

## Q3 2018 Earnings Call

### Company Participants

- Jon Liao, Chief Strategy Officer
- Lei Xu, Chief Marketing Officer, JD Mall
- Richard Liu, Chairman and Chief Executive Officer
- Ruiyu Li, Senior Director of Investor Relations
- Sidney Huang, Chief Financial Officer

### Other Participants

- Alex Yao, Analyst
- Alicia Yap, Analyst
- Binnie Wong, Analyst
- Eddie Leung, Analyst
- Hans Chung, Analyst
- James Lee, Analyst
- Jerry Liu, Analyst
- Jialong Shi, Analyst
- Jin Yoon, Analyst
- Natalie Wu, Analyst
- Ronald Keung, Analyst
- Suzanna Chuie, Analyst
- Thomas Chong, Analyst
- Tian Hou, Analyst
- Wendy Huang, Analyst

### Presentation

#### Operator

Hello, and thank you for standing by for JD.com's Third Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference is being recorded. If you have any objections, you may disconnect at this time.

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

**Ruiyu Li** {BIO 19135837 <GO>}

Thank you operator and welcome to our Q3 2018 earnings call. Joining me today on the call are Richard Liu, our CEO; Lei Xu, our CMO and CEO of JD Mall; Sidney Huang, CFO; and Jon Liao, our Chief Strategy Officer. For today's agenda, Mr. Huang will discuss highlights for the third quarter 2018. Other management will join the Q&A session.

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

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

### **Sidney Huang** {BIO 20098238 <GO>}

Thank you Li, and hello, everyone. Thank you for joining us today. We are pleased to report healthy development in major financial metrics in the third quarter. Our core e-commerce business continued its solid performance on both the top line and bottom line. Our new businesses (technical difficulty) encouraging progress.

Net revenues in the third quarter grew a decent 25.1% year-on-year, in spite of slowing consumption affecting the large ticket electronics and appliances categories. General merchandise revenues continued strong momentum with over 40% year-over-year growth during the quarter. Also notable is our fulfilled GMV, which grew over 30% in the third quarter, supported by better long-tail product performance as a result of our focus on improving marketplace operations since last year. Our fulfilled marketplace GMV grew over 40% across both electronics and general merchandise categories, as we welcomed more than 20,000 merchants to our marketplace platform this quarter.

Existing merchants also enjoyed our improving ecosystem with both top-tier and the mid-tier merchants seeing re-accelerated growth on same-store sales in the quarter. We are pleased to see JD.com remain one of the most attractive platforms for merchants in China to engage with end customers. In addition, net service revenues grew 49% year-on-year and contributed more than 10% of our total quarterly net revenues for the first time, supported by strong growth in advertising and JD Logistics third-party services.

Gross margin was relatively stable year-over-year, thanks to the gross margin expansion from the core JD Mall business, offset by JD Logistics, which is in an investment phase, but has seen sequential improvement in unit economics over the past three quarters. Non-GAAP gross margin in the third quarter was 15.2% compared to 15.3% in the same quarter last year. If we look at JD Mall, gross margin on our direct sales business improved 15 basis points on a year-over-year basis on top of a very strong third quarter last year, driven by continuous increase in economies of scale across all key categories.

During the third quarter, we continued to invest in R&D and technology infrastructure. Our R&D expenses totaled RMB3.4 billion or 3.3% of total revenues, up approximately 120

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basis points on the same quarter last year. For the first nine months of 2018, R&D expenses increased 88% to a total of RMB8.6 billion. We believe these investments are critical to position ourselves for the next phase of growth. With the key leaders and the various teams now in place, we expect R&D expense ratio to begin to stabilize going forward. Our fulfillment expense ratio improved 20 basis points in the third quarter, driven by better unit economics. Our marketing expenses ratio and G&A expense ratio was 3.9% (ph) and 1.3% respectively, comparable to the same quarter of last year.

Non-GAAP operating margin was 0.6% in the third quarter compared to 1.8% last year, with the difference mostly attributable to the higher R&D expenses. Non-GAAP operating margin for JD Mall was 2.2%, 0.1% lower than the same period last year. For the first nine months of 2018, non-GAAP operating margin of JD Mall was 1.7%, comparable to the level in the same period last year, thanks to continued improvement on our core e-commerce gross margin, offset by higher R&D expenses at JD Mall.

