

Pinduoduo (PDD US)

Temu as strong emerging driver

- Robust revenue growth momentum driven by Temu
- Ongoing investment in marketing and infrastructure for business expansion
- Maintain **BUY** with a revised TP of US\$ 185

Company Report

Mar 22, 2024

Rating: **BUY**
 TP: US\$ 185

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Robust growth driven by Temu. Pinduoduo reported robust revenue growth of 123% YoY in 4Q23. In particular, transaction service revenue rose by 357% YoY, driven by the ongoing development of Temu. Since its launch in 3Q22, Temu has expanded into over 50 international markets with increasing popularity thanks to its "value-to-money" market position. 4Q23 transaction service revenue accounted for 45% of total revenue vs. 20% in 3Q22. We estimate Temu's revenue contribution to Pinduoduo reaches over 20% currently. We project Temu's revenue contribution to reach the 30s by 2025E, supporting Pinduoduo's 35% revenue CAGR in 2023-25E.

Still in the active investing phase. Despite robust revenue growth, Temu is still in the development phase, which requires continuous investment in marketing and other customer incentives to strengthen its "value-to-money" market position, aside from developing international logistics infrastructure to support future business growth. In our opinion, this could lead to some margin volatility. We expect core net margin to moderate to 24.5% in 2025E.

Maintain BUY. We maintain our **BUY** rating with a revised TP of US\$ 185 given Pinduoduo's strong growth momentum. Our TP implies 17.3x 2025E core P/E. Conversely, ongoing regulatory development in the US remains a risk factor for Temu's US operation.

Results and Valuation

FY end Dec 31	2022A	2023A	2024E	2025E
Revenue (RMB mn)	130,558	247,639	356,526	452,710
Chg (% YoY)	39.0	89.7	44.0	27.0
Net profit (RMB mn)	31,538	60,027	71,015	92,392
Chg (% YoY)	306.0	90.3	18.3	30.1
Core net profit(RMB mn)	39,529	67,899	85,776	111,000
Chg (% YoY)	185.8	71.8	26.3	29.4
Earnings per ADS (RMB)	21.9	41.1	48.6	63.3
Chg (% YoY)	302.6	87.8	18.3	30.1
Core earnings per ADS	27.4	46.5	58.8	76.0
Chg (% YoY)	183.4	69.5	26.3	29.4
Core P/E (x)	32.1	18.9	15.0	11.6
P/S (x)	9.7	5.2	3.6	2.8
ROAE (%)	32.7	39.4	30.9	28.2
ROAA (%)	15.1	20.5	17.1	17.2

Note: 1ADS=4 ordinary shares

Source (s): Bloomberg, ABCI Securities estimates

Price	US\$ 122.3
Est. share price return	51.3%
Est. dividend yield	NA
Est. total return	51.3%
Last Rating & TP	BUY, US\$180
Previous Report Date	Mar 7, 2024

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L (US\$)	152.9/59.6
Outstanding shares (mn)	5,478
Market cap (US\$ mn)	167,490
3-mth avg daily turnover (US\$ mn)	1,131
Major shareholder(s)	
Zheng Huang	25.7%

Source(s): Bloomberg, Company

Share Performance (%)

	Absolute	Relative*
1-mth	-7.1	-8.5
3-mth	-15.4	-19.8
6-mth	27.5	33.6

*Relative to MXCN

Source(s): Bloomberg, ABCI Securities

Share performance(US\$)



