

Pinduoduo (PDD US)

A mixed quarter; Waiting for ecommerce recovery

PDD delivered mixed 4Q19 results, with revenue +91% YoY (3% below consensus) and non-GAAP net loss narrowed to RMB815mn (vs. consensus at RMB1,877mn). 1Q20E would see soft financial metrics for epidemic impact. We lowered its revenue by 12.2%/0.8% in FY20/21E, with slightly revised TP of US\$40.5. Wait for more clear catalysts regarding ecommerce recovery.

- **A mixed quarter.** 4Q19 revenue grew 91% YoY, 3%/0% below consensus/our estimates. Non-GAAP net loss came in at RMB815mn (vs. consensus at RMB1,877mn). Non-GAAP OPM narrowed to -12.4%, mainly on higher GPM and lower S&M/Rev ratio. We view this result as mixed, as its revenue and take rate were below expectation, while active buyers and S&M ratio beat.
- **Focus on user engagement and category diversification.** 4Q19 revenue growth was driven by ramp-up of active buyers (585mn, +40% YoY) and ARPU (RMB1,720, +53% YoY). Its blended take rate was 2.99% (vs. 2.98% in 3Q19), while online marketing take rate at 2.61% (vs. 2.69% in 3Q19). Take rate might see fluctuation in the short run, given preferential rates to merchants. In 2020, PDD will focus on: 1) user engagement, purchase frequency and ARPU; and 2) categories expansion. Quarterly GPM would still vary around at 70-80%, and its dynamic ROI-driven marketing continues.
- **Multiple challenges from epidemic while long-term trend intact.** Mgmt stated 1Q20E ecommerce would be suppressed by the epidemic, mainly on: 1) softer consumption from users; and 2) weaker ads demand from merchants. PDD has launched RMB1bn reserve to fund the delivery orders, RMB1.1bn subsidies for agricultural goods and epidemic supplies. Compared to JD & BABA, PDD might see more challenges from epidemic, for its logistics and agricultural goods. However, PDD has gradually seen recovery since Mar, as work resumption rate of courier reached 92.5%. Despite weak 1Q20E, mgmt keep positive on its long-term growth, mainly on: 1) subsidies to stimulate frequent purchaser; and 2) stronger agriculture goods/ fruits demand, coupled with higher DAU, Kuaituantuan's launch, to capture opportunities from epidemic.
- **Maintain BUY.** We cut its revenue by 12.2%/0.8% in FY20/21E, and adjusted earnings to -RMB 2.5bn/ +RMB9.5bn. Our new TP is slightly revised to US\$40.5, which is equivalent to 5.0x FY21E P/S. Despite quarterly fluctuation, we keep positive on its secular growth and operating leverage.

Earnings Summary

| (YE 31 Dec) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---------------------|----------|----------|----------|----------|----------|
| Revenue (RMB mn) | 13,120 | 30,142 | 42,573 | 67,375 | 89,332 |
| YoY growth (%) | 652 | 130 | 41 | 58 | 33 |
| Net income (RMB mn) | (3,456) | (4,439) | (2,540) | 9,493 | 18,345 |
| EPS (RMB) | (4.64) | (3.84) | (2.16) | 8.01 | 15.32 |
| Consensus EPS (RMB) | NA | NA | (0.96) | 6.18 | 13.03 |
| YoY growth (%) | NA | NA | NA | (470) | 91 |
| P/E (x) | NA | NA | -113 | 31 | 0 |
| P/S (x) | 21.7 | 9.5 | 6.7 | 4.2 | 0.0 |
| Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 1.0 |
| ROE (%) | (54.3) | (31.4) | (25.8) | 22.7 | 36.0 |
| Net gearing (%) | Net cash | Net cash | Net cash | Net cash | Net cash |

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

| | |
|---------------|-----------|
| Target Price | US\$40.5 |
| (Previous TP | US\$41.0) |
| Up/Downside | +15.4% |
| Current Price | US\$35.1 |

China Internet Sector

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Stock Data

| | |
|--------------------------|--------|
| Mkt Cap (US\$ mn) | 47,331 |
| Avg 3 mths t/o (US\$ mn) | 266.8 |
| 52w High/Low (US\$) | 45/18 |
| Total Issued Shares (mn) | 644 |
| Source: Bloomberg | |

