

[DDL] Dingdong (Cayman) Limited
Q3 2022 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:

Ashley Xu, Credit Suisse

Thomas Chong, Jefferies

Robin Leung, Daiwa

Amy Chen, Delta Investments

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by, and welcome to the Dingdong Ltd. Third 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, Nicky Zheng, Director of Investor Relations. Please go ahead, sir.

Nicky Zheng: Thank you. Hello, everyone, and welcome to Dingdong's third 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 third 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, the founder and CEO of Dingdong, Mr. Liang. Mr. Liang, please go ahead.

Changlin Liang: (Speaking foreign language).

(Translated). Thank you. and welcome to Dingdong's Q3 earnings call in 2022. Today I'd like to discuss our Q3 operational performance, some thoughts on product development capabilities, and our next steps.

First, let's dive into our Q3 performance. As we expected, revenue in Q3 was RMB 5.94 billion, with a non-GAAP net loss margin of 4.8%. We quickly adapted to the changing business environment in the third quarter last year, and began our strategy of "efficiency first, with due consideration to scale". Consequently, our non-GAAP net loss margin narrowed substantially to 4.8% from 31.9% a year ago.

With such momentum, we are confident of approaching non-GAAP break-even in the fourth quarter of this year, which would be sooner than expected during our IPO. By then, Dingdong will have evolved from a startup that needed external financing to a self-sustaining company with strong survival capabilities. The key drivers of our achievements are our commitments to product development, service upgrades, and supply chain efficiency, all of which contribute to our profitability and competitive moat.

Next, I'd like to share our thoughts on product development. On previous calls, I introduced our strategies and practices for enhancing product development capabilities. Today, I'll focus on the rationale behind this. First, we have a conviction in the pursuit of a better life. For the longest time, traffic was the only thing that mattered in China's e-commerce industry. Low pricing was an obvious and straightforward way to acquire users. As a result, consumption downgrade became a trend.

However, Dingdong was founded to address the mothers' concerns over their children's food safety. Since Day One, we have been dedicated to producing safer, healthier, and better-quality food products. We have unwavering faith in pursuing a better life and will strive towards the goal.

Second, we aim to create value for the consumer and society. Most startups are trapped in a competitive zero-sum dilemma, which is limiting. Dingdong has escaped from such a mindset, and emphasized the value creation instead, which is unlimited and liberating. As our consumers constantly evolve with emerging pursuits for a better life, we have infinite market opportunities to capture and demands to fulfill.

As you know, Dingdong has advocated the Clean Label of "no additives unless necessary." The ingredients on the packaging of certain food products in the market outline various chemicals, flavorings, colorings, and preservatives, sometimes written densely all over. The Clean Label we

advocate for and implement enables more consumers to access healthy and safe food products. It also forces the entire industry to strive towards creating value for society.

Today, an increasing number of people around us are obese and even suffer from diabetes due to excessive carbohydrate and sugar intake. That is why Dingdong has put tremendous efforts and resources into developing delicious but low-carb, low-GI food products. Over time, we expect to generate more products in this category to align with our current health and nutrition concepts. We rarely pay attention to the competition but rather, focus on value. We embrace infinite value creation, and are unrestricted by the competitive landscape. This is the principle that drives our product development, and also our proposition and faith.

Third, we do not just sell food products. We provide solutions that help you improve your life. Dingdong is in the food industry, a business that provides satisfaction and creates value for people. Eating is not only a basic physical need but also brings psychological pleasure. Moreover, you are what you eat. Eating is changing and shaping us, our families, and the entire society and nation.

Oftentimes, the consumer comes to us for more than just a meal. If you ask the mother how she wants to feed her child, she does not specify. All she wants is something that her child likes, that helps them grow taller, healthier, smarter, and even become a better person. That's why we curated "Mom's Choice." With traceability, scientific nutrition, and minimum additives, this curation meets mothers' needs and eases their concerns over food safety. Therefore, when we develop products, we aim to provide not only quality foods for a quality life, but also solutions embedded with expertise and deep consumer insights.

Lastly, I'd like to discuss the next steps. Our loss ratio narrowed remarkably over the past year, giving me full confidence in nearing non-GAAP break-even in Q4. When it happens, Dingdong will become a fully self-sustaining company. Dingdong will keep investing in product development to generate more quality products, building a stronger supply chain and upgrading services. These capabilities will form our competitive moat.

