Q1 2019 Earnings Call

Company Participants

- Jon Liao, Chief Strategy Officer
- Lei Xu, Chief Executive Officer of JD Retail
- Richard Liu, Chairman and Chief Executive Officer
- Ruiyu Li, Senior Director of Investor Relations
- Sidney Huang, Chief Financial Officer
- Unidentified Speaker
- Zhenhui Wang, Chief Executive Officer of JD Logistics

Other Participants

- Alex Yao, Analyst
- Alicia Yap, Analyst
- Eddie Leung, Analyst
- Ella Ji, Analyst
- Grace Chen, Analyst
- Jerry Liu, Analyst
- Jin Yoon, Analyst
- John Choi, Analyst
- Natalie Wu, Analyst
- Ronald Keung, Analyst
- Tian Hou, Analyst
- Translator

Presentation

Operator

Thank you, operator, and welcome to our First Quarter 2019 Earnings Conference Call. Joining me today on the call are JD.com's Group CEO, Richard Liu; Mr. Xu Lei, CEO of JD Retail; Mr. Wang Zhenhui, CEO of JD Logistics; Sidney Huang, our CFO; and Jianwen Liao, our CSO. For today's agenda, Mr. Huang will discuss business highlights for the first quarter of 2019. Other management will join the call later.

Before we continue, I refer you to our Safe Harbor statements 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 earnings release, which contains a reconciliation of the non-GAAP financial measures to the most directly 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 to our CFO, Sidney.

Sidney Huang {BIO 20098238 <GO>}

Thank you, Ruiyu Li, and welcome, everyone. Thank you for joining us today. We are pleased to report a strong set of financial results for the first quarter of 2019. We delivered solid revenue growth in a seasonally low quarter and set new records across all major earnings metrics. During the first quarter of 2019, our net revenues grew 20.9%, more than double Chinese national retail sales growth. Net service revenues grew by 44% year-over-year, driven by solid momentum from our marketplace and advertising service revenues. Our logistics and other service revenues grew over 91%.

Gross margin in the first quarter was 15%, up from 14.1% in the same period last year, consistent with our prior commitment to the continued margin improvement of JD Retail, formerly known as JD Mall, and JD Logistics third party business. JD Retail gross margin increased 36 basis points, mainly driven by economies of scale from the 1P business as well as technology-driven advertising revenue growth. In fact, this marks the 20th consecutive quarter of JD Retail gross margin expansion on a year-over-year basis. It demonstrates the long-term trajectory of retail scale economies, a concept that we have articulated persistently since our IPO five years ago.

At times, this powerful underlying trend was overshadowed by the short-term accounting losses from the various new innovation efforts to extend our business model in order to drive our next growth curve. But every time when some of these short-term losses were reduced or eliminated through natural progression to success or even failure, the underlying economic trend of our core business will suddenly become too obvious, even though we did disclose such underlying trend of JD Retail every quarter. While this is one of these quarters as JD Logistics third party business achieved a significant gross margin improvement through better scale and capacity utilization that we promised a year ago, which explained the remainder of the Group level gross margin expansion and restored our normal margin trend.

By the same token our fulfillment expense ratio in the first quarter also improved 2.5% to 6.7%, down from 7.2% in the same quarter last year, driven by better utilization of our logistics infrastructure and improved unit economics as a result of the third-party logistics service business. These improvements happened before the recently announced wage and benefit changes in our delivery unit in April. As we communicated internally and publicly, the new changes are designed to better incentivize our delivery staff in light of our expanding business lines and industry best practices. In fact, the majority of our delivery staff affected by the new incentive scheme saw their monthly income increase in April, while their productivity also improved. As such, we do not expect to realize any meaningful cost savings from these new changes. Any further fulfillment efficiency improvement will continue to come from better productivity of our staff and the better utilization of our infrastructure through scale and technological innovation.

Consistent with our ongoing focus on technology innovation, during the first quarter our R&D spending was the only major expense line that increased faster than revenue growth, up 54% from the same quarter last year. Our R&D expense ratio was 3.1%, up from 2.4% in the same period last year. As we mentioned in the last quarter, however, following a period of significant investments to strengthen our R&D team, we expect our R&D expenses to stabilize in the remaining quarters of this year.

