics. We believe these R&D investments are critical to extending our competitive strengths and in transforming ourselves for the next phase of growth, driven by retail infrastructure services.

Fulfillment expense ratio improved to 6.7% in the second quarter, the best level in three years, supported by higher average ticket size in the June promotion season. Marketing expense ratio and the G&A expense ratio of 4.3% and 1.1%, respectively, comparable to the same quarter last year. As a result of our continued investments in R&D, non-GAAP operating margin was 0.1% in the second quarter. Excluding new businesses, the non-GAAP operating margin for JD Mall was 1.1% this quarter, up from 0.8% in the same quarter last year, supported by higher gross margin, partially offset by the higher R&D spending.

In the first half of 2018, non-GAAP operating loss from new business increased by approximately RMB2 billion on a year-over-year basis while JD Mall further improved the profitability and booked RMB3.4 billion in non-GAAP operating profit with a record-high non-GAAP operating margin of 1.6%, the highest in any six month period since our IPO. Our free cash flow was RMB13.1 billion during the quarter, driven by healthy operating cash flow of RMB16.4 billion, partially offset by higher CapEx in logistics real estate assets. As we mentioned previously, we are in the process of monetizing some of the logistics properties we have built in the past few years, which should unleash both cash flow and hidden value underlying these highly sought-after real estate assets.

I'm also pleased to share with you that over the past two quarters, we have built a logistics asset management company with a dedicated team of experienced professionals. This will be the third separate business after JD Finance and JD Logistics that we built by leveraging the capabilities and infrastructure of our core JD Mall operations. The role of the logistic asset management company is to develop, monetize and operate JD's massive logistics property portfolio both before and after the properties are sold to outside investors or co-investment vehicles.

As of end of July, we already owned over 2.5 million square meters of completed warehouse space, which could unlock billions of RMB in value appreciation and a steady flow of future management income. And this portfolio is only a fraction of the pipeline we have signed or under construction. As a separate business, the logistics CapEx will be an integral part of its operations. Leveraging existing portfolio and our large pipeline, we expect the development, sales and management operations will begin generating significant cash flow and operating profit in the next 12 -- in the next 6 to 12 months.

In addition, we also began to see operational progress in other new initiatives this year. For example, as a result of our Retail as a Service initiatives, we are now serving and empowering nearly 1 million business customers through multiple offerings, including supply chain management, marketing solutions, logistics services and technology support. We are also gaining traction with brands on the WeChat store Mini-Program toolkits that we launched at the end of Q1. On average, we launched more than 80 WeChat stores each day for our brand partners during the second quarter. Most of the new initiatives are yet to produce meaningful financial results. But we believe we have made good traction since doubling down on technology last year and that we remain optimistic about our future growth.

This leads us to our financial outlook. We expect the Q3 2018 net revenue growth to be between 25% and 30% on a year-over-year basis. Our Q3 guidance is affected by the relatively soft sales growth after the June promotion season through the end of July due to a few seasonal factors, including the seemingly increased seasonality this year and also an exceptionally strong July for JD last year. We are pleased to see the growth rate has resumed to a normal pace since the beginning of August.

I would also like to comment on our full-year earnings outlook. As many of you may observe, there are several new changes in the industry and economic environment we are in, along with tremendous opportunities in front of us. We would like to reiterate our commitment to a stable and improving margin on our core e-commerce business while retaining the flexibility to invest in R&D and in new business initiatives that Jon will further elaborate in a minute. We also expect the monetization of our logistics properties, when realized, will compensate a part or all of the additional investments in technology initiatives this year and next year. While this may create some nonlinearity in earnings improvement between this year and the next year. We hope the underlying earnings trends remain intact.

This concludes my prepared remarks. And I now turn the call to Jon, who will highlight a few observations on the industry and our plans [ph] on the new business initiatives.

Jianwen Liao {BIO 18782053 <GO>}

Thanks, Sidney, and thanks to all for joining us today. As many of you know, I joined JD as Chief Strategy Officer nearly 1.5 years ago. So today, I'm pleased to offer our view on the retail of the future and related technology and JD's overall long-term vision.