Our operating cash flow remained positive after the seasonally high second quarter, while free cash flow was negative due to high CapEx during the quarter, including RMB3.6 billion in land use rights and construction of warehouses; and RMB5 billion in IT infrastructure. As of September 30, 2018, our cash position remained strong with cash and short-term liquid investments totaling RMB42.9 billion. In addition, as we communicated last quarter, we're in the process of transferring some of our logistics real estate assets into a co-fund, which should help unlock the hidden value of these assets and further strengthen our cash position.

Now let's discuss our financial outlook. We expect the Q4 2018 net revenue growth to be between 18% and 23% on a year-over-year basis. Our Q4 guidance reflects relatively soft retail sales in certain durable goods categories, as indicated in the latest National Bureau of Statistics report. Despite slowing retail sales, according to the NBS data, we are encouraged by the Double 11 promotion season when most categories showed above the industry growth rates based on our brand partners feedbacks and third-party industry reports. And our marketplace continued to grow faster during the promotion season.

This concludes my prepared remarks. We'll now take your questions.

## Questions And Answers

### Operator

(Operator Instructions) The first question is from the line of Eddie Leung from Merrill Lynch. Please go ahead.

### Q - Eddie Leung {BIO 15234642 <GO>}

Hi, good evening. Could you comment on the macro environment, especially in the retail space, and how does it affect your monetization strategy as far as your logistic expansion planned? And then just a follow-up question on the increase in R&D investment. Could you talk a little bit about how various projects have helped your business in the past couple of quarters, any examples and use cases that would be great? Thank you.

**A - Sidney Huang** {BIO 20098238 <GO>}

Okay. So I will start and others may contribute later. So on the macro, I mentioned that we did see some impact on durable goods categories and -- but during our latest promotion season we actually saw JD continue to lead the industry growth when we checked with our brand partners. But there seems to be some impact on the big ticket size items, while for general merchandise categories we continue to see very healthy growth rate. And in terms of impact, because we are a mass market retailer, our scale gives us unique pricing competitive advantage. So even in an economically slowing time, we do believe our value proposition with quality products, everyday low price, and better services will continue to win customers. So we do not see any major impact on our overall profitability trend moving into next year.

Now on the logistics investments, the type of customer experience that this service can provide is clearly showing the JD unique advantage, not only on our first-party business, but as I mentioned earlier, our marketplace business has expanded faster and a part of that growth is from our logistics services that are increasingly utilized by our top merchants.

**A - Jon Liao** {BIO 18782053 <GO>}

Just (inaudible). In terms of -- talking about investment, of course, we continue to invest in retail innovation in terms of social commerce and common commerce. I think this would be -- the next point here, of (inaudible) for JD, but additionally we are mainly looking to (inaudible) logistic and smart assumption in terms of a push in from here of efficiency and cost and the customer experience as well.

**Q - Eddie Leung** {BIO 15234642 <GO>}

Understood, thank you.

**Operator**

Thank you for the questions. Next question comes from the line of Alicia Yap from Citi. Please go ahead.

**Q - Alicia Yap** {BIO 15274658 <GO>}

Hi, good evening management. Thanks for taking my questions. I have questions on the JD initiative on this Retail as a Service and overall JD positioning. So could you help us understand a bit more about this Zu Chongzhi platform, which industry vertical will that specifically target? How is that service, JD's offering different from the service provider by the bigger peer? And related to that, I appreciate if management could also help us redefine JD positioning. Will JD continue to sign up global brands on your platform and since that JD is moving away from the local brands and put more focus on servicing the international brand, so any change of JD visions of being the retailer, or is it JD a shifting focus to become more a service provider? Thank you.