Our marketing expense ratio was 3.3% in the first quarter, down from 3.5% in the same quarter last year as we fine-tune our marketing strategies in light of the competitive dynamics. Our G&A expense ratio remained stable at 1.1% in the first quarter.

Now, you can see why our non-GAAP operating income reached a record high of nearly RMB2 billion during the first quarter this year. It has nothing to do with our annual reorganization that was apparently over interpreted by certain media outlets. There is no massive layoff. In fact, our total headcount increased during a seasonally slow quarter from 178,000 at the last year end to 179,000 as of March 31st.

In the nutshell, the record earnings is a natural result of ongoing JD Retail margin expansion and the JD Logistics margin recovery, driven by technology innovation, economies of scale and better capacity utilization. Our non-GAAP operating margin was 1.6%, up from 0.8% in the same quarter last year. If you ask me how sustainable this margin trend will be, I will reiterate that the improving JD Retail margin trend is sustainable on an annual basis, as we have demonstrated over the past three years and will continue for many years ahead of us.

It is driven by JD Retail's significantly lower operating expense ratio as compared to the offline retail format, which in turn will enable us to provide everyday low prices and superior services to our consumers and drive sustained growth above the market. This is the simplest, yet most powerful retail economics that have supported essentially all of the most valuable retailers around the world.

Our non-GAAP net income attributable to ordinary shareholders in the first quarter 2019 also reached a record RMB3.2 billion, with a record non-GAAP net margin of over 2.7% up from 1% in the same quarter a year ago. Our GAAP net income also set a record, at RMB7.3 billion in the first quarter, mainly attributable to the fair value change of investments during the quarter.

Our free cash flow during the first quarter turned positive RMB1.3 billion, driven by positive operating cash flow and the disposal proceeds from the available-for-sale projects, partially offset by reduced maintenance capital expenditures.

On the Q2 financial outlook, we expect net revenue growth to be between 19% and 23% on a year-over-year basis based on recent economic indicators and our April growth momentum.

Lastly, I'm pleased to share two exciting developments. We are delighted to extend our strategic partnership agreement with Tencent, covering a broad spectrum of strategic and business collaboration initiatives. We continue to expect a winning relationship with mutual benefits to both corporations in the future.

I'm also pleased to highlight the signing of the Series A financing for our JD Health business group led by a group of well-respected financial and strategic investors. The deal valued our healthcare business at a post money valuation of approximately $7 billion. JD Health operates the largest online retail pharmacy in China, with a fast-growing online healthcare services platform.

This concludes my prepared remarks. Now, I will turn the call to Richard for a few words.

Richard Liu {BIO 17167866 <GO>}

Hi, everyone. This is Richard Liu. I just wanted to share with you, as you know, this quarter our net profit is a little bit high, but I want to say, we'll never ever stop investing in our long-term future. And we'll never stop for 4 fields -- first, we would never ever stop investing for our costumer experience. Second, we will never ever stop for investing for our new business. As you know, we have our JD Digital business, JD Logistics, JD Health, and various investments on new business model.

And third, we will keep investing for our technology, because we're quite sure only that technology can improve our efficiency, reduce our cost and our customers experience. And last one -- this is the mostly investments that is talent investment. Actually, I'm sure that talent pool is only base of our every advantage. So we will continue improving our employee's net income. Actually in the past six years, every year our average employee net income improved and we will keep investing and make sure every position in my Company is generally attractive. Make sure we have the best talent. Thank you.

Ruiyu Li {BIO 19135837 <GO>}

Operator, let's move to the Q&A section.

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 Mr. Ronald Keung from Goldman Sachs. Please ask your question.

Q - Ronald Keung {BIO 15432736 <GO>}

Thank you, and congratulations on the strong results. Thank you, Richard, Xu zong, Wang zong, Sidney, Liao zong and also Ruiyu. And very solid guidance as well. So, my question is on logistics and we see a significant reduction in logistics drag and over 90% growth in the line of logistics and other services revenue. Could you share with us some of the key initiatives and maybe KPIs for the JD Logistics? And given that the gross margins did improve, as Sidney you mentioned, significantly in the first quarter, how should we think about that gross margin trajectory for the 3PL business and potentially the fulfillment cost metric as well over this year and the outlook? Thank you.