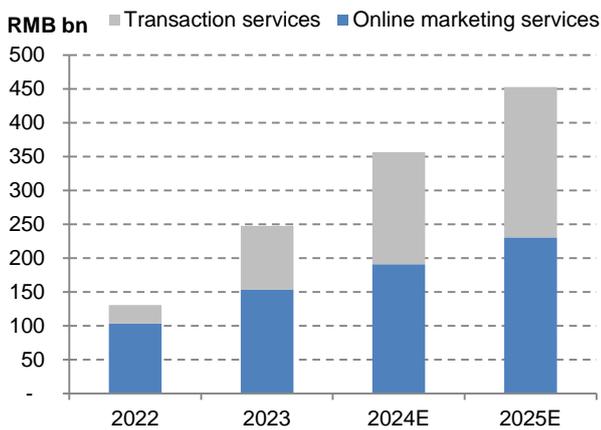
Source(s): Bloomberg, ABCI Securities

Financial outlook

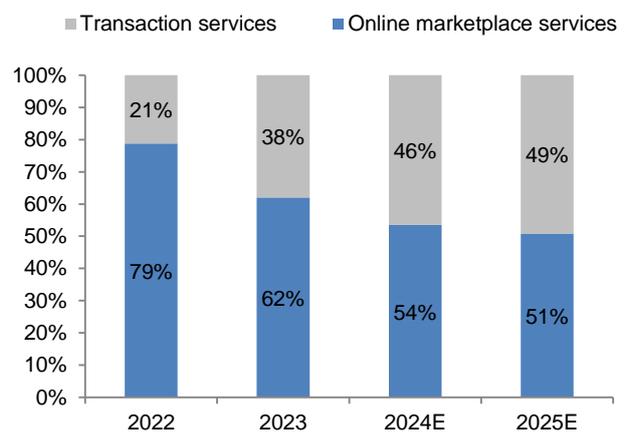
We expect revenue to increase at 35% CAGR in 2023-25E, largely driven by improving monetization via providing more value-added services to merchants and rising contribution from emerging businesses, such as Temu.

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 22% CAGR in 2023-25E, driven by improved monetization through better service offerings and merchant stickiness.

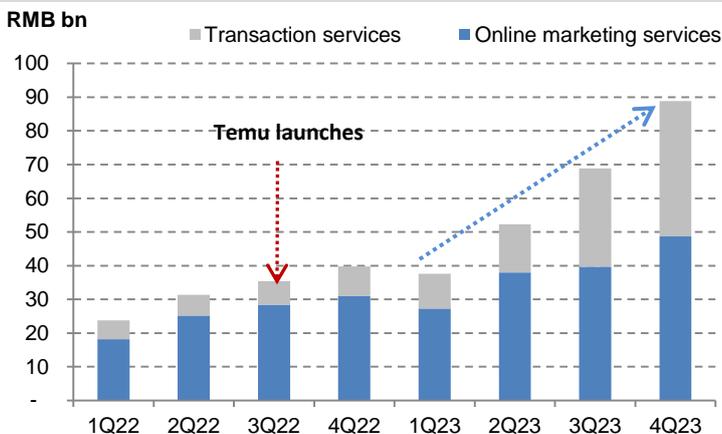
Transaction services: We expect transaction services revenue to increase at 54% CAGR in 2023-25E on increasing contributions from emerging businesses. As a result, we expect the segment's contribution to total revenue to increase from 38% in 2023 to 49% in 2025E. Specifically, Temu, which takes on a "value-to-money" market position, has been gaining popularity since its launch in 3Q22. Temu has expanded into over 50 overseas markets. We expect its overall revenue contribution to Pinduoduo to be in the 30s range by 2025E.

Exhibit 1: Revenue trend


Source(s): Company, ABCI Securities estimates

Exhibit 2: Revenue mix


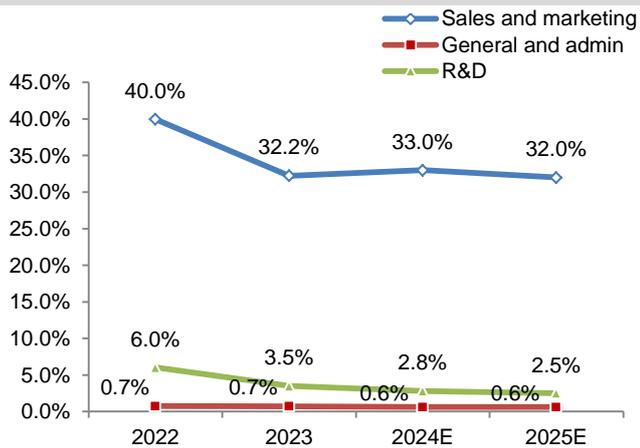
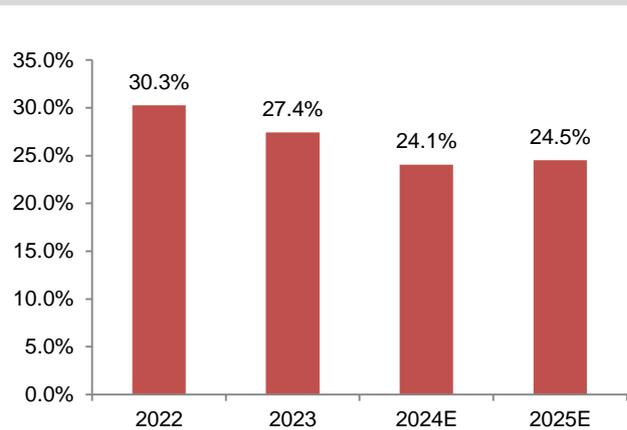
Source(s): Company, ABCI Securities estimates

