Q2 2020 Earnings Call

Company Participants

- David Liu, Vice President of Strategy
- Lei Chen, Chief Executive Officer and Director
- Tony Ma Jing, Vice President of Finance
- Zheng Huang, Chairman of the Board of Directors

Other Participants

- Alicia Yap, Analyst
- Binnie Wong, Analyst
- Gregory Zhao, Analyst
- Piyush Mubayi, Analyst
- Thomas Chong, Analyst
- Tina Long, Analyst

Presentation

Operator

Hello, ladies and gentlemen, welcome to Pinduoduo Second Quarter 2020 Earnings Conference Call. At this time all participants are in a listen-only mode. After management's prepared remarks, there will be a Q&A session. Today's conference call is being recorded.

I would now like to turn the conference over to your speaker today, Mr. Huang Zheng. Thank you. Please go ahead.

Zheng Huang {BIO 20683053 <GO>}

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

On today's call, our CEO, Chen Lei, will make some general remarks on our performance for the second quarter of 2020 and his primary areas of focus going forward. Our VP of Strategy, David Liu will then elaborate further on our specific strategic initiatives. Last but not least our VP of Finance, Tony Ma, will take us through our financial results for the second quarter ended June 30, 2020.

Before we begin, I'd like to remind you that this conference contains forward-looking statements within the meaning of Section 21E of the US Securities Exchange Act of 1934 as amended and as defined in the US Private Securities Litigation Reform Act of 1995.

These forward-looking statements can be identified by terminologies such as will, anticipate 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 and achievements to differ materially from those in the forward-looking statements.

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

Now it is my pleasure to introduce our Chief Executive Officer, Chen Lei. Lei, please go ahead.

Lei Chen {BIO 18939623 <GO>}

Hello, everyone. It's a pleasure to welcome all of you to our second quarter 2020 results announcement. This is my first time communicating with investors around the world as CEO even though I met many of you two years ago in our IPO roadshow.

It's great to reconnect and I look forward to working together again and building ongoing dialogue. I'm joined today by our Vice President of Strategy, David Liu; and our Vice President of Finance, Tony Ma. In the past month and a half we have been busy with the management transition that was announced on July 1st. It was an evolving process that started three years ago and the recent decision was made with the full support of our Board. We've always been thinking about how to create more opportunities to grow the next generation of leaders and how we keep this organization young, vibrant, and at the same time increasingly institutionalized.

This is especially important in our fast changing technical teams. We challenge ourselves continuously and incorporate less perspective so as to cautiously satisfy and serve our users needs. At the same time, we need to build a solid foundation for long-term sustainable development of the organization. Having built Pinduoduo into one of the bigger platforms in China and observing numerous initiatives by the team through the pandemic, we feel the timing was quite to pass on to our younger generation leaders more responsibility.

Pinduoduo has grown at an extraordinary pace in the past five years through a laser focus on our survival and growth. However in the next few years my goals are translated first of all into the next level; one that is vibrant, innovative, energetic, and institutionalized. The management and the Board hope to lay the strong foundation over the next few years to create a long-lasting organization and ecosystem that serves our society.

Colin Zheng takes a step back from the day-to-day management responsibility of a CEO, but he continues to be fully engaged and has been working closely with the Board and the management to explore the company's future strategic coverage and organizational structure. Colin is now also devoting more time to invest in and support fundamental research in areas that become the future driver of the company such as Agritech. We believe this new division of labor allows Colin and I to co-operate efficiently as peer company in this next phase of growth and development.

With over RMB1 trillion of GMV and 683 million annual active buyers, Pinduoduo is operating at significantly larger scale with much greater complexity today. We have demonstrated that our user-centric strategy works and we will continue to do what we do well to offer value for money products to our users through a fun and interactive experience. As we continue to see significant potential ahead for our platform, my priority as CEO are on various internal and external initiatives that we deem necessary to support and generate long-term sustainable value for our platform.

Internally, it's important that we continue to make operational decisions efficiently despite our growing number of business units and employees. I'm working with our team to leverage more technology to streamline internal processes and institutionalize best practices. We are also focused on hiring best talent and improving personal development. We continue to encourage mobility within our organization and motivate our employees to generate new ideas and compete for resources. Externally we are going to increase strategic investment in our ecosystem, particularly in agriculture value chain. Our investment in the past five years has been primarily on uses by our sales and marketing expenses and we have successfully built a very substantial user base of nearly 600 million in record time.