A - Zhenhui Wang {BIO 21020367 <GO>}

(Foreign Language) Mr. Wang, CEO of JD logistics.

(Foreign Language) Thank you very much for paying attention to our logistics business. (Foreign Language) Our core KPIs are still centered around experience and efficiency. (Foreign Language) As pointed out by Chairman Richard Liu just now, we will pay a lot of attention to how our customers comment on their experience. (Foreign Language) And also we will pay attention to how fast, how well we send our products to -- goods to our customers. (Foreign Language) I must have to say that in the first quarter we were making efforts in these key aspects. (Foreign Language) One driver is technology. We have lot of very good strong supply chain and logistics technologies.

(Foreign Language) Through better customer experience we can secure more orders from our customers. (Foreign Language) Although first quarter actually is kind of a off season -- off-peak season for us yet we've made quite good performance. (Foreign Language) And also, our profit margin from 3P orders of business has seen improvement during the past two quarters. (Foreign Language) We see this trend will continue in the future. (Foreign Language) Of course, we would not sacrifice our customer experience for that. Thank you.

Operator

Your next question comes from the line of Jin Yoon from New Street Research. Please ask your question.

Q - Jin Yoon {BIO 16293072 <GO>}

Hi. Good evening. Thanks for taking my question. Sidney, very strong net margin line compared to what you guided for full year, how should we look at that -- how should we look at the operating margin leverage as well as gross margin leverage as we head into weaker seasonality for margins in 2Q and 4Q? And how should we see the cadence for margin expectations for the rest of the year? And is there -- do you still maintain the same margin guidance or do you expect that to trend upwards going forward? Any color on that that'd be great? Thanks.

A - Sidney Huang {BIO 20098238 <GO>}

Thank you. So, we're obviously very encouraged by very strong results in Q1, but it is still only Q1. As Richard mentioned, we will continue to invest in our customer experience, we will invest in new businesses and also as you can see, in China, the competitive dynamic changes very quickly and has always been very, very fierce competitive environment. So, it is because only after the first quarter we have not adjusted the margin guidance. We will revisit the margin guidance next quarter for sure.

Now, with very strong Q1, we are also prepared to reinvest part of that gains back to our consumers through our second quarter promotion season, very similar to what we did in 2017. But again, I think we -- it's a great quarter that we again demonstrated the underlying earnings power of our business and we will not -- clearly we will continue to deliver a steadily improving margin on an annual basis, making sure that we will generate solid returns, but at the same time, only when we continue to reinvest, we can expect sustained growth for our business in a very long-term basis.

Operator

Your next question comes from the line of Alex Yao from JPMorgan. Please ask your question.

Q - Alex Yao {BIO 16818860 <GO>}

Hi. Good evening, everyone. Thank you for taking my question and congrats on a strong quarter. I just want to dig into the logistic improving gross margin trend little bit. So, you guys mentioned the gross margins for the third-party logistics continue to improve in the past two quarters. Is it because you increased the pricing for your product or you optimized the cost structure such that the fixed portion of the allocation can be more easily scaled down by improving order volume? Can you just help us understand what exactly is driving the logistic margin improvement and how sustainable these drivers are? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So let me take that. If you recall, in Q1 last year, and probably Q2 last year, we mentioned when we first started expanding the external business for logistics, we didn't know -- it's very difficult to predict how fast we can grow, especially the efforts started in Double 11 promotional season in 2017. So, we essentially build out very large capacities ahead of time to ensure that new customers can enjoy the best experience. And also, in conjunction with that new business expansion, we were also providing business customers with trial period preferential rates. So, it was basically a capacity issue plus a discounted rate. Both affected the gross margin of our external business and also because the capacity is shared by both internal and external businesses, so our internal JD Retail fulfillment expense was also affected, because we spread out the costs between internal and external. So, Q1 last year was negatively affected by those two factors and essentially, those two factors were removed by the last two quarters. We mentioned the initial discounted period gradually phased out in the second half of last year and then our capacity utilization has continuously improved throughout the year last year. So, by now, we are in a very good shape in terms of capacity utilization and we're back to more normalized rates that paid by our happy customers. I don't know if that answers your question?

