

[RERE] - AiHuiShou International Co. Ltd.
Q2 2021 Earnings Conference Call
Tuesday, August 17, 2021, 08:00 AM Eastern Time

Company Participants:

Kerry Chen, Founder, Chairman, CEO
Rex Chen, CFO
Jeremy Ji, Director of Corporate Development, Investor Relations

Other Participants:

Lucy Li, Goldman Sachs
Joyce Ju, BofA Securities
Ella Ji, China Renaissance

Presentation:

Operator:

Good morning and good evening, ladies and gentlemen. Thank you for standing by, and welcome to the AiHuiShou International Company Limited Second Quarter 2021 Earnings Conference Call. (Operator Instructions). We will be hosting a question-and-answer session after management's prepared remarks. As a reminder, this call is being recorded.

I will now turn the call over to the first speaker today, Mr. Jeremy Ji, Director of Corporate Development and Investor Relations of the Company. Please go ahead, sir.

Jeremy Ji:

Thank you. Hello, everyone, and welcome to Aihuishou or ATRenew's second quarter 2021 earnings conference call. With us today are Mr. Kerry Chen, our founder, Chairman, and CEO, and Mr. Rex Chen, our CFO.

Our second quarter 2021 financial results were released earlier today and are available on our Company's IR website at ir.aihuishou.com.

For today's agenda, Kerry will share his thoughts on the Q2 performance, followed by Rex, who will discuss the financial highlights for the second quarter of 2021. Both Kerry and Rex will join the Q&A session.

Before we continue, I refer you to our safe harbor statements in the earnings press release, which applies to this conference call. Any forward-looking statements that the Company makes on this call are based on the assumptions as of today, and the Company does not undertake any obligations to update these statements.

Also, this call includes discussions of certain non-GAAP financial measures. Please refer to our earnings release, which contains a reconciliation of non-GAAP measures to GAAP measures.

Finally, please note, unless otherwise stated, all figures mentioned during this conference call are in RMB and all comparisons are on a year-over-year basis.

With that, I will turn the call to Kerry for business and strategy updates. Please go ahead.

Kerry Chen:

Okay. (Speaking foreign language)

(Translated). Hello everyone, and thank you for joining us on our first earnings call as a public company. We are very pleased to have the opportunity to share our business updates and strategy with you as we implement our mission to give a second life to all idle goods.

Our IPO on The New York Stock Exchange in June marked a major milestone in our ten-year development history. As a technology-driven pre-owned consumer electronics transactions and services platform, our four business lines, namely AHS Recycle, PJT Marketplace, Paipai Marketplace, and AHS Device span across the entire industry value chain. These offerings, connecting all industry participants to realize a closed-loop value chain, cover both the supply and the demand side of the industry. Our platform combines C2B, B2B, and B2C capabilities to provide standardized recycling, inspection, grading, pricing, and after-sales services. In the past decade, we have dedicated our efforts to improving the scalability, standardization, and efficiency of pre-owned consumer product transactions.

Our second quarter results exceeded expectations. Second quarter GMV reached RMB7.8 billion, up 69.6% from the same period last year. Total net revenue reported RMB1.87 billion, which represented a year-over-year increase of 56.2%. The number of consumer products transacted on our platforms was 7.8 million, up 27.9%. These results are a testament to the enormous growth potential of the pre-owned consumer electronics transaction industry, and a demonstration of our supply chain capabilities and our efforts in setting the industry standards are well acknowledged.

Our GMV for the last twelve months increased by 64.9% to 26 billion, LTM revenue increased by 56.2% (corrected) to 6.4 billion, and the LTM number of consumer products transacted increased by 33.7% to over 28 million.