**A - Jon Liao** {BIO 18782053 <GO>}

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Yeah, let me explain the Retail as a Service concept. First, as I mentioned in my previous earnings call, we define the official retail as the (inaudible) retail, which means the retail industry would become even more recommended and decentralized than ever before. So in this case, JD is moving away from a vertically integrated model to more open model. So in other words, in the past, the main reason why JD has become so successful is because we provide end-to-end solutions for retailers. So we have JD Mall, we have JD Logistic and so on and so forth. So moving forward, we have to open up our retail infrastructure to a couple of value chain. So in other words, we wanted to provide our retail and logistic service to the other retailers as well. Meaning, if we look at the -- a lot of retail innovations, from common commerce, social commerce, so on and so forth. It's inconceivable for those retail innovators to develop those heavy assets and network-based retail infrastructure. So in this case, JD really wanted to open up a retail infrastructure to enable and empower more retail innovation. So this is how we define Retail as a Service, which basically consists of two components. Number one, of course, JD will continue to focus on retail innovation, that's our main focus. At the same time, we'll open up our retail infrastructure like logistic, like our technology to connect and enable more retail innovation. So that's what we mean by Retail as a Service.

**Q - Alicia Yap** {BIO 15274658 <GO>}

Sorry, what about the positioning as a service provider versus the traditional retailer?

**A - Jon Liao** {BIO 18782053 <GO>}

Yeah, possibly, the retail infrastructure will become service providers for all the retailers. So we expect, as indicated on your revenue model, the services -- the revenue has grown significantly and it is a part of our Retail as a Service strategy.

**Q - Alicia Yap** {BIO 15274658 <GO>}

Okay, all right, thank you.

**Operator**

Thank you for the questions. Next question is from the line of Ronald Keung from Goldman Sachs. Please go ahead.

**Q - Ronald Keung** {BIO 15432736 <GO>}

Thank you. Thank you, Richard, Sidney (inaudible). We're pleasantly to see -- pleasant to see the 3P growth, the strong growth of 40%, which is above the industry growth over the quarter. Could you share like what categories have brought this -- has brought this healthy growth, particularly how did apparels perform during the quarter, and how does management see sort of 2019 for them and for your marketplace growth with the new e-commerce law coming up in the upcoming year? Thank you.

**A - Sidney Huang** {BIO 20098238 <GO>}

So we have seen actually growth, of course, multiple categories on our marketplace, mainly from long tail products and the long tail merchants. We added a fairly large

number of new merchants now with total over 200,000 merchants on our platform. Both our electronics categories and general merchandise categories saw growth rate over 40%. So it is really part of a result of our overall platform improvement. We are also pleased to see that the general merchandise GMV as a total of our overall fulfilled GMV now surpass the 50% mark during the third quarter, which is again a great validation that JD continues to become a full category platform that attracts the customers and the merchants across all the key categories.

## Operator

Thank you for the questions. Next question is from the line of Alex Yao from J.P.Morgan. Please go ahead.

### Q - Alex Yao {BIO 16818860 <GO>}

Good evening guys. Thank you for taking my question. Can you help us understand your top strategic focus for 2019, given the macro outlook, but emerging growth opportunities across offline, retail, logistics, et cetera, et cetera. Where will you be focusing on for 2019? And then related to that, how would you prioritize the financial resource allocation, i.e. in the macro consumption backdrop when your financial flexibility is relatively weaker? Would you continue to invest aggressively across the new initiatives, or these initiatives will slow down a little bit depending on the macro condition? Thank you.

### A - Sidney Huang {BIO 20098238 <GO>}

Our overall growth strategy has always been long-term driven. So we'll continue to invest for various long-term initiatives. However, after the last couple of years of investments, particularly for example in R&D areas, we have -- now have our key teams and the key leaders in place and some of our initiatives over the past two years are beginning to see some very positive results. So we will continue to invest for the future, while we will obviously put more discipline at the same time on our more developed, more growth (ph) business, so that there will be a very good balance in the future. We will always be mindful of the resources we have and strike a good balance of both long-term growth and the near-term financial results.

### A - Jon Liao {BIO 18782053 <GO>}

Yeah, I think we have to have a new growth mindset moving forward, in terms of the three different balances. Number one, a balance in the top line and the bottom line to make it more profitable. That's the first one. Number two, to balance core business, growth business and its future (ph) business, to make it more sustaining. Number three, to balance net profit, people and place to make it more sustainable. So I think that's a new way we define our growth mindset.

## Operator

Thank you for the questions. Next question comes from the line of Jerry Liu from UBS. Please go ahead.

