

[DDL] DingDong (Cayman) Limited
Q2 2022 Earnings Conference Call
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Executives:

Changlin Liang, Founder and Chief Executive Officer
Le Yu, Chief Strategy Officer
Roger Zhu, Senior Director of Investor Relations

Analysts:

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 Ltd. Second Quarter 2022 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, Roger Zhu, Senior Director of Investor Relations. Please go ahead, sir.

Roger Zhu: Thank you. Hello, everyone, and welcome to DingDong's second quarter 2022 earnings call. With us today are Mr. Changlin Liang, our founder and CEO, and Ms. Le Yu, our CSO.

You can refer to our second quarter 2022 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, founder and CEO of DingDong, Mr. Liang.

Changlin Liang: (Speaking foreign language).

(Translated). Hello, everyone, welcome to the Q2 earnings call of DingDong Fresh in 2022. On the call today I will mainly cover three areas. First, I will briefly report our Q2 operating performance. Second, I will discuss our product development capabilities, and lastly, I will share the company's further development plans. Firstly, let me report the company's operating performance in Q2 2022. Our Q2 revenues were 6.63 billion, representing 42.8% year-over-year growth. We also achieved a non-GAAP net profit of over 20 million for the first time, marking an important milestone for our development.

The Yangtze River Delta region, or YRD, in particular, achieved profitability with an operating margin of 3.7% in the first half of 2022. We started our business in Shanghai back in 2017, and gradually expanded to the whole YRD, and then to other cities across China. We have seen that the entire YRD has become a solid market for the company following Shanghai. We are also confident that our product development capabilities, methodology, and management talents accumulated in the YRD will help us grow and serve more users in other cities.

We have prioritized product development capabilities to increase users and orders ever since the adoption of the quality growth strategy in August 2021, and we have made great progress. Specifically, in Q2, of all products sold, we had a total of 217 SKUs that were uniquely DingDong, and our private label accounted for 17.5% of the total GMV, with the majority being developed and processed in-house in our 3F factory. We have become not only a large-scale fresh grocery e-commerce leader, but also a food manufacturer with R&D and innovation capabilities.

As we all know, Shanghai was hit by another pandemic wave from March to May 2022. During that period, we overcame various supply chain and management difficulties to ensure the continuity of Shanghai residents' livelihood. Actually, on an evening in April, one of our riders was driving through a neighborhood on his way back from delivering an order, when he suddenly heard a shout of "DingDong, Jiayou," which means "Cheer on, DingDong" in English. Then many neighbors joined in the chanting. It was the most difficult time in the fight against the pandemic, and we were exhausted every day to fulfill the market demand. But the cheers of our users gave us the strength to battle on.

I also saw a picture of a DingDong rider drawn by a primary school student. The front and back of his scooter were covered with parcels, and each box was painted with a carrot, the DingDong logo. The rider's red cloak was flying high, and the young artist had named the painting Carrot Man. We are proud that our riders have become heroes in the eyes of the children because of their dedication to securing the supply of daily necessities in their fight against the pandemic.

Second, I would like to discuss the cultivation of our product development capabilities. Our last entrepreneurial endeavor before DingDong focused on the mother-child community. We discovered a pain point through that venture: Chinese families were constantly worried about whether their children were eating healthy and safe food. Therefore, we started DingDong to provide our users, especially children, with healthy and safe food products and convenience. Therefore, product quality is not only about our growth and profitability, but also the mission of our founding team.

We have improved our product development capabilities from the following 5 aspects: First, we don't compromise on product quality. Steve Jobs was taught carpentry by his stepfather, who told him, "It is just as important to make the back sides of cabinets and fences right, even though they are hidden." This is what we call craftsmanship, to be meticulous where it is not seen. It is especially true in producing fresh groceries and other food products.

For example, to avoid excessive pesticide residues in the cultivation of leeks and shallots, we visited over 10 provinces in China before finally establishing a reliable planting base that fulfilled our D-GAP and order-based planting requirements. But these efforts and costs are hidden from consumers, who only see that our products appear nicer and fresher than the others, and sometimes at a lower price.

Another example is how we have always advocated for the Clean label on our products. Normally, you would see various chemicals, flavorings, and preservatives densely written on the ingredient list on the product packaging. But our principle is no additives unless necessary. We call this the Clean label, which we achieve through the continuous improvement of technology. Even though by doing this, our costs sometimes increase, and although our clean products may not taste as savory as those with additives, we ensure the health and safety of our consumers first and foremost.