Operator

Your next question comes from the line of Eddie Leung from Bank of America-Merrill Lynch. Please ask your question.

Q - Eddie Leung {BIO 15234642 <GO>}

Hello. Good evening. Thank you for taking my questions. I have two questions related to your revenue mix. We have seen electronics and home appliance growth slowing down. So, just wonder would that effect our 1P gross margin improvement in future given perhaps a slower improvement in economic scale to your suppliers? And then separately, also about the revenue mix going to general merchandise. As general merchandise is growing faster, could you talk about the trend of your basket size producer and how would that affect efficiency of your fulfillment business going forward, especially given the potential lower order size, could demand pretty similar utilization of your logistic resources as well? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Okay. So I'll take the first one. Our electronics and home appliance business has actually seen a healthy growth in light of the overall macro slowdown and we were definitely growing well above industry. So, the growth rate, even though it's below the historical level, but we are continuously expanding at a double-digit rate and taking market share at a very fast pace. So, as we take market share, you continue to be able to work with your suppliers and plants to come up with more innovative products and offerings to our consumers. We mentioned in the past, for certain categories where we are already number one, we may come up with more customized models, where we can drive further customer value, meaning lower price without disrupting the offline pricing systems and then, for some other categories where we are not number one yet, the simple growth in scale by itself will automatically generate additional gross margin by better procurement prices. And Xu Lei can answer the second question.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language) This is Mr. Xu Lei, from -- CEO of JD Retail. Let me take the second question about the -- particularly the basket size of general merchandise. (Foreign Language) The relationship you have mentioned about the size of the ticket price and fulfillment expenses I think it's mainly about our direct sales business. (Foreign Language) Actually, the ticket price of our direct sale business in general merchandise is on a steady rise. (Foreign Language) This is mainly due to the fact that we make some efforts in the second tier and third tier categories in marketing. As a result, we will improve the ticket connecting conversion rate. (Foreign Language) And also, we tried once last year, we increased the delivery fee from a lower price to RMB99. (Foreign Language) As a result actually we found out this measure didn't affect the stickiness of our users, our customers in general merchandise, and it helps us to control our fulfillment expenditure. (Foreign Language) And also, starting in the end of March and also beginning of April, we've been trying or experimenting with a new measure where first buyers can enjoy free freight service and we found actually it's very effective in acquiring new users. (Foreign Language) This test will go on for a while and then we will roll it out, of course, the free freight expenditure will be accounted as new user acquisition cost. (Foreign Language) Thank you.

Operator

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

Q - Alicia Yap {BIO 15274658 <GO>}

Hi. Thank you. Good evening, management. Thanks for taking my questions. Also, congrats on the strong set of results. I have questions, Sydney, on the second quarter guidance. Can you elaborate the drivers that contribute to the reaccelerated growth for the second quarter net revenue guidance that you provide? Has that guidance back into any potential uncertainty on these ongoing trade war impact? Or are you not expecting any issue from these overhang? And should we also think about these re-acceleration potentially is driven by -- given Richard mention to reinvest the strong 1Q margin, is that suggesting you are going to reinvest into very aggressive sales and marketing promotions to drive your June '18 sales that bake into your guidance as well? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

So, it's really driven by a combination of factors, one is that we actually have a pretty strong April sales result. So that was very encouraging. We believe it's driven by our customer experience and also better technologies, in particular our user interface, so the personalized technologies that we believe are generating better conversion. And also, on a year-over-year basis, if you recall, June 18th last year was a long holiday weekend and there was also World Cup around the same time. So there is also some difference in terms of sales seasonality or sale season timeframe.

And then, also the third factor will be that, given we do have a strong Q1, we do have better resources to reinvest. Now, having said that, any investments will be also very measured. We will make sure that any investment will generate good ROI and also improve our customer experience. So the reinvestment is not just simple -- just a simple promotion. There will be -- there is innovative marketing campaigns that are being planned, but yes, clearly the price benefit will also be part of it, that's how we return to our consumers.

Operator

Your next question comes from the line of Jerry Liu from UBS. Please ask your question.

