Company Name: JD.com
Company Ticker: JD US
Date: 2017-08-14
Event Description: Q2 2017 Earnings Call

Market Cap: 63,204.67
Current PX: 44.25
YTD Change($): +18.81
YTD Change(%): +73.939

Bloomberg Estimates - EPS
Current Quarter: 0.606
Current Year: 1.975
Bloomberg Estimates - Sales
Current Quarter: 82459.786
Current Year: 354690.795

Q2 2017 Earnings Call

Company Participants

- Ruiyu Li
- Sidney Huang
- Richard Qiangdong Liu

Other Participants

- Eddie Leung
- Alicia Yap
- Alan Hellawell
- Eric J. Sheridan
- Grace Chen
- Ronald Keung
- Chi Tsang
- Jin-Kyu Yoon
- Zoe Zhao
- John Choi
- Alex Yao
- Natalie Wu
- Jialong Shi
- Tianli Wen
- Ella Ji
- Wendy Huang

MANAGEMENT DISCUSSION SECTION

Ruiyu Li

GAAP and Non-GAAP Financial Measures

Also, this call including discussions for certain non-GAAP financial measures

Please refer to our earnings release which contains a reconciliation of non-GAAP measures to the most directly comparable GAAP measures

Sidney Huang

Financial Highlights

Performance

- We're reporting another quarter of strong top line growth, solid profitability, and remarkable FCF
- Before I get into the financial highlights, let me first give you a quick update on JD Finance

- We are pleased to announce the deconsolidation of JD Finance as a result of the legal ownership transfer of the business on June 30, 2017
- All of our financial metrics in the earnings release have been revised to exclude P&L impact of JD Finance, which is now reflected in a single line item for the discontinued operations
- The financial highlights that I'm about to discuss are results from continuing operations unless otherwise noted
- As this is also Q1 adjustments, I will also highlight a few metrics assuming JD Finance is still consolidated so you can have an apples-to-apples comparison

Net Revenue

- During Q2 2017, our net revenue from continuing operations grew 43.6%, well above the 33% to 37% company guidance excluding JD Finance
- This represents an accelerated growth rate from both our Q1 and 2016 Q2 y-over-y growth rates
- If we add back the impact from JD Finance, our revenue would have grown 45%
    - This strong growth was achieved through a highly successful June 18 anniversary sales season supported by robust growth momentum across our full category retail platform

Direct Sales

- Our direct sales revenues grew nearly 43% in Q2 led by home appliance, food and beverage, cosmetics, home furnishing and baby products
- Our revenues from services and others increased 52% year-on-year, the fastest growth rate in the past four quarters, supported by higher advertising and marketplace commission revenues
- If we add back the revenues from JD Finance, our total revenues from services and others would have grown 68%

GMV

- Our GMV grew 46% y-over-y in Q2
- Growth from JD Mall was 45%, the highest growth rate in GMV over the past four quarters
- Food and beverage, home furnishing, cosmetics, and baby products were the fastest-growing general merchandise categories, while key accounts from the top apparel and footwear merchants grew over 80%
- As disclosed in the earnings release, during Q2 we reclassified fulfillment expenses related to third-party logistics services into cost of revenues to better match such costs with the associated revenues

Gross Margin and Fulfillment Expense Ratio

- As a result, both gross margin and fulfillment expense ratio are retroactively adjusted and equally reduced by approximately 0.9% to 1.1% over the past six quarters
- Reflecting the effect from JD Finance deconsolidation and the third-party logistics service cost reclassification, non-GAAP gross profit increased 44%in Q2, slightly higher than our revenue growth as we reinvested part of our gross margin back to our consumers during the June 18 sales season

Non-GAAP Gross Margin

- Non-GAAP gross margin was 13.4%, up from 13.3% in Q2 2016
- Without the JD Finance spin-off and the logistics service cost reclassification, non-GAAP gross margin would have been over 15% compared to 14.6% in the same quarter last year

Non-GAAP Fulfillment Expense Ratio

- Non-GAAP fulfillment expense ratio was 6.7% in Q2, which improved 26BPS from 6.9% in Q2 last year as we continued to benefit from the operating leverage in our established logistics infrastructure, which was partially offset by our new investment in such areas as warehouse capacity for external customers and cold chain logistics network
- Our warehouse space increased over 22% in the past three months from 5.8mm square meters in Q1 to 7.1mm square meters in Q2