Exhibit 3: Segment revenue trend


Source(s): Company, ABCI Securities

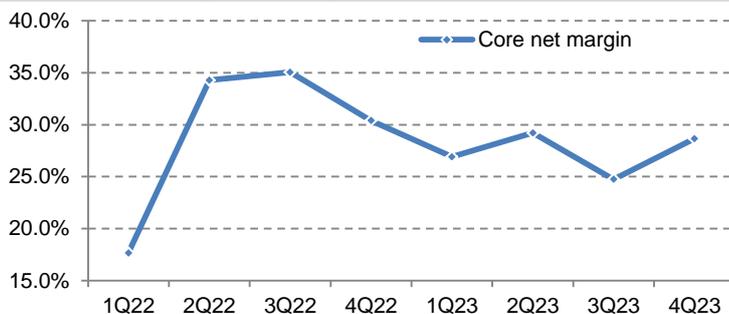
Despite robust revenue growth, Temu is still in the development phase, which requires continuous investment in marketing and other customer incentives to maintain its "value-to-money" market position. In addition, investments in international logistics infrastructure will be needed to support its global expansion. In our view, this could lead to margin volatility, as illustrated by its fluctuating core net margins over the past four quarters.

Overall, we expect non-GAAP core net profit to expand at 28% CAGR in 2023-25E, with core net margin moderating to 24.5% in 2025E.

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

Exhibit 5: Core net margin


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

Source(s): Company, ABCI Securities estimates

Exhibit 6: Fluctuating core margin trend in recent quarters


Source(s): Company, ABCI Securities

Exhibit 7: Financial forecast changes

	2024E			2025E			Comment
	old	new	Diff	old	new	Diff	
Revenues	311,196	356,526	15%	404,775	452,710	12%	Strong growth in overseas business
Core profit	70,740	85,776	21%	89,753	111,000	24%	Operating leverage

Source(s): ABCI Securities estimates



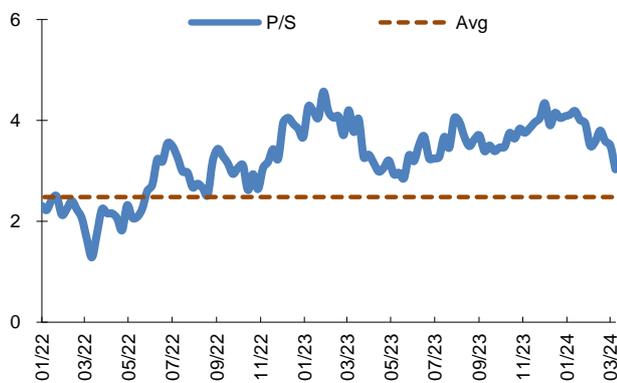
Valuation and TP

We maintain our **BUY** rating on the counter with a revised TP of US\$ 185 to reflect Pinduoduo's robust momentum. Our TP implies 17.3x 2025E core P/E, which we believe is undemanding.

On the other hand, given the Sino-US tensions and the recent regulatory action against TikTok, the regulatory risk for Temu's US operation is a near-term overhang. Furthermore, the possibility of delisting in the US remains, and the company is one of the few major online platforms that does not hold dual listing status.

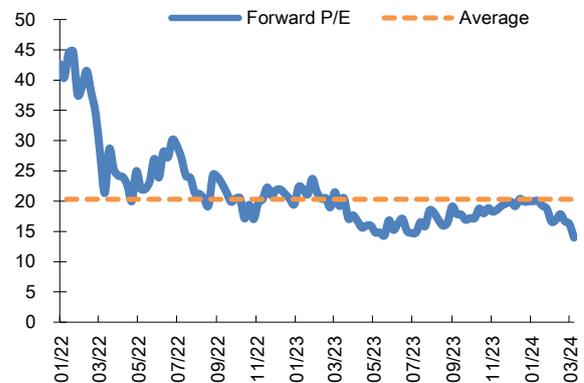
Positively, divestment risk from the company's strategic stakeholder, which presently owns around 14.7% of the company's stakes, has lessened, in our view.

