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Q3 2019 Yunji Inc Earnings Call

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PRESENTATION

Operator

Good morning, and good evening, ladies and gentlemen. Thank you, and welcome to Yunji's Third Quarter 2019 Earnings Conference Call. (Operator Instructions)

With us today are Mr. Shanglue Xiao, Chairman and Chief Executive Officer; Mr. Chen Chen, Chief Financial Officer; Mr. Hui Ma, Chief Strategy Officer and Chief People Officer; and Ms. Kaye Liu, Investor Relations Director of the company.

I would now like to hand the conference over to our first speaker for today, Ms. Kaye Liu, IRD of Yunji. Please go ahead, ma'am.

Kaye Liu ***Yunji Inc. - IR Director***

Hello, everyone. Welcome to our third quarter 2019 earnings call. Before we start, please note that this call will contain forward-looking statements. These forward-looking statements involve inherent risks and uncertainties that may cause actual results to differ materially from our current expectations.

For detailed discussion of these risks and uncertainties, please refer to our latest document filed with U.S. SEC.

Any forward-looking statements that we make on this call are based on assumptions as of today, and we do not undertake any obligation to update these statements, except as required under applicable law. These forward-looking statements are based on management's current expectations, observations that involve known and unknown risks, uncertainties and other factors that are not in the company's control, which may cause actual results, performance and achievements of the company to materially different from the results, performance expectations implied by these forward-looking statements. Our forward-looking statements are expressly qualified in their entirety by the cautionary statements, risk factors and details of the company filing with the SEC. Yunji undertake no duty to revise or update any forward-looking statements for selected events or circumstances after the date of this conference call.

With that, I will now turn over to Shanglue Xiao, Chairman and CEO of Yunji.

Shanglue Xiao ***Yunji Inc. - Chairman & CEO***

[Interpreted] Hello, everyone. Welcome to Yunji's Third Quarter 2019 Earnings Call. During the third quarter of 2019, our GMV increased by 69.8% year-over-year to RMB 9.2 billion. We generated RMB 2.77 billion in total revenue while shrinking adjusted net loss by 37.7% to RMB 24.9 million in the prior year period. As of September 30, 2019, our cumulative membership increased by 14.2% to 12.3 million from 10.8 million as of June 30, 2019. In the 12 months ended September 30, 2019, the total number of our transacting members has increased by 122.7% year-over-year, further illustrating the ongoing expansion of our platform.

Such solid results backed our meticulous execution of 3 competitive strategies. First, fostering sustainable growth and stable profitability. Second, building competitive differentiation through effective merchandising. And third, providing compelling value propositions to members and service managers through personalization.

The backdrop of us pursuing those 3 strategies is the so-called "desire economy", namely an economy centered on consumers' desires. To prosper in the "desire economy", business need to proactively uncover consumer's desire and satisfy those desires. While the current consumer market is flooded with low-end manufacturing products, we instead focus our effort on collaborating with high-end

manufacturers. We believe that high-end products are not only enjoying favorable supply-demand dynamics, but also growing rapidly with a rising tide of 800 million strong middle-income consumers in China.

We are determined to prosper by satisfying Chinese consumers' desire for consumption upgrade over the next 5 to 10 years. We refuse to market cheaply priced, low-end product that don't offer any compelling value to consumers. We don't mark product cost up by a multiple of 4 to 5x just to secure exclusivity for ourselves with brand owners. Instead, we help them attain market share through our low-cost markup of only 2 or 2.5x, that way brand owners can offer our members with high-quality and high-value products. Meanwhile, we, as an intermediary, can also achieve a reasonable ROI, thus creating a win-win situation for all these 3 parties involved.

The "desire economy" as our backdrop, now let me explain our 3 competitive strategies in more details. First, I would like to crystallize our view on the essential components of a healthy business. We believe that only those business with stable profitability and sustainable growth can be categorized as healthy. As such, we continue to optimize our market strategy and cost structures to maintain the healthy state of our business.

During the third quarter of 2019, we refined our subsidy allocation and cost-control measures to improve our gross margin and operational efficiency. By reassessing our subsidy payout arrangement, for example, we were able to effectively reduce subsidies paid to brands, that use our platform merely as a subordinate channel for marketing their products. As a result, we eliminated inefficient and duplicative market campaigns, thus improving our performance. Moreover, we also reduced subsidies for those products not meeting 3 criteria: first, high quality with competitive price; second, strong ROI potential; and third, high desirability in the eyes of the mainstream youth consumers. For those suppliers whose products meet our aforementioned criteria, we prioritize their ranking in our network's recommendation system and guarantee their marketing resources in our member community. These operational adjustments have led to more efficient utilization of our resources, gradual optimization of our staffing structure, and stronger incentives for our employees and service managers to perform better. As a result, we achieved profitability during this year's Double Eleven campaign. We anticipate our operating expenses decline further in the fourth quarter of 2019.