Second, we keep developing more signature products unique to DingDong. As mentioned earlier, we have private labels, and we are increasing contribution from in-house developed products. We have become a food manufacturer with proprietary R&D and innovation capabilities. In Q2, we had a total of 217 SKUs of signature products. For example, our 1972 farm-to-table craft beer, jointly developed by DingDong and Qiandaohu Brewery, can be delivered to consumers within 24 hours of shipping from the brewery, thus maintaining the beer's delicate taste and ultimate freshness.

Another example is that, by transforming and applying the patented technology of Jiangnan University, we have exclusively developed the Kongkakongka prune enzyme drink, which is the fusion and sublimation of California prune, citrus fiber, probiotic fruit, and vegetable enzymes. The drink achieves a refrigerated shelf life of 45 days with zero preservatives, making it a delicious choice for young users to maintain a healthy intestinal tract and a fit physique.

Our bakery's self-developed Lotus Dimsum, which combines deliciousness and oriental aesthetics, coincided with the release of the hit TV series Meng Hua Lu, which introduced a similar dim sum from the Song Dynasty. The strong cultural resonance between the two struck a chord with many young female consumers and was widely publicized in domestic and

international media. Eating DingDong's Lotus Dimsum while binge-watching the TV drama series became trendy.

Our prepared food category, which exemplifies our prowess in consumption, scenario development and manufacturing efficiency, continued to advance with the launch of the Air Fryer Gourmet and Vegetarian Prepared Food series in response to emerging consumer trends. This has further broadened consumption scenarios, enriched the user experience of our prepared food, set the direction for future healthy prepared food expansion, and augmented DingDong's leading position in the prepared food segment.

Third, we have significantly strengthened our research efforts on user consumption trends and improved the success rate of our new product development. With our strong data analysis capabilities and loyal user base, our product research department produced 15 consumer insight reports in the first half of 2022, and organized over 10 user testing sessions with nearly 1,000 participants. The consumers gave opinions on product selection and development adjustment directions, which strongly supported key products' market positioning and selection, and subsequent growth strategies early on, thus significantly increasing the success rate in product development.

Fourth, we have developed more consumption scenarios to efficiently discover new consumer needs, define new product specifications, and cultivate new labels. Executing our mission of making healthy food for every child and family, we created a specialty category called Moms' Choice. Products of Moms' Choice must pass through a comprehensive development system of origin traceability, scientific nutrition, minimum additives, and strict quality control, which eliminates parents' worries about food safety.

DingDong also became one of the first companies to meet the low-sugar-content food standards. At the same time, through our Recipe of the Day initiative, which offers varied recipes each day of the week, and our One-Click Add to Basket app feature, parents can easily plan nutritious and delicious meals for their children. Through the Grow with You section, parents concerned about their children's physical development can access diverse food options and scientific nutrition knowledge. Through Moms' Choice, we have explored the fusion of products + health services to increase user loyalty and operational profitability.

In addition to Moms' Choice, which provides superior value by integrating products with service, we also have a similar category for young people who love fitness and health, and a project in the pipeline for urban seniors who want to live an elegant and healthy lifestyle. As the general consumer group changes from a family-based unit to an individual or even a label-based individual, DingDong keeps launching dedicated categories serving targeted groups of loyal users, and has grown into a food development and brand matrix operation company with unique advantages.

Fifth, we are strengthening our infrastructure. As we have explained in previous earnings calls, DingDong has the largest high-standard, semi-automated warehouse and over 10 food factories, and we are building 3 additional large-scale 3F factories. We have also invested generously in food R&D and quality control, which are slowly paying off, ensuring that we launch more unique or industry-leading products while enhancing our product development capabilities.

Finally, I would like to touch on DingDong's future development plans. Firstly, I want to emphasize that DingDong will stay focused on the fresh grocery and food business. By comparison, our peers have attempted various business models in the past few years, while we upheld our commitment to the frontline fulfillment grid model for the past 5 years despite our struggles and challenges. We call it the "clumsy spirit," which is also reflected in the fact that we have been persistent in doing fresh groceries and food, whereas our peers have branched out to other categories. Food is our lifelong passion.

Why? Because food is a necessity. Fresh food is not ordinary consumer goods. We aim to ensure not only food availability, but also food quality. We strive to bring happiness and passion for life to the public through food, and to infuse inspiration and soulfulness into food. Only a team with unwavering, wholehearted commitment and dedication can achieve this goal.

