

PDD Holdings Inc.

PDD Holdings Inc. - Q2 2024 Earnings Call

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Event Participants

Executives 4

Unknown Executive, Lei Chen, Jiazhen Zhao, Jun Liu

Analysts 2

Joyce Ju, Yang Bai

Operator Operator

Ladies and gentlemen, thank you for standing by, and welcome to PDD Holdings, Inc. Second Quarter 2024 Earnings Conference Call. [Operator Instructions] Please be advised that today's conference is being recorded. I would now like to hand the conference over to your host today. Sir, please go ahead.

Unknown Executive Executive

Thank you, operator. Hello, everyone, and thank you for joining us today. PDD Holdings' earnings release was distributed earlier and is available on our website at investor.pddholdings.com as well as through the GlobeNewswire services. Before we begin, I would like to refer you to our safe harbor statement in earnings press release, which applies to this call as we will make certain 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 GAAP measures. Joining us today on the call are Mr. Chen Lei, our Chairman and Co-Chief Executive Officer; Mr. Zhao Jiazhen, our Executive Director and Co-Chief Executive Officer; as well as Ms. Liu Jun, our VP of Finance.

Lei and Jiazhen will make some general remarks on our performance for the past quarter and our strategic focus. Jun will then walk us through our financial results for the second quarter ended June 30, 2024. During the Q&A session, Lei and Jiazhen will answer questions in Chinese, and we'll help translate. Please kindly note that the English translation is for reference only. And in case of any discrepancy, statements in the original language should prevail.

Now it's my pleasure to introduce our Chairman and Co-Chief Executive Officer, Mr. Chen Lei. Lei, please go ahead.

Lei Chen Executive

Hello, everyone. Thank you all for joining our earnings call for the second quarter of 2024. In the first half of 2024, we have remained committed to our high-quality development strategy and consistently invested in our platform ecosystem. We received positive feedback for these efforts. Consumer experience in our services have continued to improve.

A number of new merchants and products have grown significantly, this further meets the diverse needs of our consumers. This quarter, we benefited from the improving macro environment and achieved robust financial results. Our total revenue reached RMB 97 billion, which represents a year-on-year increase of 86%. However, we are seeing many new challenges ahead, from changing consumer demand, intensifying competition and uncertainties in global environment. As a result, we will enter a new phase of high-quality development that calls for increased investments and our profitability will -- affected as a result.

Since the beginning of this year, we are seeing that consumer preferences have become more diverse. On one hand, consumers are increasingly choosing experience-based consumption over material purchases. On other hand, there's a growing emphasis on rational consumption. Consumers are making more thoughtful decisions to balance quality and [value] . In response, we have collaborated with high-quality brands and manufacturers to create customized products that cater to these diverse demands.

This approach has not only propelled many new brands to success, it also revived the popularity of many established brands. This is just one example of how digital technology and manufacturing can come together to create new opportunities. At this moment, the competition among e-commerce platforms is quickly escalating, and therefore, it's even more important that we go back to the basics of supply chain improvements and invest firmly in supply chain efficiencies. This will be the key focus for our high-quality development going forward. For example, in the second quarter, our teams continue to bring our agriculture cloud initiative to major production regions and helping local growers to bring seasonal foods directly to people's homes.

And in this process, promoted local agriculture brand. In addition, to further improve the agriculture supply chain, nurture [research] talents and promote technology inclusion, we continue to support the Smart Agriculture Competition and the Pinduoduo Academy growing competition. The Agricultural Research Fund we established in cooperation with China Agriculture University has also started to bear fruit. On the manufacturing side, we are pleased to find that very small and medium-sized businesses have been using a digital capability from our platform to support product integration and innovation. Through this process, they have not only emerged stronger from the competition, but also led the local industries towards high-quality development.

These results have strengthened our commitment to further investing in high-quality development. We have communicated for a number of occasions that profit growth in the past few quarters should not be used as a long-term guidance. And it is a result of mismatch between the business investment and the financial reporting cycles. As we enter a new investment phase, I would like to make it clear to our investors that our profits will gradually trend down starting in Q3, and there will be [saturations] or rebounds in the short term. In the long run, the decline in profitability is inevitable.

