[DDL] Dingdong (Cayman) Limited
Q3 2021 Earnings Conference Call
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Executives:
Karen Ji, Investor Relations Vice President
Changlin Liang, Founder and Chief Executive Officer
Le Yu, Chief Strategy Officer

Analysts:
Eddy Wang, Morgan Stanley
Joyce Ju, Bank of America
Ashley Xu, Credit Suisse
Thomas Chong, Jefferies
Robin Leung, Daiwa

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by and welcome to the Dingdong (Cayman) Ltd. Third Quarter 2021 Earnings Conference Call. At this time, all participants are in a listen-only mode. We will be hosting a question-and-answer session after management's prepared remarks. Please note this event is being recorded.

I will now turn the conference over to the first speaker today, Karen Ji, Investor Relations Vice President of the Company. Please go ahead, ma'am.

Karen Ji: Thank you. Hello, everyone, and welcome to Dingdong's third quarter 2021 earnings call. With us today are Mr. Changlin Liang, our founder and CEO, and Ms. Le Yu, our CSO.

You can refer to our third quarter 2021 financial results on our IR website at ir.100.me. You can also access a replay of this call when it becomes available a few hours after its conclusion on our IR website.

Before we start, please note that this call may contain forward-looking statements made pursuant to the Safe Harbor provision for the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties, and other factors not under the Company's control, which may cause actual results, performance, or achievements of the Company to be materially different from the results, performance, or expectations implied by these forward-looking statements.

All forward-looking statements are expressly qualified in their entirety by the cautionary statement, risk factors, and details of the Company's filings with the SEC. The Company undertakes no duty to revise or update any forward-looking statements for selected events or circumstances after the date of this conference call.

I will now turn the call to our first speaker today, Founder and CEO of Dingdong, Mr. Liang.

Changlin Liang: (Speaking foreign language).

(Translated). Hello, everyone, and welcome to Dingdong’s third quarter 2021 earnings conference call. First, on behalf of the entire Dingdong team, I would like to extend our sincerest gratitude and appreciation to all the investors and analysts for their support. We here at Dingdong are a rapidly maturing company with advanced supply chain capabilities, and one of China's fastest-growing companies in the domestic neighborhood retail industry.

We are delighted to report that we not only achieved strong growth in the third quarter, but also rapidly optimized efficiency and made significant improvements to our non-GAAP net loss margin. In addition, according to MAU data from Quest Mobile, our Dingdong app has grown into one of the top 10 e-commerce platforms in China this quarter. More importantly, we rank No. 1 among China's e-commerce platforms for fresh produce, and we have tremendous confidence in our prospects.

Let me share our third quarter highlights in terms of four primary aspects of our business. First, one highlight is our continued rapid growth in scale. Our overall GMV increased by 107.7% year-over-year to RMB7.02 billion in the third quarter. The number of average monthly transacting users exceeded a milestone of 10 million for the first time. In addition, the number of average monthly transacting members grew by 26.5% sequentially, with each member placing an average of 7.4 orders per month.

Deriving our total GMV resembles the formula for a cube's volume: length times width times height. The length times width refers to our geographic coverage, and its growth potential is seen in our mass expansion capabilities. Our regional mass expansion capabilities have already been thoroughly tested and verified. As of the end of the third quarter, we've seen 185% year-over-year growth in city coverage, proving that geographic expansion is a relatively simple task for us.

The height of the cube refers to the average monthly GMV contribution on Dingdong by each city's urban population. For example, Shanghai's population is approximately 24 million, and its current monthly GMV contribution is RMB30 per capita, showing that we still have significant growth potential in our existing markets. Expanding the height of this cube requires us to increase the penetration rate of our existing cities and enhance the purchase frequency of our current users.

In our pursuit of efficiency, quality, and profitability, these are necessary efforts that, though difficult, we will strive for relentlessly. Even in relatively mature markets like our Yangtze River Delta region, where we have been operating for over four years, we continue to see tremendous growth potential in terms of height, as GMV for the region increased by 64.8% year-over-year in the third quarter.