Our average daily parcel volume accounts for approximately 25% of the China's daily parcel shipment. However, in terms of average spending per active buyers, we still see substantial upside potential. We will continue to invest in building user engagement and make sure to grow our user frequency of purchases and average order value. At the same time, we plan to pursue more strategic investment and partnership opportunities that will allow us to accelerate the digitization of a supply chain and to enhance efficiency and values that could be shared with our consumers.

In particular, we started our business in agriculture and we plan to continue our focus in agriculture as our next strategic priority. Agriculture is a sector that touches largest number of people and yet has had the least amount of digitization in the past decade. Any technology that can improve productivity and efficiency, our agriculture value chain will have a huge impact. Pinduoduo is already one of China's leading online distribution platforms for agriculture produce and agriculture products.

We are uniquely positioned to drive trends in China's agriculture system. We can drive consumer demand on our platform to create scale and we can leverage consumer insights we gain to help farmers make more informed decisions across planting cycle including what to plan and when to harvest. We are prepared to invest in technology and operations across different parts of agriculture value chain in order to assess the e-commerce penetration for the category and generate more value for both the farmers and the consumers. Our aim is to further consolidate our position as China's number one online agricultural platform and to build a worldwide presence in agriculture.

Let me now turn over to David to discuss some of our specific thoughts around agriculture.

David Liu {BIO 21976168 <GO>}

Thank you, Lei. One in four Chinese workers work in agriculture, but the industry makes up less than 10% of China's GDP. This is because agriculture has lagged behind other industries in digitization. Nearly 98% of farmers in China work on farms smaller than 2 hectares. It is difficult to standardize growing practices and achieve economies of scale. The rural workforce is aging and in decline as young people choose to work in the cities.

A lack of coordination for food production leaves farmers vulnerable to price swings while wastage and high incremental distribution costs add to consumers burden. Those are the challenges and the opportunity is that agriculture e-commerce can solve a number of these problems. Based on figures from the Ministry of Commerce, they imply total addressable market in 2019 for agricultural goods sales in China was RMB8.1 trillion with less than 7% of these sales taking place online.

In contrast, the online penetration for physical goods in total was 23% in 2019. Pinduoduo is already one of the leading e-commerce platforms for agriculture. In 2019 we generated RMB136.4 billion or 13.6% of our GMV from agriculture produce and related goods. Over 240 million or 38% of our annual active buyers purchased in this category last year with a 70% repurchase rate. Pinduoduo has become the go-to destination for high quality great value agricultural products.

This recognition deepened through the pandemic. During 618 we saw orders for agriculture products grew 136% to 380 million. Nearly three quarters of the orders came from Tier 1 and Tier 2 city users. We expect to continue gaining market share in online agriculture and we see potential for our agriculture GMV to exceed RMB1 trillion in five years.

Why do we think agriculture e-commerce can be tackled -- can tackle the challenges outlined earlier? Well, put simply, only when you visualize demand and supply, then can you drive efficiency and gains through the value chain in between. Online retail has an advantage in terms of greater visibility. From production all the way through distribution, we have a unique position to make the value chain more efficient and bring more value to producers and consumers through investment and partnership that can also unlock commercial opportunities.

Our vision is to realize the economic potential of China's vast agricultural resources by improving its overall quality and production efficiencies. Starting with production, our efforts thus far have centered around the development of human capital through farmer training as well as initiation of pilot farms in our Duo Duo Farms program.

Together with partner institutions such as China Agricultural University, we have imparted farming knowledge and business training to almost 90,000 new farmers thus far who tend to be younger and more digitally savvy. We see this initiative as a way to see a new generation of farmers who are more adaptive to new technologies. Duo Duo Farms is a demonstration of how we are organizing resources through cooperatives and bringing our economic expertise can help farmers living in impoverished regions sustainably improve their productivity and household income.

Duo Duo farm serve as a testbed for us to introduce technologies to farmers such as drip irrigation while also introducing changes to existing farming practices to drive meaningful change. Building upon these experiences we plan to invest in technology necessary to implement precision farming such as robotics, IoT sensors and low-power data transmission.

Precision farming can help optimize inputs better control diseases and reduce production costs. Our ongoing Smart Agriculture Competition jointly organized with the Agricultural University of China and with the support of UN's Food and Agriculture Organization exemplifies our interest identified cost efficient and scalable technology that can be promoted as standardized solution across China.

Global teams are competing over 14-weeks to remotely grow strawberries using sensors and machine learning algorithms. The objective is to derive the most cost efficient techniques to improve yield by integrating technology with traditional growing practices.

We also plan to further invest in and develop our proprietary agriculture analytic system. By considering historical and projected data such as price, quantity, geographic distribution and logistical availability. The system will better advise farmers on which crops of high economic value to plant, how to optimize quality over quantity and how to achieve more timely distribution. The system will also help refine our recommendations to consumers to reduce mismatch in supply and demand.