Now let me share with you our second competitive strategy: building on foundation of our dual business model encompassing both marketplace business and merchandise sales, our competitive differentiation can be summarized into 2 words: inclusiveness and focus.

First, allow me to explain "inclusiveness" in more details. In the first quarter of 2019, we have started to gradually optimize our operational structure and shift part of our business from merchandise sales to marketplace business model. In the light of the general public's past misperception and disfavor of our business model shift, I would like to take this opportunity to explain from the operational efficiency perspective the myriad benefits of our dual business models that include both merchandise sales and marketplace business.

The first benefit is that the marketplace business model is asset light. As we transfer portions of those low-margin, mature brands from merchandise sales to marketplace business, we are able to reduce our expenditure in logistics, customer service and operations headcounts significantly.

The third -- the second benefit is that marketplace business model is speedy. For example, the apparel category require extensive time and effort in product selection, review and verification. At the same time, its innate nature of seasonality and fickleness puts a stringent demand on its time to market. The marketplace business model is especially suitable for the apparel category because it gives suppliers far more operational flexibility and freedom, thus allowing them to shorten their pre-market preparation operations timeline.

The third benefit is that while we keep our marketplace business platform open, we continue to foster the natural selection of high-quality suppliers with premium products through sufficient, albeit-controlled competition. We believe that our inclusive marketplace business model is conducive to continuous improvement in both our suppliers' and our own operations, which should lead to win-win in the long run.

In addition to "inclusiveness", the other pillar of our competitive differentiation strategy is "focus". We are now intensifying our focus on one target, crafted sales of each individual super products or super fresh. The crafted sale format focus on top-tier SKUs (by sales volumes), and enables leading global manufacturers to incubate products and brands distinguishable with 4 characteristics.

First, high-quality; second, attractive design; third, compelling value; and fourth, high throughput. Through the crafted sales format, we are able to cultivate brands capable of generating millions or even billions of RMB in sales, increase incomes for our service managers, provide more value to our members, improve the profitability of our platform, all at the same time. As we continuously refine our selection of innovative brands, private labels investable brands, we have built up a deeper reservoir of million- or billion- RMB brand categories, many of which are already in the lead in sales volume. For example, Solo Life and UNES, two private labels within the cosmetic and beauty categories, continued to maintain their million-dollar sales volumes.

Another example is the fruit category, in which multiple brands have achieved million-dollar sales volume on a per-day and per-SKU basis. We have also broken into health supplement category through our work with UniBeauty, a brand that leveraged advanced manufacturing technology and product formula from the United States' DuPont to create probiotic product in China. Through our unique integrated marketing and sales system, UniBeauty has attained an excellent market reception upon its launch on our platform.

Turning to our third competitive strategy, which is also our most unique strategy, we match supply with demand by leveraging individual consumers' trust of one another. This strategy builds upon the foundation of our member quality and social sharing system, in which we have achieved a number of innovative breakthroughs. First, we refined our membership enrollment system and further stimulated our users' transaction interest through the 3-month trial membership and high-quality product. After the initial taste of member benefits during trial period, upon trial expiration, users were further enticed to retain their full member status either through purchases of membership packages or by meeting the cumulative purchase amount requirement. We did a controlled test within a small group of users after launching the trial membership in the first quarter of 2019. After 3 calendar quarters of continuous observation and adjustments, we discovered that members acquired through trial membership are of high quality. Consequently, we plan to promote trial membership at a greater scale.

Beyond the success of our member enrollment systems, we also provided service manager with incentives to boost their engagement and encourage them to discover, represent and promote on our platform those products with high quality, but little notoriety available on other platforms. For instance, apparel products often have difficulties standing out in their category due to the tremendous variety of options available. By sharing their experiences of trying on apparel products and passing along word-of-mouth recommendations, our service managers have made it easy for members to discover and select those products of their liking. Such promotion method does not require endorsement for well-known internet celebrities. It can boost member engagement and improve their shopping experience without adding a lot of marketing cost.

