[DDL] Dingdong (Cayman) Limited
Q3 2023 Earnings Conference Call
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Executives:
Nicky Zheng, Director of Investor Relations
Changlin Liang, Founder and CEO
Song Wang, Senior Vice President, Head of Finance

Analysts:
Fiona Fan, Jefferies
Sophia Chi, Daiwa
Jiajing Chen, CICC

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by, and welcome to the Dingdong Ltd. Third Quarter 2023 Earnings Conference Call. (Operator Instructions). Please note that this event is being recorded.

I would now like to 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 third quarter 2023 earnings call. With me today are Mr. Changlin Liang, our founder and CEO, and Mr. Song Wang, our Head of Finance.

You can refer to our third 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 go through their prepared remarks first, which will be followed by 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). Hello, everyone, and welcome to the Dingdong's third quarter 2023 earnings call. During the call today, I will briefly review our operating performance during the quarter, share some thoughts on our instant-delivery retail business, and update you on some of our key business developments.

In the third quarter, we recorded 5.14 billion RMB in revenue, a 6.2% sequential increase. GMV grew by 6.4% sequentially to 5.67 billion RMB and net operating cash flow was 130 million RMB.

Non-GAAP net income margin was 0.3%, marking our fourth consecutive quarter of non-GAAP profitability as we continue to prioritize our strategy of "efficiency first, with due consideration of scale". In addition, we achieved quarterly profitability on a GAAP basis for the second time since Q4 of 2022.

Sustaining profitability over the past 4 consecutive quarters on a non-GAAP basis is critical for both Dingdong and the industry. First of all, it indicates that we have successfully navigated the difficult macroeconomic and competitive environment we found ourselves in, with many doubting the sustainability of the sector. Second, it reflects the corporate flexibility and adaptability we maintain. With the market continuing to change rapidly, these attributes will remain critical to our long-term sustainability.

Third, among the leading companies competing in the sector, we are the first to achieve profitability. It was a long and difficult journey to get here, but we stuck to our principles and vision, which kept us on the right path. Lastly, having reached the profitability milestone, we are confidently looking to the future, where we will maintain sustainable long-term growth.

As I previously mentioned, GMV for the third quarter increased 6.4% sequentially. This growth was largely driven by a 6% increase in total order volume and an 11.7% increase in average order volume per station. While a soft macroeconomic environment led to a decline in the average selling price of some of our top-selling fresh grocery SKUs, and dampened consumers' willingness and needs to stock up following the pandemic, our average order value remained stable year-over-year, with a 0.5% sequential increase, thanks to our continuing efforts to optimize product mix and enhance our product development capabilities.

Building on our previous initiative, we have now upgraded and optimized almost 100 frontline fulfillment stations over the past 10 months across China. In particular, frontline fulfillment stations that were upgraded in Q1 and Q2 have already seen their GMV increase by 15.2% sequentially.

On a year-over-year basis, third-quarter GMV decreased by 13%. Within this decrease, 9.8% was attributable to the suspension of operations for a number of cities and stations starting in Q4 last year. In addition, the return to post-Covid normalcy during the summer holiday season also impacted GMV, as consumers increased offline consumption and resumed holiday travel.

Despite the impact, our users are accessing our services more frequently than ever. The average monthly user order frequency increased on both a year-on-year and sequential basis, increasing to 4.2 orders during the quarter, up from 4 last quarter. Notably, Dingdong members averaged 6.9 orders per month.

We continue to develop our product offerings to foster a culture of using Dingdong for all food-related needs. As a result, nearly 1 million users during the quarter generated monthly ARPU of more than 560 RMB, accounting for more than 48.8% of total GMV. We will continue to focus on serving the needs of both new and existing users.

Looking at the geographical breakdown, our performance in Shanghai was impacted by the high base effect created during the same period last year when pandemic restrictions were impacting the region. While GMV in Shanghai declined year-over-year, the rate of decline narrowed sharply to less than 10%. On a sequential basis, however, Shanghai GMV increased 7.8% in Q3.