Non-GAAP Marketing Expense Ratio

- Non-GAAP marketing expense ratio was 4.0% in Q2, higher than the 3.3% in the same quarter last year, but in line with the level in Q4 last year when we ran our November 11 sales event with similar promotion intensity

Non-GAAP R&D and G&A Expense Ratio

- Our non-GAAP R&D and the G&A expense ratios decreased 5BPS and 12BPS respectively compared to the same quarter last year, which reflect the operating leverage in spite of our heavy investment in logistics technologies and R&D talent
- The non-GAAP operating margin decreased 18BPS to 0.6% in Q2, compared to a non-GAAP operating margin of 0.8% in the same quarter last year
  - However, if we compare our JD Mall non-GAAP operating margin with Q4 last year, excluding the effect from new businesses, we actually did slightly better in Q2 on the core operating margin

Non-GAAP Net Income

- Our non-GAAP net income from continuing operations attributable to ordinary shareholders was RMB 977mm, with an increase of 59% on a year-on-year basis, despite our heavy investment this year

FCF

- Our FCF was exceptionally strong during the quarter, mainly benefiting from our non-GAAP earnings and our ability to improve our working capital on both inventory turnover and the payable turnover days, the latter of which benefited from our annual supplier contract negotiation which completed and took effect in Q2
- We're pleased to see some solid improvement in the payment terms due to our scale economies, yet our payable days continued to remain meaningfully shorter than our key domestic and international retail peers

CapEx

- For the trailing 12 months ended June 30, 2017, FCF totaled RMB 29B or $4.3B, up 214% from the previous trailing 12 months

- Many of you may not realize, but this is roughly $3 per ADS
- Although we continue to expect our CapEx to significantly increase in H2, given the remarkable FCF in the first six months, we are confident that our FCF for the full year 2017 will remain strong, which is at least another key metric if not the more relevant one to demonstrate the value of our business model

Cash Balance

- I would also like to mention that June 30's cash balance on our balance sheet has not included the majority of the proceeds from JD Finance reorganization, as most of the proceeds are deposited in an escrow account as disclosed in earnings release
- Once we complete the standard sales procedures, the cash proceeds will be reflected in the investing activities on a cash flow statement in the future quarters
- I encourage our investors to read this earnings release carefully to capture the various changes in our financial statement presentation and the details of our [ph] deconsolidation (09:47) transaction
  - We've tried our best to disclose as much information as possible

Outlook

Net Revenue Growth

- Now let's discuss our financial outlook
- We expect Q3 net revenue growth to be between 36% and 40% on a y-over-y basis, excluding any impact on JD Finance for both current and prior year periods
  - This is a strong growth rate for a seasonally slow quarter, especially in light of the increased seasonality pattern that we have observed in Q2 and Q4 sales seasons

Non-GAAP Net Margin

- In addition, I'm pleased to raise our 2017 full year non-GAAP net margin by 50BPS to between 0.5% and 1.5% to reflect the underlying strength of our core operating [ph] earnings while assuming we retain the (10:40) full flexibility to reinvest
- We remain committed to investing heavily in our digital infrastructure and R&D talent, extending our leadership as the largest retailer in China and creating the best experience for our customers, which in turn will create a long-term value for our shareholders

QUESTION AND ANSWER SECTION

<Q - Eddie Leung>: I noticed that the GMV per order continuing to improve, so just wondering you could share a little bit more on the underlying drivers of this trend and did the trends applies to both 1P pieces and 3P pieces sales to both electronics and general merchandise. Thanks.

<A - Sidney Huang>: .Sure, Eddie. Yes, you're right that the average order size as well as average purchase size per customer has been steadily increasing. This is actually by no surprise as we continue to grow our user base and at the same time more and more of our existing customers are buying more. So in a time of faster new user acquisition, the average ARPU will remain relatively stable, but as we continue to grow with the new customer adds becoming a smaller portion of your overall customer base, then your average revenue per customer will naturally increase and this increase applies to all categories and both for 1P and 3P.

