[DDL] Dingdong (Cayman) Limited
Q2 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:
Thomas Chong, Jefferies
Joyce Ju, Bank of America
Robin Leung, 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. Second 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 second quarter 2023 earnings call. With us today are Mr. Changlin Liang, our founder and CEO, and Mr. Song Wang, our Senior Vice President.

You can refer to our second 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 later 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). Hello, everyone, and welcome to Dingdong's 2023 second quarter earnings call. I’ll start by providing a brief overview of our operating performance in Q2 2023.

In the second quarter, we recorded 4.84 billion RMB in revenue, with a non-GAAP net profit margin of 0.2%. If excluding one-time expenses, we were profitable on a GAAP basis. At the same time, if we exclude the impact of year-end bonuses issued in Q2, we were operating cash flow positive. This strong performance reflects our steadfast commitment to our Efficiency First with due Consideration of Scale approach, which has resulted in 3 consecutive quarters of non-GAAP profitability.

Our GMV reached 5.32 billion RMB in Q2. A year ago, at the height of the pandemic, we successfully met surging consumer demand by quickly adapting to difficulties across our supply chain and operations, which resulted in a strong operational performance. Despite the high base effect set in Q2 last year, we managed to achieve a 5% year-on-year increase in monthly order frequency, surpassing 4x per month for the first time.

In addition, our ARPU increased by 8% year-on-year, and our member penetration rate improved greatly, with members contributing 54% of the total GMV. This is a 10-percentage point year-on-year increase.

Thanks to our product development capabilities and full-chain operational capacity, we also made continuous improvements to overall order quality and user stickiness, even with the retail environment normalized post-pandemic. This reflects our commitment to optimizing operational efficiency to meet the evolving needs of our users.

Next, let me review our progress on the product front. Our exceptional product development capabilities are a key growth driver, enabling us to establish robust competitive advantages. We have developed numerous products that are unique to Dingdong, and our brand is gaining popularity among users. This quarter, we launched the Delicious Kylin Ranking, which highlights top-rated products that have been reviewed by experts and select users assessing everything, including deliciousness, uniqueness, and the amount of additives. This feature is creating significant growth opportunities for our outstanding products.

Since Free-Range Silkie Chicken was added to the Delicious Kylin Ranking in April, we have seen a remarkable increase in exposure, transaction volume, and customer loyalty. Our average monthly exposure has surged by 200%, while monthly average transaction volumes have skyrocketed by 360%. Additionally, the 30-day repurchase rate increased by 5.4 percentage points.

Another product that has grown, thanks to the Delicious Kylin Ranking, is our private label Striped Mochi Roll by Bao’s Bakery. In the space of just 1 month, its average weekly exposure increased by 80% and its average weekly revenue more than doubled. Fueled by this new promotional channel, we are confident that more and more customers will discover and appreciate our high-quality products in the future.

We are constantly striving to improve the user experience for our valued members. Our team has been hard at work customizing nearly 100 high-quality products exclusively to meet the unique needs of our members in East China. Our existing member benefits, such as free dishes, member-exclusive products, member-exclusive discounts, and super-member days, are just the beginning. We will continue introducing even more benefits to incentivize and reward our loyal members.

We are proud to share that in the second quarter of this year, member GMV increased by 10 percentage points year-on-year and 2.4 percentage points sequentially, while their order frequency increased by 9% year-on-year and 5.2% sequentially. Despite the high base effect created by the pandemic last year, quarterly member ARPU increased by more than 10% year-on-year.

Next, I would like to update you on the progress we have made in our supply chain. Our supply chain improvements have been a key driver of our recent profitability, alongside our product development capabilities. We have always adopted a long-term approach to every aspect of our operations. Through sustained investment in R&D and technology and continuous upgrades to every link in the supply chain, we can now digitally manage procurement, production, processing, warehousing, fulfillment, and distribution, covering everything from people, goods, logistics, and warehousing.

Our proprietary algorithms enable us to predict order size with AI technology, perform category planning, optimize pricing, provide search recommendations, replenish supplies, and manage inventory. Even with thousands of frontline fulfillment stations processing millions of FDC-SKUs daily, we still managed to upgrade our algorithm to drive consistent improvements in operational efficiency, resulting in a decrease of nearly 1 percentage point in the full chain loss rate of all categories in each of the past 3 years.

Our loss rate of unsalable goods has been carefully managed down to less than 0.5%, a rare achievement in the fresh food e-commerce industry.