Moreover, quality products naturally gain traction because consumers can trust and rely on them, bringing continuous growth in scale, while the supply chain and service capabilities are instrumental to profitability. All the above will allow Dingdong great potential and room for growth. A company striving to achieve a better life and create value for the consumer has unbeatable value. In the long term, such value will translate into premium pricing.

So thank you all for your continuous support. Let's generate long-term value together. Thank you, everyone.

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

Le Yu: Thank you, Mr. Liang, and hello, everyone. Before I walk you through our detailed financial results, please note that all numbers stated in the following remarks are in RMB terms.

Revenue in Q3 2022 was 5.94 billion, down slightly by 4% year-over-year. However, in the first 3 quarters of this year, we achieved 23.1% revenue growth while narrowing the net loss margin by 31.7 percentage points. Our higher revenue in Q3 last year was driven by extensive subsidies

and concessions granted to our users. In contrast, in Q3 this year, we were committed to enhancing product quality and order fulfillment efficiency while reducing operational costs under the strategy of “efficiency first with due consideration to scale.” As a result, we achieved significant growth in gross profit, growing by 58.2% year-over-year, a testimony to our product development capabilities and operational efficiency.

We expect to roughly break even on a non-GAAP basis in Q4 this year, with GMV returning to our year-over-year growth trajectory.

Let’s take a detailed look at the Q3 performance. The GMV to revenue conversion rate was 91.3%, up 3.1 percentage points from a year ago. Gross margin for the third quarter was 30%, up 11.8 percentage points from a year ago. The improvement in gross margin has been significant over the past year, but we still anticipate more room for growth in both the short and the long terms.

Our fulfillment costs might be higher than those of the traditional supermarket model because we are more deeply engaged in the supply chain. However, such a commitment also generates higher gross margins. For example, in our supply chain, we standardized and digitalized the management of fresh groceries in city clusters by introducing different storage temperatures in our regional processing centers.

In contrast, most of our peers from traditional supermarkets or using online models outsource such processes to suppliers. As a result, our expense ratio of the regional processing centers in Q3 was 7.3%. In addition, we conducted a higher proportion of direct sourcing and order-based farming and kept raising the standards and quality control of our products. Our extensive and far-reaching participation in the supply chain has yet to be fully reflected in our current gross margin. We expect it to translate into higher profitability as we mature.

The fulfillment expense ratio for Q3 was 26.8%, down 10.5 percentage points year-over-year, primarily owing to improved Average Order Value and optimization of frontline worker efficiency. We also recorded a 25% improvement year-over-year in AOV this quarter, driven by better product development capabilities and Dingdong’s brand dominance in consumer mindshare. Our frontline fulfillment stations’ delivery efficiency increased by 15.8%, and in-warehouse staff efficiency improved by 29.6% year-over-year.

The marketing expense ratio for the third quarter was 2.1%, down 4.8 percentage points from a year ago. In addition, the customer acquisition cost per new transacting user dropped significantly by 32.6% year-over-year, driven by better product development capabilities and brand image.

The G&A expense ratio declined to 2% from 2.5% a year ago. The R&D expense ratio grew slightly to 4.3% from 4.2% a year ago. Going forward, we will continue our investment in food R&D, agricultural technology, and technical data algorithms, while minimizing wasteful expenses at headquarters to cut costs. We believe infrastructure investment in the above three areas will strengthen our competitive advantage and create long-term value for investors.

In Q3, GAAP net loss margin was 5.8%, narrowed by 26.7 percentage points from a year ago. The non-GAAP net loss margin was 4.8%, narrowed by 27.1 percentage points compared to Q3

last year, and 3 percentage points compared to Q1 this year before the COVID lockdown. Excluding a one-time expense of 52.7 million, our adjusted non-GAAP net loss margin was 3.9%.

In Q3, we reduced our operating cash outflow from 407 million to 244 million by introducing supply chain finance. At the end of Q3, we had 5.9 billion in cash, cash equivalents, restricted cash, and short-term investments.