<Q - Alicia Yap>: My question is related to your international partnership for example on Walmart, with your expanded cooperations with Walmart, can you share with us what kind of likely GMV or revenue upside that we could see, for example from the inventory integrations and also the availability of the Walmart SKU selections now on the JD platform? And then separately on these, for Walmart, any potential conflicts between the JD-Walmart vs. the Walmart and the Daojia O2O offering? Thank you.

<A - Sidney Huang>: Sure. For Walmart, we conducted a very successful August 8th joint promotion, we achieved remarkable sales results. I think it was more than 10 times of the average volume in the latest month, but more importantly, also the order size increased more than 100% on that day. Our Walmart collaboration with Dada also increased more than 200% during that day. So, we had a lot of great results coming out of the latest promotion, which is just one example of our intense collaboration.

Now, because the new Walmart flagship store was just launched during Q2, so the actual contribution to our overall GMV or revenue is still very, very small. But the growth rate has been very, very encouraging. And also your question on Dada, there's no conflict at all, in fact we have seen very, very robust growth, not only on the number of stores connected to our Jingdong Daojia mobile app. But also, the average store sales through Dada has been growing at a really, really fast pace. So, we're very, very pleased to see the development on both JD side and also Dada side.

<Q - Alan Hellawell>: Just with regard to the gross margin we're obviously internalizing the reclassification of fulfillment expenses and then understanding the JD Finance deconsolidation. I think we flagged that 1P gross margin due to potentially – particularly intensive promotions and rebating in Q2 may not continuously trend upward. And that, however, linked with what is the very encouraging lift in net margin guidance just leads me to wonder how should we think about gross margins as we kind of move our way through these reclassifications as we move into the third and fourth quarters of the year? Thank you.

<A - Sidney Huang>: Sure, Alan. As we mentioned on our last earnings call and also previous earnings calls that we do expect our overall core operating margin to continue to improve on an annual basis from now on. So you will see meaningful improvement on an annual basis for sure. So this is why we are raising our guidance this quarter. Coming back to Q2, you mentioned about first-party gross margin, what we had mentioned also in the previous quarters that Q1 overall margin was exceeded – has exceeded our expectations and we had a full intention to reinvest that excess return – our excess margin back to our consumers through more promotions and return value to our customers.

So, we did exactly that in Q2, and you saw from our results that our top line growth was very robust and exact – that's what exactly what we had hoped. So, with our preset of internal budget for our bottom line improvement, we'll reinvest the excess to maximize top line growth, that has been our strategy and that has not changed.

<Q - Eric J. Sheridan>: I would love to get a little more detail about the partnership with Baidu artificial intelligence, which you think might do for the platform medium to long-term with respect to the deployment of big data, and how that might inform the shopping experience? Thanks, Sidney.

<A - Richard Qiangdong Liu>: [Foreign Language] (18:28-19:25)

<A - Sidney Huang>: So, Richard was saying that after we had the partnership with Tencent [indiscernible] (19:31) client, we had partnered with [ph] Total (19:36), which has tremendous traffic on mobile internet as we announced before. And we also just partnered with Baidu. And we, in fact, expecting another major collaboration in the near future. So, with the four strategic collaboration, with probably the four most – the highest classic entry points on mobile Internet, we expect 100% penetration to Chinese consumers or 100% reach to all the consumers in China.

Now, having said that, these collaborations are still, especially with Baidu and [ph] Total (20:22) are still in the early stage. We do have a lot to work with together with our partners. So, in the near-term, you may not see a very meaningful G&A contribution, but we are very confident with the broader reach to the Chinese consumers. We will have very meaningful results.

<A - Richard Qiangdong Liu>: [Foreign Language] (20:43-21:29)

<A - Sidney Huang>: So, every quarter, for example, even with Tencent, we have continued to improve the quality of our data collaboration through a lot of closer partnership and also artificial intelligence technologies. In that process, improved the ROI, the quality of advertising results. So, we are also expecting to launch our JD Tencent 2.0 program, part of the [indiscernible] (22:06). And so, we can expect even better results for both data analytics and advertising results for both our brands and also for our companies to achieve better ROI.