At the same time, GMV growth picked up significantly in Jiangsu and Zhejiang provinces, as our user base there continued to expand and existing users placed more orders. These two provinces built on their strong growth momentum last quarter, delivering double-digit growth on both an annual and sequential basis in Q3. Moreover, each region was profitable for the past 4 consecutive quarters, even after allocating headquarter expenses.

Sustainable and stable profitability provides us with additional human resources, operational know-how, and cash to drive growth initiatives in North and South China, where we stabilized the build-out during the quarter and see significant room to further optimize our operations going forward.

Next, I will share our perspective on the current state of the instant-delivery retail industry and the overall consumer environment, before moving on to cover some of our key business developments. As the global economy slows, consumer preferences and shopping habits are changing, and retailers really need to adapt to a complex new environment. What consumers want most in the current environment is certainty, and instant-delivery retail can cater to this by providing reliable service, stable quality assurance, and competitive pricing.

Our core abilities have been directly aligned with these changes in consumer preferences. Since our inception, we have focused on cultivating three core competencies: solid product development capabilities, services that exceed expectations, and a robust supply chain that delivers optimal cost-effectiveness and maximum value for money products. Despite changing market conditions, we remain steadfast in our commitment to these values.

Let me further expand on our service capabilities. We are able to meet high demand among urban consumers for quick and efficient delivery of groceries and other products through a network of self-operated front-line fulfillment stations “as quickly as 29 mins” – something that we have become synonymous with. We are able to provide families with affordable, high-quality fresh food and other products through a timely and reliable home delivery service. Service is critical to exceeding customer expectations.

We are committed to delivering orders in a timely manner through a reliable delivery service. In Q3, we improved order fulfillment efficiency by restructuring our delivery capacity and optimizing scheduling. As a result, we saw a 6.8 percentage point year-over-year increase in rush orders delivered within 40 minutes, while the average earliest available timeslot for scheduled order delivery was brought forward by 14.3 minutes compared to the same period last year.

During the quarter, we optimized our network of regional processing centers to bring them in line with the more stable post-pandemic supply chain environment. As a result, fulfillment expense ratio for regional processing centers decreased by 2.7 percentage points year-over-year and 0.3 percentage points sequentially.

Our product development capabilities remain the core driving force of our business. This year, we implemented a strategy of "extensive SPUs and concentrated SKUs" where we expand SPUs within a product category, and allocate more capacity to top-selling SKUs and phase out slow-moving ones across different regions. In Q3, we offered 10 more SKUs with monthly sales exceeding 5 million when compared to Q1.

GMV contribution from the SKUs with monthly sales exceeding 5 million increased by 4 percentage points during the period. Over the same timeframe, we had three more SKUs with monthly sales exceeding 10 million. GMV contribution from the SKUs with monthly sales exceeding 10 million increased by 2 percentage points. Our SKU selection strategy and strong product development capabilities enable us to create more top-selling products.

Additionally, our efficient supply chain and a larger scale of these products enable us to minimize sourcing costs and maintain a price-competitive product offering. Through this strategy, we have boosted contribution to GMV from best-sellers, phased out excessively long-tail products, and improved product turnover rates.

During Q3, we offered both regular and dynamic scenario-based discounts to pass on more savings to consumers. The discount amount per order increased by 17% compared to Q1, which shows that we can meet the changing needs of our users and offer better products at lower prices. Our focus on selling products with better prices and discounts, and quick turnover creates a scale effect, and the increasing concentration of best-selling products strengthens our bargaining power during the procurement process. This dynamic represents our powerful competitive advantage, and we will continue executing this approach to offer greater value to consumers.

We are more than just a retail company; in fact, we are a food company with R&D and production capabilities. Our top priority has always been to provide our customers with unique, high-quality products. As we grow, our customers are not only buying products on Dingdong, they are increasingly buying Dingdong-branded products. We develop and produce private-label products in 12 self-operated factories in addition to cooperating with high-quality upstream suppliers.