That is why we choose to go deep while our peers choose to go broad. We will stay grounded, focused, and dedicated. We will continue strengthening our product development capabilities, reinforcing the supply chain, increasing investment in infrastructure, and working tirelessly for the cause of food. China's food market alone is worth over RMB10 trillion, not to mention the international space. The food market is large enough to give rise to many successful and great enterprises.

Our second development plan is to improve the user experience. Our user experience was affected during the lockdown because of the difficulties in managing the supply chain, warehouses, and frontline fulfillment centers. After the lockdown, we quickly mobilized resources to improve user experiences. Going forward, we will reconfigure our logistics and warehousing systems to establish precise warehouse locations and accurate inventory. We will optimize our service process to improve the efficiency of our staff and warehouses to serve a broader user base and expedite deliveries.

At the same time, we will strengthen the recruitment and training of frontline personnel and provide them with industry-leading remunerations and career advancement options, to enhance their sense of joy and achievement, as we firmly believe that happy riders lead to superior customer experiences.

Finally, I would like to conclude that the milestone profit we achieved in Q2 was partially a result of the lockdown. Looking ahead to Q3, we may expect a slight loss. However, comparing our post-lockdown and pre-lockdown numbers, we expect the net loss margin to narrow continuously while we sustain our revenue growth. And we are confident that DingDong can be fully profitable by the end of this year.

Thank you, everyone. With that, I'll 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. All comparisons and percentage changes are on a year-over-year basis unless otherwise noted.

In Q2 2022, we maintained quality growth, with revenues increasing 42.8% year-over-year to 6.63 billion. Our product development capabilities and operational efficiency have significantly

and steadily improved since we began implementing the strategy of efficiency first, with due consideration to scale, at the end of August 2021.

Our non-GAAP net loss margin has narrowed consistently to 37.2%, 31.9%, 18.9%, and 7.8% over the past 4 quarters, respectively. This quarter we also reached a positive non-GAAP net margin of 0.3% for the first time, up 37.5 percentage points from Q2 2021.

Now, let's look at the Q2 results in detail. The company's revenues reached 6.63 billion, representing year-over-year growth of 42.8%. The GMV-to-revenue conversion rate was 93.2%, up 6.9 percentage points from the same period last year.

The gross margin in Q2 was 31.6%, up 17 percentage points year-over-year and 2.9 percentage points quarter-over-quarter. This is because we kept developing and diversifying the source of our supply. For example, our newly-developed food production and processing initiative improved our product R&D capabilities, expanded our processing scale and boosted our product sales, thus increasing our production's positive contribution to gross margin.

Data analytics also empowered our order-based production and reduced production inefficiency and wastage. In addition, a high percentage of direct sourcing has penetrated not only the fresh produce, but also the non-fresh-produce categories. The final step of our supply chain is doorstep delivery, providing convenient, reliable and reputable value-added services to the consumers.

In summary, the long, multi-linked and deep supply chain has not only brought us differentiated products that dominated the mindshare of users, but also generated higher gross margins.

The fulfillment expense ratio in Q2 was 23.2%, down 13.2 percentage points year-over-year, mainly driven by the improvement of Average Order Value and enhanced frontline labor efficiency. Q2's sales and marketing expense ratio was 2.2%, down 6.6 percentage points year-over-year. Our product development capabilities have become a new source of user traffic, reducing both online traffic acquisition expenses and offline marketing expenses significantly, while optimizing average customer acquisition costs.

Thanks to the scaling effects, our G&A expense ratio was optimized to 2.3% from 6.6% in the same period last year, down 4.3 percentage points. Our R&D expense ratio declined to 3.8% from 4.4% last year, despite its absolute value increasing by 23.7% year-over-year. Going forward, DingDong will keep investing in food R&D, agricultural technology, technical data algorithms, and other infrastructure. These investments will strengthen our competitive advantage and create a long-term return for investors.

We further improved our efficiency in Q2, with a net loss margin of 0.5%, down 41.2 percentage points from last year. We also achieved a positive non-GAAP net profit margin of 0.3% for the first time.