<Q - Grace Chen>: My first question is about Q3 guidance. We noticed that on a y-over-y basis, Q3 sales guidance still represent very strong growth. On sequential basis, the midpoint – well, the sequential basis Q3 sales guidance implies is now probably around 10% to 12% Q-o-Q. This compare was 4% to 6% sequential decline in the past few quarters. I'm wondering whether this represent a new norm in the future, given the more aggressive promotion in Q2?

Also, my second question is about the marketing dollars that we saw that in marketing expenses sequential revenue increase a bit. And can you tell us what are the key product categories that we are focusing on in the past quarter? Thank you.

<A - Sidney Huang>: Sure. Yes, on Q3 sequential, it's actually the flip side of Q2 sequential growth. So, I did mention on our earnings call – on my remarks earlier that we have observed increased seasonality patterns over the past couple of years where Q2 and Q4 grow faster on top of a very strong previous sale season. And then as a result, the sequential movement will also see a slightly larger kind of holdback. So, this is all – it is becoming a new normal for sure.

On the marketing dollars, I mentioned that even though it's 0.7% higher than previous Q2, in fact, if we use the same intensity, we will probably have been GAAP profitable, but it is, however, consistent with our Q4, last year's intensity of promotion. That marketing dollar is mostly actually spent on incentives to our customers, namely, for the marketplace business, because there's no direct sales revenue against the marketplace sales volume. So, any promotion incentives will go into the marketing dollars and, obviously, other marketing activities during sales season. So, it's actually quite consistent. We see a lot of similarities with Q4 last year, both in terms of gross margin, operating margin, and also, other expense lines, if you take a closer look.

<Q - Ronald Keung>: Just want to ask about your apparel strategies. Could you share some of the initial, I think, its targets – or some targets that you've set with Farfetch through your investment, and whether you would focus more on growing the apparel segment through organic, or is open to any acquisitions to grow the apparel segment further? Thank you.

<A - Richard Qiangdong Liu>: [Foreign Language] (26:03-26:33)

<A - Sidney Huang>: Yeah. So, investment in Farfetch is really part of our effort to – for further demand of Chinese consumers for luxury products. In fact, we are also preparing for our own luxury platform to be launched later this year.

<A - Richard Qiangdong Liu>: [Foreign Language] (25:56-27:26)

<A - Sidney Huang>: So, you may wonder, we have two platforms, would they be competitive or have any conflict? We believe there won't be, because Farfetch, the specialty for Farfetch is they have collected a huge number of boutique stores around the world. And the product selections under Farfetch merchant are quite unique. And we have observed that vast majority of those selections not available in China. And for JD, our own client luxury platform will be focused on luxury products available through the official channels in China, of those, basically, the Chinese subsidiaries of the global luxury brands.

We believe we would acquire both approaches, both means of – both types of selections to meet the rising demand of Chinese consumers for luxury brands.

Yeah. So, if we see more similar opportunities, high-quality platforms like Farfetch, we clearly don't rule out the possibility of other investments.

Yeah. So obviously, we will continue to pay more attention to our own apparel and footwear business. This is one area, as we mentioned previously, we were trying to make some adjustments since last year to eliminate the [ph] brushing

(30:29) activities. This happened to be the area, the category where [ph] brushing (30:36) activities are more prevalent throughout the China.

So we continue to enhance our technologies to detect these kind of activities. And at the same time, our focus this year is to the key accounts, as I mentioned earlier, and make sure that they are successful on JD's platform and using those key accounts to bring better and better – to facilitate the growth for medium and smaller merchants on our platform. If we don't focus on the key accounts, we think, the current traffic may not support the entire merchant base especially for this particular category. So this is our strategy, but we have seen very, very positive results out of our key accounts growth rate and which in turn is bringing more traffic to us for the mid-sized merchants as well.

Right. And one side benefit of integration effort is actually benefiting the key accounts and major brands, because major brands do not conduct those activities, so as the smaller merchants' traffic and activities reduce, the major accounts will actually benefit from enhanced exposure.

So, in sum, our apparel category has now reached a very healthy state, which is what we had hoped and worked for. So, we are expecting a very healthy growth trajectory from now on.