Turning to strategic areas: First, on our 1P business, we expanded our geographic coverage and trade-in channels rapidly during the quarter. We continue to optimize user experience for device trade-ins with our strategic partner JD Group to cultivate consumer willingness to participate in the trade-in process. We aim to make our one-stop trade-in experience the go-to solution for new phone purchases in China. Also, to better address the issue of rising retail prices for new devices, we cooperated with JD group during the "June 18" shopping festival to launch a "multiple device trade-in" campaign that awarded discounts for the trade-in of multiple devices. These efforts allow us to offer consumers trade-ins at more attractive prices and enhance our ability to source more supplies. As a result, the year-over-year increase in GMV for our 1-stop trade-in business exceeded 170%.

Second, we continued to expand our service coverage, open new offline stores, and expand third-party merchant services in lower-tier cities. As of June 30, 2021, the number of offline stores further increased to 862, covering 184 cities in China. Among them, 485 were self-operated AHS stores, 365 were jointly operated AHS stores, and 12 were Paipai Selection stores. Our business philosophy is to open quality stores and manage them well. Stores raise our brand awareness and fulfill the online-to-offline trade-in orders, and they build a strong moat of efficient sourcing. By integrating our online platform with offline stores and services, we are able to provide an optimal trustworthy user experience. Furthermore, the well-established stores generate solid cash flow and profit – these are great assets. In the second quarter, we accelerated the penetration of city-level operation stations. As of 30 June, 2021, we have 30

city-level operation stations. Backed by our pre-owned consumer electronics supply chain capabilities, we integrate the offerings at our offline Paipai Selection stores and online sales channels to establish a new city-level distribution model for Paipai Marketplace. We expect this to become a new driving force for our business growth in the second half of 2021.

In terms of our online marketplaces, we continued to go deep - expanding our reach to buyers and sellers in lower-tier cities. During the quarter, we acquired over 10,000 registered sellers on PJT Marketplace. As for Paipai Marketplace, we sourced additional devices from dispersed suppliers and performed integrated quality inspections and operations, before selling directly to individual consumers, thus further consolidating the industry chain.

Third, in terms of new distribution channels of Paipai, other than JD.com, including Douyin and Kuaishou, our strategic investments into this field exceeded RMB20 million. We have built up our partnership with Kuaishou, the leading live-streaming platform. As we empower small merchants on Kuaishou with our certified pre-owned consumer electronics supply offerings, inspection and operation capabilities, we are able to effectively establish live streaming-driven sales channels. In mid-July, we launched the recycle portal on Kuaishou through Kuai Shop. Going forward, we will enhance our collaboration with live-streaming channels to provide users with premium recycling services and integration of operation centers to establish our new city-level distribution model for the online marketplaces.

Notably, we have also strengthened our corporate governance by establishing an ESG Committee under the board of directors and releasing our 2020 ESG report, which is currently available on our IR website. The report establishes an index of GRI standards based on characteristics of the pre-owned consumer electronics industry and outlines an industry-leading calculation methodology for carbon emissions in the sector. In accordance with China's 14th Five-Year Plan for the Development of the Circular Economy released by the National Development and Reform Commission in July, we aim to further develop our supply chain capabilities for pre-owned electronic devices to promote sustainability and standardization of the industry. Looking ahead, we will continue to improve our ESG initiatives, optimize corporate governance, and operate our business with strict risk management measures to anticipate and adapt to regulatory changes.

As we move forward into the third quarter and beyond, we will continue to enhance our supply chain capabilities, increase the penetration rate for China's trade-in services, and improve the recycling and trade-in experiences for consumers. We believe that supply constraints on quality devices continue to be the bottleneck for the industry's development.

We will also continue to diversify our supply channels in lower-tier cities, empower merchants with our service offerings, and maintain strong growth momentum for our platform businesses.

We will continue to improve operational capabilities, and reduce fulfillment expenses through investment in automated testing and grading. We are pleased to report that Matrix 2.0, the second generation of our automated inspection system was put into trial operation at our Changzhou operation center. It brings the automation rate to the next level. Matrix 2.0 fortifies the foundation for upgrading our automated operation center in South China later this year. For future expenses saved from improved operating efficiency, we intend to invest in long-term business development.