Let us begin with the overall industry. We believe the e-commerce industry is at a strategic inflection point. While it maintained healthy growth, we have observed changes taking in place while we fundamentally reshape future development in four key areas.

First, we are seeing a shift from centralization to decentralization. The boundary between retail and other industries has become increasingly blurry, which is why we define the future of retail as boundaryless. China is uniquely seeing an influx of retail innovation across industry boundaries. This includes the emergence of common commerce, social commerce, AI commerce, IoT commerce, to name just a few. As such, the retail space will become more distributed and decentralized than ever before.

Second, e-commerce is moving away from more focusing on mass traffic to precision targeting. Retail is no longer just about selection, quality and pricing but more increasingly about the shopping moment, providing the right products to the right customers in the right settings and the right time. This fast evolution of technology, big data, AI, IoT in a host of areas enables retailers to interact with customers at more touch points and has managed the business at a more granular level. We believe that to succeed, players need to move from an area store mentality to (inaudible) store, meaning from the approach of a mass market to a (inaudible).

Third is supply chain is increasingly more important than a true platform model. Retail innovation and the supply chain (inaudible) enhancement are clearly the two most important drivers of success both for online and also in retail. This is exactly why JD has emerged as a leader despite entering the market later. It is also the reason why we remain dedicated to investing a small supply chain solutions, which I will elaborate a bit more later on.

Fourth, the 2B market has proven to hold great potentials. In China, there are many e-commerce companies focused on 2B business innovation. Meanwhile, the 2B Internet is still at its nascent stage and a recognizable market leader remains absent. By contrast, in the US, 2B Internet accounts for 40% of market cap by some metrics. Over the past few years, we have seen startups and venture capital shift attention towards 2B market in the field of enterprise service, SaaS service and AI service. We believe that 2B market will soon take off in the near future in China, which opens up an attractive opportunity for JD to extend its capability [ph] into this field.

Now let me turn to how we view technology. On the light of the changes I just mentioned is technological innovation, which continuously expands the possibility in retail across areas, including cost, efficiency and customer experience. Richard had made it clear that there are only three keywords for the next (inaudible) of JD: technology, technology and technology. Investing in technology will drive this company for the next decade, much like logistic has given us a major advantage over the last decade.

Our vision is to leverage technology to develop world-class tech-based supply chain platform capabilities, integrating both hardware and software solutions. In particular, we will focus our efforts on three key areas: smart consumption, smart supply and smart logistics. These three areas remain the focus of our continuing investment in R&D.

Let me explain how those three areas will drive our development. Smart consumption smooths the barriers for retailers and the customers across online and offline channels. The goal is to improve consumer experience at every stage, creating more engaging experience with greater customer retention and the loyalty.

Smart supply improves the upstream supply chain. With the goal of improving the operational efficiency of brand, AI technology has been broadly used on supply-related application, such as sales planning, dynamic pricing and inventory replenishment. As a result, we are able to improve brands' time-to-market, inventory control and product design.

Smart logistics helps get product into hands of our consumers with better speed and lower cost. JD is still the market leader in smart warehouse and smart transportation systems. We're also pioneering unmanned warehousing and drone delivery and driverless delivery. Continuous development in these areas remain critical for us to maintain and expand our competitive advantages.

Now I would like to discuss our overarching strategy of Retail as a Service, in short, RaaS, which you might have heard us discuss about before. You'll see us covering both retail and retail infrastructure. First and foremost, we will continue to expand our current retail business and also focus on retail innovation. In the meantime, in the light of the future boundaryless retail, JD will continue to develop, and most importantly, open up retail infrastructure capabilities, such as smart supply chain, to enable and empower more retail innovation for other companies to leverage. More specifically, we identified three categories of business for future growth under RaaS with different growth models.