Traditionally agriculture produce go to at least five layers of distribution before reaching consumers. Industry research estimates as much as 105% added costs, 37% wastage across the chain for vegetables. Pinduoduo team purchase model aggregates scatter interest into sizable coordinated demand and connect sellers directly with consumers to eliminate necessary costs.

The next step is to find further optimized logistics for agriculture produce. From how it is packaged, handled, and routed, there are hardly any cost effective specialized solution for agricultural produce today.

We plan to partner with logistic services providers to develop logistics dedicated to agriculture as we can forecast demand by region we can develop technology solutions with logistics partners to optimize delivery routes, coordinate delivery schedules, implement better quality service standards and optimize loading to and from the rural areas of China.

We're also looking at various packaging solutions to offer our sellers and considering opportunities in warehousing technology and temperature controlled logistics. We will also invest in technology for quality control and food safety. Unlike manufactured goods, it is more difficult to provide assurance on the quality and safety of agriculture produce. As consumers in China become more health conscious, we expect more will be willing to pay a premium for quality and safety.

We intend to address such needs through a combination of technology and certification backed by credible platforms. We started collaborating this year with a research institution to develop a cost-effective robust method for testing fresh produce for contaminants like pesticides. We envision deploying such test across a wide array of produce and at various points of the supply chain to provide greater assurance on food safety.

We can offer such testing solutions and certification as value-added services to our farmers and merchants. Certified products will receive preferential traffic support and command a premium from our users. Our ability to differentiate such products will allow us to curate and price SKUs based on quality and recommend them to the relevant target users.

With better quality products it is equally or perhaps more important to invest in marketing to grow brand awareness. Take the French Regional Champagne as an example. Sparkling Wine made in Champagne are tightly regulated and must be made from a few prescribed burritos using traditional methods to ensure consistent quality.

Its sterling rigorously defended reputation fuels consumers willingness to pay a premium. Similarly in China, given its vast agricultural resources, we see opportunity to help create new brands for consistently high quality produce for the various geographic indications around the country.

In fact one of our Duo Duo farm projects in Hunan is working to establish a nationally recognized destination for yacon grown there. To meet the destination, farmers will have to standardize improve their farming practices. Farmers are incentivized to improve their practices and exchange for their products fetching a premium.

And we as a platform can provide more visibility to farmers and sales volume and pricing. We can help build awareness to promote origin stories to market including virtual live streaming tours. The recognition of the quality provides further opportunity to develop related sub-industries from selling oranges to making marmalade and from selling peaches to validating ecotourism. We see potential to work with farmers and distributors to develop branding for their produce and to address other value-add opportunities leveraging our consumer insight.

Well this may be a long journey. We are committed to investing in agriculture and agri-tech as it enables us to truly benefit all of our platform's participants.

Now let me pass it to Tony to discuss our financial results for the second quarter.

Tony Ma Jing {BIO 19801533 <GO>}

Thank you, David. For the 12 months ended June 30th, 2020, our GMV increased 79% to RMB1.27 trillion from RMB709 billion a year ago. As a result of higher user engagement and increased spending per user.

We report GMV on the same basis as other industry players to provide a meaningful comparison with that of our peers. The industry definition includes canceled and returned orders. Comparing our GMV in Q2 versus Q1 the level of canceled and returned orders has returned to normal historical levels as China recovers from the pandemic.

Our average monthly active users in the second quarter increased by 81 million from the previous quarter to 569 million or an increase of 55% from a year ago. Our annual active buyers for the 12 months ended June 30 grew 41% year-over-year to reach 683 million.

This represents a net add of more than 200 million in the past 12 months. The annual spending per active buyer in the 12 month period ended June 30, 2020 increased 27% to RMB1,857 from RMB1,468 for the same period in 2019.

The increase in annual spending per active buyer was moderated by a significant number of new users added who contributed less than 12 months of purchases to our GMV. During Q2, China's economy continued its recovery from the disruption caused by the pandemic.

According to National Bureau of Statistics online sales growth of physical goods accelerated in the second quarter resulting in 14.3 increase for the six months ended June 30 2020 from a year ago. This is up significantly from 5.9% growth for the three month period ending in March. Consumer staples and household goods were significant growth contributors during this period.

We observed a similar recovery trend on our platform. In Q2, our users had strong demand for household necessities and agricultural products and continue to be more selective and cautious on their discretionary spending. To address their needs we expanded our promotion offering under the June 18 campaign to cover more household necessities, food and beverage products and agriculture produce.