<Q - Chi Tsang>: I was wondering if you could comment on what type of data you might share with your 3P merchants to enable them to drive higher conversion on your marketplace? In particular, what type of customer segmentation and targeting can you offer? Thank you.

<A - Sidney Huang>: Yeah. So we mentioned before that we have been improving the data analytic tools for our merchants. So, in this area, because we are relatively younger in the marketplace business, but over the years, we have collected and developed many, many very useful tools for our merchants. And this year, you will see more and more of those products being introduced to our merchants especially key accounts. And so, we're making very good progress.

<Q - Jin-Kyu Yoon>: Sidney, did I hear you correctly, the JD Finance impact was about 200BPS or gross margin a little bit over 15% if that was included? So, should that be the same impact on H2, or is there certain seasonality regarding the impact of JD Finance? Thanks guys.

<A - Sidney Huang>: Yeah, no problem. The impact is from two elements, right. One is JD Finance and the other is the reclassification of third-party logistics service cost, which was grouped in fulfillment expenses. And for that line item, it's roughly 1% as we actually previously always mentioned. So, this time, we actually did a lot of detailed work to allocate in a more methodical way, so that we can re-class them back into the cost. So, that has a roughly more or less 1 percentage point impact, and then the remaining from JD Finance, which is – should be around 60BPS, 70BPS.

<Q - Zoe Zhao>: We see very strong cash flow this quarter, but since we still carry like [indiscernible] (35:43) receivables and related non-recourse securitization debt on your balance sheet, could you elaborate the cash flow impact in this quarter from the deconsolidation from JD Finance? Thanks.

<A - Sidney Huang>: Sure. Yeah, the deconsolidation itself doesn't result in any operating cash flow for continuing operations, nor any impact on FCF. So, all the FCF we discussed are from continuing operations. The JD Baitiao balance remaining on balance sheet, we actually had a footnote underneath the balance sheet explaining that there are really two very technical elements that prevented us from deconsolidating JD Baitiao. One is essentially the legal permit. Right now, we have – the JD more has the permit. And then two is there's some technical aspect for securitization, which actually could potentially be resolved in the future quarters.

So, in any event, as JD Finance is positioned as a finance technology company, so we expect future additional volume or more and more actually coming from our banking partners, rather than from our own balance sheet. And also, this is true – has been true even before spin-off. All the economies, basically all the rewards and the risks have been passed to JD Finance. So, even though we continue to carry JD Baitiao and the securitization on our balance sheet or the economic benefit and the costs will no longer and has not been part of the JD P&L.

<Q - John Choi>: I have a question on your FCF right now, because if you look at your FCF on the past trailing 12 months, it's been very strong. But it seems to me as you've mentioned in your earlier early remarks that the CapEx should be more or less towards H2 this year, but at the same time, Sidney, you mentioned that your cash flow should remain pretty strong. So, can you elaborate a bit more about how should we think about the CapEx and also the overall operating cash flow towards H2 this year?

And also just quickly on the key categories. I've noticed that apparel, cosmetics have done extremely well, the past couple of quarters. What could the management do further in order to further enhance these categories? Do you have to invest more, or do you have to also think about strategic investments in other companies? Thank you.

<A - Sidney Huang>: Sure. So, on FCF, as I mentioned, it's also partly, because we had our annual contract renewal in Q2. So, much of the new payment terms begin effective in Q2, which benefited our payment turnover days. And also our inventory turnover days was well under control. Again, in fact, with our increasing scale, the average payment, even on a trailing four quarter basis, you saw a decline in inventory turnover days. If you look at it just one quarter the improvement was even more notable. So, it's really a very remarkable quarter.

And when I said earlier about full year 2017, as I commented before, when you look at cash flow you should look at on the trailing 12-months or trailing four quarter basis, because there will be volatilities between and among the quarters. So, I was referring to full year 2017. Obviously, we'll benefit from our Q2 FCF.

CapEx as we mentioned before, we will see more spending in H2, but once again, when we actually incur those, we believe investors should be thankful, because normally, we will get very, very good deals from the government, because we are creating jobs for this local municipality when we acquire land in their jurisdiction. And so, normally, come with those land acquisition, we'll get a lot of benefit, not only very cheap land price, but also a lot of other government support locally.