Let's start with the core business. The first area where we can grow is in our flagship online retail business. We can do this both through new customer acquisitions, especially in Tier 3 to Tier 5 cities as well as expanding our relationship with existing customers by increasing the customer loyalty and their spending with us. We have more than 300 million high-quality loyal customers, including approximately 200 million, who have joined us in the last three years. This growing customer base and expanded relationship offers tremendous room for future growth for our core business.

Now let's look at our growth business. We believe we can expand our online capabilities through the categories where we -- through the categories that are underpenetrated and ready for high growth rate. Internally, we call these categories 100 million club. Those categories tend to be growing at least double the average for JD categories. And they also tend to be in areas where quality is particularly important, a key strategic differentiator for JD. Some example include fresh-cooked food and sales through the enterprise. Achieving the full potential of these categories will drive our long-term growth in retail.

Finally, we have the future business. This covers innovation of our retail business as well as the retail infrastructure with a focus on renovation and employment. In the 2C area, we will continue to place great emphasis on offline retail innovation in common commerce, social commerce and IoT commerce. In the 2B area, we will open up capabilities in advertising, store count, supply chain and logistics and the cloud to empower brand and other retailers.

Sidney had just mentioned that we have invested 2.8 billion in R&D last quarter with the majority invested in our retail infrastructure development. While the investment is significant, we have already seen some positive early results. As Sidney mentioned, logistic and other service revenue has increased by 103% this quarter. We have confidence that with our continuous focus, retail infrastructure can be our next core competency and profit driver.

In summary, JD is moving from a vertically integrated model to an open model to become attractive retailer and a technology-based retail infrastructure service provider at the same time. There will be challenges for sure. But we believe that we have a clear vision, determination and the capability to achieve our goals. At the end of the day, delivering trust to our consumers, partners, investors, employees and broader society is something that sets us apart from our competitors.

With that, we will take your questions. Thank you.

Questions And Answers

Operator

Thank you. The question-and-answer session of this conference call will start in a moment. (Operator Instructions) Our first question comes from the line of Eddie Leung of Merrill Lynch. Please ask your question.

Q - Eddie Leung {BIO 15234642 <GO>}

Thank you for taking my questions. I have a question on perhaps the environment that, Sidney, you mentioned that perhaps starting the third quarter. Could you elaborate a little bit more on some of the macro factors and seasonal factors we have seen that might affect the future growth of our business? And then related to that, would that affect our near-term margin profile, given the timing of the investment in areas of new initiatives? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Sure, Eddie. I think you were asking about the Q3 sales guidance. As I mentioned, July -- actually, after our June 18 promotions, in the last 10 days of June, we started to observe somewhat of a softness in our sales growth. But we have since seen a recovery in August basically back to the normal pace. We internally analyzed that we believe they are mainly seasonality factors probably is one. Probably for this year, we may have seen a stronger-than-before seasonality post promotion.

And two is that we did have a very strong July last year in JD. So I think it's a combination of these factors. And obviously, there's also some particular category was affected by the overall market environment. But in any event, starting August, we have seen pretty well recovery across all categories. So we are still quite optimistic looking ahead. You asked about our view on the macro. I think we are still cautiously optimistic, given that in China, the overall consumption growth, consumer income and also consumption as a percent of GDP are all pointing to a continuous consumption growth for many years to come. So we are still quite bullish in terms of both outlook.

Operator

Thank you. Our next question is from the line of Alicia Yap of Citigroup. Please ask your question.

Q - Alicia Yap {BIO 15274658 <GO>}

Hi, good evening, management. Thanks for taking my questions.I have a couple questions, if I may. Could you actually maybe perhaps elaborate and share with us any update on the close collaborations with Google so far since the strategic investment in June? And if in the event if Google has interest to launch the Google Shopping Actions program in China, will JD be the strategic partner to work with them? And then housekeeping question, Sidney. Given all this initiatives, I wasn't quite sure, are we still retaining the full year net margin guidance of 1% to 2%? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Okay, we're taking those Google questions. Now, of course, JD and Google are very much complementary in terms of a lot of the skill set. The infrastructure strategic partnership of Google and JD were very much mutually beneficial for both companies. And of course, in your space, the JD, of course, we are working closely with Google Shopping Actions as a gateway for JD to be -- for JD, our products to be listed on Google Shopping platform.

