Pinduoduo (PDD US)
From strength to strength

- Recent quarters' strong revenue growth and gains in market share demonstrate the success of its "value-for-money" offering and international expansion
- Robust revenue growth offsets the depletion of margin caused by continued investments in new businesses and changes in the business mix
- Maintain **BUY** with a TP of US$ 180

Company Report
Dec 1, 2023
Rating: BUY
TP: US$ 180

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Ongoing market share gains. Pinduoduo has been achieving strong revenue growth in recent quarters (58%/66%/94% YoY in 1Q/2Q/3Q23), implying ongoing market share gains against peers. In our view, this can be attributed to 1) solid position in the industry as a "value-for-money" platform amid consumers tighten their purse strings during economic downturn; 2) improving monetization capabilities driven by operational improvement; 3) optimized product portfolio driven by deepened cooperation with brands and continuous investments in agriculture and other areas; 4) increased contribution of emerging businesses, including Duoduo Grocery and Temu. We expect revenue to grow 79% YoY and 33% YoY for 2023E and 2024E. Based on our estimates, we believe Pinduoduo now commands a mid-20s market share in China's e-commerce market, challenging incumbents such as Alibaba (9988 HK, BABA/US).

Robust revenue growth mitigating margin dilution. In our view, the improved operating leverage arising from strong revenue growth has provided financial resources for the company to compete in the market by allowing for higher subsidiaries and investment in new businesses.

Maintain BUY. We maintain our **BUY** rating with a revised TP of US$180 given Pinduoduo's strong growth momentum. Our TP implies 26.7x 2024E core P/E. Despite recent share price rally, current valuation of 21.8x 2024E core P/E is still justified, in our view. Also, we believe divestment risk from its major strategic shareholder has lessened.

Price	US$ 147.4
Est. share price return	22.1%
Est. dividend yield	NA
Est. total return	22.1%
Last Rating &TP	BUY, US$110
Previous Report Date	Dec 29, 2022

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (US$)	147.4/59.6
Outstanding shares (mn)	5,462
Market cap (US$ mn)	201,293
3-mth avg daily turnover (US$ mn)	981
Major shareholder(s)	
Zheng Huang	26.5%

Source(s): Bloomberg, Company

Results and Valuation

FY end Dec 31	2021A	2022A	2023E	2024E
Revenue (RMB mn)	93,950	130,558	233,140	311,196
Chg (%,YoY)	*57.9*	*39.0*	*78.6*	*33.5*
Net profit (RMB mn)	7,769	31,538	48,687	57,792
Chg (%,YoY)	*NA*	*306.0*	*54.4*	*18.7*
Core net profit*(RMB mn)	13,830	39,529	58,513	70,740
Chg (%,YoY)	*NA*	*185.8*	*48.0*	*20.9*
Earnings per ADS (RMB)	5.4	21.9	33.8	40.1
Chg (%,YoY)	*NA*	*302.6*	*54.4*	*18.7*
Core earnings per ADS (RMB)	9.7	27.4	40.6	49.1
Chg (%,YoY)	*NA*	*183.4*	*48.0*	*20.9*
Core P/E (x)	110.8	39.1	26.4	21.8
P/S (x)	16.3	11.8	6.6	5.0
ROAE (%)	11.5	32.7	33.2	27.4
ROAA (%)	4.6	15.1	17.1	15.8

Note:1ADR=4 ordinary shares

Source (s): Bloomberg, ABCI Securities estimates

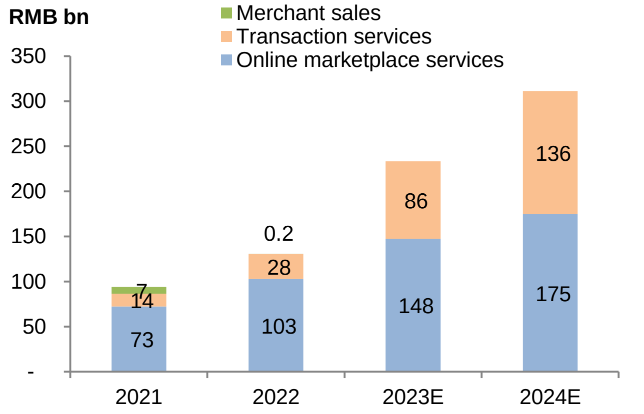
Financial outlook

We expect revenue to increase at 54%CAGR in 2022-24E, largely driven by improving monetization via providing more valued-added services to merchants, in addition to rising contribution from emerging businesses such as Temu and Duoduo Grocery.