Our order volume was up 2.3% sequentially. We are confident that there is still room for additional growth in the East China region, and are working hard to optimize the network layout of our existing frontline fulfillment stations. Our frontline fulfillment stations in East China saw a 5% increase in average daily order volume sequentially. In the first half of this year, we upgraded, split, and optimized the layout of nearly 100 frontline fulfillment stations in East China, which has improved both our out-of-stock rate and fulfillment efficiency.

We are confident that we can achieve full-year non-GAAP profitability in 2023, and that we will maintain healthy and high-quality growth throughout the year.

Thank you all. That concludes my remarks.

Next, I would like to invite Wang Song, our Senior Vice President and Head of Finance, to review the company's financial performance.

Song Wang: (Speaking foreign language).

(Translated). Thank you, Mr. Liang. Hello, everyone. Before I review our financial performance, please note that all our figures are in RMB.

During Q2, we remained committed to achieving high-quality growth by following our Efficiency First with due Consideration of Scale strategy. We have achieved non-GAAP profitability for 3 consecutive quarters through our ongoing efforts to improve operational efficiency and optimize costs and expenses.

We also achieved a non-GAAP net profit margin of 0.2%. Additionally, if we exclude one-time expenses, we were profitable on a GAAP basis.

Now let's dive in. In Q2, GMV was 5.32 billion RMB, a decrease of 25.2% from the same time last year, while revenue was 4.84 billion RMB, a drop of 27%. As previously mentioned by Mr. Liang, the primary reason for the decrease was the high base effect created during the same period last year, when the pandemic restrictions were impacting Shanghai and other regions. During that period, we successfully navigated supply chain and operational challenges to fulfill the surge in consumer demand.

Given the base effect and short-term macro headwinds, we experienced a decrease in average order value or AOV on a year-on-year and sequential basis. However, we remain confident that with the continued optimization of our product offerings and a gradually improving macroeconomic environment, AOV still has substantial room for growth.

Although gross margin decreased by 0.6 percentage points year-on-year in Q2, it remained stable overall at 31%. To achieve sustainable growth, we plan to continue focusing on product development as our core driver and deepen our supply chain engagement. Upgrading and optimizing our systems and algorithms will help improve operational efficiency in our supply chain, lower costs, and increase profitability. We aim to establish this as our competitive advantage, resulting in stronger profitability in the long term.

Fulfillment expense ratio increased by 0.4 percentage points year-on-year to 23.7%. This was due to last year’s pandemic, which created a high AOV base effect. Despite this, our average order fulfillment cost decreased by 7.8% year-on-year, indicating continued improvement in our efficiency on the fulfillment side.

We are committed to enhancing efficiency across every aspect of the fulfillment process, which is reflected in the significantly improved efficiency of our mainline logistics and transportation unit. Average mainline logistics cost per order dropped by 8.4% year-on-year.

Additionally, we are passionate about conservation and environmental protection, and achieved a 17.6% year-on-year reduction in the cost of packaging consumables per order.

Marketing expense ratio was 1.8%, down 0.4 percentage points compared to the same time last year. This highlights our success in using product development as our main source of traffic by creating distinctive and unique products that attract a greater number of target customers and boost user retention.

We are also pleased to report that our G&A expense ratio decreased by 0.5 percentage points compared to last year, and is now at 1.8%.

While our R&D expense ratio increased by 0.3 percentage points year-on-year to 4.2%, we remain committed to investing in food R&D, agricultural technology, and our algorithms, while advocating for our conservation and environmental protection. These investments will strengthen our competitive advantage in the long run.

Our infrastructure investment in these areas has already yielded significant efficiency improvements, and we have also adopted cloud computing, big data, e-commerce, and supply chain applications to optimize our systems and reduce costs. As a result, our IT service costs decreased by 23.7% year-on-year in Q2, while maintaining consistent service quality and system stability.

During Q2, we achieved a non-GAAP net profit margin of 0.2%. As previously mentioned, after excluding one-time expenses, we were profitable on a GAAP basis. This demonstrates that we can continuously improve our product development and full-chain capabilities, leading to better operational efficiency and profitability, even in the post-pandemic environment.

Operating cash outflow was 178 million. We achieved positive operating cash flow when excluding the payment of year-end bonuses for 2022. Our cash and cash equivalents, short-term restricted cash, and short-term investments totaled 5.52 billion at the end of Q2.

We proactively optimized our financing structure by reducing short-term and supply-chain financial loans, which decreased the loan balance by 127 million. Although this was the main reason for the decrease in our balance of cash, we have ensured sufficient operating funds to serve our suppliers with supply chain finance.

We are highly confident in our ability to attain non-GAAP profitability in the remaining quarters and for the full year of 2023.

This concludes our speeches today. Operator, now we can enter the QA session.