And of course, on behalf of -- domestically, we have 170,000 high-quality merchants. So JD -- I mean, Google Shopping Actions will be one more important gateway for those high-quality merchants as well. So clearly, of course, we have great ambition in working closely with Google in many ways. Now with this kind of a strategic collaboration, I think there will be much more initiatives coming along the way, so -- and we'll see how this unfold as time goes by, yeah.

Q - Alicia Yap {BIO 15274658 <GO>}

And on your second question, on the earnings guidance, I mentioned that we'll remain committed to the JD Mall core margin being stable. But we are investing more in other initiatives, as I mentioned. To compensate for that, we actually accelerated our monetization plan for logistics properties and which when realized, should be more than compensating or at least compensating the shortfall due to the additional investments. But as I mentioned earlier, the timing of the monetization is relatively -- we don't necessarily can guarantee it will be completed by the end of this year. So that will create some nonlinearity in earnings trend from this year and the next year. So I don't know if that will answer the question.

Operator

Thank you. Our next question is from the line of Alex Yao of JPMorgan. Please ask your question.

Q - Alex Yao {BIO 16818860 <GO>}

Hi. Good evening, management. Thank you for taking my question. Sidney, can you elaborate a little bit more on the JD Logistics asset management business? How does it work? How does it generate revenue, free cash flow? What is the long-term vision for this initiative? And I think you kind of, mentioned in the prepared remarks that the financial contribution from this part of the initiative will increase into the second half this year in terms of revenue and the free cash flow. Can you maybe elaborate on the magnitude of this contribution? Also following up on Alicia's question, what exactly does it mean the earnings or the margin trend will be nonlinear towards the rest of the year? Does it mean the margin could be more volatile than the historical pattern? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, sure. So we actually mentioned in the past few quarters that the reason we were investing in logistics assets is because that JD is in a very unique position to acquire the land resources by working with the government. And obviously, we're creating jobs for the local economies. So as a result of that effort, we have now built over 2.5 million square meters of our own logistics properties. But we actually have a lot more than that in the pipeline. And when we have that portfolio, we are in a very good position to monetize these properties by several ways. One is to sell it to outside investors. There are already investors for these types of assets in China, and actually globally, because the logistics assets have been appreciating quite steadily and with steady rental increase. So it has been a very, very attractive asset class for many very long-term investors globally and domestically.

So there are already investors to purchase these assets, which will help us realize the hidden value appreciation that has not been realized currently on our financial statements. And after the transaction, we would also continue to serve as the management company for those assets. For that, we -- now as I mentioned, we established a separate operations, which will continue to develop those warehouse facilities. And they will also monetize and the sales transaction and also manage those properties afterwards.

So there will be management income after we monetize those products. I mentioned that will happen in the next 6 to 12 months. So it may not have a very near-term impact on our financials in the second half. And that is why I said that nonlinearity, meaning that part of that -- essentially, the monetization could happen by next year. So then it will impact our overall bottom line forecast for this year.

Operator

Thank you. The next question is from Ronald Keung of Goldman Sachs. Please ask your question.

Q - Ronald Keung {BIO 15432736 <GO>}

Thank you. Thank you, Rich and Sidney, and Ruiyu. I guess, I'll ask a similar question as last quarter. I just want to hear any updates on your apparel. Particularly, we see a lot of new initiatives for JD Mall within the marketplace from -- encouraging merchants to sell more targeted sales and with commission and advertising bundled together. I just want to hear how apparel growth, has it resumed back to at least positive growth in the second quarter and how we're looking on our strategy for apparel in the second half of this year as we lapped the one year of exclusive partnerships we're seeing at our competitors?. Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Sure, yeah. First, we have not passed the one year anniversary of that anticompetitive practice by our competitors last year, which has started in August. And so as a result, during the second quarter, unfortunately, our fashion category is still under the shadow of this unfortunate anticompetitive practice, which essentially uses traffic control to force apparel merchants to stay off our platform, in fact, also other platforms.