We are continuing our efforts to provide compelling value in these categories together with China Consumer Association in early July. Our total revenue in June quarter were

RMB12.2 billion representing an increase of 67% from RMB7.3 billion in the same quarter last year.

The increase was driven primarily by the strong momentum in online marketing services. Our online marketing services revenue grow 71% to RMB11.1 billion and our transaction services revenue increased 38% to RMB1.1 billion.

We continued our support for certain SME merchants in Q2 by offering discounted transaction fees, but in general observed a healthy recovery in merchant advertising activities. We benefited from merchants pent-up demand and deferred marketing budget from the previous quarter.

We also attribute high advertising activities to better merchant ROI due to the higher user engagement on our platform and more compelling advertising products. The implied monetization rate defined as total revenue divided by GMV for the last 12 months ended June 30, 2020 was 2.9% in line with the same period in 2019.

Now moving onto costs. Our total cost of revenue this quarter increased to 67% from RMB1.6 billion in the same period last year to RMB2.7 billion this quarter, translating to a gross margin of 78%. Total cost of revenues increased mainly due to higher costs for cloud services, call center, and merchant support services.

Total operating expenses this quarter were RMB11.2 billion as compared to RMB7.2 billion in the same quarter in 2019. Our sales and marketing expenses this quarter increased 49% to RMB9.1 billion from RMB6.1 billion in the same quarter of 2019.

On a non-GAAP basis our sales and marketing expenses as a percentage of our revenue was 73% as compared to 81% for the same quarter last year. We manage our sales and marketing spending dynamically based on expected ROI recognizing the sales market dynamic in this year's 618 promotional events. We decided to moderate our investment during the second quarter. We continued with our 10 billion program and expanded our offering to cover household staples that our users were looking for.

Looking ahead we see significant potential to improve our users annual spending on our platform by building more user mind share and trust. We expect to continue our sales and marketing investments in the second half of 2020 to drive more user engagement. We will continue to spend whenever we see attractive opportunities that meet our internal ROI hurdles.

General and administrative expenses were RMB395 million, an increase of 42% from RMB278 million in the same quarter of 2019 primarily due to an increase in headcount. On a non-GAAP basis, our G&A expenses as a percentage of our revenue was 1.1% in Q2. Research and development expenses were RMB1.7 billion, an increase of 107% from RMB804 million in the same quarter of 2019.

The increase was primarily due to an increase in headcount and the recruitment of more experienced R&D personnel and an increase in R&D related cloud service expenses. On a non-GAAP basis, our R&D expenses as a percentage of our revenues was 10.4% in Q2. Technology is fundamental to our operations and we plan to increase our spending on engineering talents and technological capabilities going forward.

Some of our key R&D initiatives include developing our demand forecasting system for agriculture. Database for C2M manufacturers and the logistics planning system. As a result, our operating loss for the quarter was RMB1.6 billion on a GAAP basis compared with operating loss of RMB1.5 billion in the same quarter of 2019.

Non-GAAP operating loss for the quarter was RMB725 million compared with RMB898 million in the same quarter of 2019. For the quarter ended June 30th, 2020, we recorded net non-operating income of RMB740 million compared with RMB487 million in the same quarter in 2019.

The increase primarily reflects the net impact of higher interest income. Interest expenses from amortization of our outstanding convertible bonds and the gain on fair market value change from long-term investments. We excluded the latter two items in addition to share-based compensation in our presentation of non-GAAP metrics.

To sum up, our net loss attributable to ordinary shareholders was RMB899 million on a GAAP basis as compared to net loss of RMB1 billion in the same quarter of 2019. Basic and diluted net loss per ADS was RMB0.75 on a GAAP basis compared with RMB0.88 in the same quarter of 2019.

Non-GAAP net loss attributable to ordinary shareholders was RMB77 million compared with RMB411 million in the same quarter last year. Non-GAAP basic and diluted net loss per ADS were RMB0.06 compared with RMB0.36 in the same quarter of 2019. That completes the profit and loss statement for the second quarter.

Now on the cash flow. Our net cash flow generated by operating activities was RMB5.5 billion as compared to RMB4.1 billion in the same quarter of 2019 primarily due to an increase in online marketing service revenues. As of June 30th, 2020 the company's cash reserve comprising of cash, cash equivalents and short-term investment was RMB49 billion as compared to RMB41.1 billion at the end of December 2019.

We allocated most of our cash reserve to a highly liquid short-term investment to receive better cash yield and maintain flexibility to withdraw and deploy capital strategically as necessary. Finally, let me touch on the ongoing development in the US to prohibit foreign issuers access to US capital market if sufficient audit access cannot be provided to the US Public Company Accounting Oversight Board.