**Q - Jerry Liu {BIO 17515547 <GO>}**

Thank you. Sydney and Jon, from your comments so far on this call, I'm hearing about logistics unit economics improving, R&D expense ratios stabilizing, no macro impacts on profitability trends, and just now talking about balancing top line and bottom line. So despite year-to-date net margins being lower this year than last year, I'm hearing a lot of things to suggest maybe net margins can stabilize or improve as we head into next year. Is that the right read? Thanks.

**A - Sidney Huang {BIO 20098238 <GO>}**

Sure. Yeah, we have maintained that on a long-term basis our margin should gradually improve. So this year, because of JD Logistics was in an investing year. So in my last earnings call, we mentioned that this year we will be more, making sure that JD Mall will maintain a stable margin trend with some upside. But if you look at from a couple more years, or from last year to next year, we do see the margin continue to gradually improve. Obviously, there will be some of the other new business lines, like I mentioned JD Logistics -- real estate business as part of the contribution as well. So overall, we do intend to have the full intention to grow the business, investing for the long term, while gradually improving the bottom line.

**Q - Jerry Liu {BIO 17515547 <GO>}**

Got you. Thank you.

**Operator**

Thank you for the questions. Next question is from the line of Thomas Chong from Credit Suisse. Please go ahead.

**Q - Thomas Chong {BIO 21155199 <GO>}**

Hi, thanks gentlemen for taking my questions. I have two questions. My first question is about the customer growth during the quarter. We are seeing negative sequential growth. Can management explain about the reason and how we should think about the trend going forward? And my second question is about our CapEx, how should we think about the CapEx in 2019 and 2020 as a percentage of revenue, if there is any? Thank you.

**A - Sidney Huang {BIO 20098238 <GO>}**

Yeah, I'll take the CapEx question first and Xu Lei will take on the user question. So, for CapEx, this is definitely a very heavy CapEx investment year, partly it's driven by our logistics warehousing buildout and partly it's because of our IT infrastructure. But both of which we hope we'll complete the heaviest investing phase this year and there should be somewhat of a moderating trend moving into next year.

**A - Lei Xu {BIO 21705778 <GO>}**

(Foreign Language) Let me take the question about users. (Foreign Language) As the economy slows down and in the light of JD.com having already more than 100 billion -- 300 billion users, I think at this particular stage we need to focus more on the quality of

growth, quality of users. (Foreign Language) As our logistics network penetrates into the lower tier cities, we have recently started to step up our marketing efforts towards those areas. (Foreign Language) And also we find that's very effective to attract new users, particularly lower tier users and female users through initiatives in the area of decentralized and non-open shelf models, like global buying, mini programs and Kepler and Stretcher.

(Foreign Language) Some categories enjoy ample room for growth offline, especially in lower tier cities. To capture this opportunity, we will integrate online with offline operations, come up with new product models and create new offline setting scenarios. (Foreign Language) In Russia, I'd like to add two more claims. One is that we find there are plenty of middle income and low income people in first and second-tier cities. We have extensive market penetration and brand awareness. So we will tap into that segment too. (Foreign Language). We will also work to boost our retention rate and ARPU, average revenue per user, by enhancing our cross-category penetration. The end.

## Operator

Thank you for the questions. We'll now go on to the next questions, from Grace Chen from Morgan Stanley. Please go ahead. Next question from Morgan Stanley, now is open, you may unmute locally. We will move on to our next questions from the line of Jin Yoon from New Street Research. Please go ahead.

## Q - Jin Yoon {BIO 16293072 <GO>}

Hey, guys, thanks for taking my question. Sydney, in your prepared remarks you talked about strength in advertising. Can you just talk about the drivers behind that in the quarter, any potential structural or meaningful changes you have seen in the recent quarter as well? Thanks.

## A - Lei Xu {BIO 21705778 <GO>}

(Foreign Language) Let me take the question. The continuous growth in our advertising income is mainly due to the optimization of our algorithm and the improvement in technology capacity. Our eCPM is a constant rise. (Foreign Language) Since JD is a retail business, includes both direct sales and marketplace platform. We will balance advertising income with user experience. Also in the utilization of traffic, we will try to strike a balance between retail sales and advertising monetization.

(Foreign Language) As our algorithm optimized, we have changed the composition of our advertising products, cutting down on CPD and jacking up RTV (ph). However our advertising income has still maintained very good growth momentum. We aim to get win-win situation with both ad monetization and merchant satisfaction.