Another highlight for the third quarter is that while continuing to grow in scale, we also significantly enhanced efficiency. When major shifts to macro policy changed the logic behind market growth, we quickly and proactively responded to keep pace. In late August, we changed our strategy from “scale first, with due consideration of efficiency” to “efficiency first, with due consideration of scale”. We will continue to work hard to improve our product development capabilities, strengthen our supply chain, and optimize our operational efficiency to achieve high-quality development and self-sufficient capacity.

We achieved rapid efficiency improvements in the third quarter thanks to our ability to act swiftly, which is one of our core strengths. Moreover, an accumulation of long-term investments in our supply chain began to bear fruit. Our non-GAAP net loss margin improved by 530 basis points from 37.2% in the previous quarter to 31.9% in the third quarter. We are confident that we will narrow the non-GAAP net loss margin to a greater extent in the next quarter with the further execution of our “efficiency first, with due consideration of scale” strategy.

The improvement in our non-GAAP net loss margin was primarily due to the returns from the long-term upfront investments in the supply chain. These include investments in contract farming, direct sourcing, private label brands, agricultural technology, and food processing. While we are aware that it takes a long time for us to see returns on these investments, we are confident that we will significantly improve our efficiency and benefit from these investments in the future.

Third, we continued to enhance our product development capabilities, which are our core competitive strengths and primary growth drivers, to satisfy people's ever-growing demand for a happy life. Previously, customers would “buy groceries on Dingdong”. Our goal for the near future is for more customers to “buy Dingdong's groceries”. This goal requires us to diligently develop differentiated products with better quality, as we continue to iterate and optimize our private-label brand and our in-house production and processing lines.

Since their launch in July last year, our private label brands have leveraged our product development capabilities to develop rapidly. GMV of our leading private label brands in aggregate accounted for 27% of GMV for their corresponding categories during the quarter, representing an increase of 22.6% points compared to the same period last year. As we advance, we will continue to evolve according to user needs and develop more high-quality private label products in increasingly diverse product categories.

From a long-term perspective, we expect the GMV contributions from our private label brands to reach as high as 30%, increasing from the 5.8% of this year's Q3.

We steadfastly adhere to our principle of applying rigorous attention to detail to every product while creating our private label brand. Putting this principle into practice, we selected 18 different flavors for our private label hot pot brand, Dingdong Damanguan, after developing and testing over 720 recipes and conducting over 240 rounds of tasting. Each flavor features a unique local taste, and together, these flavors represent a culinary hot pot map of the entire nation.

While proactively developing the private label brands, we will keep an open mind towards non-private label products. We firmly believe that to be an excellent company, we must establish an ecosystem to lead the development of the entire industry. As we advance, we will work closely with more partners to develop more distinctive and better-quality products for the gratification of our customers. Doing so puts us in a position to capitalize on the transition from an era of simply serving people's basic needs to a period of prosperity and a nationwide consumption upgrade.

As of the end of the quarter, we had 10 in-house production and processing plants. As we rapidly scaled our production and processing capabilities, GMV contribution from products developed and processed in-house in the third quarter increased by 85.8% quarter-over-quarter. On the production and processing side, we are driven by the core principle of ingenuity to perfect our supply chain and enhance automation in our production lines, thereby reducing costs and increasing efficiency.

Moreover, we diligently monitor our factory environment, products, processes, and personnel through the lens of 4 core aspects: excellent production practices, strict process control, end-to-end monitoring systems, and 2-way traceability systems. We have established stringent rules for food safety and the flavor and quality of our products, which are non-negotiable priorities for us. In the third quarter, Dingdong's grain processing plant obtained IFS international food standard certification, reflecting our strategy to invest in high-quality products.

Fourth, we continued to further our commitment to rural revitalization, participating in public welfare activities and taking on additional social responsibilities. For example, in this year's Q3, we began to build the first environmentally-friendly land-based antibiotic-free shrimp breeding base collaborating with the Ziyang Municipal Government of Sichuan Province and Shanghai Ocean University. Upon completion, this base will be the most advanced and largest antibiotic-free shrimp base in China, with the potential to quickly drive the development of the fish and shrimp aquaculture in that region. We understand that the prerequisite of rural revitalization is industrial revitalization, which requires technological advancement.