Online marketing service: We expect online marketing service, which mainly includes performance-based marketing services, such as search ranking, recommendation feeds, among others, to increase at 30% CAGR in 2022-24E, driven by the GMV CAGR of 20% during the period and increased monetization through better service offerings and merchants' stickiness.

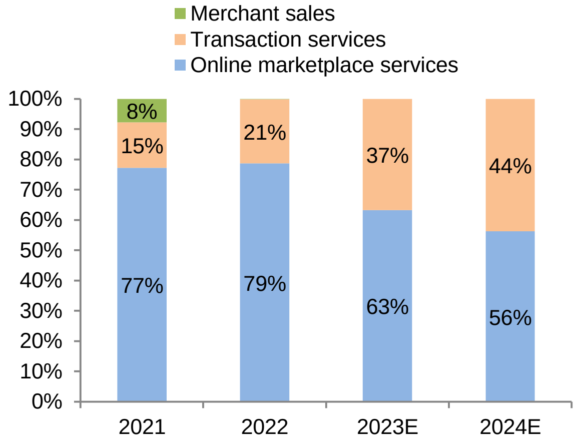
Transaction services: We expect transaction services revenue to increase sharply at 122% CAGR in 2022-24E on increasing contribution from emerging businesses such as Temu and Duoduo Grocery. As a result, we expect the segment's contribution to total revenue to increase from 21% in 2022 to 44% in 2024E. Specifically, Temu, which takes on a "value-to-money" market position, has been gaining popularly since its launch. We expect its overall revenue contribution to Pinduoduo to be around mid-teens level by 2024E.

Exhibit 1: Revenue trend



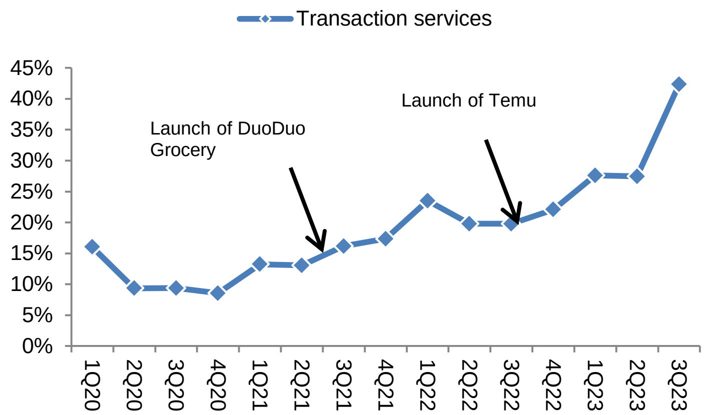
Source(s): Company, ABCI Securities estimates

Exhibit 2: Revenue mix



Source(s): Company, ABCI Securities estimates

Exhibit 3: Rising contribution of transaction service (% of revenue)



Source(s): Company, ABCI Securities

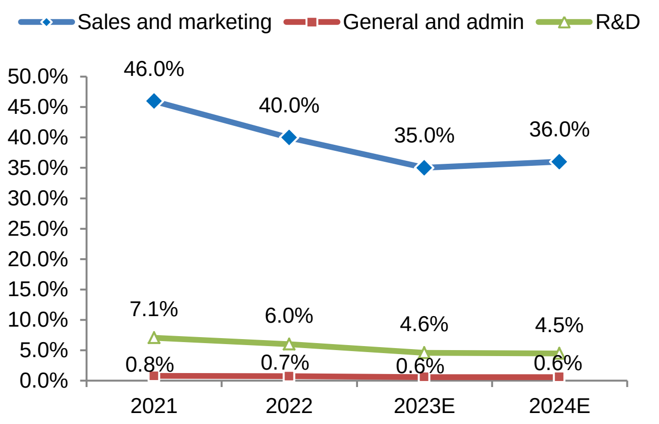
We expect gross margin to drop from 75.9% in 2022 to 65.0% in 2024E due to lower margins in transaction services.

Sales and marketing expenses has been the largest cost item to support the company's "value-to-money" market position. The company's strategic shift from marketing to R&D and emphasis on quality growth has led to more disciplined sales and marketing expenses in recent quarters.

In our view, the improved cost control has provided additional financial resources to compete in the market by allowing for higher subsidiaries and investment in new businesses.