Questions and Answers

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

Thomas Chong: (Speaking foreign language). Hello, Mr. Liang, congratulations on achieving 3 consecutive quarters of non-GAAP profitability. Can you introduce the current development of the company in different regions? What is your specific focus in different regions?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. To address the challenges presented by the pandemic, we strategically prioritized our efforts in Shanghai during the first half of last year. As we progressed into Q3 and Q4, we shifted our focus to Jiangsu and Zhejiang. Our plan was to optimize efficiency, enhance order density, and increase ROI in our existing focus areas before expanding further. Once the gross profit margin stabilized in East China, we could then concentrate on improving operational indicators in North and South China and expanding to new cities.

In retrospect, our strategic approach has proven to be well-founded. The Jiangsu, Zhejiang, and Shanghai regions have all experienced steady growth, with each contributing stable profits for 3 consecutive quarters. Based on operational data, daily order volume in Jiangsu and Zhejiang has increased by 27% and 21% year-on-year, respectively. These key performance indicators also demonstrate our ongoing success in East China.

Our product development capabilities in this region continue to improve, and we have developed the ability to rapidly analyze user feedback and iterate accordingly. This has contributed significantly to our ability to achieve results across different regions. Since operations in North and South China began after those in East China, we expect that it will take some time for us to ramp up the Unit Economics and establish a strong presence in these areas. Nevertheless, we see significant potential for growth in these regions.

In sum, we will focus on consolidating our market share in mature markets in East China to provide support for the development of our operations in North and South China.

Operator: Joyce Ju with Bank of America.

Joyce Ju: (Speaking foreign language). We noticed that the company exited the Sichuan and Chongqing regions. If the company has given up on the market in the southwest region? How should we understand the strategy direction, specific direction, going forward?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. We decided to suspend our services in Chongqing and Chengdu in May of this year, following our extensive evaluation of the overall return from the region. The business volume from the Sichuan-Chongqing area comprised a small portion of our overall business and was not expected to be profitable anytime soon. Moreover, we determined that the surrounding city hubs would not support large-scale supply chain operations in the short term. As a result, we have decided to exit the region temporarily. Our focus now is on cost reduction and efficiency improvement.

We will continue to focus on building a stable and profitable business in our core existing markets, and consider expansion into new regions afterward. Despite the exit, we will continue to maintain in-depth cooperation with leading food companies in Sichuan and Chongqing. Thank you.

Joyce Ju: (Speaking foreign language).

Operator: Robin Leung with Daiwa.

Robin Leung: (Speaking foreign language). I understand that Ding Dong has been emphasizing product development capabilities and quality products. Can you elaborate on your efforts in this area?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. Our primary focus is on product development capability as our core competitive advantage and growth driver. To achieve this, we have made the following specific optimizations. We have made extensive efforts on the supply chain front. We cover a long and comprehensive section of the supply chain, sourcing over 80% of fresh products directly from the origin, including through contract farming in production areas.

We have established D.GAP standards for growers, specifying protocols for fertilizer and pesticide use, among other things, to ensure product quality and stability. This allows us to place orders before planting season at fixed prices and volumes, while controlling upstream quality. For instance, our Red River Valley Blueberries achieved tremendous success, generating nearly 15 million GMV and over 400,000 purchases in just one month of online sales. This success was attributable to our extensive collaboration with purchasers and growers to ensure optimal planting technology, management, quality control, taste, and packaging. We secured 600 acres of production through contract farming, resulting in our best-selling product of the season.

We have taken a unique approach to our private-label products, distinguishing us from our peers, who usually rely on OEMs. At our company, we prioritize in-house R&D and production, resulting in better product quality, differentiation, and higher production efficiency, as well as greater control over production rhythm. Connecting the front and back ends of our business enables us to respond promptly to customer demands based on data and user feedback.

Youdouzhi Shanjian firewood tofu, a low-unit-price product, is a prime example of this success, with a quarterly GMV of nearly 6 million and a quarterly repurchase rate of 35%. Our private label products accounted for 16% of total GMV last year, and 19% this quarter, and we aim to increase that to 30% in the future. Additionally, our own brand gross profit margin increased by over 3 percentage points compared to the same period last year.

Third, we have always advocated innovation and prioritized investment in food R&D. We can better align with consumption trends and attract new users by developing new product categories like prepared meals, bakery items, and craft beer. These categories not only command higher unit prices, but also offer higher gross profit margins. As a result, GMV in these categories is on the rise.

Specifically, our prepared meals business officially launched Healthy Prepared Meals 2.0 this year, aiming to meet growing customer demands around nutrition and health. We will develop distinctive, high-quality, and differentiated prepared meals in line with this trend.