The breeding base was established in the suburbs of a southwestern city in China. While enhancing our product development capabilities, we simultaneously reduced shrimp transportation costs, product waste, and carbon emissions. In addition, the base adopts cutting-edge advanced water circulation technology and a zero-drug, zero-discharge breeding system, significantly reducing environmental and biological pollution.

While further developing our supply chain technology, enhancing our product development capabilities, and serving our consumers, we will continue to insist on our philosophy of “greater power, greater responsibility” and actively devote ourselves to public welfare.

In July, Henan Province in China suffered from heavy rainstorms and floods. We donated 5 million RMB to provide daily necessities, flood prevention supplies, and emergency rescue for the victims.

It is also worth mentioning that we are the first fresh grocery app available for the visually impaired, and we continue to impact disadvantaged groups. 2021 is the fourth consecutive year that we have run our charity donation program for the visually impaired. Our employees accompany visually impaired individuals as one-on-one guides, helping them get outdoors, explore the world, and experience sunshine, nature, and societal concern and care. Our research and development team has scheduled regular visits with visually impaired users to collect their feedback and develop our technology to serve their daily lives better.

In summary, as a new type of supply chain company, we will deepen the integration of internet technology with agriculture, food processing, and neighborhood retail operations to offer high quality and differentiated products to meet the users' ever-growing demands for a happy life.

In the third quarter, we proactively adjusted our strategic focus to efficiency first, with due consideration of scale. As such, we rapidly improved efficiency and significantly narrowed our non-GAAP net loss margin. We are confident that we will further reduce the non-GAAP net loss margin substantially in the fourth quarter.

We are more optimistic now than we were during the IPO process about our expected profitability timeline. Many great companies' growth trajectory is often not linear, but more closely resembles the curve of a smile. Similarly, we may experience slowdowns in growth pace in the coming 1 to 2 quarters. Nevertheless, we are confident that we will achieve new and more solid growth through improvements in efficiency and quality that will complete that perfect smile curve.

China has transitioned from an era of simply meeting basic human needs to a period of prosperity, leading to tremendous changes in people's consumption habits. This is a momentous era. Through deeper engagement in our supply chain and enhancement of our product development capabilities, we will live up to the opportunities presented by the times, create value for consumers, and generate long-term returns for our investors.

Thank you, everyone. With that, I will hand the call over to Ms. Yu, our CSO, to go over the financials.

Le Yu: Thank you, Mr. Liang, and hello, everyone. Before I walk you through our detailed financial results, please note that all numbers stated in the following remarks are in RMB terms, and all comparisons and percentage changes are on a year-over-year basis unless otherwise noted.

In the third quarter of 2021, total revenue increased by 111% year-over-year to RMB6.19 billion, and our GMV to revenue conversion rate increased by 140 basis points year-over-year to 88.2%. This result was primarily driven by a decrease in coupons as a percentage of GMV, and as well as our substantially optimized marketing efficiency enabled by the drip marketing system we launched in the previous quarter.

During the quarter, while revenue growth in tier-1 cities maintained a rapid pace, we experienced even stronger momentum in second, third, and fourth-tier cities. Take Fujian, for example, one of our newest markets, which we entered in late May. With newly added frontline fulfillment stations in this quarter accounting for up to 68.4% of the service grid, average daily orders per station still grew at an amazing speed, up 33.4% from the previous quarter to 1,286.

Because the overall supply of fresh groceries and daily necessities from both online and offline channels in lower-tier cities is relatively inadequate compared to that in tier-1 cities, we believe that consumers in lower-tier cities are ready and willing to switch from traditional offline retail models directly to the on-demand home delivery model.

In addition, our product development capabilities will further promote rapid improvements in our user experience. As a frontrunner of the on-demand home delivery model, we see huge growth potential in these lower-tier cities.

Our gross margin for the third quarter increased by 360 basis points from the previous quarter to 18.2%. As Mr. Liang mentioned earlier, the primary drivers for such improvement were the efficiency gains and the continued enhancement of our product development capabilities empowered by our long-term investment in our supply chain. We are confident that our product development efforts will further improve our gross margin and, more importantly, serve as a basis for attracting more consumers and cultivating their brand loyalty.