On interactive activities, our platform helped to establish trust relationship between our members and service managers. Moreover, to enhance those relationships, we organized a variety of offline events. The majority of our offline events were not intended to drive product sales or promotions, but instead to provide our members and service managers with opportunities to learn something new, share their experience and better interact with each other. As a result, our offline events have attained positive feedback from both our members and service managers.

In summary, all 3 of our competitive strategies have formed an upward spiraling growth funnel. As we continue to optimize our cost control measures and increase profit margins, we are confident that we will be able to grow our profitability steady and generate attractive returns for our shareholders.

With that, I will turn the call over to our CFO, Chen(Rex) Chen, to go through the details of our financial results.

Chen Chen ***Yunji Inc. - CFO***

Thank you, Shanglue. Hello, everyone. Before I go through our financial results with you, please note that all numbers stated in the following remarks are in RMB terms, and our percentage changes are on a year-over-year basis unless otherwise noted.

During the third quarter of 2019, our GMV increased by 69.8% to CNY 9.2 billion, and our total revenue were CNY 2.77 billion compared with CNY 3.08 billion in the same period of 2018. Since its launch in the first quarter of 2019, our marketplace business platform has attracted a growing number of merchants interested in tagging to our massive user group. Additionally, some merchants from our

merchandise sales platform have decided to move on to our marketplace business platform and therefore, have taken responsibility for the procurement, storage, and management of their own inventory. As a result of this transfer, a portion of our revenues previously generated on our merchandise sales platform and recognized on a gross basis was shifted to our marketplace business platform, which recognizes sales on a net basis.

In the third quarter of 2019, revenues from net sales of merchandise were CNY 2.47 billion, accounting for 89.1% of our total revenue. As we continue to attract a more popular brands to our marketplace business platform and improve our commission rate, revenues from our marketplace business were CNY 86.3 million compared with nil in the same period of 2018.

During this quarter, as we continue to enhance our merchandising mix, refine our value proposition and engage more users through our diversified membership enrollment system, revenues from our membership program increased by 16.3% to CNY 206.7 million. Meanwhile, as some merchants move to our marketplace business platform, a portion of our product purchasing and storage activities was shifted back to the merchants, which reduced our costs related to activities such as inventory write-downs and merchandise procurement. More importantly, our gross profit margin expanded to 17.8% from 16.8% in the prior year period, which was mainly attributable to our subsidy allocation plan improvements and the refinement of our product offerings for both our marketplace business and the merchandise sales platforms.

Now let's move to our operation expenses. During the third quarter, the shift in a portion of merchandise sales to the marketplace business [format] (added by company after the call) model and our ongoing efforts to improve our logistic efficiency led to a decrease in fulfilment expenses. Additionally, we also invested more in sales and marketing as well as general and administrative expenses to attract more popular brands and merchants onto our platform, support our increased number of business initiatives, and capture additional market share.

Moreover, in line with our efforts to improve users' shopping experience, we continued to invest in our data and the technology capabilities. And as a result, our total operating expenses increased to CNY 636.4 million in third quarter of 2019 compared with CNY 592.9 million in the prior year period.

Despite the uptick in operating expenses, we are confident in the strengths of our long-term plan to streamline operations. Going forward, we will continue to perfect our product mix, engage in prudent resource planning and allocate subsidies to those brands and suppliers that meet our criteria.

For the third quarter of 2019, our loss from operations was CNY 132.3 million compared with CNY 74.7 million in the prior year period. We expect our operating income to be improved continuously in the fourth quarter of 2019 and 2020. Net loss decreased by 4.3% to CNY 51.3 million in the third quarter of 2019 from CNY 53.6 million in the prior year period. Our adjusted net loss decreased by 37.7% to CNY 24.9 million in the third quarter of 2019 from CNY 39.9 million in the prior year period.

Basic and the diluted net loss per share attributable to ordinary shareholders were CNY 0.02 in third quarter of 2019 compared with CNY 0.17 in the same period of 2018.

Now let's also take a look at our cash and liquidity positions. As of September 30, 2019, we had a total of CNY 2.3 billion in cash and cash equivalents, [restricted cash] (added by company after the call) and the short-term investments on our balance sheet. Heading into the fourth quarter of 2019, we're focused on advancing towards healthy profitability and continuing to develop our competitive value propositions. We plan to take advantage of our solid cash position, to convert more users into members, stimulate service manager engagement, enhance brand equity and cultivate more strategic partnerships with reliable suppliers and quality brands. Furthermore, we are confident that our prudent balance of sales between both our marketplace business and the merchandise sales platform will help us to drive our long-term profitability.