Currently, our presence has reached a considerable scale, and we will remain committed to high-quality development and focus on creating a healthy and sustainable platform ecosystem. And to this end, we'll adopt the necessary policies to vigorously support high-quality merchants and tackle low-quality ones. On the supply side, we will invest substantial resources to support high-quality merchants who are willing to innovate and improve qualities. And we will offer significant transaction fee reductions to these merchants, with an initial target of CNY 10 billion in the first year. By doing so, our goal is to provide clear incentives for the merchants to join high-quality development.

On the other hand, we will further deepen our trust and safety capabilities to improve our merchant ecosystem and strengthen our supply chain. We are actively identifying and removing a lot of bad actors from our platforms, and we will continue to strengthen these efforts. At the moment, we have already started a new round of investments in operations and R&D to streamline the merchant onboarding and product-listing process. Leveraging technology, we will gradually improve the quality of products sold on our platforms and create a fair and transparent business environment for our merchants. In this process, we believe that sacrificing short-term profit is necessary.

A clear downward trend in profit is expected but we are prepared to invest firmly and tacitly in the platform's long-term health. This is a decision that has received unanimous support from all our management team. And now moving on to the global business. In the past few quarters, we have noticed the rapid shift in external environment which brought significantly greater uncertainty. Our operations has also become increasingly affected by nonbusiness factors.

And meanwhile, the competition we face is growing stronger. Competition is here to stay and is expected to intensify in our industry. Our global business is facing significant uncertainties from intense competition and evolving external environment. These factors combined will inevitably cause fluctuations to our business. As shown in this quarter's results, high revenue growth is not sustainable and a downward trend in profitability is inevitable.

And finally, as the environment evolves and our company continues to grow, our management team and I often discuss how we can better fulfill our corporate social responsibilities. We believe there is still many things that can be done, for example, through enhancing our governance structure and extracting resources to better adapt to a changing time. We can also do more to give back to society to support agriculture and other industry sectors and offer greater support to the people who need it most. We fully recognize that simply measuring our

company's performance by short-term capital returns no longer aligns with where we are today. As a global company in this era, we are committed to drive innovation, adapting to change and taking on greater social responsibilities in the region across the globe.

And now I will hand it over to our Co-CEO, Zhao Jiazhen, to talk more about our operations in the second quarter.

Jiazhen Zhao Executive

[Interpreted] Thank you, Lei. Hello, everyone. This is Zhao Jiazhen. Thank you all for joining our earnings call for the second quarter of 2024. In the first half of this year, online retail in China continues to perform well, bringing fresh energy to the overall consumption market.

Over the past quarter, we continue to advance our high-quality development strategy, making steady long-term investments to support both supply and demand side of our platforms. Looking ahead to the second quarter of this year and beyond, we're very confident in the future of the Chinese consumer market. This quarter, we continued to focus on consumer demand, further enhanced our more savings and better services capabilities and upgraded our after-sales services to provide consumers with more value and more enjoyable shopping experiences. During the June 18 promotion, we continue to provide consumers with straightforward savings and introduced new promotions to meet the increasingly diverse consumer preferences. We also brought product categories like fresh produce, daily necessities and high-end appliances into third and four tier cities and made our contribution to consumption upgrades across the regions.

On the supply side, we stepped up our support for quality merchants and brands, directing more traffic to high-quality products through 10 Billion Program and fresh sales. We have also focused on enhancing the quality and efficiency of the supply chain, bringing more value to the agricultural areas and industry regions, and benefiting more producers through quality, agricultural and domestic group. To support the countryside home appliance program and the consumer group [indiscernible] we invested RMB 1 billion during the first week of June 18. This boost led to remarkable growth for many local brands in categories such as electronics, home appliances, kitchenware and household products. For example, utilizing our digital technology, we helped a local brand with 36 years of history to understand the latest market demand and return to growth with a blockbuster product.

It achieved RMB 100 million in sales after joining the platform for just 2 months. In addition, the number of new merchants and new products support of our platforms saw meaningful growth. In the first week of June 18, the number of merchants participating in the 10 Billion Program grew by over 90% year-on-year, and the number of agricultural merchants increased by 83% year-on-year. Our platform also attracted a great number of new merchants in categories such as electronics, home appliances and cosmetics. To create a better business environment for high-quality merchants, we have started a new round of investments in operations and R&D.