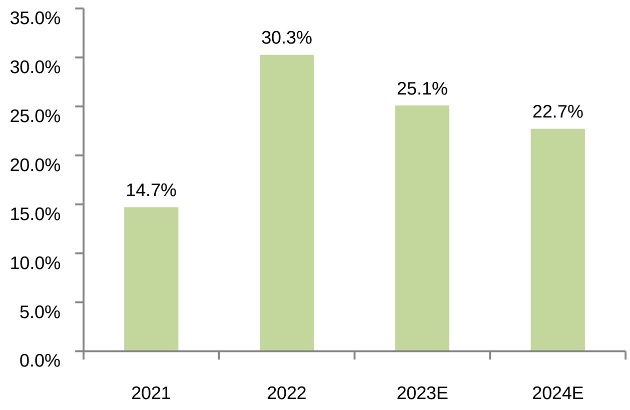
Looking forward, we expect non-GAAP sales and marketing expenses/revenue ratio to fall from 40% in 2022 to 36% in 2024E on stringent expense control. In addition, we expect R&D expenses/revenue ratio to drop from 6.0% in 2022 to 4.5% in 2024E thanks to economies of scale. Overall, we expect non-GAAP core net profit to expand at 34% CAGR in 2022-24E.

Exhibit 4: Non-GAAP cost trend (% of revenue)



Source(s): Company, ABCI Securities estimates
Note: Excl. impacts of share-based compensation and other non-operating items

Exhibit 5: Core net margin



Source(s): Company, ABCI Securities estimates

Exhibit 6: Forecast changes

RMB mn	2023E old	new	Diff.	Comment
Revenue	161,608	233,140	44%	Contribution from transaction service and increasing monetization
Core net profit	40,381	58,513	45%	

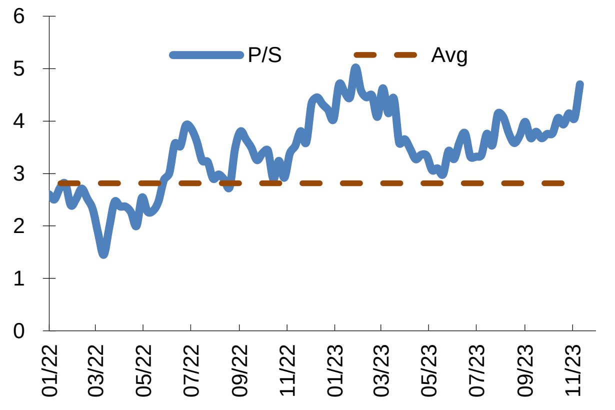
Source(s): ABCI Securities estimates

Valuation and TP

We maintain our **BUY** rating on the counter with a revised TP of US$ 180 to reflect Pinduoduo's robust growth momentum. Our TP implies 26.7x 2024E core P/E.

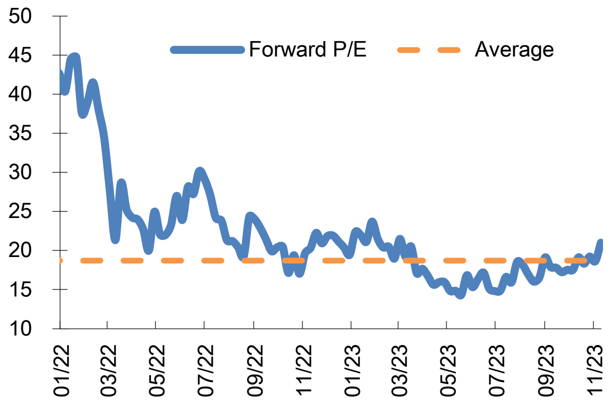
US delisting risks will remain in the near term as the company is one of the few major internet platforms without a dual listing status. Positively, divestment risk from the company's strategic stakeholder, which presently owns around 14.7% of the company's stakes, has lessened, in our view.