So this practice does affect our fashion business line but also have a ripple effect on our overall profitability. But we have been working very hard through other categories to better serve our customer base while enhancing our merchant products and services. So we remain optimistic about regaining the momentum in this category in the next few quarters.

Operator

Thank you. Next question is from Jerry Liu of UBS. Please ask questions.

Q - Jerry Liu {BIO 17515547 <GO>}

Thank you. My question is about JD Mall. I understand when we look outside of that, there are some maybe milestones, right, such as the logistics asset management milestones that may or may not fall in this year. And that complicates the net margins a little bit. But if we just focus on JD Mall, how do we see the margins trending in the second half of the year versus last year or versus the first half of this year? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So as we -- when we look at the second quarter, gross margin did expand on our first-party business over 50 basis points actually, so quite meaningful improvement. And also we continue to see robust growth in our advertising revenues. So these are the main drivers for our profitability for the JD Mall business, which we believe will remain a stable margin and potentially higher margin for the remainder of the year.

Operator

Thank you. Next in line to ask the question is from Thomas Chong of Credit Suisse. Please ask your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi. Thanks, management for taking my questions. I have three questions. The first question is about our 2Binitiatives. Can management give us some KPI that we may have over the next couple of years? And my second question is about 7Fresh. Can management comment about how is the status so far? And my third question is also about the land margin question. Is there any color that the 1% to 2% net margin guidance that we still keep it as is? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, I think we have -- now if you look at our service revenue, a vast majority of that is from 2B business segments, and -- but these are -- today, a majority of that is still coming from our platform business. And we have one recent example is that we have been putting a lot of investment in third-party logistic services or supply chain management services. And we have seen great traction in that business line.

Going forward, the investment we have made in technologies will also produce what we believe very solid revenue going forward. And there are also areas that we can invest in the supply chain capability, leveraging supply chain capabilities we have. On the 7Fresh, we have a couple stores that are -- we have been observing the results of those stores, which actually has shown very, very encouraging results.

Overall, our sales per square meters have seen at least 3x to 4x the traditional offline supermarkets. So we are very encouraged by the initial results. And we are in the process of opening up another 20 to 30 stores in the next few months.

Operator

Thank you. Next is Ms. Wendy Huang of Macquarie. Please ask your question.

Q - Wendy Huang {BIO 15034507 <GO>}

Thank you. My question is mainly about your logistic. So you mentioned about the appreciation value of your logistic asset. So can you give us some color regarding the self-owned warehouses versus the (inaudible) warehouses among the 521 warehouses you are operating right now? Or maybe a split between the 12 million square meters size, that's fine as well. And also can you give us some color on the number?

A - Sidney Huang {BIO 20098238 <GO>}

Okay. So yeah, the space that we own is roughly -- is over 2.5 million square meters out of the 12 million warehouse space we have. So just for those self-owned facilities, we can see, in fact, billions of RMB in unrealized appreciation. And there are also multiple times of that space in the pipeline. So we do see great potential in this business as a stand-alone separate operations.

Operator

Thank you. Next is Jin Yoon of New Street Research. Please ask your question.

Q - Jin Yoon {BIO 16293072 <GO>}

Hi, guys. Just a couple of questions on the advertising front. I understand that the advertising seasonality is a little bit more positive in the second half of the year with 11/11 and so forth. But just wanted to see kind of how you're looking at that business, if you could share with us some metrics behind that, including the number of advertisers, ad loads or anything that you could share with us, that would be great. And second of all, on the logistic...

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So on advertising, we mentioned, I think, that today or really in the past couple of years, our strategy has been using technology and artificial intelligence to provide better position and better ROI for our brands. So we have seen very, very good results of that effort. And this is what's driving our advertising revenue growth besides ad loads. And we have not been very aggressive. We have not been very aggressive in increasing ad load at all. If anything, we are under-monetizing in this area. But for JD, we want to maintain the right balance between monetizing -- monetization and customer experience. So we will continue to adapt that approach, use more of a technology-driven approach to enhance our advertising revenue.