Q - Jerry Liu {BIO 17515547 <GO>}

Hi. Thank you, Richard, my question goes back to your comments earlier about reinvesting. Certainly, understand given the very strong results in the first quarter, we should expect some of that to be reinvested, but want to understand maybe a longer-term view. When you look at the last few years, JD net margins have had some years of increase and some years of decrease. Given the bigger scale of the business now, do you think we could enter a period where our margins steadily increase year-by-year? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

So, yeah, Richard just step away. So let me try to answer this question. We did have internal discussion on this. As we communicated in the past, we have been committing to steadily improving margins year-over-year. Now, last year was a exception where we invested heavily in technologies and also a few new initiatives such as JD Logistics. And we tried to make clear that: one, JD Retail will continue to improve in margins as we did; and two is that, we accelerated our monetization effort, the logistics properties business so that we can in some way make up the profit shortfall last year which also has been materialized as we mentioned in the Q1 earnings release.

So, our first Core Fund established with GIC. So we are taking the revenue trend very seriously, and we have also guided on our intention this year, that clearly, the intention from Richard is to ensure that margin will steadily improve while we will reinvest at the same time. So, it is really a balance and we hope we will master better this balance going forward.

Operator

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

Q - Natalie Wu {BIO 19852429 <GO>}

Hi. Good evening. Thanks for taking my question and congratulations on very robust result. My question is regarding the new app interface. I noticed that you have launched AV testing for a new app in the base rate and the price on the recommendation fees and in the personalization. I was just wondering can we get some color on the effects of your -- of this a new app interface on your conversion rates based on the recent AV testing? And how should we think about the growth for your advertising business this year? Thank you.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language) Mr. Xu Lei, CEO of JD Retail will take this question.

(Foreign Language) We have already rolled out the new version of our app, 8.0. And by the end of this month actually, we will roll it out of to all users. Of course, our users have to download the new version of the app, so it may take some people longer time. So, as the time goes on, our coverage will increase.

(Foreign Language) As you know, our platform has been performing very well in terms of providing the right product to the right people at a faster speed and also very precise. So to speak, save time for our customers. So, we did very well in this aspect. But at the same time, we have also seen a trend, especially among younger users, they not necessarily want to save time by shopping, they want to kill time by shopping around, that why's we started this project last year August or September last year.

(Foreign Language) So this new version will be more catered -- this new version is more catered to the tastes and preferences for young people, it's more fashion and also there will be more interactive opportunities. For us, the metrics we used to evaluate our new version is again customer experience, and also the conversion rate, as you mentioned and also the efficiency in traffic distribution on homepage and also on product detail page. So, far it has been doing very well in terms of PV, UV increase.

(Foreign Language) Also, you will find this new version has improved our customer stickiness and also return rate. And as you know new model of news feed has already been used by some of our industry peers. And the result is that their research -- that their search rate actually has been hurt. However, this hasn't happened in our story. UV from search as a percentage of total UV has remained constant, that means we've maintained our competitive edge at the same time we have improved the kill time part of the story so to speak.

(Foreign Language) Besides that, the improvement in PV and the UV on the product detail page, we've found that this new offer change has also helped us in attracting more PVs and UVs into the stores and also the content page. (Foreign Language) At the same time, the personalized user interface and news feed also helped us to increase our advertising inventory this caused the result we will be kicked in, in the following quarters.

(Foreign Language) At the last, I want to -- and I emphasize one point. This new user interface XL is a long-term assets and it's a long-term endeavor. It means that we have to make a continuous effort to optimize our algorithm. So, plenty of improvement to make.

A - Unidentified Speaker

Thank you.

Operator

Your next question comes from the line of John Choi from Daiwa. Please ask your questions.

Q - John Choi {BIO 16529883 <GO>}

Good evening, and good morning. Thank you for taking my question. I have a question on -- couple of questions here. First on collaboration with Tencent. Has there been any further discussion about -- in the e-commerce space with Tencent and how you guys will further collaborate and cooperate with Tencent? And secondly, if you look in your active customer counts, it has been pretty much flattish for the past few quarters. So going forward, what kind of user acquisition strategy, the management has to further accelerate the user growth? Thank you.

A - Jon Liao {BIO 18782053 <GO>}

This is Jon Liao. And let me answer your first question.