Shareholding Structure

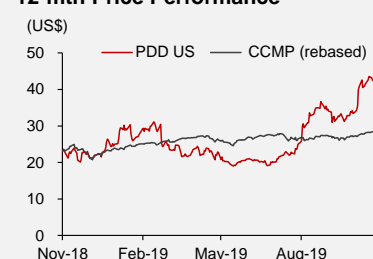
| | |
|-------------------|-------|
| FMR LLC | 3.48% |
| Banyan Partners | 3.13% |
| Baillie Gifford | 2.55% |
| Source: Bloomberg | |

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | 22.0% | 15.1% |
| 3-mth | 59.2% | 48.7% |
| 6-mth | 79.4% | 63.6% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Related Reports

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- Eye-catching 2Q19; More to come – 22 Aug 2019
- Initiation: Rising star with growing pains – 27 Jun 2019

Figure 1: Earnings revision

| RMB mn, Dec-YE | New | | Old | | Diff (%) | |
|------------------|---------|--------|---------|--------|-----------|----------|
| | FY20E | FY21E | FY20E | FY21E | FY20E | FY21E |
| Revenue | 42,573 | 67,375 | 48,485 | 67,919 | -12.2% | -0.8% |
| Gross Profit | 32,992 | 52,927 | 38,376 | 53,766 | -14.0% | -1.6% |
| Operating Profit | (6,876) | 4,147 | (1,590) | 5,511 | 332.5% | -24.8% |
| Net profit | (2,540) | 9,493 | 2,926 | 9,648 | -186.8% | -1.6% |
| EPS (RMB) | (2.16) | 8.01 | 2.49 | 8.14 | -186.9% | -1.6% |
| Gross Margin | 77.5% | 78.6% | 79.1% | 79.2% | -1.6ppts | -0.6ppts |
| Operating Margin | -16.2% | 6.2% | -3.3% | 8.1% | -12.9ppts | -1.9ppts |
| Net Margin | -6.0% | 14.1% | 6.0% | 14.2% | -12ppts | -0.1ppts |

Source: Company data, CMBIS estimates

Figure 2: CMBI estimates vs consensus

| RMB mn, Dec-YE | CMBI | | | Consensus | | | Diff (%) | | |
|------------------|---------|--------|--------|-----------|--------|--------|----------|----------|----------|
| | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E | FY20E | FY21E | FY22E |
| Revenue | 42,573 | 67,375 | 89,332 | 48,131 | 68,615 | 83,395 | -11.5% | -1.8% | 7.1% |
| Gross Profit | 32,992 | 52,927 | 69,930 | 37,905 | 54,035 | 65,863 | -13.0% | -2.0% | 6.2% |
| Operating Profit | (6,876) | 4,147 | 14,221 | (5,200) | 2,292 | 7,346 | 32.2% | 80.9% | 93.6% |
| Net profit | (2,540) | 9,493 | 18,345 | (836) | 8,049 | 16,386 | 203.7% | 17.9% | 12.0% |
| EPS (RMB) | (2.16) | 8.01 | 15.32 | (0.96) | 6.18 | 13.03 | 126.4% | 29.6% | 17.6% |
| Gross Margin | 77.5% | 78.6% | 78.3% | 78.8% | 78.8% | 79.0% | -1.3ppt | -0.2ppts | -0.7ppts |
| Operating Margin | -16.2% | 6.2% | 15.9% | -10.8% | 3.3% | 8.8% | -5.3ppts | +2.8ppts | +7.1ppts |
| Net Margin | -6.0% | 14.1% | 20.5% | -1.7% | 11.7% | 19.6% | -4.2ppts | +2.4ppts | +0.9ppts |