One example for our logistics headquarters in Xi'an, the government actually gave us one office building. So, it's just one example when we actually start securing those local partnership, you will see a lot of benefit to our shareholders.

<Q - Alex Yao>: I have two quick ones. One is on the revenue side, you guys have been showing a lot of the trends in the past few quarters, and the revenue accelerated in this quarter. Can you help us to understand what are the key drivers for the strength of the revenue growth, and how sustainable can we think of the top line trends? Apparently, there are a number of things you guys are benefiting from, such as the structural migration from offline transaction to online, the expansion of [indiscernible] (42:01) into FMCG and low base last year, et cetera, et cetera. In terms of the importance to the top line, what are the key drivers, the underlying reason?

And then, secondly, can you give us updated thoughts in terms of how are you approaching the offline opportunities? Apparently you guys are doing a number of new initiatives this year, including building the convenience through network. Actually, I think, that there are also a number of other things you guys are currently exploring. Can you give us updated thoughts in terms of how you approach this offline opportunity? Thank you.

<A - Sidney Huang>: Sure, so based on the first question, I think, sales growth has always driven fundamentally by better customer experience. Over the years, we continue to improve that, and the growth is really an outcome. I think, in the end, it's all about continuously improving customer experience. And part of that is benefiting from our scale of economies. As we mentioned in the past that we wish to scale economies, we can continue to be able to offer everyday low price and very, very attractive promotions and incentives to continue to attract the new customers and also reward our existing customers. So, there is really no to other metrics, because sales growth coming from all categories. It's not about any particular category, not about any kind of unique events impacting any of the particular categories. So, that's why we continue to be quite optimistic for our future growth.

For the offline opportunities, I think we talked about – we are in fact the pioneer in our auto initiative in China, starting from Jingdong Daojia initiative by connecting offline supermarkets to location-based mobile apps. So, we have seen very, very encouraging growth, in fact, there has been – we start to see some deflection point in that business, as volume continue to improve in a very dramatic way. And the same-store sales for Walmart and the Yonghui, for example, and Dada has been growing at a exponential kind of way. So that's one – the first initiative and continue to gain traction.

The other areas as Richard actually on the last earnings call, we essentially leverage our existing capabilities, whether it's from our supply chain or from our user reach to create really more customer interface. One, in addition to Jingdong Daojia, for example, we had in the past, we are introducing JD Home concept stores, which specialize in selling electronic products. And comparing to, for example, Apple Store, which is a single brand concept store, and we have the benefit of having multiple brands, having their best products in those very, very chic showrooms. So, we have received some very, very good initial success in those initiatives, but all of those initiatives are franchise-based. They are asset-light. It will not cost a lot of heavy investment.

<**Q - Natalie Wu**>: For the payment-related costs, given that JD Finance already deconsolidated, so just wondering which line would the segment-related fee go, cost or expenses? And if [ph] Angela (46:36) could share with us the gross profit margin for direct sales in second quarter 2017 apple-to-apple basis, that will be great. Thank you.

<**A - Sidney Huang**>: Yeah. On the payment related cost, part of the fulfillment expenses. So, they have always been in that line with the deconsolidation, you are right. So, whatever we pay to JD Finance will be reflected in the fulfillment expenses, whilst historically, that amount will be eliminated at a consolidation.

For the gross margin, as I mentioned, we don't necessarily look at quarter-by-quarter, especially given that Q1, we well exceeded our internal budget. So, clearly, we had mentioned and we, in fact, reinvested during Q2. So, I think, it may be better to look at a trailing 12-month basis, just like the cash flow going forward. We are committed to steadily improving all of our core margins on an annual basis or on a trailing 12-month basis.