Of course, past five years, JD has a very strong relation with Tencent and the relationship has been extremely successful. Now, the extension of our relation with Tencent was perhaps next three years as obviously we will continue, and we are deepen our relationships in three major areas, One is Level 1 and Level 2 , Gateway access. Number 2, in terms of advertisement. Number three in terms of our membership in Tencent Video and QQ Music.

Now, in terms of user acquisition and I will turn over to Mr. Xu Lei to provide more explanations.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language)

Q - Translator

I'm Mr. Xu Lei, I'm CEO of JD Retail. Let me add to the first question.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language)

Q - Translator

During the past five years, the cooperation with Tencent, we have built a strong client base and also brand awareness and also business side in the Weixin WeChat market.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language)

Q - Translator

At the same time, we see a trend -- in the past five years WeChat has been involved in a lot in terms of the number of users and also what they do using WeChat, especially in the area of retail or e-commerce, this is becoming more and more active. (Foreign Language) For example, our partnership with Tencent provides us with many resources, one of them being privileged access points [to JD from WeChat] which we have enjoyed for the last five years, but still we've got actually more than 50% of the visits are new visitors. (Foreign Language) That means there's still ample room for growth. So, we're determined beef-up our operations with Tencent and we're doing more innovation and also differentiated measures in terms of leveraging this partnership. (Foreign Language) That answers your second question. Let me say something about users in other aspects. (Foreign Language)

As I said last time, we've been making a lot of efforts in terms of acquiring new customers. In terms of organization, we've put together all the resources or unified all the resources in this aspect. We've set up specialized teams in charge of new user application. As a result, our new users have been increasing tremendously without incurring a lot of cost. (Foreign Language). Also we've been doing two pilot projects in terms of creating new scenario -- engagement scenarios to acquire new customers in second quarter. We'll step up efforts in this suspect.

A - Lei Xu {BIO 21781653 <GO>}

(Foreign Language) Another thing was done in the past quarter was that we've made efforts in awakening or reactivating customers that haven't bought anything from us in the past 12 months. (Foreign Language) As we all know, the current active client base is composed of two parts. One is new users -- new user acquisition. The other one is awakening of old existing users who haven't been activated in a certain period of time. (Foreign Language) In the first quarter, we've put more resources in this aspect. And also we've utilized the new technologies and from an innovative operations. As a result, the so-called awakened or reactivated user base has been very promising. (Foreign Language) Thank you.

Operator

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

Q - Grace Chen {BIO 2548665 <GO>}

Hi. Thank you. Congratulations for the strong results of the first quarter. My question is about the operating margin. So we see the JD retail, JD Mall operating margin has been increasing on a year-over-year basis. Last year, it was 1.6% and we're also see encouraging improvements in the first quarter. So, it'd be great if the management can share with us the long-term margin target for JD Retail and given the scale is the key driver of the margin expansion, so, I have been wondering on what kind of GMV target can we achieve these OP margin targets? Thank you.

A - Sidney Huang {BIO 20098238 <GO>}

Sure. Yeah, Grace. So we have discussed in the past. In China, the retail market is almost as large as the US market while the top retailers still contribute a small fraction of the overall retail pie, while the top. For example, Top 20 retailers in the US already contributed 50% of the overall retail volume. So in China, even though JD is the largest retailer, we are still quite small comparing to very large market size.

So the growth outlook and in terms of when we can get to the right scale, if you just think about -- take Walmart of US, as an example, by 2018 revenue size, even just with the US revenue size of Walmart, we are still only about one-sixth of its size. So the growth potential is tremendous and that is why we are willing to reinvest a part of the profitability back to the business to drive growth because as you continue to grow, your scale economies will naturally kick in. And so -- and the faster with growth, the earlier we can get there.

So, in terms of long-term margin trajectory, we had mentioned in the past, even at IPO, our first-party business longer term because we have a much better operating structure. Our expense ratio when comparing to the Top 5 offline retailers. For example, our JD Retail expense ratio was 5 percentage point lower. And that is tremendous advantage for us to reinvest part of the gross margin and we can afford to reinvest the gross margin to drive growth. But the longer term, when we get to the steady state this better operating margin or Op expense ratio will enable us to actually earn a higher margin than offline retailers. We have maintained that we should be able to earn 2 percentage point to 3 percentage point higher margin than offline retailer just for our 1P business and then, the 3P business has a much higher accounting margin. So if you layer that on top of the 1P business, it will give you somewhere in the high-single-digit at least for our long-term JD Retail margin profile.