## Operator

Thank you for the questions. I will now move on to the next question from James Lee from Mizuho Securities. Please go ahead.

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**Q - James Lee** {BIO 15949362 <GO>}

Thanks for taking my question. And this question is for Richard specifically. Maybe, can you help us understand how your role will be changed at the firm going forward, given that a new leadership team has been put in place and what is your key focus going forward and what business segment will you be focusing on personally? Thanks.

**A - Richard Liu** {BIO 17167866 <GO>}

(Foreign Language) As you correctly pointed out, the leadership team of JD has already been put in place and is doing a very steady good job. (Foreign Language) For me, personally, I will focus more on new businesses. For mature businesses, our team can handle that. (Foreign Language) Since some friends have raised a question about our growth strategy for next year, so I'd like to take this opportunity to say a few words about that. (Foreign Language) As we have just mentioned, our R&D expenditure for the first nine months, from January to September, experienced a growth of 88% (ph) year-on-year and that number actually has included Jingdong's (ph) R&D expenditure. (Foreign Language) We have started a lot of new R&D projects and also we encourage competition across -- among different R&D teams, for example, our store-based technology, we encourage them to compete. (Foreign Language) In the past year, we've tried out in many ways and now, actually, we can see the future, see the direction very clearly. So, we are now deploying our teams to the right R&D projects, to the right direction. (Foreign Language) So, from next year, the total amount of R&D expenditure might not increase, will not grow. (Foreign Language) At the same time, the net profitability of JD Logistics will boost a lot. (Foreign Language) So I just think, next year, our net profit performance will be better than this year.

(Foreign Language) In terms of growth of customer, well, our growth are faster than industrial average to gain more market share. (Foreign Language) First, in terms of cash flow, this year the underwrites cost and logistics, the investment will be coming this year. So put our cash flow position into quite a strong pressure -- for next year, severe pressure. Next year, I do see we will improve a lot in this area. (Foreign Language) In a nutshell, next year, we will grow much higher than the industry average and we will improve our gross profit and also our net profit. (Foreign Language) And with this consistent investment in R&D for so many years, I do think next year we can get the result, we will do better in technology income. (Foreign Language) For me, I personally focus on four things. One is strategy. The other is culture, then team and then new businesses.

**Operator**

Thank you. I will continue with the next questions from Wendy Huang from Macquarie. Please go ahead.

**Q - Wendy Huang** {BIO 15034507 <GO>}

Thank you. I just had two quick questions. One is on the competitiveness in the logistics space. So, on one hand you are expanding aggressively into third-party logistics with several initiatives in past few quarters, but on the other hand, we also notice (inaudible) they are fighting back in (inaudible) set to build a large automatic sorting center in Shumi (ph) as well. So, maybe if you can give any color on that will be great. And second thing,

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Richard, is on core, I just wonder if you can give us any update on the allegation against the (inaudible) case? Thank you.

### **A - Sidney Huang** {BIO 20098238 <GO>}

Okay. So, on the Logistics, as we mentioned in the past, JD Logistics has built an unrivaled infrastructure by serving our own first-party e-commerce business, and along the way a great customer and very, very good service quality over the years. And as we continue to implement our retail infrastructure strategy -- Retail as a Service strategy, we have seen merchants actually and brands came to us to provide similar logistic services to these third-party partners. So, this has been a thing that we mentioned since earlier this year, and obviously with the sales growth this year at a triple-digit for the past several quarters, clearly there are very unique value being provided by the JD Logistics.

And on your second question, I just want to answer that, we really do not have any new information to share with you. And honestly, we cannot further comment, because it is important that we expect the due process of the US Justice system. As you see, Lisa has been back to work as usual in the Company and the situation did not and is not expected to have any material impact on JD's day-to-day operations. Our strong senior leadership team with most of its members having spent 5 to 10 years with the Company continues to effectively guide our Company towards its goal to grow our business and serve our customers. So as the purpose of today's call is to discuss our earnings results, so we would appreciate you limiting further questions to this topic. Thank you.

### **Operator**

Thank you. We'll take the next questions from Jialong Shi from Nomura. Please go ahead.