Our goal is to build industry-leading compliance capabilities and foster a healthy platform

ecosystem. For example, we continue to streamline our merchant onboarding and product-listing processes to better control product quality and offer consumers a safe and reliable shopping experience. We integrate automatic technology for product screening with thorough manual reviews by our trust and safety team. This approach ensures rigorous oversight on product compliance while avoiding unintended penalties for quality products and merchants. At the same time, we have invested heavily in developing comprehensive user-friendly training materials for merchants to boost their compliance capabilities.

This effort aims to enhance our supply chain quality, while helping merchants lower compliance costs and expand their market reach. We also deeply recognize that building a healthy platform ecosystem and achieving high core development is a gradual process, especially given the [consumer] scale of our platforms. So we are committed to a dual approach. One side, providing strong support to high-quality merchants while addressing issues with low-quality ones. This way, we aim to create a healthy and sustainable ecosystem.

In this process, we will inevitably face short-term costs, as Lei has mentioned. Our managing team is fully committed to investing heavily for the long-term health of our platforms. While profits might vary or even rebound in the next few quarters, it is unavoidable that profitability will trend lower over the long term. As the largest platform for agricultural products in China, this quarter, we further advanced our agricultural strategy. We launched the Science and Technology Courtyard project in [indiscernible] and [indiscernible] and also kicked off the fourth Smart Agricultural Competition in collaboration with top research team from around the world.

We will continue to increase investments in agricultural research to promote the commercial application of research funding and accelerate the market adoption of high-quality agricultural products. Meanwhile, we also leverage our strength as a platform, working with ecosystem partners to proactively take on more social responsibilities. We invested tens of millions in Reading Month and subsidies to launch the seventh Duo Duo Reading Month. This initiative provides direct discounts on thousands of products, making knowledge more accessible to more people. 2024 is a critical year on our path towards high-quality development.

We will focus on creating healthy and sustainable platform ecosystem and empowering our ecosystem partners with more platform resources and technical support. Together, we will lay a solid foundation towards the high-quality development of our platforms. Next, I will hand over to Jun. She will provide an update on our financial performance for the second quarter.

Jun Liu Executive

Thank you, Jiazhen. Hello, everyone. Let me walk you through our financial performance for the second quarter ended June 30, 2024. In terms of income statements in the second quarter, our total revenues increased 86% year-over-year to RMB 97.1 billion. This was mainly driven by an increase in revenues from online marketing services and transaction services.

Revenues from online marketing services and others were RMB 49.1 billion this quarter, up 29% from the same quarter of 2023. Revenues from transaction services were RMB 47.9 billion, up

234% from the same quarter last year. In Q2, our top line growth slowed down significantly versus the last few quarters. Further slowdown is inevitable as a result of competition and global uncertainties. Moving on to cost and expenses.

Our total cost of revenues increased 80% from RMB 18.7 billion in Q2 2023 to RMB 33.7 billion this quarter, mainly due to increase in fulfillment fees and payment processing fees. On a GAAP basis, total operating expenses this quarter increased 48% to RMB 30.8 billion from RMB 20.9 billion in the same quarter of 2023. On a non-GAAP basis, total operating expenses increased to RMB 28.4 billion this quarter from RMB 19 billion in Q2 2023. In Q2, we continued to invest in firmly to support the high-quality developments of our platforms. Our total non-GAAP operating expenses as a percentage of total revenue this quarter was 29% compared to 36% in the second quarter last year.

Looking to specific expense items. Our non-GAAP sales and marketing expenses this quarter were RMB 25.4 billion, up 54% versus the same quarter last year. Throughout Q2, we stepped up our promotional efforts to give back to consumers and invest in marketing to promote our platforms. On a non-GAAP basis, our sales and marketing expenses as a percentage of our revenues this quarter was 26% versus 32% for the same quarter last year. Our non-GAAP general and administrative expenses were RMB 594 million versus RMB 370 million in same quarter of 2023.

Our research and development expenses were RMB 2.4 billion this quarter on a non-GAAP basis, up 15% year-over-year and RMB 2.9 billion on a GAAP basis. It's critical that we maintain our long-term focus and continue to invest in R&D to drive supply chain efficiency and customer experience. On a GAAP basis, operating profit for the quarter was RMB 32.6 billion versus RMB 12.7 billion in the second quarter last year. Non-GAAP operating profit was RMB 35 billion versus RMB 14.6 billion in the same quarter last year. Non-GAAP operating profit margin was 36% this quarter compared with 28% for the same quarter last year.