In Q3, we worked closely with our upstream supply chain to create the "Dingdong Handmade Thin Skin" series of rice flour products. After conducting extensive research on consumer preferences, we carefully selected a factory to produce these handmade paper-thin wrappers for wontons, dumplings, and other pastries. The factory manages the production process while Dingdong leads research and development. By cooperating directly with the factory, we are able to ensure the quality of these innovative products.

Our "Dingdong Handmade Thin Skin" products are delicious, affordable, and high-quality, making them a hit with customers. Since their launch at the end of August, they have generated more than 16 million RMB in sales in just over 2 months.

I will conclude with a few words on our outlook. Looking ahead, we are confident that we will achieve non-GAAP profitability for the fourth quarter and full year in 2023. We remain focused on sustaining the healthy and high-quality growth of the business. Thank you all very much.

I would now like to invite Wang Song, our Head of Finance, to review the company's financial performance.

Song Wang: Thank you, Mr. Liang, and hello, everyone. Before I review our financial performance, please note that all our figures are in RMB. During Q3 of 2023, we generated 5.14 billion RMB in revenue, with a non-GAAP net profit margin of 0.3% and net operating cash inflow of 130 million RMB.

We are pleased to report that we achieved GAAP profitability for the second time since Q4 of last year. Amid a rapidly-changing external environment, we remain committed to prioritizing our strategy of “efficiency first, with due consideration of scale”. Through these efforts, we have now achieved non-GAAP profitability for 4 consecutive quarters.

Let's take a closer look. Q3 recorded GMV of 5.67 billion RMB and revenue of 5.14 billion RMB, representing an increase of 6.4% and 6.2%, respectively, as compared to the second quarter this year. The increases were mainly due to a 6% increase in order volume and a 0.5% increase in AOV relative to the prior quarter. These figures indicate improved user loyalty driven by our optimized product structure and product development capabilities. However, GMV and revenue decreased by 13% and 13.5% year-over-year, respectively.

It is also worth noting that we saw double-digit GMV growth in Jiangsu and Zhejiang provinces on both a year-over-year and sequential basis. In addition, our growth rate in South and North China has now stabilized, where we are a relatively new player facing intense competition.

In Q3, gross profit margin increased by 0.4 percentage points year-over-year, reaching 30.4%. This was driven by the continuous improvement of our operational capabilities and efficiency as we expanded along the fresh food supply chain. Our “extensive SPUs, concentrated SKUs” strategy allowed us to leverage our supply chain and product development capabilities to create top-selling products while managing slow-moving ones. This approach also helped us improve supply chain efficiency, resulting in a companywide turnover time of only 10.7 days and 4.5 days for frontline fulfillment stations.

Our end-to-end loss rate was kept below 1.5%. This helped us utilize economies of scale, while improving our bargaining power and optimizing our product mix. As a result, our gross profit margin remains stable while maintaining our ability to provide significant value to our users.

Our fulfillment expense ratio in Q3 was 23.3%, an improvement of 3.5 percentage points compared to the same period last year, reflecting the substantial impact of this year’s optimization measures. We completed the optimization our network of regional processing centers.

Additionally, the fulfillment expense ratio for regional processing centers improved by 2.7 percentage points year-over-year. We have refined our operations to improve labor efficiency in frontline fulfillment stations. Our stations have also seen a 6.6% year-over-year increase in average daily order volume, further boosting operational efficiency.

Selling and marketing expense ratio in Q3 was 1.9%, a 0.2 percentage point improvement from the same period last year. We continue to leverage our product strengths to engage users and enhance our brand image.

Compared to the same period last year, general and administrative expenses ratio improved by 0.5 percentage points and is now at 1.7%. Similarly, R&D expense ratio improved by 0.4 percentage points and is now at 3.9%. We remain committed to investing in research and development, focusing on food research, agricultural technology, and technical data algorithms. We believe that investing in these areas will enhance our competitive edge and deliver long-term value to our investors.