Furthermore, we will accelerate the exploration of new initiatives. We remain optimistic about the growth potential of our livestreaming e-commerce channels, Paipai Selection stores, and overseas markets. Leveraging our competitive strengths in integrated online and offline platforms, we are confident in achieving our operational goals and reinforcing our industry-leading platform. We will continue to execute on our principles as we enhance our supply chain and technology to empower the entire industry. We believe that the greater the social value a business creates, the greater the economic value the business will have. We aim to build ATRenew into a business that does social good in addition to generating long-term shareholder returns.

Rex Chen:

Thanks, Kerry, and hello everyone. Before sharing details on our second quarter financial results, please note that all amounts are in RMB and all comparisons are on a year-over-year basis unless otherwise stated.

During the second quarter, our increasing scale led to strong revenue growth, narrowed non-GAAP operating loss margin, and further improvements in our free cash flow.

Total GMV increased by 69.6%, among which GMV for product sales increased by 72.7%. The increase was mainly driven by the rapid growth in our trade-in business collaboration with JD Group, the opening of new stores, the efficient operation of existing stores, and the fast sales growth of 1P devices on Paipai. Keep in mind that new stores were opened midway through the second quarter, and are still at an early development stage. We expect improvements in efficiency in the following quarters. GMV for online marketplaces including PJT and Paipai increased by 68.6%, mainly driven by strong customer demand and the continued expansion of our platform's network effects.

In the second quarter, total revenues increased by 56.2% to 1,868 million. Product sales revenue increased by 53.1% to 1,603 million, while our service revenue increased by 77.9% to 264 million. As our platform's service capabilities improved, service revenue grew faster than product sales revenue, and the revenue mix continues to develop in a more beneficial direction. The revenue contribution from services increased to 14.2% of total revenue during the second quarter, compared to 12.4% in the second quarter 2020.

Notably, GMV for consignment model accounted for 19.7% of Paipai's GMV in Q2. We believe that our gross margin will improve in the medium- to long- term, as we increase the proportion of 1P recycled products that can be sold to individual consumers via Paipai, and more importantly, we can further increase the commission rate over time with greater adoption of the Paipai consignment model and more value-added services provided to merchants of PJT and Paipai.

Next, turning to our operating expenses. To provide greater clarity on the trends in our actual operating-based expenses, we would like to share the trends of our non-GAAP expenses, which better reflect the views of management. Under the non-GAAP measure, which excludes share-based compensation expenses and amortization of intangible assets resulting from business acquisitions, total operating expenses increased by 55.7% to 1,923 million.

Merchandise costs increased by 56.9% to 1,395 million. We didn't have any adjustment to merchandise costs.

Fulfillment expenses increased by 84.4% to 276 million. In addition to the immediate recognition of share-based compensation expense resulting from options granted to employees with an IPO performance, which we will refer to as “SBC”, the increase was primarily due to (i) the growth of personnel-related expenses as the increased number of front-line operation center personnel with the growth of core business, and (ii) the increases in logistics expenses and operation center related expenses, which were in line with the increase in sales of pre-owned consumer electronics. Non GAAP fulfillment expenses, excluding SBC, increased by 56.0% to 233 million. Due to the revenue mix of 1P product sales revenue and 3P service revenue, one metrics to evaluate the profitability of our platform is non-GAAP fulfilled gross margin, which remained stable at 12.8% compared with the first quarter 2021.

Selling and marketing expenses increased by 60.3% to 316 million. In addition to SBC, the increase was primarily due to an increase in promotion expenses, advertising expenses and sales commissions paid to JD Group in connection with traffic acquisition and sourcing of pre-owned devices. In addition to upfront payments to merchants as a way to promote the consignment model of Paipai Marketplace, we invested in sales promotions during the June 18th shopping festival as well as the new distribution channels, including Douyin and Kuaishou. Non GAAP selling and marketing expenses, excluding SBC and amortization of intangible assets resulting from business acquisitions, increased by 78.8% to 214 million.