We have also taken steps to optimize our category structure, specifically focusing on enhancing our older categories. While maintaining some essential livelihood commodities, we have incorporated a greater range of mid-to-high-end products. For instance, our vegetable category has been a top performer. Previously, it primarily consisted of L1 goods for everyday use. However, we have now expanded to L2 and L3 categories, such as organic vegetables and specialty vegetables from high altitudes and Rugao, the Village of Longevity in Jiangsu. These additions are medium and high-end products with relatively higher unit prices.

Additionally, our quarterly GMV for local specialty vegetables, meat, and poultry has reached nearly 30 million.

Reflecting on the past year, we are thrilled to report a continuous increase in our gross profit margin and a narrowed overall cost ratio. This achievement can be attributed to our successful utilization of product development capabilities as the primary source of traffic, resulting in a reduced reliance on external traffic. In essence, we have successfully established a competitive moat. Thank you.

Operator: Jiajing Chen with CICC.

Jiajing Chen: (Speaking foreign language). Let me translate myself. We've seen that Ding Dong has been profitable for 3 consecutive quarters. What is your strategy to ensure sustained profitability in the future?

Changlin Liang: (Speaking foreign language).

Song Wang: (Speaking foreign language).

Unidentified Company Representative: Thank you for your question. Our Head of Finance is going to take this question. Thank you, Mr. Wang.

(Translated). As we continue to execute our Efficiency First with due Consideration of Scale strategy, we have achieved 3 consecutive quarters of non-GAAP profitability since Q4 2022. We have also achieved GAAP profitability, excluding the one-time impact of Sichuan-Chongqing adjustments this quarter. This is mainly due to our continued focus on honing our product development capabilities and improving our operational capacity to serve users better. Our overall order quality and user loyalty are improving as we optimize operational efficiency.

Specifically, since our strategic adjustment in 2021, we have adjusted our category mix. In terms of GMV, this has led to a 7 percentage point increase in the proportion of non-fresh food, and particularly prepared meals, whose proportion increased by 4 percentage points, and private-label products, whose proportion increased by nearly 13 percentage points, enriching the range of products available to consumers.

Additionally, the number of SKUs per station has increased nationwide by around 500, with Shanghai seeing an increase of over 1,000 SKUs compared to 2021. The new additions are mainly prepared meals and non-fresh products. With these changes, the AOV has increased to 72.9 RMB nationwide in the first half of the year, with Shanghai seeing an increase to 75.8 RMB, while the gross profit margin nationwide has remained stable at around 31% since last year.

While restructuring the national market, we focused on expanding in the East China region and increasing profitability there. Shanghai achieved overall profitability since Q1 2022, and Jiangsu and Zhejiang have achieved 3 consecutive quarters of profitability since Q4 2022.

In terms of mature market growth, Jiangsu and Zhejiang recorded double-digit year-on-year growth in daily order volume per station. Despite the pandemic impact last year, Shanghai had a positive Q1, reaching an average daily order volume of 1300-1400.

As the East China region becomes more profitable, we will focus on expanding it. There is room for improvement in order penetration and average order volume per station in Jiangsu and Zhejiang compared to Shanghai. Additionally, we plan to improve our operating capabilities in North China and South China in the second half of the year.

Meanwhile, we are working to improve our full-chain operational capability. On one hand, we are investing in IT innovation to improve the systems and algorithms that can boost our end-to-end operational efficiency, and we have already seen some promising early results from this. As mentioned above, the platform's end-to-end loss, including processing loss, continues to narrow, and has stabilized within 1.5% in 2023.

As the post-pandemic situation stabilized this year, we optimized our regional network layout, adjusted frontline fulfillment station stock, and improved mainline delivery efficiency with algorithms for end-to-end order fulfillment. Frontline station operational capabilities are also continuously improving. After excluding the impact of the pandemic, the efficiency of personnel both inside and outside frontline stations has steadily improved. Despite initial adjustment costs and the impact from the pandemic, fulfillment cost improved throughout the year, resulting in a 1.2 percentage points decrease year-on-year during the first half of this year and a 9.2% decrease year-on-year in cost per order.

That said, the company will continue to prioritize efficiency in the East China market and optimize product structure, while improving operational efficiency in the North and South China regional markets. Our focus will remain on product development and building full-chain operational capacity. Based on this, we are confident that we will continue achieving non-GAAP profitability in Q3 and Q4, and for the full year of 2023.

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

Nicky Zheng: Thank you again for joining our call today. If you have 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. You may now disconnect.