### **Q - Jialong Shi** {BIO 18647437 <GO>}

Good evening management, thanks for taking my call. I will ask my question first in Chinese, and would translate into English myself. (Foreign Language) I have two questions. My first question is about 7Fresh. I just wonder what's management store open plan under 7Fresh initiative and whether or not 7Fresh will be accounted as part of JD Mall and how should we assess the margin impact from 7Fresh for this year and next year? And for JD Logistics, I just wonder if the management can provide an update on the progress of capitalizing the JD Logistic, some of JD logistics resources, which CFO mentioned on last quarterly call, and I just wonder how should we assess the margin impact from this initiative? Thank you.

### **A - Sidney Huang** {BIO 20098238 <GO>}

Sure. So for 7Fresh, we expect in aggregate a dozen or so stores by end of this year and probably another 20 plus stores in the first half of next year. Now, because we want to be - expand the business in a prudent manner, we are actually opening the stores in a very careful and be well prepared for all the initial preparations. So in terms of impact on the margins, we do not expect any material impact on our overall margin. And for the current performance of the existing stores, we are actually pretty comfortable that on a single store basis the margin should be breakeven and turn positive in a relatively short period of time.

And for the logistics assets, we are transferring some of the existing assets into a co-fund and we've received very good initial investor interest, very good indication, we still expect that transaction to happen in the first half of next year.

## Operator

Thank you. Next question comes from the line of Natalie Wu from CICC. Please go ahead.

### Q - Natalie Wu {BIO 19852429 <GO>}

Hi, good evening. Thanks for taking my question. Just wondering what the contract with Tencent regarding the Weixin level-one access point to be terminated next year, can management update us the following, the newer progress? Thank you.

### A - Jon Liao {BIO 18782053 <GO>}

And of course -- since the Tencent investment in the JV, we have been collaborating very well in a number of fronts, in terms of investment, in terms of offline retailing, such as (inaudible) as well. I think for the next level of collaboration, of course we will expand the - from base scale gateway access to multiple fronts, such as social commerce and 2B business as well. So right now we will continue our discussion and we shall have more update in the near future. Thank you.

## Operator

Thank you for the questions. Next question is from the line of Tian Hou from T.H. Capital. Please go ahead.

### Q - Tian Hou {BIO 20458526 <GO>}

Yes, good evening management. The question is related to the category expansion. So I think you mentioned the general merchandise the first time was about 50%. I remember since the day JD become a public listed company this has been the goal and since like -- finally we have accomplished that. And, however, given the fact that cell phones and home appliances facing some headwinds, what's the Company's strategy in expanding in other categories rapidly to really offset this high clients in other two major categories? (Foreign Language)

### A - Sidney Huang {BIO 20098238 <GO>}

Yeah, sure. As we mentioned in the past, JD as a platform has always invested first in the overall marketplace operations, improving merchant experience, we've talked about for some time. And also, from our overall strategic planning point of view, Jon mentioned last time that in addition to growing our more established business, we have been also investing in some of the so-called RMB100 billion (ph) club into some of the new categories. So it's really a result of all of these efforts that helped us expand our general merchandise categories. So we did mention some of the categories in the past. Obviously, our home products, FMCG, fresh products, also our -- a number of other ones that we mentioned along the years, because when you look at these categories, we do

see fairly consistent growth across all of these categories. So it is really the power of the overall platform rather than any particular focus on just one of them.

## Operator

Thank you for the questions. Next question is from the line of Binnie Wong from HSBC. Please go ahead.

### Q - Binnie Wong {BIO 16260213 <GO>}

Hi, good evening management. Thank you for taking my question. My first question is on the Retail as a Service strategy. So I think in the last few quarters, we have been saying that we have been gaining traction as we open up it to a wide range of partners. So can management update -- share with us any progress update in terms of like the number of partners or any use cases of how our strategy has improved the productivity for our retail partners and also update on any monetization strategy in this area would be very helpful?

And my second question is a follow-up on the growth strategy, right, because I think management has mentioned that the decline in the annual active customers this quarter was because we want to focus on the quality. So we of course see the GMV per customer has been improving, so just wanted to see that -- that focus, is it mainly like the driver for the GMV increase, like the quality customer, is it mainly from the consumption upgrade or is it because that the customers are buying more categories. So how should we think of that? And second to that is that on the loyalty program, because we see good progress on the premium membership, how much higher is the users that have the premium membership, how much bigger basket size are they buying versus those that do not have this premium membership? Thank you.