Exhibit 7: P/S trend



Source(s): Bloomberg, ABCI Securities

Exhibit 8: Forward P/E trend



Source(s): Bloomberg, ABCI Securities estimates

Exhibit 9: TP changes (US$ per share)

Old	New	Methodology-old	Methodology new
110	**180**	DCF	DCF with revised financial forecast

Source(s): ABCI Securities estimates

Exhibit 10: DCF sensitivity

		WACC				
		10.0%	**11.0%**	**12.0%**	**13.0%**	**14.0%**
Terminal growth	**1.0%**	206	181	161	145	131
	2.0%	222	193	170	152	136
	3.0%	242	207	181	160	143
	4.0%	268	225	194	169	150
	5.0%	305	250	211	181	159

Source (s): ABCI Securities estimates

Appendix: Company profile

Business
● Major ecommerce platform in China with **estimated market share at the mid-20s level** ● Platform based business model which generally does not bear inventories ● **Rapid growth in recent years** despite a relatively short operating history since 2015 ● Rising popularity driven by its **innovative business model** that provides buyers with value-for-money products and interactive shopping experiences. For example, it provides various "mini-games" for users to earn coupons ● "RMB 10bn subsidy" has been its major marketing program in recent years to reinforce its **"value-for-money" proposition** ● Annual active buyers estimated to be over 900mn, similar to Alibaba ● Estimated GMV per buyer around CNY 3.3K in 2022, versus about CNY 9K for Alibaba, illustrating its focus on the value-for-money segment ● Strategic partnership with Weixin to leverage its traffic ● **Strategic investments in agriculture** in recent years ● **Launched Temu for international market** in 3Q22 with growing popularly globally
Financials
● High gross margin over 60% thanks to platform based business model but a changing business mix towards emerging businesses could lead to margin dilution. ● **Marketing expenses has been a major cost item** and swing factor for profitability given its "value-for-money" proposition ● **Strategic shift from marketing to R&D** and emphasis on quality growth has led to more disciplined marketing expenses in recent quarters, thus improving the overall profitability. ● Achieved break-even since 2Q21 with core net margin rising to 25%-35% range in recent quarters ● **Swing factors for future profitability** includes potential increase in customer subsidies to compete in the market as well as Temu's profitability ● **Strong balance sheet** with RMB 203bn cash and short-term investment against RMB 16bn convertible bonds in Sep 2023.
Management and shareholder
● Largest shareholder and co-founder Zheng Huang (26.5% stake) **stepped down from his management role** of Chairman/member of board of directors in Mar 2021. He also gave up his 1:10 super voting power and entrusted his voting rights to the board. CEO Lei Chen was appointed as the new Chairman. ● **PDD partnership:** PDD partnership is entitled to appoint executive directors and nominate and recommend the CEO ● **No dividend record** since listing ● **US delisting risk** arising from tightened regulatory requirement ● **Strategic shareholder**, a major online platform in China, holds about 14.7% stakes.
Corporate governance/information disclosure
● Like other major e-commerce platforms, the company has ceased disclosing some operational metrics such as GMV/users in recent years ● **Google reportedly suspended Pinduoduo app in Mar 2023** due to information security concern, while Pinduoduo has rejected its claim ● Various ESG initiatives in recent years

Appendix: E-commerce industry profile

- **China's online sales growth has turned steadier** after years of development. According to NBS, online sales of physical goods grew 8.4% YoY in 10M23. In particular, the 8.4% industry growth in 10M23 was lower than the 10.8% industry growth in 1H23, indicating a slowdown in recent months.

- By product category, online sales of food products, groceries, and apparel rose 11.3%, 8.2%, and 7.6% in 10M23.

- **Online shopping penetration rate was generally in an uptrend** in recent months, indicating an ongoing consumption shift from offline to online.

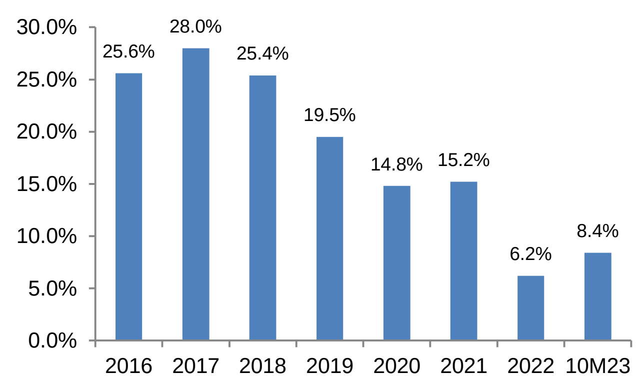
- **Live-streaming e-commerce** has been fast growing in recent years. In 9M23, live-streaming e-commerce sales rose by 60.6% YoY and accounted for 18.3% of total online sales, according to Ministry of Commerce. Short video platforms such as Douyin and Kuaishou (1024 HK) are major players in this emerging segment, leading to competitive pressure to traditional e-commerce platforms. On the other hand, Alibaba has been actively developing live-streaming business to defend its market position.