In summary, since we emerged from the lockdown in Q2 and our product development capabilities gained traction, we observed a solid upward trend in our online penetration, AOV, gross margin, and operational efficiency. At the same time, we offered higher product quality to meet consumers' growing demand for a better life. As a result, Dingdong's members, or our loyal users, were highly sticky, with a next-month retention rate of 84.2% and a next-month GMV contribution of over 400 on average. The longer these members stayed with us, the more their monthly GMV increased. We believe Dingdong is becoming an integral part of more users' lives.

Going into Q4, we expect to return to our year-over-year growth trajectory and be close to non-GAAP break-even. When we achieve that, we will have lowered our non-GAAP net loss margin by over 30 percentage points from 31.9% when we began the "Efficiency First" strategy in Q3 last year. Such a notable optimization in less than 1.5 years would demonstrate the vitality and profitability of our business model.

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). Ashley Xu, Credit Suisse.

Ashley Xu: (Speaking foreign language). Just want to check, given the overall weak macro environment, have you sensed any change in consumers' behavior? And what's the key changes we have seen?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. We all know that consumers are constantly changing, and so are their consumption habits. This is the fascinating part of our industry. Change is the only constant and so are our efforts to serve the users. Here are some consumption trends observed from the recent user behaviors. For one, young consumers are paying more attention to health and wellness. That's why Dingdong developed a prune enzyme drink. With over 20 kinds of fruits and vegetable enzymes and four kinds of probiotics, it is perfect for your GI tract, and became a big hit as soon as it was launched with basically all 5-star reviews.

Following this trend, we subsequently developed more products such as lime compound juice without added white sugar and lightly fermented mango juice, which are all very popular. Later, we curated the Qingyang Planet page to meet the needs of youngsters pursuing health and wellness. Another trend is Meal-for-One, but it's nothing perfunctory. Instead, it's a dish with balanced nutrition. That's why we have been developing certain prepared meals emphasizing nutritional balance at a small portion, which truly caters to this trend.

In addition, from their search results and purchasing behaviors, we notice young consumers expect to diversify their meals with changes and surprises. We also noticed the categories such as bakeries and coffee are trending up. Lastly, the ratio of processed food, including prepared meals and packaged foods, have been increasing in our product category mix.

While it's important to identify changes, our core focus remains to address the constant demands in consumer consumption. First, it's a common hope for all to enjoy better quality, taste and nutrition in food. Second, it's desirable to have varied innovative categories. In addition, fast delivery is expected; people want instant gratification. Finally, consumers expect reasonable pricing. To sum up, people expect quality, diversity, speed and affordability. To meet the ever-changing needs of users, we need to have better product development, supply chain, and service capabilities. All of these are the core competitiveness that Dingdong has always been focused on. Thank you.

Operator: Thomas Chong, Jefferies.

Thomas Chong: (Speaking foreign language). We have been talking about Mom's Choice since last quarter. Just wanted to ask management about the strategy in this area and how's the operation so far?

Changlin Liang: (Speaking foreign language).

(Translated). Thank you for your question. Mothers' needs have always been important to us. Offering nutritious and tasty meal solutions to children of various age groups based on our understanding of mothers' needs aligns with our founding motivation, which is to provide healthy food products to children and ease families' concerns over food safety. We saw more than 88 million average monthly GMV of Mom's Choice products nationwide, half of it actually came from Shanghai where we kicked off this program.

Regarding our product offering, we have best-selling SKUs that exceed millions in sales each, such as Salmon for Kids and Twisted Rolls with Minced Pork. Our exclusive Orange Bun and Banana Bun, customized to appeal to children, are also very popular among mothers. At the same time, we enhanced the readability of our ingredient list to highlight high-protein, low-fat, low-sugar and other key nutritional facts that are important to mothers.

Going forward, we will develop scientific and nutritious food solutions for children based on our understanding of different families' needs. Our goal is to cultivate children's love for food, so that they grow up healthy and strong, and their mothers have peace of mind. Thank you.

Operator: Robin Leung, Daiwa.

Robin Leung: Could management provide some updates on the competitive landscape, especially in competition in community purchase or other on-demand players? (Speaking foreign language).

Changlin Liang: (Speaking foreign language).