### A - Sidney Huang {BIO 20098238 <GO>}

Yeah. So we try to limit two questions each person. I will try to answer the first one and then Xu Lei can answer the Plus membership program. So for the 2B business, I mentioned first, our service revenue has surpassed 10% of total revenue for the first time. So a lot of that is happening. Obviously, namely was -- JD Logistics is one of them. But also our mini programs on the -- we've got a project Kepler internally as Sidney mentioned earlier, these are all also generating meaningful progress for our merchants, brands and also for our customers and the partners. So some of these, in terms of revenue contribution is still small, but clearly we are gaining traction in these areas. Xu Lei?

### A - Lei Xu {BIO 21705778 <GO>}

(Foreign Language) In the third quarter, Plus members have exceeded 10 million (ph). These are our core users with the strongest purchasing power, performing great in terms of buying frequency and average revenue per user, ARPU. (Foreign Language) We will continue to optimize and invest in membership benefits with more and more brands and partners coming aware of the value of those Plus members. A co-membership and value-added service will be our focus for the next stage. (Foreign Language) Our co-ambition for project with IT has been doing very well. We'll look at expanding from videos, to travel, to entertainment, catering, knowledge (inaudible) et cetera.

## Operator

Thank you. Our next question is from the line of Suzanna Chuie (ph) from RBS. Please go ahead.

### Q - Suzanna Chuie

Hey, hello, good evening. Thank you for taking my question. Could management update the 7Fresh operating data, for example, sales per square meter versus the traditional supermarket and the online order contributions and could management share how your retail strategy differentiate from the competitors? Thanks.

### A - Sidney Huang {BIO 20098238 <GO>}

Yeah, on 7Fresh, because the current scale is still relatively small, but I did mention last quarter that sales per square meters is roughly three to four times of the traditional offline retail sales figure. Sorry, I lost your second question.

### A - Richard Liu {BIO 17167866 <GO>}

What's the second question again?

### Q - Suzanna Chuie

Yes, sure. I would like to -- management to share how's your retail strategy differentiate with your other competitors.

### A - Jon Liao {BIO 18782053 <GO>}

I think you lost interest. I think we're moving in -- I mean because we look at retail for the future in different ways. As such, we have a different strategy. From JD's standpoint, we move from a vertically integrated model to become a open model and comparatively speaking, while competition is moving from an open model to become more vertically integrated model. So that's the best way to put it.

## Operator

Thank you. Next question is from the line of Hans Chung from KeyBanc Capital. Please go ahead.

### Q - Hans Chung {BIO 19153490 <GO>}

Good evening management team. Thank you for taking my question. So I have a question regarding the JD Logistics, and the management team mentioned earlier the profitability will improve a lot next year or. So, I just want to know, is this driven by like pricing or new customer growth or the cost reduction initiatives? And then follow-up is when we will start to see the logistics start to break even? Thank you.

### A - Sidney Huang {BIO 20098238 <GO>}

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Yeah. Sure, it's actually from multiple areas, as we mentioned, because it was the initial year, we did expand capacities at the beginning, so that we can have ample capacity to serve the new customers very well. And so initially, there was some overcapacity, that was one initial reason. Two is that we offered discounted trial period for the customers to try out our services. Part of the reason for that is our supply chain management services involving integrated warehouse and delivery service. So for the warehousing part there is a natural kind of startup costs, because the merchants and brands tend to have their own warehouses, existing warehouses. So any migration to our service may incur initial incremental cost.

So our initial trial period essentially lowered the barrier for this initial service period. And as we move past those initial periods, obviously also with the capacity -- warehouse capacity better utilized, loss ratio will gradually shrink. So that's actually a fairly natural outcome after the initial investing phase. So for the third quarter, which is at actually a seasonally low quarter, we were very pleased to see continued narrowing on loss ratio, because the business volume still grew on a sequential basis for this particular business, which continue to have better -- improving the utilization for our overall capacity.

## Operator

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

## A - Ruiyu Li {BIO 19135837 <GO>}

Thanks, operator, and thank you everyone for joining us today. Please feel free to contact us if you have any further questions. We look forward to talking with you in the coming months. Thanks.

## Operator

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

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