Net income attributable to ordinary shareholders was RMB 32 billion for the quarter compared to RMB 13.1 billion in the same quarter last year. Basic earnings per ADS was RMB 23.14, and diluted earnings per ADS was RMB 21.61 versus basic earnings per ADS of RMB 9.64 and diluted earnings per ADS of RMB 9 in the same quarter of 2023. Non-GAAP net income attributable to ordinary shareholders was RMB 34.4 billion versus RMB 15.3 billion in the same quarter last year. Non-GAAP diluted earnings per ADS was RMB 23.24 versus RMB 10.47 in the same quarter of 2023. As noted last quarter, our business does not follow a linear path and the profitability in the last few quarters does not represent future.

Looking ahead, we will invest firmly to support a healthy ecosystem that encourages high-quality merchants. Our profitability may fluctuate in the short term, but we gradually track lower in the long run. This is inevitable as we focus on the long-term, high-quality development of our platforms. That completes the income statements. Now let me move on to cash flow.

Our net cash generated from operating activities was RMB 43.8 billion compared with RMB 23.4 billion in the same quarter last year. As of June 30, 2024, we have RMB 284.9 billion in cash, cash

equivalents and short-term investments. Thank you. This concludes my prepared remarks.

Unknown Executive Executive

Thank you, Jun. Next, we will move on to the Q&A session. In today's Q&A session, Lei, Jiazhen and Jun will take questions from analysts on the line. [Operator Instructions]. Lei and Jiazhen will answer questions in Chinese, and we'll help translate for convenience purposes.

Operator, we are open for questions.

Operator Operator

[Operator Instructions] Your first question comes from Joyce Ju from Bank of America.

Joyce Ju Analyst

[Foreign Language] I will translate for myself. I have two questions. My first question is we have seen Duo Duo's profit growth remain robust this quarter. But in the prepared remarks, management mentioned there will be increased investment and profitability fluctuations caused by the competition. Could management share how you assess the profit plans in the future?

In addition, in terms of shareholder returns, does management have any plan for share buyback or dividend payout? My second question is, in the prepared remarks, we noted that management emphasized a lot on the merchant ecosystem and the merchant supporting policies. Could you please elaborate a bit on your understanding on how's the merchant ecosystem, how to review it, how to understand it and why this will become the focus of the platform in the next stage?

Lei Chen Executive

[Interpreted] This is Chen Lei. Let me take your first question. We have communicated on a number of occasions that profit growth in the past few quarters should not be used as a long-term guidance. And it was a result of the mismatch between the business investment and financial reporting cycles. In addition, our business is currently facing intense competition and shifting external factors, which will inevitably bring fluctuations to our business and also slow down our top line growth.

We are now entering a new phase of a steady transformation towards high-quality development. And we need to invest patiently in the platform's long-term health. And to support a sustainable development of our platform ecosystem, we will invest substantial resources over the next 12 months to support high-quality merchants. And looking ahead, our profitability may fluctuate in the short run, but directionally, it will gradually enter a downward trend. And empowering and supporting merchants is crucial to building our high-quality supply chain and also creating a robust platform ecosystem.

Over the long run, this will start off a virtuous cycle for the platform. And therefore, we will remain committed to patient investments even though short-term profits will be affected. In

terms of shareholder returns, the company is still in the investment phase, and we are facing intense competition on different fronts and also uncertainties from external factors. And therefore, our management team and I unanimously believe that it is not an appropriate time for share purchase -- for share repurchases or dividends. And in the foreseeable years ahead, we also do not see such a need.

Thank you.

Jiazhen Zhao Executive

[Interpreted] This is Zhao Jiazhen. Let me take your question on merchant ecosystem. Our platform is a mutually dependent community as merchants, consumers and our operations teams. Merchants are our key partners in our joint efforts to serve consumers. The increased competition in our industry brings new demands on our community.

In this process, we feel a strong sense of responsibility as a platform. On one side, we must ensure strict oversight of product quality to prevent substandard goods and protect consumer rights. On the other side, we must ensure fairness so that dedicated high-quality merchants can earn meaningful rewards, which is essential for the healthy development of platform ecosystem. To achieve balance in the ecosystem, we have no choice but to firmly transition towards high-quality development. Therefore, we will adopt the necessary policies to provide strong support to high-quality merchants while tackling low-quality ones.