Operator

Our next question is from John Choi of Daiwa. Please ask your question.

Q - John Choi {BIO 16529883 <GO>}

Thank you. I just want to ask a more broader question regarding the overall industry. So right now, we are obviously seeing a very intense competition here. So how does the management think about the long-term growth outlook that we're seeing? There has been some -- first half was very good, particularly in the first quarter. And starting from later part of the second quarter, we're seeing some sort of slowdown. So how should we think about the growth? And just on that, I mean, are you seeing any new retail having a negative impact to our core business?. Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

I think Jon has elaborated quite a bit on our growth strategy that we are still -- we still have a very long growth trajectory for our core e-commerce business. And we are also investing in some under-penetrated categories that will produce RMB100 billion on the revenue potential. And we also have a third growth curve that's focusing on the 2B business and also some of the innovation and empowerment-driven businesses. So internally, we have very clear strategies and we have various task forces to drive these initiatives. And we hope as we continue to grow the core business, you will start to see other streams of revenue being generated through these efforts.

Operator

Thank you. Our next question is from Winnie Wang [ph] of HSBC [ph]. Please ask your question.

Q - Unidentified Participant

Hi. Thank you management for taking my questions. My question is on the margin trend. I think that you have shared with us in terms of the gross margin improvement and other key drivers here. Can you elaborate a little bit on the expansion in (inaudible) business gross margins? Which capital you have seen more improvement here? And also you mentioned about in terms of the ad -- robust growth in ads and that also helps to drive our overall margins. Can you elaborate (inaudible) more in terms of the advertiser that you have been seeing? Are those are coming from the luxury brands? Or are those coming from usually the big brands that you have seen launching, as you had mentioned, in the recent business development? What type of advertisers have you been seeing mostly for each category? Thank you so much.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, sure. So as far as our gross margin drivers, we do see gross margin expansion in all categories in the second quarter. Those are driven by our scale economies. As we purchase more from the brands, we get natural rebates for gross margin expansion. So not only on the electronics and the home appliance categories, which we continue to see margin enhancement but also FMCG, for example, we are also gaining more and more scale economies with the brands.

So that -- that's essentially the driver of gross margin and also on our ability to provide competitive pricing to our customers, which we expect will continue to drive our business for many years to come. As far as consumer -- for the brand advertising, it's the usual suspect, obviously the consumer goods brand and -- actually, brands across all industries have been working closely with us. Obviously, the plans that we work are the categories we are the strongest will provide more advertising spending with us.

Operator

Thank you. Next question is from the line of Natalie Wu of CICC. Please ask your question.

Q - Natalie Wu {BIO 19852429 <GO>}

Hi, good evening. Thanks for taking my question. Just curious, what's your view on the industry competitive landscape change, especially as the rising of some social e-commerce platforms? Did you see any kind of the impacts in terms of shopping frequency for your certain categories? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. As I mentioned in my statement, we have seen an influx of new innovators in the landscape. Now, however, JD is a quality Internet platform. Now with those emerging social commerce platforms, I think they'll provide tremendous opportunities to educate new customers. So in other words, we do see this as a consumption upgrading (inaudible) downgrading as many of you have pointed out.

So what I mean by upgrading is it provides -- the new social commerce provides customers with the choice, meaning in the past, they have no choice. Now they have a choice, but of course, from no choice to have a choice. And then JD, on the other hand, from a choice to have a better choice. So in this case, I think that the customer education will provide the foundation for the future in terms of JD's growth. So I think this -- so in other words, there will be new customers moving to the online space, which provides better growth opportunities for JD.

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A - Unidentified Speaker

We also have our own (inaudible) purchase product called PINGO on our WeChat Pinterest point. And interestingly, we are also seeing a lot of demand from both our merchants and from customers on this (inaudible) purchase product that we offer. So just give you a couple of data points, in the second quarter, the percent of merchants that participated in our PINGO program, up from 16% in Q1 to 40% in Q2, so very active participation on the high-quality SKUs participating in our PINGO program. And if you look at the purchase orders for our 3P platform, the PINGO transaction volume is now over 10% already.