In the third quarter, non-GAAP fulfillment expenses as a percentage of total revenue increased slightly from the previous quarter to 37%, primarily due to the higher revenue contribution from new markets, the resurgence of Covid in some regions, utility cost increases during summer, and high-temperature subsidies to delivery riders. New markets tend to have lower order density and therefore, higher fulfillment expense ratios than mature markets.

Meanwhile, we have made significant improvements in average daily orders per frontline fulfillment station in new markets, which is a core indicator of order density. As order density in new markets increased, fulfillment expenses as a percentage of total revenue naturally decreased substantially. For example, from the unit economics perspective, Q3 fulfillment expenses as a percentage of total revenue decreased by 810 basis points from the previous quarter in southwestern markets. As such, we are confident that fulfillment expenses as a percentage of total revenue will continue to decrease as overall order density rises.

With the change in strategic play from “scale first, with due consideration of efficiency” to “efficiency first, with due consideration of scale”, our marketing expenses as a percentage of total revenue were 6.9% in the third quarter, representing a decrease of 190 basis points from the previous quarter. The improvement was primarily driven by a decrease in user acquisition costs in both online and offline channels. Despite that, the number of new users still increased by 14.7% sequentially.

Going forward, we will focus more on the quality of new users and reduce the number of ineffective users while steadily acquiring new users. We will strictly manage user acquisition costs in each channel and attract more users with higher consumption potential.

Our non-GAAP G&A expenses as a percentage of total revenue decreased from 2.9% a year ago to 2.3% in the third quarter, thanks to our growing economies of scale. We believe that technology and data are crucial for operating the on-demand home delivery model, and thus, we increased our investments in product development accordingly. To be more specific, we invested more in our supply chain systems and personnel with agricultural technology expertise this quarter.

As such, our non-GAAP product development expenses as a percentage of total revenue increased to 4.1% in the third quarter from 2.9% in the same period last year. We believe our investments in technology and data will generate great value throughout the full cycle of our supply chain shortly.

On our last earnings call, we announced our guidance to reduce our non-GAAP net loss margin by 400 basis points in the third quarter. We managed to beat our guidance by reducing our non-GAAP net loss margin by 530 basis points from 37.2% in the previous quarter to 31.9% this quarter. We are confident in our ability to sustain this momentum and further narrow our non-GAAP net loss margin in the coming quarter.

Net cash outflow from operating activities was RMB1.3 billion in the third quarter. Considering supply chain finances, adjusted net cash outflow from operating activities improved to RMB0.8 billion. Our Capex in the third quarter was RMB0.1 billion. Our cash, cash equivalents, restricted cash, and short-term investments totaled RMB6.8 billion as of September 30, 2021.

To sum up, we not only achieved satisfactory top-line growth, but also narrowed our non-GAAP net loss margin in the third quarter. From the user perspective, the number of average monthly transacting users increased by 24.2% from the previous quarter, and users' repeat purchase rate and purchase frequency improved.

In terms of our supply chain, the percentage of direct sourcing in fresh grocery supplies increased to 79.1% in the third quarter. In the long run, we will continue our commitment to providing consumers with better and safer products.

For the fourth quarter, we will remain focused on serving higher-value users, improving our non-GAAP net loss margin, and growing our GMV on a year-over-year basis. We will continue to improve our gross margin while further benefiting from our upfront investments in the supply chain, increasing the GMV contribution from our private label brands and in-house products, and optimizing our product mix.

In terms of our non-GAAP net loss margin, we expect to achieve a greater sequential improvement in the fourth quarter than in the third quarter. In Shanghai, the home of our first operation, we expect our unit economics to reach breakeven in the coming quarter, driving unit economics in the Yangtze Delta region to steadily turn positive in the future.

This concludes our prepared remarks for today. Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. (Operator Instructions). Today's first question comes from Eddy Wong at Morgan Stanley.

Eddy Wong: (Speaking foreign language). My question is about the profitability timeline. So as Mr. Liang mentioned that right now, we are more focused on the operating efficiency, and we are kind of slowing down in terms of the expansion in new market. So I just wonder if you can give more color about the profitability timeline, if this is a little bit different versus we previously communicated during the IPO stage.