Source: Company data, Bloomberg

Figure 3: 4Q19 review

| RMB mn | 1Q18 | 2Q18 | 3Q18 | 4Q18 | 1Q19 | 2Q19 | 3Q19 | 4Q19 | QoQ | YoY | Consensus | Diff % | CMBI | Diff % |
|-------------------|---------|---------|---------|----------|---------|---------|---------|---------|-------|-------|-----------|--------|---------|--------|
| Revenue | 1,385 | 2,709 | 3,372 | 5,654 | 4,545 | 7,290 | 7,514 | 10,793 | 43.6% | 90.9% | 11,121 | -3% | 10,817 | 0% |
| Operating profit | (253) | (6,636) | (1,269) | (2,641) | (2,121) | (1,490) | (2,792) | (2,135) | NA | NA | (3,091) | NA | (2,971) | NA |
| Net profit | (282) | (6,494) | (1,098) | (2,424) | (1,878) | (1,003) | (2,335) | (1,752) | NA | NA | (2,563) | NA | (2,655) | NA |
| Adj. net profit | (268) | (673) | (619) | (1,896) | (1,379) | (411) | (1,660) | (815) | NA | NA | (1,877) | NA | (1,898) | NA |
| Adj. EPS (RMB) | (0.60) | (1.40) | (0.68) | (1.72) | (1.20) | (0.36) | (1.44) | (0.72) | NA | NA | (1.70) | NA | (1.63) | NA |
| Margin (%) | | | | | | | | | | | | | | |
| Gross margin | 77.0% | 85.7% | 77.0% | 74.9% | 80.9% | 78.2% | 75.6% | 81.1% | | | 75.6% | | 75.2% | |
| Operating margin | 18.4% | -245.0% | -37.6% | -46.7% | -46.7% | -20.4% | -37.2% | -19.8% | | | -27.8% | | -27.5% | |
| Adj. net margin | -19.3% | -24.9% | -18.4% | -33.5% | -30.3% | -5.6% | -22.1% | -7.6% | | | -16.9% | | -17.5% | |
| Growth (%) | | | | | | | | | | | | | | |
| Revenue (YoY) | 3640.3% | 2489.5% | 697.2% | 379.4% | 228.3% | 169.1% | 122.8% | 90.9% | | | 96.7% | | 91.3% | |
| Revenue (QoQ) | 17.4% | 95.7% | 24.5% | 67.7% | -19.6% | 60.4% | 3.1% | 43.6% | | | 48.0% | | 44.0% | |
| Operating profit | 17.2% | 5306.8% | 441.6% | 11531.9% | 737.7% | -77.5% | 119.9% | -19.1% | | | 17.0% | | 12.5% | |
| Adj. net profit | 262.9% | 531.2% | 183.9% | -7319.9% | 414.8% | -38.9% | 168.2% | -57.0% | | | -1.0% | | 0.1% | |

Source: Company data, Bloomberg, CMBIS estimates

Figure 4: 4Q19 revenue breakdown

| RMB mn | 1Q18 | 2Q18 | 3Q18 | 4Q18 | 1Q19 | 2Q19 | 3Q19 | 4Q19 | QoQ | YoY |
|----------------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|---------------|--------------|---------------|
| Total revenue | 3,249 | 3,773 | 4,100 | 4,641 | 4,545 | 7,290 | 7,514 | 10,793 | 43.6% | 132.6% |
| Online marketing | 1,115 | 2,371 | 2,974 | 5,062 | 3,948 | 6,467 | 6,711 | 9,687 | 44.3% | 91.3% |
| Transaction services | 270 | 338 | 398 | 592 | 597 | 823 | 802 | 1,106 | 37.8% | 87.0% |
| Merchant Sales | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | NA | NA |

Source: Company data

Figure 5: DCF valuation

| DCF valuation (RMB mn) | | | | | | | | | | |
|--------------------------|---------|---------|---------|---------|---------|---------|----------|----------|----------|----------|
| | 2020E | 2021E | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E |
| EBIT | (6,876) | 4,147 | 14,221 | 20,833 | 28,583 | 37,089 | 45,920 | 54,666 | 62,995 | 70,674 |
| Tax | 0 | (1,037) | (3,555) | (5,208) | (7,146) | (9,272) | (11,480) | (13,666) | (15,749) | (17,669) |
| D&A | 665 | 698 | 733 | 770 | 808 | 848 | 891 | 935 | 982 | 1,031 |
| Working capital | 7,501 | 7,876 | 8,269 | 8,683 | 9,117 | 9,573 | 10,052 | 10,554 | 11,082 | 11,636 |
| CAPEX | (89) | (140) | (186) | (223) | (268) | (322) | (386) | (463) | (556) | (667) |
| FCF | 1,201 | 11,543 | 19,482 | 24,854 | 31,094 | 37,917 | 44,996 | 52,026 | 58,755 | 65,006 |
| FCF Growth | | 861% | 69% | 28% | 25% | 22% | 19% | 16% | 13% | 11% |
| Terminal Value | | | | | | | | | | 595,272 |
| PV (FCF+ Terminal Value) | 1,051 | 8,844 | 13,064 | 14,588 | 15,975 | 17,051 | 17,711 | 17,924 | 17,718 | 174,277 |