- Major e-commerce platforms are **increasing their sales and marketing effort** by raising user incentives and price subsidies. In our view, **online shoppers have turned more price-sensitive** in past years due to the pandemic and moderating economic development, prompting e-commerce platforms to enhance price competitiveness.

- In terms of market share, we estimate that Alibaba is still the largest e-commerce platform with mid-40s market share, vs. Pinduoduo (mid-20s), Platform A (low-20s), Douyin (high-single-digit), and Kuaishou (mid-single-digit).

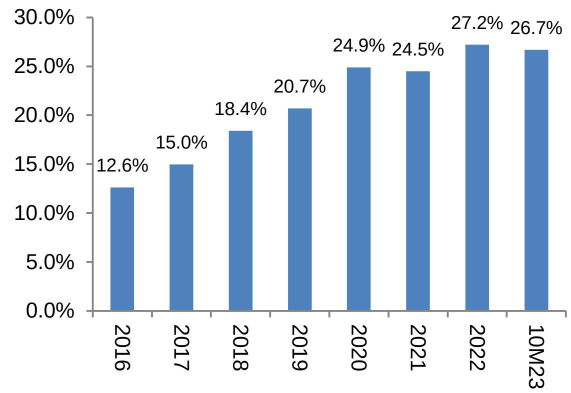
- Over the past few years, **Pinduoduo and short-video platforms (Douyin and Kuaishou) are gaining market shares.** Common features of these platforms: 1) Product offers have low prices; 2) More interactive features (social e-commerce, live streaming, etc.) than traditional search-based e-commerce format.

Exhibit 11: Online sales of physical goods growth



Source(s): NBS, ABCI Securities

Exhibit 12: Online shopping penetration rate



Source(s): NBS, ABCI Securities

Financial forecast

Consolidated income statement (2021A-2024E)

FY Ended Dec 31 (RMB mn)	2021A	2022A	2023E	2024E
Total revenue	**93,950**	**130,558**	**233,140**	**311,196**
Cost of sales	(31,718)	(31,462)	(79,308)	(108,973)
Gross profit	**62,232**	**99,095**	**153,832**	**202,223**
Sales and marketing	(44,802)	(54,344)	(84,207)	(115,512)
General and admin	(1,541)	(3,965)	(5,029)	(6,713)
R&D	(8,993)	(10,385)	(13,771)	(18,071)
Operating Profits	**6,897**	**30,402**	**50,825**	**61,928**
Interest income	3,062	3,997	7,500	7,500
Interest expenses	(1,231)	(52)	(100)	(100)
Fx gain	72	(150)	0	0
Others, net	656	2,221	1,000	1,000
Share of results of investee	247	(155)	150	150
PBT	**9,702**	**36,264**	**59,375**	**70,478**
Tax	(1,934)	(4,726)	(10,687)	(12,686)
PAT	**7,769**	**31,538**	**48,687**	**57,792**
Minority interests	0	0	0	0
Profits attributable to shareholders	**7,769**	**31,538**	**48,687**	**57,792**
Share-based compensation	4,775	7,718	9,326	12,448
Other non-core items	1,286	273	500	500
Non-GAAP profits attributable to shareholders	**13,830**	**39,529**	**58,513**	**70,740**
Basic earnings per ADS (RMB)	6.20	24.94	38.51	45.71
Diluted earnings per ADS (RMB)	5.44	21.90	33.80	40.12
Diluted non-GAAP earnings per ADS (RMB)	9.68	27.45	40.63	49.11
Growth				
Total revenue (%)	57.9	39.0	78.6	33.5
Gross Profit (%)	54.8	59.2	55.2	31.5
Operating Profit (%)	NA	340.8	67.2	21.8
Net profit (%)	NA	306.0	54.4	18.7
Non-GAAP net profit (%)	NA	185.8	48.0	20.9
Operating performance				
Operating margin (%)	7.3	23.3	21.8	19.9
Net margin (%)	8.3	24.2	20.9	18.6
Core net margin (%)	14.7	30.3	25.1	22.7
ROAE (%)	11.5	32.7	33.2	27.4
ROAA (%)	4.6	15.1	17.1	15.8

Note. Individual items may not sum to total due to rounding
Source(s): the Group, ABCI Securities estimates

Consolidated balance sheet (2021A-2024E)