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your questions. The short answer is yes, we are now expecting a faster pace in delivering profitability than we previously expected. Deriving our total GMV resembles the formula for a cube's volume: length times width times height. The length times width represents our geographic coverage, and its growth potential is seen in our mass expansion capabilities. Our regional mass expansion capabilities have already been thoroughly tested and verified in our track record.

The height of the cube refers to each city's average monthly GMV contribution on Dingdong by the urban population. While geographic expansion, or as we call it, length times width, is a relatively simple task for us. Growing the height is comparatively challenging, as it tests our product development capabilities, service capabilities, and overall efficiency.

Starting from Q3, we have postponed our expansion into new regions and focused more on improving quality and service efficiency. We believe that this will add the most value to our business in the long run, and it also guarantees the high quality and sustainable growth of Dingdong.

In Q3, our revenue in Shanghai, where we have been operating the longest, grew by over 50% year-over-year, together with a substantial decrease in operating losses at the regional level. As we further enhance our product development capabilities and supply chain, we believe that our penetration rate in existing markets, user purchase frequency, and each city's average monthly GMV contribution on our platform by urban population will improve, despite the slowdown in new region expansion speed.

As such, our path to profitability consists of 3 steps. First, in Shanghai, we expect our unit economics to reach breakeven in the coming quarter, driving unit economics in the Yangtze Delta region to steadily turn positive in the future. Second, we aim to reach breakeven for operating cash flow. Third, we will then target the delivery of positive net income to our shareholders. During the IPO process, we expected to recognize positive net income in Q4 of 2024. We are now even more optimistic about our timeline to achieve profitability based on the current status of efficiency improvements.

Operator: Thank you. Joyce Ju from Bank of America.

Joyce Ju: (Speaking foreign language). I will translate myself. My question is regarding the competitive landscape, and how it affects our strategic direction. We have seen there are a lot of competitors in this like fast-growing segment, including from frontline fulfillment grid model and also the platform model such as JBBJ and Meituan. Could management elaborate a little bit in terms of the recent update of the competitive landscape and how you look at the competitors, and what strategy will you choose to try to stand out from our competitors?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. In terms of user experience, we all belong to the on-demand delivery model, focusing on fresh groceries and daily necessities. The fresh produce and daily necessities market is enormous, and any business model there that generates user value can blossom. The trend of neighborhood retail and digitalization is a consensus among the prominent participants in the on-demand industry, including JD, Meituan, Alibaba and us, reflecting the excellent prospects and strong vitality of the on-demand business model.

We are happy to see a healthy competitive landscape in this large market. While monopoly ages a company, strong competitors ensure that a company is always striving for excellence, just like a day-one market entrant.

Regarding the differences between the platform-to-home model and us, I would like to elaborate on four aspects. First, the supply side of the platform-to-home model is based on offline merchants. Such a platform can quickly expand into many cities and offer users more diversified product selections utilizing society's existing infrastructure.

However, the self-operated model has several other outstanding features such as solid supply chain capabilities, higher quality products, better service experiences, and more efficient delivery services. As a result, the self-operated model is more widely accepted by users and has a higher repeat purchase rate. In the cities where both models exist, self-operated business models usually enjoy a higher order density and a larger scale.

Second, the platform model is a traffic-driven mentality, and it charges fees from offline merchants through traffic allocation. In our opinion, times are evolving. A company's actual value lies in value creation, including developing products for users, ensuring the safety and quality of fresh produce, enhancing supply chain efficiency, and empowering upstream business partners.

Third, we think digitalization is a prerequisite for online services. For example, the platform-to-home model has a more significant inventory management challenge because supermarkets and street markets are its suppliers that also operate offline. In addition, the standardization level of fresh produce in offline retail markets is low, which is also a challenge for online sales. In general, offline merchants face enormous digitalization challenges that restrict their development, efficiency, and user experience.

Fourth, the self-operated model has a higher efficiency in the last-mile delivery. At Dingdong, we deliver from a single point to multiple points, which increases delivery efficiency and lowers the delivery cost per order. In contrast, the platform model usually delivers from multiple points to multiple points, and the starting point for the delivery rider is uncertain, which constrains the development of delivery efficiency, leading to higher delivery costs per order.