On August 6th, the President's working group on financial market released its report recommending SEC to implement rules that would require issuers grant PCAOB access to work papers of the principal audit firm in order to maintain listing by January 1st, 2022.

The recommendations also provide an option for companies to provide a co-audit from an audit firm that needs PCAOB inspection requirements. The administration's recommendation if adopted will still require SEC to design and put in place detailed implementation rules.

We continue to monitor the situation closely and are prepared to work with relevant regulators in China and US to address these concerns when there is more clarity. We completed our soft internal control audit for 2019 with no material deficiency identified.

We are confident of the quality of our disclosure and the financial reporting and we are committed to continuing our efforts to provide a high degree of integrity in our company. This concludes our prepared remarks.

Operator we are ready for questions.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and-answer session. (Operator Instructions) Your first question comes from the line of Gregory Zhao of Barclays. Please ask your question. Mr. Gregory Zhao your line is now open.

Q - Gregory Zhao {BIO 18710278 <GO>}

Hi. Sorry, I was on mute. Thanks for taking my question. So we saw PDD made some efforts to move up to the high end market and started to sell some luxury products including Tesla cars. So just want to understand a bit more about how this will help you improve the ARPU and help you to get expanded into the high-end market. A quick one on the year-over-year growth of the GMV growth. So we know last year was the first time you've joined the 618 promotion season. So how shall we think about the relatively high base. The impact to your 2Q GMV growth? Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Gregory thanks for the question. Let me take your first question around brands and products. Our products and brand strategy is actually oriented around giving users what they want and serving them well. So it is not our intention to build or engaging in the type of promotion I have seen, the intention is not to drive our AOV.

The aim is actually to build Pinduoduo into a destination for quality authentic and value for money products across categories and price points. So we are continuing to grow the depth and breadth of SKU across the platform and whether they are branded or unbranded.

In fact as I highlighted in my comments earlier, we are highlighting agriculture as a product category where we think we can strategically add a lot of value over the next few years by investing in our supply chain and making available higher quality and better product for our users.

And with regard to your question on GMV. First of all, I would like to just remind the audience that comparing our GMV growth in the second quarter versus the first quarter is a meaningful because of the impact of the pandemic.

In fact we are very pleased with our GMV growth this quarter and particularly in the context of having added 100 million of active buyers since the beginning of this year. Our focus as a company this year in terms of our strategy is to continue to invest in user engagement and to build our mind share because as you look at the scale of the user base we have accumulated 683 million active buyer.

We believe that what we need to do is continue to improve our engagement with them and to grow their mind share. The journey for the second quarter are impacted. I will also note that changes in consumer spending.

We saw a pickup in consumer activity since the first quarter as the economy recovered. However we did notice that consumer spending was much more value conscious and consumers are looking for more household necessities such as FMCGs and agriculture produce among our platform.

So as you saw in our 618 campaign we actually expanded our coverage in the campaign to cover more products in these categories and we are continuing to support the consumers in these efforts.

Q - Gregory Zhao {BIO 18710278 <GO>}

Okay, thank you.

Operator

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

Q - Piyush Mubayi {BIO 1530844 <GO>}

Thank you for taking my question. And may I just ask a couple of details on how the transaction commission revenues, marketing services revenues are progressing and how that take rate has evolved. Your marketing service take rate seems to have gone up to 3.2% in the quarter, which is a huge improvement year-on-year on any of the metrics probably the highest ever. Should we then think of that as a number that we can expect for you to continue to maintain in the future. And also when you look at the growth rates in transaction commissions, which was 76% in 1Q. That slowed down to 38%. Is there anything there that's different that would lead us -- lead to that slow growth rate and in the similar manner the marketing services revenue, which is at 71% is meaningfully higher than the pace of growth that you're seeing in the GMV for the quarter. So if you could just take us through what's going on there, then I have a few questions in agriculture, if I might. Thank you.

A - Tony Ma Jing {BIO 19801533 <GO>}

Okay. Let me take this one then. We do saw a stronger than expected recovery in merchants advertising in Q2.

Our merchant had more budget to spend given limited activities in Q1 and they were eager to make up for the loss in Q1 and higher user activities and better advertising products also helped to improve the advertising returns. Our higher take rate in Q2 reflects the supply demand dynamic post the pandemic actually.

The level of returned and unpaid order also returned to the normal level. If we take together our Q1 and Q2 number at an aggregate level. The take rate for the first half of the year actually, is 2.9% in line with our historical results. Take rate for us, it's an output, not a KPI we try to optimize. Our priority is on our user engagement on -- with stronger user engagement merchants would naturally want to advertise more.