| Assumptions | |
|----------------------|-------|
| WACC | 14.2% |
| Tax rate | 25.0% |
| Risk free rate | 3.6% |
| Cost of debt | 0.0% |
| Beta | 1.30 |
| Market risk return | 11.8% |
| Cost of equity | 14.2% |
| Debt/Assets | 0.0% |
| Terminal growth rate | 3.0% |
| Debt value | 0 |

| | | WACC | | | | | |
|--------|------|------|------|------|------|------|------|
| | | | 12% | 13% | 14% | 15% | 16% |
| Growth | 1.5% | | 48.5 | 43.3 | 38.0 | 35.3 | 32.3 |
| | 2.0% | | 49.9 | 44.3 | 38.8 | 36.0 | 32.8 |
| | 2.5% | | 51.4 | 45.5 | 39.6 | 36.7 | 33.4 |
| | 3.0% | | 53.1 | 46.8 | 40.5 | 37.5 | 34.0 |
| | 3.5% | | 55.0 | 48.2 | 41.5 | 38.3 | 34.6 |
| | 4.0% | | 57.1 | 49.7 | 42.6 | 39.2 | 35.3 |
| | 4.5% | | 59.5 | 51.5 | 43.8 | 40.2 | 36.1 |

| Equity Value | |
|----------------------------------|----------|
| PV | 298,202 |
| minus: Net cash | (30,013) |
| minus: Minority Interest | 0 |
| Equity Value | 328,215 |
| Shares (mn) | 4,627 |
| Target Price (US\$) based on DCF | 40.5 |

Source: Company data, Bloomberg, CMBIS estimates

Financial Summary

Income statement

| YE 31 Dec (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|------------------------------|----------|----------|----------|----------|----------|
| Revenue | 13,120 | 30,142 | 42,573 | 67,375 | 89,332 |
| Online marketing | 11,522 | 26,814 | 38,113 | 60,625 | 80,894 |
| Transaction | 1,598 | 3,328 | 4,460 | 6,750 | 8,438 |
| Merchant Sales | - | - | - | - | - |
| COGS | (2,905) | (6,339) | (9,581) | (14,448) | (19,402) |
| Gross profit | 10,215 | 23,803 | 32,992 | 52,927 | 69,930 |
| S&M | (13,442) | (27,174) | (32,746) | (37,983) | (42,257) |
| Admin.Exp. | (6,457) | (1,297) | (1,559) | (2,224) | (2,977) |
| R&D | (1,116) | (3,870) | (5,563) | (8,574) | (10,476) |
| Others | - | - | - | - | - |
| Operating profit | (10,800) | (8,538) | (6,876) | 4,147 | 14,221 |
| Financial Cost | 585 | 1,396 | 1,781 | 2,487 | 2,895 |
| Associates | (2) | 146 | - | - | - |
| Pre-tax Income | (10,217) | (6,996) | (5,095) | 6,634 | 17,115 |
| Income Tax | - | - | - | (510) | (3,237) |
| Convertible preferred shares | (80) | - | - | - | - |
| Net profit | (10,298) | (6,996) | (5,095) | 6,124 | 13,878 |
| Adj. net profit | (3,456) | (4,439) | (2,540) | 9,493 | 18,345 |