<**Q - Jialong Shi**>: Hi. [Foreign Language] (48:02-48:49) I would like to ask Richard for his colors on the private label e-commerce like what [indiscernible] (48:54) is doing. I just wanted how Richard think of the outlook and potential of this private label e-commerce service. Will JD has any plans to enter this niche market in the future? Thanks.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (49:07-49:49)

<**A - Sidney Huang**>: Yeah. So Richard said, the [indiscernible] (49:53) model is actually quite interesting, and it's a good model. But for JD, because we are a full category retailer supporting numerous brands, so our priority is continue to support our brand partners in the foreseeable future. However, we are experimenting in a smaller way in for quite a few categories of our own private label products.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (50:31-50:44)

<**A - Sidney Huang**>: Yeah. So, in comparison to a full category retailer like JD.com, despite how successful it could be for private label business, it will remain at the very small part of overall business volume.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (51:02-51:17)

<**A - Sidney Huang**>: But we'll continue to explore private label initiatives. So, over a longer-term period, we expect it could become somewhat meaningful part of our business.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (51:33-52:16)

<**A - Sidney Huang**>: So, for the strategic collaboration with Baidu, because it's strategic and comprehensive collaboration, so there will be many, many areas of collaboration with different types of collaboration models. So, with those model, they will have different fees or revenue in terms of whether it's a CPS or a CPC. But in the end, we believe the collaboration can significantly improve the ROI and also enhance the traffic in our user base.

Yeah. So, we believe it's a win-win partnership for both of us, where Baidu can expect [indiscernible] (53:17) increasing advertising revenue, and we can expect a much higher quality of advertising spending and ROI.

<**Q - Tianli Wen**>: Question on the logistics side. I noticed that we had launched two initiatives on the logistic area. And one of those initiatives is the collaboration with SF Express, regarding the use of pickup cabinet [Foreign Language] (53:54) I just want to know how the reception of our customers towards picking up their deliveries on the cabinets and since I noticed that we also have a own pickup station [indiscernible] (54:05) I want to ask what is our view towards the pickup and its future in the delivery industry? And lastly if I can clarify if JD Logistics reduced our

margin by 1% and the fulfillment cost reclassified is RMB 2.6B, what is the revenue size of JD Logistics under this calculation and is the loss mainly G&A or marketing? Thanks.

<A - Sidney Huang>: Sure. Yeah. So for our collaboration on the [indiscernible] (54:37) self pickup cabinets, we actually had our own small network as well. So this is nothing new. We actually call our customers before we put any of the packages into those self-pickup cabinets. And so it's only at the permission of our customers that we will do that.

Increasingly, we see especially for our working professionals that they may not be at home during the working hours or they could be stay out fairly late. So, there is a demand for consumers for those type of job of services. This is also very similar for our own self-pickup locations.

So, again these are all based on consent from our customers, before we will actually put their products, drop off their parcels in those locations. And we do think this is potentially one interesting last-mile alternative. It also help save cost, because it will clearly improve the efficiency of our delivery men, but again, this will be based on the consent, prior consent for our customers on a case-by-case basis.

For logistic revenue, we had mentioned in the past we have been running our third-party logistic services on a more or less breakeven basis. So, obviously, this is not 100% flat based on the cost, there will be potentially some volatility among different quarters. But all together, it should be quite close to a breakeven basis.

<Q - Ella Ji>: [Indiscernible] (56:49-56:54).

<A - Sidney Huang>: Sorry. I don't think we can hear you.

<Q - Ella Ji>: Hello?

<A - Sidney Huang>: Hello.

<Q - Ella Ji>: Hello. Can you hear me now?

<A - Sidney Huang>: Yes.

<Q - Ella Ji>: Okay. So my first, I have – first I have a quick follow-up regarding the sales and the marketing spending, so, Sidney you mentioned about the current quarter spending, the pattern is similar to Q4 last quarter, however, that was comparing to Q2 last year, it was an acceleration. So I wonder looking forward given that the current market competition is still strong, should we expect Q4 this year the sales and marketing spending will likely be even higher than Q2 level?

Then my second question is overall this year in so far the online retail sales, the market has been very strong, especially in certain categories including home appliance. I wonder if management can share your insights, what do you think are the drivers that help driving up the whole online market acceleration? Thank you.

<A - Sidney Huang>: Sure. So I think on the first one we invest and run our business based on our own business fundamentals. So if you look at when we continue to improve our underlying strength of the core business, we do have more and more resources to reinvest and give back to our consumers. So as I mentioned Q4 – obviously Q4, we also had a very, very robust quarter of growth and so the additional investment in sales and marketing provided very good ROI and similarly for Q2 as well. So I think we will also formulate a strategy in H2. But this is not necessarily in reaction to any competition. I think we first and foremost is to really follow our own business logic in running our business.