General and administrative expenses increased by 593.2% to 310 million. The increase was primarily due to the immediate recognition of SBC. Non GAAP G&A expenses, excluding SBC, decreased by 37.0% to 28 million. The decrease in Non GAAP G&A expenses reflected an improved cost efficiency in our middle and back offices.

Technology and content expenses increased by 144.5% to 82 million. In addition to the SBC, the increase was primarily due to an increase in personnel-related expenses in connection with the expansion of the research and development team to improve our technological capabilities. Non GAAP technology and content expenses, excluding SBC and amortization of intangible assets resulting from business acquisitions, increased by 65.1% to 53 million.

As a result, our non-GAAP operating loss increased by 39.3% to 51 million in the second quarter 2021. Non-GAAP operating margin narrowed to negative 2.7%, compared with negative 3.1% in the same period last year.

As of June 30, cash, cash equivalents, restricted cash, and short-term investments added up to a total of 2.8 billion. We believe that the sufficient liquidity on hand will be able to fuel our business development and strategic partnerships which generate lasting shareholder value.

Now turning to outlook. First, we expect the growth momentum for the fiscal year 2021 to remain unchanged. Second, for the third quarter of 2021, the Company currently expects its total revenues to be between RMB1.87 billion and RMB1.93 billion. This forecast only reflects the Company's current and preliminary views on the market and operational conditions. However, there might be mild uncertainties, for example, the occurrence of the COVID-19 Delta Variant in multiple regions in China, which might adversely impact our offline stores and business.

This concludes our prepared remarks for today. Operator, we are now ready to take questions.

Questions and Answers:

Operator:

Yes, thank you. At this time, we will begin the question-and-answer session. (Operator Instructions). Our first question comes from Lucy Li with Goldman Sachs.

Lucy Li:

(Speaking foreign language). I have 2 questions here. The first one is regarding COVID-related travel restrictions. We see that the third quarter guidance is still quite strong, but considering the COVID-related travel restrictions, I would wonder, if management could further help us to understand what kind of impact that would impact to or create on our business.

And the second question that is with regard to collaboration with JD and Kuaishou, management has already shared with us key strategies on one-stop trade-in with JD. And we have already opened up the recycling channel on Kuaishou stores. I wonder if you can further help us to understand, for example, helping to improve build and improve the 3C or recycling infrastructure and the supply chain capabilities on Kuaishou stores.

Kerry Chen: (Speaking foreign language).

(Translated). Okay. Thank you, Lucy. To answer your first question, in July, the COVID-19 Delta Variant appeared in multiple regions in China. The company immediately arranged swab tests for employees passing through high-risk areas and worked from home to ensure the safety of the working environment. At the same time, anti-epidemic materials were delivered to those cities.

We do not rule out the further impact of urban lockdowns or travel restrictions and its short-term or continuous impact on our 1P business. Referring to the second quarter performance last year, as long as the hard lockdown is eased, our trade-in business resumes very quickly.

In addition, we need to say that the launch date of the iPhone 13 Series is uncertain; either it will fall in the third quarter or the fourth quarter. So there might be seasonality of revenue growth year-over-year. Also, we will recommend you to compare the results of the second half of the year with the same period of last year.

Kerry Chen: (Speaking foreign language).

(Translated). So we would also like to mention about the successful one-stop trade-in services, as it's resulted in continued growth momentum in both GMV and revenue. Also, we will continue to innovate and to strengthen the partnership with JD.com.

One thing to highlight is on the 10th of August, we've launched a 3P service project as a pilot project with JD Retail. And also, we started from the pilot city of Shanghai and undertake the last-mile delivery of some models such as iPhone, which is provided by our offline store employees. And also, these employees will provide users with screen protectors, extended warranty services. And we also wanted to cover the nearby 2 to 3 kilometers to -- by the offline store staff to cover the fulfillment of JD new phone sales. And we will like to expect successful collaboration from this.

To answer your question regarding Kuaishou, Kuaishou invested in our pre-IPO round in May 2020. We are one of the few investments Kuaishou made this year. The cooperation with Kuaishou mainly includes 3 aspects: Opening the recycling entrance from Kuaishou, providing quality inspection for the third-party

merchants leveraging our operation centers and the supply to KOLs. And Kuaishou provides traffic sources to us.