Exhibit 8: P/S trend



Source(s): Bloomberg, ABCI Securities

Exhibit 9: Forward P/E trend



Source(s): Bloomberg, ABCI Securities

Exhibit 10: TP changes (US\$ per share)

Old	New	Remark
180	185	DCF with revised financial forecast, 12% WACC (unchanged), and 3% terminal growth rate (unchanged)

Source(s): ABCI Securities estimates



Company profile

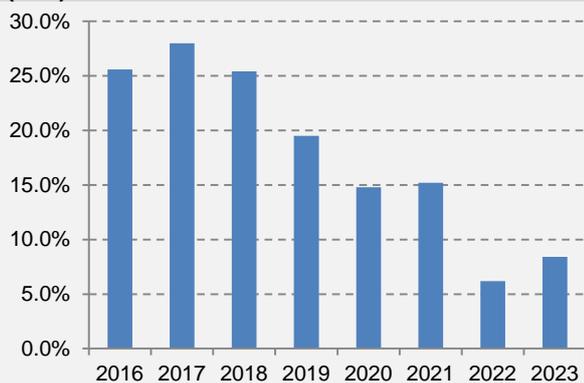
<p>Business</p> <ul style="list-style-type: none"> Major ecommerce platform in China with an estimated market share at the mid-20s level Platform-based business model, which generally does not bear inventories Rapid growth in recent years despite a relatively short operating history since 2015 Rising popularity driven by its innovative business model that provides buyers with value-for-money products and interactive shopping experiences. For example, it offers 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 (9988 HK/BABA US) Estimated GMV per buyer around RMB 3.3K in 2022, vs. about RMB 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 the international market in 3Q22 with growing popularity globally
<p>Financials</p> <ul style="list-style-type: none"> High gross margin over 60% thanks to platform-based business model, but a changing business mix towards emerging businesses may shave margins 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 controlled marketing expenses in recent quarters, thus improving 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 217bn cash and short-term investment against RMB 5.8bn convertible bonds in Dec 2023
<p>Management and shareholder</p> <ul style="list-style-type: none"> Largest shareholder and co-founder Zheng Huang 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 a c 14.3% stake
<p>Corporate governance/information disclosure</p> <ul style="list-style-type: none"> 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 concerns, while Pinduoduo has rejected its claim Various ESG initiatives in recent years



Industry profile: Online shopping

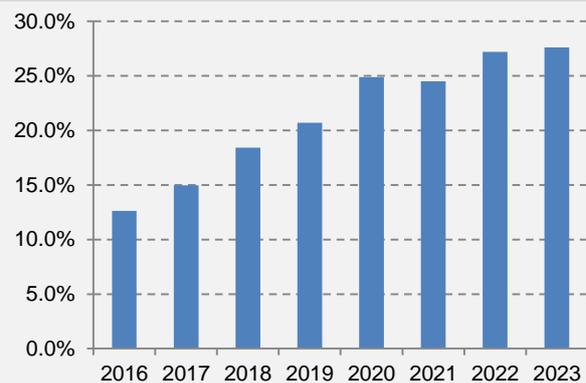
- **China's online sales growth has turned steadier** after years of development. According to NBS, online sales of physical goods grew 8.4% YoY in 2023. In particular, the 8.4% industry growth in 2023 was lower than the 10.8% industry growth in 1H23, indicating a slowdown in 2H23
- By product category, online sales of food products, groceries, and apparel rose 11.2%, 7.1%, and 10.8% in 2023
- **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 the 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 efforts** 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
- Selected platforms such as Pinduoduo and Shein are actively developing **cross-border e-commerce** and have gained growing traction in various overseas markets

Exhibit 11: Online sales growth of physical goods (YoY)



Source(s): NBS, ABCI Securities

Exhibit 12: Online shopping penetration rate



Source(s): NBS, ABCI Securities



Financial forecast

Consolidated income statement (2022A-2025E)