To sum up, we believe that those two business models will coexist in the long run but will likely have different market shares because of the differences in their models. We think that self-operated model will grow faster in the future, thanks to the more robust product development capability, better user experience, and higher supply chain efficiency.

Operator: Thank you. Ashley Xu with Credit Suisse.

Ashley Xu: (Speaking foreign language). I have a follow-up on our profitability. In terms of gross profit margin, can we have a more detailed breakdown or more color on the underlying driver of the improvement? And at the same time, can management share more color on the outlook.

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. There are three factors mainly drive the improvement in gross margins. The first is product development capability. Product development capability is our core competency, and also the primary growth driver for our development. While we capitalize on the growth potential of China's consumption upgrade, we will do our part to meet people's ever-growing needs for a happy life by developing more differentiated products and more private label products with better gross margins.

The second is the supply chain. We will continue to invest in our supply chain to enhance its efficiency to empower our upstream partners and further reduce the intermediate process and losses. In addition, we remain committed to our investment in agricultural technology and production and processing capabilities, which will simultaneously help boost our product development capability and increase our gross margins.

Building on our efforts to enhance our product development capability, we will attract more users and increase repeat purchase rates with our differentiated and superior products. In this way, we will avoid being dragged into relying on common promotion tactics used on the internet, such as price wars or special offers, which in turn will raise our gross margins.

In conclusion, as our product development and supply chain capabilities further improve, we are on track to achieve high-quality and highly-efficient development with gradually improving gross margins.

Operator: Thank you. Thomas Chong at Jefferies.

Thomas Chong: (Speaking foreign language). We have seen private labels have been ramping up very quickly. I just wanted to get a sense about our strategy for private labels, as well as the outlook.

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. First of all, we see opportunities in consumption upgrades, so we will be focusing on developing differentiated and superior products for our private label brands, instead of simply replicating the top-sellers on the market. Second, Dingdong will not compete with leading upstream suppliers directly. We mainly focus on areas that require technological breakthroughs and long-term investment. We will work hard to maintain a sound supply chain ecology and hope to promote the industry's progress.

Dingdong has always believed in the seed spirit. A tiny and well-planted seed will grow into a towering tree in the long run. Therefore, we will not just force the development speed and scale of our private label brands. Instead, we are steadfast in adhering to our principle of applying rigorous attention to detail to every product to lay a solid foundation for future prosperity.

Operator: Thank you. Robin Leung at Daiwa.

Robin Leung: (Speaking foreign language). Could management share more on the unit economics improvement in Shanghai, for example, the number of daily orders for warehouse and also the number for other mature cities? And for the new added warehouse, do we see a faster-than-before breakeven timeline because of the declining user acquisition cost trend in the industry?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. I would like to ask our CSO Yu Le to answer this question.

Yu Le: (Speaking foreign language).

(Translated). In Q3, the UE in our mature markets, including Shanghai and the Yangtze Delta region, improved sequentially. For example, our UE was enhanced by two to three percentage points in Shanghai. And in Jiangsu province and Zhejiang province, our UE was enhanced by over four percentage points. Starting in late August, we have changed our strategy to efficiency first, with due consideration of scale. Since then, UE has improved even more than what I just mentioned. In September, the UE in Shanghai was close to the breakeven level.

As our product development capabilities and supply chain further drive the increase in our gross margin and average order value, our order density helps to improve fulfillment efficiency. We believe our unit economics in Shanghai will reach breakeven in Q4. This will in turn drive unit economics in the Yangtze Delta region to steadily turn positive in the future. We are very confident and even more optimistic in our timeline to achieve profitability now than during the IPO process. Thank you.

Operator: And ladies and gentlemen, this concludes your question-and-answer session. I'd like to turn the conference back over to Karen Ji for any closing remarks.

Karen Ji: Thank you again for joining our call today. If you have any further questions, please feel free to contact us or request through our IR website. We look forward to speaking with everyone in our next earnings call. Have a good day.

Changlin Liang: Bye. Thank you.

Le Yu: Thank you. Bye-bye.

Operator: Thank you. Ladies and gentlemen, this concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines.