[DDL] Dingdong (Cayman) Limited
Q1 2023 Earnings Conference Call
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Executives:
Changlin Liang, Founder and Chief Executive Officer
Le Yu, Chief Strategy Officer
Nicky Zheng, Director of Investor Relations

Analysts:
Lauren Zuo, Credit Suisse
Joyce Ju, BAML
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 Ltd. First Quarter 2023 Earnings Conference Call. (Operator Instructions). Please note that this event is being recorded.

I will now turn the conference over to the first speaker today, Nicky Zheng, Director of Investor Relations. Please go ahead, sir.

Nicky Zheng: Thank you. Hello, everyone, and welcome to Dingdong's first quarter 2023 earnings call. With us today are Mr. Changlin Liang, our founder and CEO, and Ms. Le Yu, our CSO.

You can refer to our first quarter 2023 financial results on our IR website at ir.100.me. You can also access a replay of this call on our IR website when it becomes available a few hours after its conclusion.

For today's call, management will provide their prepared remarks first, and then we will be hosting a question-and-answer session.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which also applies to this call, as we will be making forward-looking statements. Please note that all numbers stated in the following management's prepared remarks are in RMB terms, and we will discuss non-GAAP measures today, which are more thoroughly explained and reconciled to the most comparable measures reported in our earnings release and filings with the SEC.

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

Changlin Liang: (Speaking foreign language).

(Translated). Thank you, everyone, and welcome to Dingdong's Q1 2023 earnings conference call. Let's first review the quarter's operational results.

Our GMV was RMB 5.45 billion, and our revenue was RMB 5 billion. Both figures declined year over year due to three primary factors.

First, the lockdowns in Shanghai and nearby areas last March resulted in a shortage of supply and a surge in consumer demand on our platform. Subsequent to China's reopening in December, consumption patterns returned to their pre-pandemic levels. Therefore, as the first full post-pandemic quarter impacted by seasonal factors such as increased travel during the Chinese New Year, our Q1 sales were lower this year. However, Our GMV showed steady growth for January and February, with a 5.3% increase year over year, despite the decline in March compared to the high base of the previous year.

Second, our order and sales volumes in Q1 were also impacted by our decision to stop services in several cities due to difficulties in attaining profitability in the short term. However, it is worth noting that the average order volume per station increased by 7.7% year over year, and order frequency per user rose by 13.8%. This indicates that both order quality and profitability have improved.

Meanwhile, geographically speaking, our GMV in the East China region alone went up 6.3% over last year, demonstrating a significant expansion of our regional reach and operational capability across East China.

Another contributing factor to our Q1 result is that we have completely shifted away from our previous strategy of gaining and retaining customers through subsidies and discounted pricing. Such a change was based on a timely analysis of the post-pandemic consumption trends and opportunities, and a review of our strengths and challenges.

Our new approach entails crafting exceptional and differentiated products to grow user mindshare and build trust and brand attachment. With the expanded order scale, product development has improved, creating a new flywheel. There is a Chinese saying that the deeper you squat, the higher you can jump. Therefore, the temporary slowdown in Q1 was anticipated and was necessary for future development.

In summary, during Q1 2023, there was reduced consumer demand for our products, as China lifted its dynamic zero-Covid policy and people were traveling during the Chinese New Year and engaging in spring outings. We also incurred additional expenses and labor costs to ensure timely order fulfillment during the holiday, remaining open through the Chinese New Year. Despite these setbacks, we are proud that we were still able to achieve our expected non-GAAP breakeven this quarter.

Our operational results demonstrate a remarkable level of efficiency that allows us to make profits. This indicates that our product development strategy is effective and in line with our organizational goals. I would like to provide you with an update on the progress of developing our product.

We have been focusing on Efficiency First and prioritizing product development as our main growth driver since Q3 of 2021. In Q1 of this year, our management team agreed that building trust and brand attachment is key to increasing user mindshare and boosting sales, which will, in turn, empower product development. Our new growth flywheel revolves around this idea.

After analyzing post-pandemic consumer demand and trends, we found that there was a high demand for immunity-boosting and healthy foods. That's why we have been promoting our clean-label series, increasing the proportion of functional food products, and launching healthy food products for specific demographics.

Our company has solid food R&D and processing capabilities that allow us to provide high-quality, nutritious prepared foods that are both tasty and cooked using minimal oil, resulting in low calorie and sodium content. We were pioneers in the industry to prioritize "clean label products." In Q1, our private-label prepared foods made up 19% of our total GMV, and we saw more than 70% increase in private-label penetration. The number of private label products with monthly sales exceeding 10 million RMB each has increased from 7 to 12. Our "Caichangqing" brand, which offers home-cooking-style prepared meals, has a user penetration rate of 27% and generates over RMB 70 million in monthly sales on our platform.

As previously stated in our earnings calls, our selection of baby food, meals, and snacks known as "Mom's Choice" is the epitome of health, traceability, and nutritional planning backed by science. Our entire "Mom's Choice" line contains minimal additives and is subject to rigorous quality control. This category made up 5% of our total sales in the first quarter.

In addition, our "Qingyang Planet" page is dedicated to providing quality food and drink options for health and weight-conscious millennials and Gen Z consumers. We offer a diverse range of low-GI rice, noodles, and pastries, in addition to low-carb baked goods and beers, high-fiber beverages, and low-fat, low-sodium seasonings. Furthermore, we offer the ability to generate customized diet plans based on individual calorie requirements and allow users to archive their calorie profiles. Sales from "Qingyang Planet" contributed to 7.4% of our GMV in the first quarter.

These initiatives clearly demonstrate our continuously-improving product development capabilities. With this growth, we are poised to expand our user mindshare and form a new and improved growth flywheel.

Dingdong is a start-up dedicated to providing safe, healthy, and delicious food to users. Our mission is to innovate relentlessly for the betterment of people's lives. We will leave no stone unturned to create value for consumers and society, while adhering to our roots and maintaining strict discipline. Our beliefs extend far beyond mere profitability, fueling our passion and drive to achieve success both now and in the future.

Based on our current operating situation, we expect to maintain non-GAAP profitability for both Q2 and the full year of 2023.

Thank you for your attention. This concludes my speech. Next, I would like to welcome Ms. Yu Le, CSO of the company, to present the financial results.

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.

In Q3 2021, we began the strategy of "Efficiency First, with Due Consideration of Scale" and focused on product development capability as our core strength and primary growth driver. By an effective execution of this strategy through the beginning of 2023, we have achieved superior product quality with consistency, along with significant product differentiation and diversity in the product mix.

In Q1 2023, GMV was 5.45 billion, down 6.8% year over year. Revenue was 5 billion, down 8.2% over last year. To break it down, the GMV in January and February enhanced by 5.3% over a year ago, and the decline in March was a comparison with the high base from the lockdown in Shanghai last March. Geographically speaking, the GMV of our East China region went up 6.3% in Q1 year over year, due to higher penetration in the region. For the rest of our cities, we recorded lower GMV in Q1. An important contributing factor was that last year, we withdrew from a handful of cities because of the difficulty of attaining short-term profitability.

Our Q1 gross margin was 30.7%, up 2 percentage points over a year ago. Going forward, in addition to deepening our upstream engagement for fresh grocery products, we will also invest in non-fresh-grocery categories, or NFGs, where building differentiated SKUs is easier than in fresh groceries. Such differentiations help increase user mindshare and enhance brand image. NFGs also have better blended gross margins over fresh groceries, with lower fulfillment costs in our regional processing centers and frontline fulfillment stations.

In Q1, the fulfillment expense ratio was 23.9%, down 3.3 percentage points year over year. AOV went up 2.7% over last year, despite the high base from the lockdown, suggesting that we are gaining user mindshare thanks to our superior product-development capability. Average daily orders per frontline fulfillment station increased by 7.7% over last year, which also improved our operational efficiency.

Sales and marketing expense ratio was 1.8%, down 1.5 percentage points year over year. The main driver was our product development capabilities that allowed our flywheel to gain a stronger momentum.

On a year-over-year basis, G&A expense ratio was optimized from 2.2% to 1.7%, and R&D expense ratio from 4.3% to 4.2%. While remaining committed to energy and resource management and environmental protection, we will continue to invest heavily in infrastructure such as food R&D, agricultural technology, and technical data algorithms in order to solidify our competitive edge in the long run.

As projected in our last earnings call, we successfully reached non-GAAP profitability in Q1 this year and optimized our non-GAAP net margin by 7.9 percentage points from a year ago despite multiple headwinds in the quarter. To put this in perspective, the Q1 topline is typically the lowest of all quarters due to Chinese New Year travels and holiday overtime compensation that adds expenses. Especially in this Q1, after China's reopening, we saw the pre-pandemic seasonal factors return to impact on the quarterly performance. Navigating these challenges, we delivered strong quarterly results and continued to demonstrate the viability of our frontline fulfillment grid model.

Our operating cash outflow was 307 million in Q1, mainly due to the sequential decline in GMV at the end of Q1, resulting in a sequential decrease of 422 million in accounts payable. We ended the quarter with 5.7 billion in cash, cash equivalents, restricted cash, and short-term investments.

In Q1, we managed to deliver previous forecast and break even on a non-GAAP basis, despite headwinds such as seasonality and extra labor costs in the quarter. Our success adds confidence in our ability to achieve a full-year non-GAAP breakeven for 2023.

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

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Lauren Zuo with Credit Suisse.

Lauren Zuo: (Speaking foreign language). I will translate myself. Congratulations on another quarterly profit. We're wondering when the company returned to the growth trajectory of scale, and how do you balance scale and profit in the future?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. Let me review the three reasons behind the decline in our sales. Firstly, due to the shortage of supplies during the pandemic, demand increased on our platform, and we fulfilled more orders during the lockdown, which resulted in a high base. Therefore, when the pandemic ended, and the supply and demand returned to normal, we saw a year-over-year decline.

Secondly, after conducting a comprehensive analysis, last year, we exited some cities that were not profitable in the short-term. This reduction in the number of frontline fulfillment stations affected the overall order volume and sales. Finally, we shifted our operational strategy to focus on developing quality products and building user mindshare for long-term growth. Although these adjustments may take some time for users to adapt and have affected the growth of order volume temporarily, it is necessary for our long-term development.

However, by focusing on specific indicators, such as monthly order volume compared to non-lockdown months from the previous year, the daily average order per frontline fulfillment station and order size in East China, we can see that our development has improved year over year. This growth is similar to starting a new exercise routine, where you may initially lose weight, but gain muscle in the long run.

We are confident about our long-term success. We'll continue to generate profits while making necessary operational adjustment for a more stable and healthy development. This will lead us toward a consistent growth trajectory in the near future.

Operator: Joyce Ju with BAML.

Joyce Ju: (Speaking foreign language). During the prepared remarks, Mr. Liang mentioned the growth flywheel twice and said the company has a new one. Could you kindly introduce your new growth flywheel, and what's the driving force for this flywheel? Is this already started to drive the growth or like driving power for the company?

Changlin Liang: (Speaking foreign language).

(Translated). All right. Thank you for your question. Online competition within the e-commerce industry frequently relies on subsidies and price cuts to lure in users and increase traffic. However, our findings have shown that this approach is not sustainable. Firstly, fresh grocery products have a unique characteristic where the quality of the products cannot be guaranteed when relying on discounted prices and subsidies. Overemphasizing low prices and subsidies also contradicts our mission of enhancing the quality of life for our customers.

Secondly, relying on low prices to attract users cannot generate a positive cycle, competitive advantage or profitability. In today's business landscape, a company that fails to generate profits will struggle to survive.

With that in mind, our management team has refocused on our original aspiration and mission as a start-up company that provides nothing but top-quality food. We are unwaveringly committed to producing healthy, tasty and innovative food products that are designed to help people live better, more fulfilling lives.

Our current growth flywheel is to build user mindshare by ensuring that our brand image is of the highest quality, trustworthy and reliable. On this basis, as we increase user purchase frequency, word of mouth, order volume and scale, we will continue to develop superior products and increase profits. This positive growth flywheel is our unequivocal path to success. We understand that gaining, changing and retaining the mindshare of users is a challenging task, but it is also highly rewarding. The key to our flywheel is to consistently create exceptional, unique and innovative products. This requires a long-term commitment.

Our flywheel is gaining momentum. Our “Mom's Choice” product line, which features quality items for children, has contributed to 5% of our total sales. We have also created a dedicated page on our platform named “Qingyang Planet” to cater to millennials and Gen Zers who are looking to maintain a healthy lifestyle. On this page, we offer various healthy food and drink options, including low-GI rice, low-carb bakery products, low-carb beer, high-dietary fiber drinks and low-fat and low-sodium seasonings. This category alone accounts for over 7% of our total sales. In addition, we've introduced many more delicious and healthy prepared food products, which contribute to 19% of our sales. Thank you.

Operator: Thomas Chong at Jefferies.

Thomas Chong: (Speaking foreign language). I will translate myself. Prepared food has been mentioned multiple times in the past several earnings calls, and Mr. Liang mentioned today that private-label products, primarily prepared foods, accounted for 19% of all the GMV. So what's the next step for the development of prepared foods? Is this category profitable for the company?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. Now, our prepared food products are designed to satisfy your cravings without compromising your health. We specialize in authentic dishes that are simply mouth-watering, such as our classic deep-fried mandarin fish in sweet and sour sauce, pork tripe and chicken soup, and hot and sour fish with pickled mustard greens. We understand the need for healthier food options, which is why we have created a range of clean-label products that are additive-free. In addition, we offer low-sugar, low-sodium and low-GI options to cater to all dietary needs. Our ultimate goal is to enrich people's lives through our food choices.

Our next goal is to create a wider variety of prepared food options using innovative methods that prioritize both taste and nutrition. Additionally, we plan to expand our sales channels to include overseas markets, so that people worldwide can savor the deliciousness of Chinese cuisine.

Our prepared food category is proving to be quite profitable, just like many other R&D projects we have undertaken. As we continue to expand our scale, gain more experience and improve our supply chain, we expect this profitability to grow even more strongly. Our goal is not only to become the biggest company in the prepared food segment, but also the most profitable one.

Operator: Robin Leung with Daiwa.

Robin Leung: (Speaking foreign language). Hi, Mr. Liang, can you comment on the current competitive landscape, and who's your biggest competitor? And what's your competitive advantages and weakness?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. We are a start-up company that is committed to providing high-quality food that adds value to both consumers and society. We remain focused on our mission and maintain discipline while keeping an open mind, rather than solely concentrating on competition. Although some of our industry peers have experienced their own share of ups-and-downs, we are committed to steady progress. Instead of viewing others as competitors, we strive to build a collaborative ecosystem that benefits all.

Our company is unique, and we want to work together with our peers to create value for consumers and improve people's lives.

We have many advantages, including strong product development, supply chain management and quality control. Our financial stability allows us to generate profit and abundant cash flow, and our business is gaining momentum. However, we acknowledge that the market is vast, and consumer demands are diverse, and we are only scratching the surface of our potential. We're motivated to work harder to tap into the larger market. Thank you.

Operator: Thank you. This concludes our question-and-answer session. I'd like to turn the conference back over to management for closing remarks.

Nicky Zheng: Okay. 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.

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.