On the supply side, we will strongly support merchants with product and technology innovation capabilities. We will significantly reduce transaction fees for these high-quality merchants with an expected amount of RMB 10 billion in the following year. We will continue to enhance incentives for the merchants to drive our high-quality development of ecosystem. On the other side, we will further enforce strong governance of our platform and merchants. This includes identifying and removing unlawful merchants from our platforms to strengthen our supply chain.

As of now, we have already started a new round of investment in operations and technology to optimize the merchant onboarding and product listing processes, we use advanced technology to ensure strict product quality control and create a better environment for our high-quality merchants. We grow together with our high-quality merchant partners, working together to offer consumers high-quality products and services. The consumers can in turn bring new growth opportunities to the ecosystem, creating a virtuous cycle, which is the key to the long-term healthy development of our community. To achieve the goal of high-quality development of the merchant ecosystem, our management has reached the consensus to firmly commit to long-term investments and create a healthy, sustainable platform ecosystem. Thank you all.

Operator Operator

The next question is from Yang Bai from CICC.

Yang Bai Analyst

[Foreign Language] I have two questions. The first one, we have observed that the growth of your global business remains strong, but some external data suggests that the growth rates and the investment in certain markets are slowing down. In your prepared remarks, we also noticed that the company takes a relatively cautious approach towards the future development of your global business. Is the company trying to manage some risks proactively? Could the management please elaborate on your thinking in this regard?

The second one is we saw that the overall competitive environment is quite intense. Has it caused any impact on the company's growth? In such a competitive environment, how will the company adjust your investment priorities? And how does the management think about your positioning?

Lei Chen Executive

[Interpreted] This is Lei. Let me take your question on the global business. Our global business is still evolving, and we are actively exploring new opportunities. Currently, our global business has entered over 70 markets. And during this growth, we have always prioritized compliance and see it as the foundation for our development.

And over the past few quarters, we have invested significant resources in building a safe shopping environment. As our business develops, we have noticed that the changes in the external environment are accelerating. And our operations are increasingly affected by some nonbusiness factors, and we are seeing a significant increase in uncertainty. And meanwhile, competition is a constant theme in the e-commerce industry and is expected to intensify. At this moment, such intense competition combined with the impact of external factors will inevitably lead to disruptions on our global business.

But nevertheless, we remain committed to our vision of allowing more consumers worldwide to enjoy the benefits of the digital economy, and this has not changed. And in response to the complex environment, we will focus on our core strength, and continuously improve our capabilities in supply chain, customer services and compliance to better meet the expectations of consumers around the world and also achieve high-quality development in our global business.

Jiazhen Zhao Executive

[Interpreted] This is Zhao Jiazhen. Let me take your question on competition. Over the past few quarters, the competition has been intensifying, which is natural to the e-commerce sector. In such a competitive environment, our revenue growth mix was down. For instance, in the second quarter, our revenue growth declined, indicating that high revenue growth is not sustainable.

Currently, consumer demand is becoming more diversified and e-commerce platforms are actively adjusting their strategies to meet this evolving need. Each platform has its own strength and competitive edge and commit substantial resources to cater to consumer demand. At this moment, we need to focus on our core strength and continue on our path to high-quality development. For e-commerce platforms, a robust supply chain is essential to providing good

services to consumers. To meet the diversified needs of consumers, we remain focused on the fundamentals and strive for innovation in the supply chain.

In the second quarter, our teams continue to bring agricultural core initiatives to major production regions, helping local agricultural products [indiscernible] their brands and empowering small and medium-sized agricultural merchants through collective marketing efforts. Apart from agricultural products, we have expanded our support to the manufacturers through digitalization. By collaborating with high-quality national brands and manufacturers, we have successfully launched tailored products for niche categories. These brands and merchants have achieved higher quality developments through continuous technological updates and product innovation. We will strongly encourage and support high-quality merchants who are dedicated to their business and innovation.

In addition to the significant reduction in transaction fees that we plan to offer, we will continue to leverage our platform's supply chain capabilities to help merchants improve quality and efficiency and guide manufacturers towards innovative and high-quality developments. We fully understand that only by optimizing and upgrading the supply chain is essential to meeting deeper consumer needs and ensuring the long-term healthy growth of our platform ecosystem. We are committed to making long-term and patient investments. Thank you all.

Unknown Executive Executive

Thank you, Jiazhen, and thank you all for joining us today. We look forward to speaking with you again next quarter. And thank you, have a nice day.

Operator Operator

Thank you. Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may all now disconnect. [Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]