We achieved a non-GAAP net profit margin of 0.3% in Q3, a year-over-year increase of 5.1 percentage points. This marks our fourth consecutive quarter of non-GAAP profitability and the second with a positive GAAP net profit margin since Q4 of 2022.

As Mr. Liang mentioned, our primary goal is to offer customers the most cost-effective and high-quality products through our exceptional services. We will achieve this by focusing on our core competencies: product development, service, and IT-enabled supply chain capabilities. Leveraging these strengths, we will continue to improve our operational efficiency and profitability.

We recorded a positive net operating cash inflow of 130 million RMB during the quarter. By the end of Q3, we had a total of 5.63 billion RMB in cash, cash equivalents, short-term restricted cash, and short-term investments. We maintain close relationships with banks, and our credit line for credit liquidity loans, which can be used at any time, has reached 1.14 billion RMB.

Additionally, credit lines for supply chain financing stood at 9.6 billion RMB. We are constantly optimizing our financing structure to ensure the efficient use of our funds. Compared with the end of September last year, our short-term borrowing balance decreased by 564 million RMB.

Additionally, we are also committed to empowering our suppliers with supply chain financing. As of the end of Q3, our supply-chain finance loan balance was 2.81 billion RMB. After deducting the balance of short-term loans, the fund balance now stands at 1.94 billion RMB. When compared to the same period last year, we achieved a net increase of nearly 320 million RMB in self-owned funds.

Additionally, the improving profitability of our core business provides us with more adequate financial reserves to respond to changes in the market as well as for future operations.

This concludes our speech today. Operator, we can now start the question-and-answer session.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Fiona Fan with Jefferies.

Fiona Fan: (Speaking foreign language). So I'll translate myself. Congratulations on achieving the fourth consecutive quarter on non-GAAP profitability, and another quarter of GAAP profitability. And recently, some of our peers, such as [Hema and YH] have adapted your strategies. Can you provide an overview of the complete landscape in which Dingdong currently operates?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. Before delving into the details of our frontline fulfillment grid model, I'd like to provide you with an overview of our market and highlight the key differentiators between our model and that of our competitors. The market for fresh groceries in China is vast and fractured; it cannot be monopolized. As a startup, Dingdong is committed to providing value to consumers. We believe that many different business models can thrive in this market.

As discussed earlier, we believe instant-delivery retail will bring the sector back to the basics of providing efficient service, better product development capabilities, and competitive pricing. In today's world, efficiency and low prices are critical factors that everyone considers when making purchasing decisions. Low prices result from an improvement in efficiency, not a compromise in quality.

As for fresh grocery products, we continue to work directly with farmers on the ground, cutting out numerous intermediaries in the supply chain. For non-fresh products, we have increased the proportion of private-label products and in-house production to boost our gross profit, while attracting consumers with our exceptional products. In essence, our approach entails improving our product supply, maintaining quality control from the source, meeting a diverse range of user needs, and responding promptly to demand.

Given the current economic environment, I believe our product positioning is relatively advantageous. We mainly focus on offering products that are everyday life staples. For instance, vegetables are a core category, and we enjoy strong customer loyalty in this category. To leverage this, we implemented the strategy of “extensive SPUs, concentrated SKUs”. This approach will allow us to offer a wider range of options to our customers while still focusing on our best-selling products.

Building on our existing advantages and capabilities, we also plan to increase our investment in promotions and discounts to further drive sales of our top-selling products. In doing so, we aim to offer better touch points to customers who are more price-sensitive and deepen market penetration. Thank you.

Operator: Sophia Chi with Daiwa.