This concludes our prepared remarks for today. We're now ready to take questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Ivy Liu of Credit Suisse.

Ivy Liu ***Crédit Suisse AG, Research Division - Analyst***

(foreign language) I'll quickly translate myself. So my first question is on GMV. Will the 3P GMV continue to expand in terms of the contribution ratio? And what will the stabilized level be like looking into 2020? And what type of merchants or brands are management particularly interested in working with or bringing in onto the platform? So my second question is on member growth. So will there be other user acquisition strategies or tactics aside from the existing ones? And is there any specific target number in terms of the transaction numbers for 2019? That's it.

Chen Chen ***Yunji Inc. - CFO***

Thanks, Ivy. I will take this question. So for your first question, is that GMV allocation between the 1P model and the 3P model. So currently, because our focus is due on the -- to select the products that member needs, and we focus on what products and what sales format can best fit our members' needs. So we do not set the expectations. On the percentage of how much GMV will come from 1P or how much GMV will come from 3P. So if the 3P platform -- if 1 product in 3P platform can provide more value and a more efficient logistic efficiencies to our members, we'll choose the 3P model. And if 1 product can provide us, our member more value and bring us more gross margin in the 1P model, so we'll choose the 1P model. So we do not have the detailed expectations. But we hope we can balance the 1P and the 3P business in the 50 to 50 in 2020. And for the brands to cooperate with, so because, if we want to differentiate us with other e-commerce platform like JD, Alibaba, PDD, I think our unique place is to promote the emerging brands with high-mark gross margin and high profit because these brands need more -- need a moderate communication between the platform members and the buyers. And these brands need Yunji to educate the market. So because Yunji has a larger social network, so I think for these brands, it's the best for these brand to cooperate with Yunji and Yunji can also gain more profits through cooperation with these brands. So the good emerging brands, which removes a very high profit of the well-known famous brands, and can also bring us more profit is the brand we -- Yunji want to cooperate with. So for your last question, is our member acquisition strategy, I think we will continue to use our current strategy to recruit members, but we will use both online/offline activities to do the recruitment. So traditional -- I mean in previous years, we already use the online method to acquire the members, use WeChat to send the link and ask the young people to register as the members. But starting from this year, we think that if we do more offline promotions, which can bring us more -- the member stickness will be much, much higher.

So we set a lot of trainings and workshops in the offline and also, we encourage our active members and our service managers to do the experience sharing and to hold the offline gathering and -- also other kind of the sharings to recruit the members. So our key member acquisition method will not be changed. We'll continue to use our method, but we will allow more and more offline activities.

Operator

(Operator Instructions) Our next question is from the line of Andre Chang of JPMorgan.

Andre Chang ***JP Morgan Chase & Co, Research Division - Analyst***

(foreign language)

Chen Chen ***Yunji Inc. - CFO***

Thank you, Andre. So for your first question about the gross margin in Q3 is lower than Q2. So if we look at the gross margin, it -- traditionally, in Q3, some gross margin is lower than Q2 and also lower than Q4. So in Q4, you can expect the gross margin will be higher than the Q3. So it -- and the second reason is that, starting from this quarter, as our CEO stated in the CEO statement, that we -- our focus is to introduce more emerging brands to our members and to our buyers. And of course, these new and introduced emerging brands, because we need more time to do the education in the market, and also, we need to encourage our members to do more communication between the members and the buyers to facilitate the transactions. So in this quarter, indeed, we set a higher member commissions. If a member refers a product to the buyers or if the member do the sale purchase. So that is what you think. And in addition, we also set a little bit higher service manager service fee to encourage the new-introduced emerging brands sales. So I think the gross margin for these new-introduced products will be in effect in Q4. So in Q4, because we have already some -- did some education of these brands, so these brands' margin will be higher in Q4. So you can expect our gross margin and both -- also the

operating income will be increased in Q4. So it's for your first question. And then for your second question is our private label. The private label GMV in Q3 is around close to 12% in Q3, and we estimate that -- our target for the whole year is also close to 13%, in whole year of 2019.

Operator

(Operator Instructions) Now I'd like to hand the conference back to our management for closing remarks. Please continue.

Kaye Liu ***Yunji Inc. - IR Director***

Thank you, everyone, for joining today, and we are looking forward to speaking with everyone next quarter. If you have any questions, please contact the IR team of Yunji. Thank you.

Operator

Ladies and gentlemen, that concludes our conference for today, and thank you for participating. You may now all disconnect.

[Portions of this transcript that are marked [Interpreted] were spoken by an interpreter present on the live call.]