Balance sheet

| YE 31 Dec (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|--------------------------------|--------|--------|--------|--------|---------|
| Non-current assets | 2,791 | 5,044 | 7,022 | 9,498 | 12,521 |
| Fixed asset | 29 | 69 | 111 | 173 | 241 |
| Associates | - | - | - | - | - |
| Intangible assets | 2,579 | 4,975 | 6,911 | 9,324 | 12,279 |
| Others | 183 | - | - | - | - |
| Current assets | 40,391 | 56,795 | 61,250 | 80,900 | 107,230 |
| Cash | 14,160 | 27,031 | 30,013 | 47,391 | 71,767 |
| Restricted cash | 16,379 | 16,379 | 16,379 | 16,379 | 16,379 |
| Account receivable | 248 | 528 | 780 | 1,074 | 1,342 |
| Others | 9,604 | 12,856 | 14,077 | 16,057 | 17,741 |
| Current liabilities | 24,359 | 39,536 | 48,509 | 61,142 | 72,150 |
| Amounts due to related parties | 478 | 631 | 956 | 1,442 | 1,936 |
| Customer advances | 191 | 268 | 381 | 606 | 809 |
| Payable to merchants | 17,276 | 25,165 | 29,732 | 36,820 | 43,467 |
| Accrued expenses | 2,226 | 5,418 | 7,034 | 8,979 | 10,597 |
| Merchant deposits | 4,188 | 8,053 | 10,406 | 13,296 | 15,341 |
| Non-current liabilities | - | - | - | - | - |
| Borrowings | - | - | - | - | - |
| Others | - | - | - | - | - |
| MI | - | - | - | - | - |
| Total Equity | 18,823 | 22,303 | 19,763 | 29,256 | 47,600 |
| Shareholders' equity | 18,823 | 22,303 | 19,763 | 29,256 | 47,600 |

Source: Company data, CMBIS estimates

Cash flow summary

| YE 31 Dec (RMB mn) | FY18A | FY19A | FY20E | FY21E | FY22E |
|---------------------------|----------|---------|---------|---------|---------|
| Net income | (10,217) | (6,996) | (5,095) | 6,124 | 13,878 |
| D&A | 497 | 641 | 665 | 697 | 736 |
| Change in WC | 10,725 | 11,826 | 7,501 | 10,360 | 9,055 |
| Others | 6,763 | 2,558 | 2,554 | 3,369 | 4,467 |
| Operating CF | 7,768 | 8,029 | 5,625 | 20,549 | 28,136 |
| Capex | (27) | (63) | (89) | (140) | (186) |
| Associates | 160 | - | - | - | - |
| Others | (7,681) | (3,014) | (2,554) | (3,032) | (3,573) |
| Investing CF | (7,549) | (3,077) | (2,643) | (3,172) | (3,759) |
| Equity raised | 17,705 | 7,919 | - | - | - |
| Change of Debts | (4) | - | - | - | - |
| Others | (356) | - | - | - | - |
| Financing CF | 17,344 | 7,919 | - | - | - |
| Net change in cash | 18,111 | 12,871 | 2,982 | 17,377 | 24,377 |
| Cash (beg of yr) | 12,429 | 30,540 | 43,411 | 46,393 | 63,770 |
| FX | 547 | - | - | - | - |
| Cash (end of yr) | 30,540 | 43,411 | 46,393 | 63,770 | 88,147 |

Key ratios

| YE 31 Dec | FY18A | FY19A | FY20E | FY21E | FY22E |
|---------------------------|--------|--------|--------|---------|-------|
| Sales mix (%) | | | | | |
| Online marketing | 87.8 | 89.0 | 89.5 | 90.0 | 90.6 |
| Transaction services | 12.2 | 11.0 | 10.5 | 10.0 | 9.4 |
| Merchant Sales | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Growth rate (%) | | | | | |
| Revenue | 652.3 | 129.7 | 41.2 | 58.3 | 32.6 |
| Gross profit | 900.2 | 133.0 | 38.6 | 60.4 | 32.1 |
| EBIT | NA | NA | NA | NA | NA |
| Net profit | NA | NA | NA | (473.7) | 93.2 |
| P&L ratios (%) | | | | | |
| Operating margin | (82.3) | (28.3) | (16.2) | 6.2 | 15.9 |
| Pre-tax margin | (77.9) | (23.2) | (12.0) | 9.8 | 19.2 |
| Net margin | (26.3) | (14.7) | (6.0) | 14.1 | 20.5 |
| Effective tax rate | - | - | - | (0.8) | (3.6) |
| Returns (%) | | | | | |
| ROE | (54.3) | (31.4) | (25.8) | 22.7 | 36.0 |
| ROA | (12.2) | (8.5) | (3.9) | 12.0 | 17.5 |
| Per share | | | | | |
| EPS (RMB) | (4.64) | (3.84) | (2.16) | 8.01 | 15.32 |
| DPS (RMB) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| BVPS (RMB) | 10.67 | 7.51 | 4.27 | 6.23 | 10.04 |

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| | |
|------------------|---|
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| | |
|-----------------------|---|
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