(Translated). Thank you, Robin, for your question. Dingdong does not focus on competition; rather, we prioritize value creation. We're not limited by the competitive landscape. We embrace the infinite opportunities in the space. From an industry perspective, fresh groceries and food products are a RMB10 trillion market in China. Any business model that is valuable to users can stay. Business models that align with user consumption trends and create more benefits for users will have a brighter future and survive economic cycles.

Although the online penetration rate of the fresh grocery category remains low, it is going up fast and strong. At the same time, the industry competition has become more benign and rational. Our long-term strategies are to enhance our product development, supply chain and service capabilities. We're not doing it for competition purposes, but consequently, these efforts allow us to gain competitive advantages.

First, regarding building product development capabilities. Since the suppliers of fresh groceries and most foods are scattered and technologically backward, we're determined to go deep into the source of the supply chain, improving our in-house product R&D, actively developing differentiated products that align with consumption trends, and expanding our production and processing capabilities. Such heavy liftings will pay off over time with a strong first-mover advantage and long-term value.

We are in the era of surplus and our supplies have been extremely enriched. That's why customized differentiated SKUs that meet the needs of consumers can provide a better product experience, which can greatly improve our user stickiness. Dingdong's long supply chain involvement can also bring higher gross profit margin, stronger profitability and self-sustainability.

In terms of developing services, as the Chinese saying goes, a craftsman must sharpen his tool to do his job. We iteratively optimize the layout of the frontline fulfillment stations, and manage inventory stocking with granularity and transparency, so that each frontline fulfillment station can accommodate more SKUs and items. This brings abundance in our product diversity, and enhances the upper limit of daily GMV.

At the same time, the frontline fulfillment stations are distributed across the country, which takes work to manage. We adopt dual standardization in our management, leveraging corporate values and our granular SOP. We will keep strengthening training and make data transparent to each action in the SOP, so the SOP can be effectively implemented. To sum up, although we do not focus on competition, our long-term strategies build competitiveness and create high value, allowing us to gain an advantage in the future. Thank you.

Operator: Amy Chen, Delta Investments.

Amy Chen: (Speaking foreign language). I'm going to translate my question myself. I want to know is the frontline fulfillment station business model can really make profit? And if yes, when will Dingdong achieve profit?

Changlin Liang: (Speaking foreign language).

(Translated). All right. Our CSO, Yu Le, will take this question.

Le Yu: (Speaking foreign language).

(Translated). Thank you for your question. We expect to roughly achieve non-GAAP breakeven in Q4. We believe that whether a business model is profitable or not depends on whether it creates value for users. We have built our supply chain capabilities to customize research and produce differentiated products based on user demand. We operate in high-consumption frequency categories that are difficult to manage, and we deliver these products quickly to users' doorstep, all of which are valuable.

Secondly, whether a business model can be profitable depends on the profit margins of the industry. The price markup of fresh groceries from the origin to the user is significant, but the dispersion and inefficiency of the supply side lead to low gross margins for the industry. After gradually breaking through the bottleneck of the supply chain, we managed to raise the gross profit margin of Dingdong very rapidly.

Third, whether a business model can make money depends on their engagement in the supply chain. The width and depth of our expansion in the supply chain are second to none in the industry. Firstly, let's look at the upstream. In the fresh food category, we have a high proportion of direct sourcing from the starting point of the supply chain, and we are gradually increasing the share of order-based production directly signed with large and medium-sized farmers. We choose to carry out the standardization and informatization of fresh food in the regional processing centers, while establishing our in-house production and processing capabilities in the non-fresh food category.

Regarding the downstream, the user only needs to place an order on the mobile phone before we deliver the goods to their doorsteps in about half an hour, which is extremely convenient. Dingdong not only creates value for its users, but also operates in an industry with great profit margin potential. In addition, it has been more deeply involved in the supply chain than its peers do. All of the above will naturally translate into stronger financial performance.

Since we adopted the "Efficiency First" strategy in Q3 last year, our gross margin has gone up over 11 percentage points from a year ago. Fulfillment expenses down 10 percentage points and the loss ratio narrowed by over 26 percentage points. Such a rapid reduction of losses is not only unique in the industry, but also rare in other industries. There is no doubt that Dingdong can achieve profitability. Thank you.

Operator: Thank you. And as there are no further questions at this time, 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 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.