On the overall acceleration of online sales, I think it does reflect again, I think it is similar to my earlier comments about retail business in the end is about customer experience. So I think overall the online retail and e-commerce market, all players have been obviously providing very, very good value proposition to our consumers in China. I think this is fundamentally what's driving the accelerated growth.

Obviously the healthy economic environment is also helpful. Overall retail consumption volume has also been quite stable, driven by the fundamentals we had mentioned before about stable employment rate, rising salary and also the high savings rate among the consumers.

<**Q - Wendy Huang**>: [Foreign Language] (01:00:52-01:01:58).

I have two questions. The first question is about your logistic business. Can you give us some update about the percentage of your third-party merchants using your warehouse and the fulfillment? And also with the reorganization of your logistic business are you also opening it to any third-party platform merchant such as travel merchants?

Second question is about your collaboration with three internet companies, Tencent, Daojia and Baidu. Given the high user base of those companies and also the overlap of their user base are you actually seeing any difference in terms of the users or the shopping behaviors that you can actually acquire through their channels? Thank you.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:02:43-01:03:40)

<**A - Sidney Huang**>: Right, so the reason we open up our logistic platform capabilities is to really as a result of seeing tremendous demand from the brands for logistics services. So JD happened to have built a very strong logistic network, not only the small, medium-sized products, but also big large appliance products, cold chain logistics and also O2O crowdsourcing logistics. So we can – we're best equipped to fulfill these needs.

We have seen for example apparel brands requiring services to ship their products to various store locations and also their official stores requiring logistic services to serve their consumers and also O2O initiatives where consumers place orders and their stores can help fulfill. So, there will be a lot of demand in all channels for our services.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:04:56-01:05:11)

<**A - Sidney Huang**>: Yeah. So, in the past, the brands, because of these different requirements, we'll have to contract very different types of logistics service providers, but because JD has all of these services available or capabilities available, so we can offer a one-stop solution to these brands.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:05:33-01:05:54)

<**A - Sidney Huang**>: So, although we only open our services in two months, we can – we have already seen a lot of big brands approaching us and – or using our services. So, we are pretty confident even just for the first year, we can probably achieve RMB 600mm of revenue.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:06:20-01:06:56)

<**A - Sidney Huang**>: Yeah. And we will expect over 100% growth next year, and also decent profitability for this business. But more importantly we will – in addition to the traditional services where we can offer one-stop solution, but we can also utilize our big data to help these customers to enhance the efficiency of their supply chain. And when that objective is accomplished there will be huge win-win opportunities for both of us.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:07:32-01:07:44)

<**A - Sidney Huang**>: And this kind of big data analytic capabilities is not currently available with existing logistics service providers. So, we are very, very uniquely positioned to take advantage of this demand and for this reason, we believe our business could be very, very profitable over the long term.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:08:11-01:08:29)

<**A - Sidney Huang**>: Yeah, so for the differences between those different platforms with Tencent or Baidu. Even though Tencent has this huge amount of number of customers, because different mobile internet destinations have different value propositions. So customers going to different sites for different purposes and using their different products. So for that reason, we continue to see very different insight when working with different partners.

<**A - Richard Qiangdong Liu**>: [Foreign Language] (01:09:07-01:09:36)

<A - Sidney Huang>: Yeah. So we hope in the end our advertising products can be available in all different channels, not only in WeChat, but also in search engines and in the media and the streaming video streaming products and also – and games, yes.

<A - Richard Qiangdong Liu>: [Foreign Language] (01:10:06-01:10:12)

<A - Sidney Huang>: Yeah. And also cyber safety products for example.

<A - Richard Qiangdong Liu>: [Foreign Language] (01:10:21-01:10:32)

<A - Sidney Huang>: Yeah. So, we believe with those multiple channels of collaboration, we can optimize the – our advertising quarterly ROI and creating win-win solutions for everyone.

<A - Richard Qiangdong Liu>: [Foreign Language] (01:10:52-01:11:02)

<A - Sidney Huang>: Yeah. So, after we collect the user behavior in all these different channels, we can also better analyze and utilize those data to better target these customers.