Operator

Thank you. Our next question is from Grace Chen of Morgan Stanley. Please ask your question.

Q - Grace Chen {BIO 2548665 <GO>}

Yes, thank you for taking my question. I have three questions. The first question is about the overall consumer demand in the market as there have been some talks about slowdown. So would you share with us your observation of the consumer demand, and if possible, by segment, such as home appliance, 3P, apparel, FMCG? And my second question is a follow-up of the margin guidance. Specifically, on JD Mall margin, we talked about JD Mall margin to be stable. But does that mean we aren't expecting to see a flattish JD Mall operating margin year-over-year? If you can add a bit more color in terms of JD Mall margin trend, that would be great. Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So on the consumption trend, as I mentioned, other than the somewhat soft July sales, which we believe is more due to seasonality, we actually don't see much of an impact at this point starting August. The growth is still quite solid. And I think we are -- given that the consumer income growth continue to be faster than the GDP growth, employment level continues to be very high in China and also the consumption as a percent of GDP is still quite low.

So I think given all those dynamics, we do feel still quite optimistic about the consumption trends. On the JD Mall margin, as I mentioned, it should be -- remain stable with some upside throughout this year. Again, it's driven by our economies of scale in the first-party business and also driven by our advertising growth.

Operator

Thank you. And next question is from Tian Hou of T.H. Capital. Please ask your question.

Q - Tianxiao Hou

Hi Sidney and management. I have two questions. One is again related to the company's margin. So Sidney, you give a revenue guidance as a combined entity, JD Mall and Logistics. And now we know the JD Mall margins could be stable with some upside. So I wonder the investment side on the logistics, how much you expect to have a margin drag? So that's on the logistics side. And also how much revenue contribution should we expect from logistics? So that's number one question. Number two...

A - Sidney Huang {BIO 20098238 <GO>}

Yeah, sure. So on the logistics margin, we are pleased to see margin -- the loss ratio has been narrowing in the second quarter. But this year is an investing year for JD Logistics. So we do expect some losses in the remainder of this year. And we do hope the loss margin will continue to narrow. The growth rate is well over 150%. We did separate the logistic and other services in a separate line in our half year supplemental information section. So we wanted to provide some color on this new business, along with a few other new business lines. So very, very strong growth rate, very good customer adoption -- corporate customer adoption of our service. So a very good revenue growth, but we'll continue to sustain some short-term losses.

Operator

Thank you. Our last question is from the line of Xiaoyan Wang of 86Research. Please ask your question.

Q - Xiaoyan Wang {BIO 19077174 <GO>}

Hi, management. Thank you for taking my question. So we noticed in the second quarter, the JD Logistics launched a Flash Delivery initiative. So can you offer more color on this new delivery model? For example, what kind of category are you focusing on? And do you expect to expand this kind of short, more faster delivery to consumers, to expand in geography expansion and also the category expansion? And currently, what kind of percentage of GMV or orders is from this model? I think my second question will be we know your...

A - Sidney Huang {BIO 20098238 <GO>}

Ye , so on cash delivery, we have been always stayed in the innovation forefront for logistic services. So this is just one of the recent examples that we established a new product, really providing customers with 1-hour delivery in selected cities. So it is another really higher service-level delivery product that we offer. But even before that, as I mentioned, for over 90% of all of our first-party orders, we deliver either within same day or next day across the country. Our own delivery and warehouse network will cover well over 2,800 counties and districts. Essentially, 99.9% of the country is covered by our differentiated logistics services. So we will introduce more and more differentiated products at different tiers of the cities, providing differentiated services to our customers.

Operator

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

A - Ruiyu Li {BIO 19135837 <GO>}

Thank you operator and thank you everyone for joining us on the call. Feel free to contact with us, if you have any further questions. We look forward to talking with you in the coming months.

Operator

Thank you for your participation in today's conference. This concludes the presentation. You may now disconnect. Good day.