And we will continue to support good quality merchants and incentivise them to improve the service and provide better value for our users. And regarding the second question or the question on the transaction services revenue.

The transaction services revenue comprised primarily of what we previously termed commission fees. The payment process fees, which we charge at a standard record rates of 0.6%. However we continue to offer a preferential rates for certain merchants as incentive.

Q - Piyush Mubayi {BIO 1530844 <GO>}

And may I just ask a follow-up question. Just wanted to understand where, what percentage of the GMV today is agricultural say for the second quarter. When you talk about RMB1 trillion five years out, we presume that's about 15% to 20% of GMV at that point of time, would that be the right mix to think through for agriculture, and if you could just give us a feel for what the sort of take rate that we could earn from a business, would it be commensurate to or comparable to the 3.2 for example or you've shown us in Q2, but five years down the line, I mean. Thank you.

A - David Liu {BIO 21976168 <GO>}

Piyush, thank you for that. Let me just also add a little bit to our context around the take rate, as we have communicated to the market previously, the take rate really is an output, it's a function of the merchants advertising on our platform and seeing the right levels of return. So we actually saw in the second quarter, a very strong merchant activities as merchants try to -- some -- move more inventories and goods in the second quarter and as a result we saw very strong advertising demand which we think actually contributed to that take rate.

Similarly I would note that on our platform -- we are seeing advertising activities really across the board from many different sectors. So it isn't any particular categories per se. And similarly we do believe there are potentials in agriculture merchants and distributors to contribute to advertising as long as they are able to actually offer the type of premium product that allow them to generate the type of return.

So what we are seeing is, given the low e-commerce penetration rate in agriculture, we actually see substantial opportunity for us to invest in our supply chain and to drive more value creation down the road.

So, yes, we do believe that certainly generating the type of return commensurate with what the platform generating today is possible in agriculture, but that may come in the form of both advertising and also us providing technology solutions to the participants in our ecosystem.

Q - Piyush Mubayi {BIO 1530844 <GO>}

Thank you.

Operator

Your next question comes 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 question related to more medium-longer term. So how will PDD attract broader varieties of merchants and brands to join the platform when you indeed now have a larger base of merchants. And then you also have that your user base also reaching quite large number. So how do you balance and ensure all the merchants will receive the relevant exposure and what does PDD need to do to serve this broader range of the merchants and how will you know the team purchase model evolves if we get more branded products or branded merchants on our platform? Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Thank you, Alicia. Our strategy around products and brands have not changed. In fact as I mentioned earlier today the idea is to continue to focus on providing what the users want.

So from that perspective what we are seeing is the team purchase model working and this is the reason why we have been able to accumulate several hundred million users within such short period of time and this continues to work because we are a recommendation based business model focusing on specific SKUs as opposed on brands, right. So we do believe that as everyone's demand on the platform really ranges across different price points for different categories. And through -- as we continue to get better our recommendation, we understand the users better.

We are able to push them the most relevant products at the most relevant price points. And as the user activities and user engagement grow, the merchants naturally are coming to our platform seeking for growth and more opportunities. And the merchants themselves will be able to get the right level of traffic if they are able to offer the right value for their customer base.

So what we are doing is through the algorithms, through our recommendation, working with the merchants to help them provide more suitable products that are targeted at the users.

And we believe that algorithm is working and continuing over time, while recommendation will get better and through a combination of offering the right product and also advertising on the platform. We believe the merchants will continue to see the attractive returns on their investments.

Q - Alicia Yap {BIO 15274658 <GO>}

I see. Okay, thank you.

Operator

Your next question comes from the line of Thomas Chong of Jefferies. Please ask your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi. Good evening. Thanks management for taking my question. My question is about the business momentum in July and August across different product categories? Thanks.

A - Lei Chen {BIO 18939623 <GO>}

Sorry Thomas.

A - David Liu {BIO 21976168 <GO>}

Hey, Thomas. Is the question around our strategy or the trends we're seeing across different categories?

A - Lei Chen {BIO 18939623 <GO>}

Operator maybe we can take the next question first before we take Thomas back.

Operator

Certainly. Your next question comes from the line of Tina Long of Credit Suisse. Please ask your question.