Operator

Your next question comes from the line of Tian Hou from T.H. Capital. Please ask your question.

Q - Tian Hou {BIO 20458526 <GO>}

Congratulations on the good results. My question is a much more broad related to the China underlying e-Commerce development. Recently, for so many e-Commerce company IPOs, so if we categorize those e-commerce, we can say you guys and your peers are much more centralized, the leaders in e-commerce front. But the other guys like Yunqi, Youzan such as Ruhnn are much more decentralized e-commerce and for those kind of a decentralized e-commerce vendors, we can actually see millions of them big and small, and do you see any future impact from those mushroom type of growth. Of those the decentralized e-Commerce vendors, are they going to eat into your market shares in your major categories? And how are you going to prevent them from getting into your space? That's my question. Thank you.

A - Jon Liao {BIO 18782053 <GO>}

This is Jon Liao, and I will answer this question briefly. Now remember I believe last year, we talked about our strategy called Retail-as-a-Service, which means JD will be let me -- we are the retailers, but more importantly we're retail infrastructure service providers. Now, you absolutely right. I think the retail space would become more fragmented and more decentralized than concentration, so which means we continue to observe an increased number of players moving from social space, content and so on, so forth, but this -- the trend will continue. But at the same time, it is inconceivable -- retail loss where we will be able to build lots of sophisticated network-based retailing structure. So, in this case, that's the reason why JD is moving away from a vertically integrated model to become older model. So in this case, we opened up our retail infrastructure to connect -- to enable and empower more retail innovation.

So in other words, on one hand, JD for sure will continue to participate in those retail innovation, but at the same time, we will become retail service providers to build the retail ecosystem. So those retail innovations will utilize our retail infrastructure like logistics and the other service as well.

A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So Jon has brought up this very interesting value proposition that we started -- mentioned last year Retail-as-a-Service and which is really part of our second growth curve, which we have seen very good progress so far. But I just also want to just come back to the basics, what you mentioned on the various decentralized retail formats, you can also draw comparison to the various innovative boutique shops in the offline world, I think in every -- at different times, you always have different new innovative retail format, but in the end, the retail economies of scale driven by large procurement and also operating efficiency will remain intact.

I think even with all these new online or e-Commerce formats, JD remains the only and clearly the largest and only 1P retailer with (Technical Difficulty) while others are mainly operating on platform basis. So I think on that particular unique advantage, the most investors and analysts have somewhat overlooked and this is a long-term gain. But when you do such a scale, it is actually very difficult to be disrupted. I just want to mention this point again. Thank you.

Operator

Your next question comes from the line of Ella Ji from China Renaissance. Please ask your question.

Q - Ella Ji {BIO 16168552 <GO>}

And thank you for taking my question and congratulations on the strong results. I just have a quick question regarding the investment cycle of JD Logistics. I understand that you now are achieving a higher utilization rate of your facilities. Could you share with us what's the utilization level for now and how long or when do you think it's times for you to start with the next round of investments as you continue to expand your business? Thank you.

A - Zhenhui Wang {BIO 21020367 <GO>}

(Foreign Language) So Wang Zhenhui, CEO of JD Logistics. (Foreign Language) In terms of logistics infrastructure since last year, we are making a very significant strategic investments into warehousing and transportation and terminals, and technologies. (Foreign Language) Last year, we've mentioned actually, there's still room for improvement in infrastructure utilization. (Foreign Language) We can benefit by economies of scale and also we can benefit by improving of technologies. (Foreign Language) This year and also years into the future, we will continue to make more investments. (Foreign Language) Of course, terminals are where we are very strong. We will continue to be an area we -- to receive our investment. (Foreign Language) We are sure through technologies we can improve our customer experience and also size and also efficiency, which are very important to spread out our logistics company.

A - Unidentified Speaker

Thank (technical difficulty) today on the call. Yes, thank you operator and thank you everyone for (technical difficulty) our call. Please feel free to contact us if you have follow-up questions. And we look forward to (technical difficulty). Thank you.

Operator

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