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E
Fixed assets	2,203	1,045	3,045	5,045
Intangible assets	701	134	141	148
Other non-current assets	17,396	19,323	40,812	42,781
Total non-current assets	**20,301**	**20,502**	**43,997**	**47,974**
Cash & equivalents	6,427	34,326	60,333	109,560
Restricted cash	59,617	57,974	63,772	70,149
Short-term investments	86,517	115,113	155,113	160,113
Account receivables	674	588	617	648
Other current assets	7,675	8,617	8,933	9,265
Total current assets	**160,909**	**216,618**	**288,767**	**349,734**
Total assets	**181,210**	**237,119**	**332,764**	**397,708**
Payable to merchants	62,510	63,317	92,582	87,481
Merchant deposit	13,578	15,058	20,421	20,558
Convertible bonds and borrowings	0	13,886	14,886	8,806
Other current liabilities	17,642	24,629	24,812	25,005
Total current liabilities	**93,730**	**116,890**	**152,702**	**141,849**
Convertible bonds	11,789	1,576	1,654	-
Other non-current liabilities	577	884	2,625	2,756
Total non-current liabilities	**12,365**	**2,459**	**4,280**	**2,756**
Total liabilities	**106,095**	**119,349**	**156,981**	**144,605**
Equity attributable to shareholders	75,115	117,771	175,784	253,103
Non-controlling interests	-	-	-	-
Total equity	**75,115**	**117,771**	**175,784**	**253,103**

Note. Individual items may not sum to total due to rounding
Individual items may vary from reported figures due to rounding /definition differences
Source(s): the Group, ABCI Securities estimates

Consolidated cash flows (2021A-2024E)

As of Dec 31 (RMB mn)	2021A	2022A	2023E	2024E
Net income	7,769	31,538	48,687	57,792
Depreciation and amortization	1,495	2,224	2,000	2,000
Other non-cash adjustments	5,957	7,323	9,326	12,448
Change in working capital	13,562	7,423	8,994	(15,013)
Operating cash flow	**28,783**	**48,508**	**69,007**	**57,227**
Acquisition of fixed asset	(3,287)	(636)	(4,000)	(4,000)
Net purchase of investments	(32,720)	(21,090)	(40,000)	(5,000)
Other investment cash flow	445	(636)	-	-
Investing cash flow	**(35,562)**	**(22,362)**	**(44,000)**	**(9,000)**
Financing cash flow	**(1,875)**	**10**	**1,000**	**1,000**
Fx effect	(145)	100	-	-
Net cash flow	**(8,800)**	**26,256**	**26,007**	**49,227**

Note. Individual items may not sum to total due to rounding
Individual items may vary from reported figures due to rounding /definition differences
Source(s): the Group, ABCI Securities estimates

Risk factors

Market competition

The ecommerce industry is highly competitive, with companies contending on commission rate, promotion discount, brand advertising, technological investment, and more.

Slowdown in ecommerce consumption

As the industry is dependent on consumer spending, any significant slowdown of consumption in China would hamper the Company's performance. In the long term, we believe consumption growth in domestic market would converge with income growth, which is usually in line with GDP growth.

Non-GAAP financials

Ecommerce platforms generally disclosed the non-GAAP financial metrics, such as the non-GAAP net profit, to supplement its GAAP financial measures. Historically, there were differences between its GAAP net profit and non-GAAP net profit due to inclusion of items such as share-based compensation and other non-core items in the former.

Among these items, share-based compensation expense is related to various factors including price movement of ordinary shares, expected volatility, risk-free interest rate, etc.

While investors tend to exclude these items when performing analysis given their non-cash nature, we believe these non-GAAP financial measures should only serve as references.

Slowdown in profit growth in 2024

We expect profit growth to slow in 2024E due to slowing revenue growth and margin decline due to change of business mix.

Potential conversion of convertible bonds

USD1bn and USD2bn of CBs will mature on Oct 1, 2024 and Dec 1, 2025 respectively, leading to earnings dilution risk should these CBs are converted (conversion prices of 2024/2025 CBs are USD42.61 and USD190.63 respectively). Otherwise, the Company needs to repay or refinance these CBs offshore.

Disclosures

Analyst Certification

The analyst, CHOW Sau Shing, primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company(ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

Disclosures of Interests

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Definition of equity rating

Rating	Definition
Buy	Stock return rate≥ Market return rate (9%)
Hold	- Market return rate (-9%) ≤ Stock return rate < Market return rate (+9%)
Sell	Stock return < - Market return (-9%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months
Market return rate: average market return rate since 2006 (HSI total return index 2006-22 averaged at 8.4%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

Disclaimers

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