Q - Tina Long {BIO 21068620 <GO>}

Hi, management. Thank you for taking my questions. I have two questions. The first one is on the sales and marketing. Because in your prepared remarks you mentioned that you intentionally moderated sale and marketing spending due to I think probably peers actually have been pretty aggressive and also you expanded the 10 million program to some (inaudible). So I want to know in the next two quarters, third quarter and fourth quarter, what are the plans for your sales and marketing and under what circumstances you will actually set up the sales and marketing. That's the first question. I'll do the second one after that. Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Sure, Tina. Let me ask Tony to address the question.

A - Tony Ma Jing {BIO 19801533 <GO>}

First of all the Q2 on sales and marketing expenses. We say to moderate our sales and marketing spending is when we observe this aggressive promotion spending by our peers on electronics.

Relative to that we saw household goods has more attractive opportunity to advance user engagement. Therefore household goods has -- actually has a higher purchase frequency than electronics. So we choose a different strategy to invest in Q2. We actually plan to deepen our user engagement going forward. So that we will continue to spend on sales and marketing in the coming quarters to grow the mind share and trust among our users.

We expect to increase our sales and marketing investment in second half of 2020 in a prudent manner as well as we spend whenever we see opportunity meets our internal ROI hurdles.

Our annual spending per active user are still lags behind our peers. We believe we can narrow that difference by growing our mind share with users and gain -- to get more wallet share. That's why we have to continue this type of investment.

Q - Tina Long {BIO 21068620 <GO>}

Okay. Thank you, Tony. Yes, my first question is sort of related to this. Because I think based on the public data, the parcel volume is actually very strong from PDD. So but the GMV actually was sort of slower. So does that imply the average order size is actually trending down. And can you share a little bit more about the average order size and also the outlook because if you continue to allocate more traffic to the household goods. So we continue to see the average order size to be to stay at low level. Thank you.

A - Tony Ma Jing {BIO 19801533 <GO>}

Let me take this. Users tends to associate Pinduoduo as their go-to platform for great savings every day. So for us we also tend to have a less of concentrated spike in GMV and the user activities around shopping promotion unlike our users our peers.

And our user engagement tends to trend in a steady fashion and reflective which reflective of our game in building our mind share. We will continue to invest in the user mind share to build on high frequency of engagement.

In fact that's what we did in Q2. We noticed the consumer spending was more value conscious and the consumer were looking for more household necessities including FMCG agriculture produce. That's why we dedicated our promotional program during the June 18 to include more products in these categories.

This definitely have an impact on the AOB. Also we add almost 100 million active buyers since beginning of this year. And these users are just getting to know Pinduoduo and actually their contribution to the GMV is less than 12 months. Also they are still developing their spending behavior on our platform.

Q - Tina Long {BIO 21068620 <GO>}

Okay. So does that mean the outlook of AOB will stay at a lower level for a longer period of time?

A - Lei Chen {BIO 18939623 <GO>}

Tina, so what we have seen in the second quarter is a growth across the categories. But as I mentioned the consumer behaviors in the second quarter were more value conscious and we adapted the marketing strategy accordingly.

So we do believe that Pinduoduo -- many users associate Pinduoduo as a platform where they would go for great value product and we have seen people coming to us in the second quarter particularly looking for those products. We find these product categories to be quite compelling in a sense because they are very high frequency, high engagement.

And we do believe that over time the AOB will continue to grow as they build their shopping behavior, their spending behaviors in our platform over time.

Q - Tina Long {BIO 21068620 <GO>}

Okay, got it. Thank you very much.

Operator

Your next question comes from Thomas Chong of Jefferies. Please ask your question.

Q - Thomas Chong {BIO 21155199 <GO>}

Hi. Good evening. Thanks management for asking my questions. Can you comment about the live streaming online shopping strategies? Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Thomas, in terms of live streaming, we have seen continuing adoption of our merchants using the live streaming as a feature to create engagement with consumers on our platform.

However we do not position or do not consider live streaming to be a separate marketing tool. We consider really as part of the integrated experience on our platform.

So on Pinduoduo as you will note that we don't have actually a better dedicated channel at entrance for live streaming. Instead you actually are -- our users come in contact or come in access to the live streaming through their browsing experiences. As they explore their SKUs, they will notice that this particular SKU may be in live streaming.

And they will click into the live streaming and view the products being introduced. And in that context they may choose to purchase or they may choose to bookmark the seller. Actually you may have seen something and as through the browsing next time day end up purchasing.

So we do and we position intentionally live streaming to be part of the holistic experiences our merchant can offer to our users and -- to add to that exploration exploratory experiences our users have on the platform.

A - David Liu {BIO 21976168 <GO>}

Yes, one more thing, I'd like to add is live streaming would be one of the key demands our customers as opposed to in this year and actually there are many others and then we try to have a full perspective understanding about our customers and we actually have more than just one features try to capture different kind of needs, different kind of demand our customer has had since the starting of this year. So I believe that live streaming just is one of them, but not all of it.