The cooperation with Kuaishou can broaden our B2C sales channels outside JD.com. Since we only reached cooperation with Kuaishou in June, the cooperation is still in the stage of speeding up exploration and improving business process. In mid-July (corrected), we launched the recycle channel on Kuaishou through Kwai Shop. And from a city-level model perspective, we're still accelerating this exploration. We have made additional investment this quarter with more than 20 million in new sales channels this quarter.

And in addition to the city model, we'd like to clarify that we stick to the strategy of building the integrated platform. Over the past few months, we have continued to deepen the capabilities of our integrated platform by integrating the capabilities of operation center, JD channel, new channel such as Douyin and Kuaishou, and Paipai Selection stores on a city-level basis; and continue to explore and validate Paipai new retail's integrated city model.

To form Paipai's integrated city model, we've set up a city-level operation station to provide quality inspection and certification services locally. For small merchants with local sourcing of supply, we developed them as franchisees and authorized them to use the brand of Paipai Selection, so that they can open stores and operate in a standard manner. Franchisees obtain second-hand mobile phones supplies in the city, and send them to the local operation station for quality inspection. For goods that are not qualified to retail, rapid distribution will be carried out through PJT Marketplace.

And this model is in line with the ATRenew's integrated platform strategy. In a more detailed city-level dimension, various capabilities, such as JD channel, Douyin Kuaishou channel and PJT Marketplace, operation center for the inspection; and Paipai Selection stores should be integrated into a more efficient way to form an integrated overall capability locally.

And regarding the city-level model project under Paipai new retail, the upfront investment by us in a single quarter exceeded RMB20 million. Relying on city-level operation stations in 30 cities, we have opened 12 Paipai Selection stores that provide online and offline sales. In the second quarter, GMV for new channels reached RMB170 million, with the sequential quarter-over-quarter growth of more than 100%.

While good results and validation, we will continue to explore and solidify this model with cautious optimism, and hope to have more data to share with you in the next quarterly earnings result briefing.

Operator: Thank you. Joyce Ju with Bank of America.

Joyce Ju: (Speaking foreign language). I will translate by myself. My first question is regarding the outlook for the third quarter assumptions in terms of the iPhone new model launch, and also the promotion together with the platform having been baked in the forecast. And how should we look at the visibility for next quarter and the fourth quarter?

The second question was related to the gross margin. It seems like decline sequentially slightly and we'd like to get more color on it. And also, we'd like to have more insight in terms of going-forward trend.

Kerry Chen: (Speaking foreign language).

(Translated). So to answer your question regarding the launch of new iPhone model, we have an assumption that the date might fall in late -- in mid-September to early October. But however, we will like to make a conservative assumption that launch date will be in late September. And this shall be minimizing the impact on our Q3 and Q4 earnings results, and we might make adjustments to our assumptions regarding the actual launch date of the new model of iPhone.

Regarding the collaboration with JD.com, we would also continue the collaboration regarding trade-in services in the third quarter and going forward, and we are happy to provide more color on this later.

Rex Chen: Okay, thanks. I will take this question. If you look at the 1P gross margin rate, you will find that the gross margin of the 1P business decreased compared to prior quarters, and also decreased compared to the same quarter of last year. If you look at the overall gross margin, you can see the company's overall gross profit margin in Q2 remained stable at 25%, which was consistent compared with prior quarter in the same period last year. The contribution from service revenue in this quarter increased to 14.2% this quarter. This can bring higher margin and offset the impact of the decrease in 1P business margin of Q2. So we believe the overall gross margin will keep increasing gradually going forward.

As we leverage multiple marketing campaign approach, we prefer to review the non-GAAP operating profit margin. Non-GAAP operating loss was at RMB51 million in this quarter, and operating margin was negative 2.7% compared with negative 3.1% in Q2 2020. We anticipate a positive non-GAAP operating margin in Q4 this year. Once we can meet our internal target of non-GAAP operating margin rate in certain quarter, we will invest all these additional resources to expand our scale as large as possible.