FY Ended Dec 31 (RMB mn)	2022A	2023A	2024E	2025E
Total revenue	130,558	247,639	356,526	452,710
Cost of sales	(31,462)	(91,724)	(135,746)	(173,273)
Gross profit	99,095	155,916	220,780	279,437
Sales and marketing	(54,344)	(82,189)	(122,397)	(150,890)
General and admin	(3,965)	(4,076)	(6,751)	(8,572)
R&D	(10,385)	(10,952)	(14,623)	(17,210)
Operating Profits	30,402	58,698	77,010	102,765
Interest income	3,997	10,238	7,500	7,500
Interest expenses	(52)	(44)	(100)	(100)
Fx gain	(150)	36	0	0
Others, net	2,221	2,953	1,000	1,000
Share of results of investee	(155)	(5)	150	150
PBT	36,264	71,876	85,560	111,315
Tax	(4,726)	(11,849)	(14,545)	(18,924)
PAT	31,538	60,027	71,015	92,392
Minority interests	0	0	0	0
Net profit	31,538	60,027	71,015	92,392
Share-based compensation	7,718	7,079	14,261	18,108
Other non-core items	273	794	500	500
Core net profit	39,529	67,899	85,776	111,000
Growth				
Total revenue (%)	39.0	89.7	44.0	27.0
Gross Profit (%)	59.2	57.3	41.6	26.6
Operating Profit (%)	340.8	93.1	31.2	33.4
Net profit (%)	306.0	90.3	18.3	30.1
Non-GAAP net profit (%)	185.8	71.8	26.3	29.4
Operating performance				
Operating margin (%)	23.3	23.7	21.6	22.7
Net margin (%)	24.2	24.2	19.9	20.4
Core net margin (%)	30.3	27.4	24.1	24.5
ROAE (%)	32.7	39.4	30.9	28.2
ROAA (%)	15.1	20.5	17.1	17.2

Note: Individual items may vary from reported figures due to rounding /definition differences

2023 results are unaudited figures

Source(s): the Group, ABCI Securities estimates



Consolidated balance sheet (2022A-2025E)

As of Dec 31 (RMB mn)	2022A	2023A	2024E	2025E
Fixed assets	1,045	980	2,980	4,980
Intangible assets	134	21	22	22
Financial investments	16,862	47,951	57,951	67,951
Other non-current assets	2,461	4,376	4,390	4,390
Total non-current assets	20,502	53,328	65,342	77,342
Cash & equivalents	34,326	59,794	167,280	248,058
Restricted cash	57,974	61,985	68,184	68,184
Short-term investments	115,113	157,415	167,415	177,415
Account receivables	588	3,914	4,110	4,110
Other current assets	8,617	11,641	12,012	12,012
Total current assets	216,618	294,750	419,001	509,779
Total assets	237,119	348,078	484,343	587,121
Payable to merchants	63,317	74,997	116,442	114,721
Merchant deposit	15,058	16,879	26,689	25,919
Convertible bonds and borrowings	13,886	649	5,231	0
Other current liabilities	24,628	60,376	60,627	60,627
Total current liabilities	116,889	152,901	208,989	201,267
Convertible bonds	1,576	5,232	-	-
Other non-current liabilities	884	2,704	2,836	2,836
Total non-current liabilities	2,460	7,936	2,836	2,836
Total liabilities	119,349	160,836	211,826	204,104
Equity attributable to shareholders	117,771	187,242	272,517	383,017
Non-controlling interests	-	-	-	-
Total equity	117,771	187,242	272,517	383,017

Note: Individual items may vary from reported figures due to rounding /definition differences

2023 results are unaudited figures

Source(s): the Group, ABCI Securities estimates

Consolidated cash flows (2022A-2025E)

As of Dec 31 (RMB mn)	2022A	2023E	2024E	2025E
Net income	31,538	60,027	71,015	92,392
Depreciation and amortization	2,224	2,000	2,000	2,000
Other non-cash adjustments	7,323	21,323	14,261	18,108
Change in working capital	7,423	10,813	44,858	(2,491)
Operating cash flow	48,508	94,163	132,134	110,009
Acquisition of fixed asset	(636)	(4,000)	(4,000)	(4,000)
Net purchase of investments	(21,090)	(50,000)	(20,000)	(20,000)
Other investment cash flow	(636)	(1,431)	-	-
Investing cash flow	(22,362)	(55,431)	(24,000)	(24,000)
Financing cash flow	10	(8,961)	(649)	(5,231)
Fx effect	100	(291)	-	-
Net cash flow	26,256	29,480	107,485	80,778

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.

US regulatory risk

Pinduoduo's Temu has a growing operation in the US, and is subject to US regulatory risk given the rising geopolitical tension between China and the US.

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.



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Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (7%)
Hold	- Market return rate (-7%) \leq Stock return rate < Market return rate (+7%)
Sell	Stock return < - Market return (-7%)

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 2005-23 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.

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