We achieved a net profit in Shanghai back in December 2021. Today we are pleased to report that our P&L has turned positive for the entire Yangtze River Delta region in both Q1 and Q2 of this year. Meanwhile, in the first half of this year, the Yangtze River Delta region achieved 47.9% year-over-year revenue growth. Such quality growth and rapid optimization of our unit

economics is a strong testament to the profitability of DingDong's business model and the responsiveness of our organization.

In Q2, we had 220 million cash inflow from operating activities. By incorporating supply chain finance into our cash management, we attained 880 million actual operating cash inflow. As of the end of Q2, we had 6.1 billion in cash, cash equivalents, restricted cash, and short-term investments.

The pandemic has led to many uncertainties that increased our operational difficulties greatly. However, we undertook these challenges and enhanced our organizational capabilities, supply chain adaptabilities and responsiveness. These improvements will remain our most valuable assets. Driven by the growing product development capabilities, we also realized quality growth and a non-GAAP positive net margin in Q2.

As we established word-of-mouth on our product development capabilities among consumers, comparing our pre-lockdown and post-lockdown performances this year, we also saw a significant increase in the AOV post-lockdown and an improvement in our operational efficiency, which validated our efficiency first, with due consideration to scale strategy.

Looking ahead to Q3, we expect quality revenue growth with narrowing losses compared to the pre-lockdown Q1 this year. We also expect to achieve a single-month, non-GAAP breakeven in December this year.

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

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). When asking the question, please state your question in Chinese first, then repeat your question in English for the convenience of everyone in the call.

And our first question comes from Joyce Ju of Bank of America.

Joyce Ju: (Speaking foreign language). I will translate my question by myself. Recently, we noted there is a close competitor of the company was reportedly having some difficulties in terms of cash flows and also a shrinkage in operations. We wonder like if management can share some color in terms of your viewing in the market, competitive landscape. How this company's business or like situations will actually affect DingDong's in terms of like competitive landscape in terms of capabilities, in terms of the relationship with the customer, and also the suppliers?

Changlin Liang: (Speaking foreign language).

(Translated). Okay. Thank you for your question. Indeed, the news has triggered heated discussions recently. First of all, we rarely comment on our peers. It's more important to focus on

what we do than to point fingers. Also some people think that the whole industry is doomed when they see one company in trouble. We strongly disagree with such a simple linear way of thinking. Even in the same industry, the differences between companies can be drastic. DingDong is very unique in our industry. We have always been focused on one thing, always paid more attention to the needs of our users, and then pushed ourself to progress. We don't cut corners, we don't compromise. We are committed to developing product development capabilities, which have gained us love and trust from our users. Any company loved by its users is a promising company.

We also hope that the society can be more tolerant towards entrepreneurs, and wish entrepreneurs who encounter difficulties will persevere in a moment of darkness and usher in a bright future. That's all for my answer. Thank you.

Operator: Ashley Xu of Credit Suisse.

Ashley Xu: (Speaking foreign language). I just want to check, during the lockdown period, other than our revenue growth, any other improvement or development, especially in terms of our operation or supply chain that is worth sharing?

Changlin Liang: (Speaking foreign language).

(Translated). Okay. Thank you for this particularly good question. In addition to our revenue growth, DingDong has grown in three areas after the lockdown. First, we have established a more flexible and adaptive supply chain, and a responsive organization. During the lockdown, we faced various problems, including supply disruption, logistic blockages, our regional warehouses and frontline centers are being locked down, and personnel management difficulties.

However, we adapted and created new supply models; for example, using direct delivery by merchants and neighborhood group buy, not only ensured supply during the lockdown, but also calmed prices and sharpened in our supplying system to hold the basic duty of securing supply in case of unexpected incident.

Second, we have improved the cohesiveness of the team. During the lockdown, the workload was heavy, life was tough, and there was the risk of being quarantined at any time. We were under unprecedented pressure, but we all took it upon ourselves to maintain supplies for local residents, creating plenty of heroic stories. Everyone here at DingDong could also feel the sense of accomplishment from serving our users. After the lockdown, we, as a team, became more united.

Third, DingDong had been with our customers throughout the lockdown, keeping supplies and prices stable. And as a result, we are loved by more customers than ever before. Whether it's routine consumption or lockdown purchases, DingDong is always a destination that you can trust, without a doubt.

Finally, I'd like to highlight that we have been complying with the government's pandemic control requirements, and fulfilling our basic duties as a daily supply company for the general public. We also wish that the pandemic -- we hope that the pandemic will end soon, and that everyone can enjoy a healthy and stable life. Thank you. That's all for my answer.