So in this Q2, also due to the June 18 festival, we collaborated with JD, and we directly increased the recycling price to attract more consumers to do the trade-in business, instead of using other sales campaigns, resulting in amount decreasing our 1P gross profit margin by 2%. Totally additional amount spend in this area was RMB36 million.

If we did not increase the recycling prices to attract the consumers, but investing the same amount, RMB36 million, in selling and marketing activities, 1P gross margin of Q2 2021 would be 15.2%, similar to that of Q2 2020, which was 15%. Of course, selling expense would increase accordingly. So basically, we believe the non-GAAP operating margin has already meet our internal target, so we spend additional money into the coupons to directly increase the recycling price, which showed decreasing gross margin of 1P business in Q2 --

Joyce Ju: Got it. Thank you.

Rex Chen: -- and we believe the overall gross margin will increase gradually.

Operator: Thank you. (Operator Instructions). Ella Ji with China Renaissance.

Ella Ji: Thank you. (Speaking foreign language). So I have 2 questions. The first one is - could management provide an update on the value-added services, which is the PJT in your Marketplace? Just wanted to know the progress there.

The second question is - can management give us the details of your take rate in your Marketplace, specifically for both PJT and Paipai? What is the take rate for this quarter and how is the year-over-year comparison of both of them?

Rex Chen: Okay. Thank you, Ella. So for your first question, since late May, we have launched value-added maintenance services. The service fee totaled RMB1.4 million and increase overall commission rate of PJT Marketplace by about 0.1% per month. So in the future, we will continue to expand and diversify the value-added maintenance services and increase the corresponding take rate. So we expect additional take rate from the maintenance service can be around 0.2% by the end of this year.

And also, starting from August, we start to charge logistics service fee, inspection service fee and a consignment service fee to sellers on PJT Marketplace based on their size, and if the goods will be shipped to our operation center.

So we expect the overall (increase in) take rate from these 3 value-added services, including logistics service, inspection service and the consignment service can be around 0.6% in September 2021. So that means by the end of this year, we can charge additional 0.8% take rate from the PJT Marketplace.

And in Q2, the average take rate of PJT Marketplace is still 4.5%, consistent with Q1 2021. So PJT Marketplace, the take rate will be increased in the next 2 quarters, in Q3 and in Q4. So by Q4, the take rate can be around 5.3% of PJT Marketplace.

So for the growth rate of Paipai Marketplace increased to 4.7% in Q2 from 4.2% of (that in) Q1. The take rate of the consignment model of Paipai Marketplace was 5.8% in Q2, while we barely charged any commission fee in Q2 2020. The 3P consignment model is expected to generate higher commission fees, and we expect to charge 8% to 10% take rate in the future.

So by the end of this year, we expect the consignment model take rate can be around 6.5%. So the consignment model is being quickly adopted by the merchants. The reasons include the complexity and fragmentation of the pre-owned electronics transaction industry chain. Therefore, the recyclers face challenges when distributing the products to consumers. The consignment model of Paipai eases the burden of retailing from small merchants. At the same time, the take rate of the Paipai POP model for electronics devices also increased by 0.5%, starting from this quarter. But the take rate of the POP model will be stable within this year.

So for the overall, the Paipai Marketplace take rate increase was from the consignment model. So we expect the overall Paipai take rate can increase from current 4.7% of Q2 to around 5.2% in Q4 this year.

Ella Ji: Thank you very much.

Operator: Thank you. And this concludes our question-and-answer session. I'd like to turn the call to Jeremy Ji for any closing comments.

Jeremy Ji: Thank you. Thank you again for joining. A replay of today's conference call will be available on our IR website shortly. If you have any additional questions, please feel free to email us at ir@aihuishou.com. Have a good day.

Operator: Thank you.

Jeremy Ji: Thank you.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.