Q - Thomas Chong {BIO 21155199 <GO>}

Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Thank you, Thomas. Operator, next question please.

Operator

Your last question comes from the line of Binnie Wong of HSBC. Please ask your question.

Q - Binnie Wong {BIO 16260213 <GO>}

Hi. Good evening, management. Congrats on a strong improvement in the bottom line. I have two questions here. First question is on the monetization rate. It's true that I mean the second quarter the monetization rate sharply increased to 3.2%. But if we look at on a half year basis, right. There's only -- there's around a 2.5% which is just similar to what we have did in the past years. So should we just think of it. This is more about rising and spending from the pent-up demand or should we think about second quarter. Is there some structural positive drivers that can last into the second half of the year just directionally thinking about it. And then following on that, is that if you are thinking about the rising online marketing firm which pool -- which advertising category. Is it because that we also do more management said about the agricultural advertiser and FMCG. Do they tend to see bigger ad spending like do they have a bigger ad pockets. Thank you. And I just have a quick follow-up. Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Hi, Binnie. Thank you for the question. Your question around the take rate. I would say that and as I would say that take rate itself really is a function of our merchant investing or pay on buying advertising to generate return for their sales. And as many of you have noted in your interviews with merchants.

The advertising return on our platform are better than that relative to our peers. So it is I would consider -- were you to consider the advertising spend from merchant job from that perspective. Of course it is true that because in the first quarter the merchants weren't in a position to spend the advertising budget.

So we did benefit from some of that pent-up demand, but our conviction is that -- as always continue to deliver better or good solid attractive advertising return to the merchants. They will continue to advertise. So we're doing this both in terms of improving our recommendation algorithm. But also improving better advertising products. So as an example we rolled out at the end of last year and product that helps a smart tool that help merchants to optimize their advertising return as an example.

So many of the merchants on platform may not be as savvy and they don't really understand how to optimize for keywords or for banner ads. However by using our automated system they at least are guarantee the minimum threshold return.

So they are in a better position and more willing to spend. So we do think that part of that pickup has to do with the better advertising products that we are providing and also of course you cannot do this without a very, very active user.

So as I mentioned on our call, our strategy this year is to continue to invest in user engagement and with user engagement we believe the return to merchants advertising will continue to be attractive and they will continue to have that demand over time.

As to your question specifically around advertising tools. As you know we started our business advertising business in primarily in search, but as our business model focuses on recommendation, we have seen pickup and we expect to continue to see pickup fee advertising as a contributor to the online marketing services revenue.

Q - Binnie Wong {BIO 16260213 <GO>}

Okay, thank you so much. And just a quick question here is that is, I mean, is a very good quarter that we see the operating margin is historically the narrowest in terms of the losses. It's a significant improvement in the operating margin side. Do you think this is something that we can extrapolate because of this efficiency and we wish kind of like an equilibrium as to how much we spent and then how much we can grow our top line or is it that we should expect some quarterly fluctuation because I do understand sales and marketing is -- that's quite impacted by seasonality. So should we think about this to extrapolate into the second half. And is there something that is kind of like we reached this inflection point already. Thank you.

A - Lei Chen {BIO 18939623 <GO>}

Yes, I think, you're talking about the profitability question here. Our Q2 results do demonstrate how leverageable our business model is and how we could deliver profitability in the short-term, but we don't believe it is the right strategy to focus on a short-term profit over a sustainable long-term value.

Our vision is to offer value for money products to all users through fun and active shopping experience. We still need to continue our investment to grow user mind share and engagement as we mentioned several times in the prepared remarks.

So we are not considering profitability this year. Actually we also plan to step up our investment in our ecosystem through a strategic partnership and the capital investment to better support our merchant in offering better value and better service to our users.

Q - Binnie Wong {BIO 16260213 <GO>}

Okay, thank you. That's very, very clear. Super clear. Thank you so much.

A - Lei Chen {BIO 18939623 <GO>}

Thank you.

A - David Liu {BIO 21976168 <GO>}

Thank you, Binnie.

Operator

I would now like to hand the conference back to the presenters for the closing remarks. Please go ahead.

A - Zheng Huang {BIO 20683053 <GO>}

Thanks, Operator, and thanks everyone for joining us on the conference call today. If you have any further follow up questions please feel free to reach out to the IR team. We're always here for you. Thank you and have a good weekend.

Operator

Ladies and gentlemen that does conclude our conference for today. Thank you for participating. You may now all disconnect.