Operator: Thomas Chong of Jefferies.

Thomas Chong: (Speaking foreign language). We are seeing a very good job in achieving profitability in Q2. How should we think about the situation in Q3 and Q4? And when should we expect full year profitability? And also before you reach full year profitability, how should we think about our cash flow? Will there be any issues? Thank you.

Changlin Liang: (Speaking foreign language).

(Translated). All right. Our CSO Ms. Yu will take your question.

Le Yu: (Speaking foreign language).

(Translated). Okay. Thank you, Thomas, for your question. First of all, Q2 was a very difficult period for the company, and the operational headwinds were tremendous under the influence of macro factors. However, the good thing is that the company's staff were united to battle the challenges, and we finally achieved quarterly profit in Q2.

We also observed very positive progress post-lockdown compared to pre-lockdown period both in terms of product development capabilities and user satisfaction, which are the aspects that we care about most, and also about core performance indicators, such as the AOV and penetration rate, we also achieved very positive progress as well. Therefore, we believe that our non-GAAP net loss will be down at least 3 percentage points in Q3 compared to the pre-lockdown Q1. And Q4 will be further optimized on the basis of Q3.

Second, in January this year, when we were all still completely in the dark about the subsequent lockdown, the management had already set the goal of achieving a single-month breakeven by the end of the year, a goal that we have never changed. And we are still convinced that we will achieve this goal.

Finally, although there is no change in the timing of us achieving full profitability, the Q2 result objectively optimizes our loss ratio and cash outflow for the year. So for Q3 and Q4 this year, our loss and cash outflow will be significantly optimized compared to the same period last year. Next year, we forecast that the company will still be cash flow-positive, and as of the end of Q2, our cash balance was RMB6.06 billion. Banks have been working more closely with the company, with short-term bank borrowings increasing to RMB890 million. In Q2, many banks have given us higher credit limit on loans after renewal at the end of the term.

In short, we don't have many capital spending needs at the moment, and the balance on the books is still quite sufficient. So we think that the company is not at any cash flow risk. Thank you. That's all for my answer.

Operator: Robin Leung of Daiwa.

Robin Leung: (Speaking foreign language). Congratulations on the strong set of results. Some investors have concern on the frontline warehouse models, given what happened to Miss Fresh. Also, some competitors in the local retail industry explicitly said frontline warehouse is not going to work. Could management share your thoughts on that?

Changlin Liang: (Speaking foreign language).

(Translated). Well, thank you for your question. First of all, I'd like to draw your attention to the fact that, excluding the 3 months during the pandemic when the lockdown hit hard, DingDong has been able to continue improving its loss ratio for 10 consecutive months. And we are very confident that we will achieve full and sustained profitability by the end of this year. Therefore, we have a strong belief in the frontline fulfillment grid model. There are many analyses of this model on the market, and they are up for you to judge.

But we often forget that the most important criteria to assess the pros and cons of the model are whether it really meets the needs of the users, and whether it's in line with the changing trend of user consumption behavior. Only the users' choice can determine the success or failure of a business model.

The frontline fulfillment grid model enjoys the highest efficiency, the fastest delivery, and can better control the quality of fresh food. This model meets the needs of consumers for a better life, and caters to the younger generation of new consumption habits. With that, we firmly believe that this is a business model with a bright future. And we, in turn, push ourselves to strive for progress. When people think that the gross margin of fresh groceries is low, we improve it by making the supply chain deeper and stronger. When people criticize the losses and the high loss rate in fresh groceries, we improve it by enhancing our order density and improving our prediction and product recommendation technologies. As a result, our recommendation is excellent today, and our loss rate is far lower than the traditional fresh produce peers. When people think that the quality control of non-standardized or non-standard product is difficult, we standardize the process, and we increase human resources and technology investment. As a result, our quality control now is industry-leading in the entire fresh grocery industry.

Our way of thinking is identifying the users' needs, and then pushing ourselves to improve accordingly. Some people see problems and immediately, they try to be smart and announce to the world that they know everything. Others, on the other hand, keep their heads down and solving problems. In fact, entrepreneurship is the process of problem-solving. Why do we need entrepreneurs if there is an perfect industry, with a huge, highly lucrative market with no problems or difficulties? Thank you.

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

Roger Zhu: 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: The conference has now concluded. Thank you for attending today's presentation, and you may now disconnect.