Sophia Chi: (Speaking foreign language). Let me translate myself. Congrats on another solid quarter. Could you elaborate on Dingdong's growth strategy under the current macro environment, as well as the competitive landscape? What will be the key drivers for the growth going forward?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for the question. Let me break it down into a few different aspects. First, Our metrics in Jiangsu and Zhejiang are improving rapidly. For example, GMV growth in these provinces increased by over 13% sequentially and around 10% year-over-year. Both markets have achieved overall profitability for 4 consecutive quarters, even after allocating headquarter expenses. We aim to further strengthen the scale and profitability of these two regions and pay more attention to the growth opportunities in South and North China.

Another aspect is that our user consumption frequency has increased this quarter, both year-over-year by 7.8% and sequentially by 4%. This is a very positive trend for our business. We have also seen consistent growth in average daily order volume for our frontline fulfillment stations both year-over-year and sequentially.

In addition, we have found that the longer customers use our service, the more orders they tend to place. On average, users who joined our platform in 2017 place around 6 orders per month, while the 2018 cohort place 5.4 orders per month. This suggests that our existing users are highly loyal and tend to increase their order frequency over time. We are confident that we will achieve sustained growth by meeting consumer needs and retaining users for longer term.

During the third quarter, we collaborated with third-party platforms such as “Ele.me”, which helped us achieve an average monthly GMV of over 50 million RMB, a year-over-year increase of 82%. We also partnered with “Douyin” to offer local life services. By promoting and selling our products via livestreaming, we are reaching new consumers with our instant home delivery services, supported by our full-chain order fulfillment capabilities. We launched this program in September, and achieved daily sales of 340,000 RMB. In October, our average daily sales volume increased by 78%, reaching 600,000 RMB per day. Thank you.

Operator: (Operator Instructions). Jiajing Chen with CICC.

Jiajing Chen: (Speaking foreign language). Let me translate myself. I noticed several improvements in your financial metrics compared to the last quarter. For instance, when looking at your operating cash flow, it was a net outflow last quarter, but it is a net inflow this quarter. Also, short-term borrowings among your current liabilities also improved significantly. Can you please elaborate on these developments?

Changlin Liang: Thank you. Thank you for your question. I will let our Head of Finance, Mr. Wang Song, to answer this one. Thank you.

Wang Song: (Speaking foreign language).

(Translated). Thank you Mr. Liang. Earlier, we provided you with an update on our current cash position and credit lines. In the second quarter, we paid the year-end bonus for the previous year, which impacted our cash flow last quarter, but not this one. Additionally, we made some inventory preparations in September for China's National Day in October, resulting in a net outflow of operating cash. Despite these circumstances, we benefited from improved sales volume and achieved a net operating cash inflow of approximately 130 million in the quarter.

In terms of our interest-bearing liability structure, we have three types of short-term borrowings. The first involves bank borrowings, which is relatively small, amounting to about 510 million RMB. Major domestic banks provide these loans to improve our liquidity. The balance of these borrowings has decreased significantly by 43.9% compared to last year.

The second type is referred to as reverse factoring or supply chain finance, and amounts to about 2.81 billion RMB. The third one is notes payable, and amounts to about 371 million RMB. Our collaboration with high-quality service providers has been crucial to our success, given that we have a complex supplier network with many upstream suppliers.

Our main objective is to work closely with these suppliers to develop superior brands while providing them with stable financial support, resulting in mutual benefits of both parties. That is why we provide the latter two short-term borrowings to them. In sum, we have further optimized our short-term liability structure, leading to a net decrease of 564 million RMB in interest-bearing liabilities year-over-year.

At the end of Q3, our self-owned fund balance was 1.94 billion RMB after deducting the balance of short-term borrowings. We also have sufficient cash reserves. Our net interest income and expenses increased by 21.04 million RMB year-over-year due to the improvement of the overall operating efficiency of funds and financing structure. This optimization helped us to strengthen our balance sheet structure and improve the performance of the P&L.

Operator: As there are no further questions, I'd like to hand the conference back over to management for closing remarks.

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

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.