[RERE] – ATRenew Inc.
Q3 2021 Earnings Conference Call
Thursday, November 18, 2021, 07:00 AM Eastern Time

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

Other Participants:
Joyce Ju, BofA Securities
Lucy Li, Goldman Sachs
Sam Lee, China Renaissance

Presentation:

Operator:
Good morning and good evening, ladies and gentlemen. Thank you for standing by, and welcome to ATRenew Inc. third quarter 2021 earnings conference call. At this time, all participants are in a listen-only mode. We will be hosting a question-and-answer session after management's prepared remarks.

Please note, today's event 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 ATRenew's third quarter 2021 earnings conference call. With us today are Mr. Kerry Chen, our founder, chairman, and CEO, and Mr. Rex Chen, our CFO.

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

For today's agenda, Kerry will share his thoughts on our third quarter performance and some updates on our strategy for our city-level service integration model, followed by Rex, who will discuss the financial highlights for the third 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 call. Any forward-looking statements that the Company makes on this call today are based on 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, that unless otherwise stated, all figures mentioned during this conference call are in renminbi and all comparisons are on a year-over-year basis.

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

Kerry Chen:
(Speaking foreign language)
(Translated). Hello everyone, and thank you for joining us on our third quarter 2021 earnings conference call. We are delighted to share our recent business developments for this quarter, as well as our strategic reasoning.

Before we start, let me share some thoughts regarding China's policies. According to the "Action Plan for Carbon Dioxide Peaking Before 2030" released by the State Council in late October, the central authority issued a framework to address initiatives including the promotion (of) business models combining Internet and recycling. It clearly establishes synergy between the development of the circular economy and carbon reduction initiatives.

We believe this backdrop is favorable to the development of ATRenew. Our business model is characterized by sustainability and stability. ATRenew is a leading player in the field of pre-owned consumer electronics transactions and services. Our business evolution derives from an industrial Internet model and is in accordance with the nation's goals for the development of the circular economy. Thus, we have strong visibility on our long-term development while steadily evolve with the industry.

Now, I'd like to walk you through some of our business highlights for the quarter.

We achieved notable organic growth in the third quarter, with a year-over-year increase of 56.6% in total GMV, and 48% in total net revenues, respectively. As a percentage of total net revenues, net service revenues increased to 15.2% from 13.4% in the same period last year.

In terms of 1P business, product revenues grew further, increasing by 45% year-over-year. This was driven by the steady expansion in our AHS store network and our volume of pre-owned device trade-ins with strategic partners such as JD.com. We set a target of adding 200 stores per year at the beginning of 2021, and we have realized this target ahead of schedule. As of September 30, the number of offline stores increased to 956. We are very attentive to the quality of our newly opened stores as we expand rapidly, while also ensuring that we maintain healthy operations in our existing stores. In terms of our trade-in collaboration with JD, we had another strong quarterly revenue growth at 79.2% year-over-year. We upgraded the portal for one-stop trade-in on JD in the third quarter to provide users with a more convenient shopping experience, especially in effective preparation for the launch of iPhone 13 lineup and the Single's Day shopping festival.

Notably, it appears that the pre-owned consumer electronics transaction industry was, basically, immune to the macro challenges in the third quarter. To elaborate, consumer acceptance toward trade-in services and shopping for pre-owned devices increased during a slowdown in economic conditions and consumer spending. This demonstrates the circular economy's ability to thrive even during economic slowdowns.

The second highlight is the development of our revenue mix trending in a favorable direction. Service revenues increased by 67.3% year-over-year and accounted for 15.2% of total net revenues in the third quarter. The increase in service revenues was primarily due to the expansion in GMV of our marketplaces and the steadily rising service take rate. This demonstrates that ATRenew's value-added services and the consignment model of Paipai are widely acknowledged by merchants and consumers.

The third highlight is that we are on track to reach profitability in the near future. In the third quarter 2021, non-gaap operating loss and non-gaap net loss halved. Looking ahead, we anticipate non-gaap operating profit and are confident in securing non-gaap profitability for the fiscal year of 2022.

Outside of these highlights, I'd like to take a moment to introduce some details about our strategy update on city-level service integration.

We re-allocate our resources in each city and integrate our core capabilities of C2B, B2B, and B2C offerings locally to establish a cohesive operating unit in each city. We then review the financial performance of each city and provide incentives to the local teams. We then measure city-level market penetration rate to evaluate and optimize growth strategies locally.

There are a couple of reasons for implementing city-level service integration.

First of all, China's second-hand mobile phone market has relatively strong geographic characteristics on both the supply and the demand side, and the market penetration rate within each city is a very important indicator. We calculate the penetration rate as the number of recycling orders divided by new device sales. Take Shanghai as an example, our penetration rate increased to 12.5% in 2021 from 9.3% in 2020. However, the bigger picture in China is that the penetration rate in 70% of cities are below 5%. These numbers indicate that the ceiling is still quite high and it's meaningful to exploit the growth potential of local markets.

Second, city-level service integration is an extension in reach for our omni-channel platform strategy. Through the consolidation of our C2B, B2B, and B2C offerings following the acquisition of Paipai Marketplace in 2019, we are able to offer integrated platform capabilities in hundreds of cities for a more refined operation.

Third, it's the natural path in the evolution for our Company to explore the city-level service integration strategy following the successful establishment of our supply chain capabilities, service scenarios, and customer service capabilities over the past decade. As of November, our total number of AHS stores nationwide exceeded 1,000. As of September 30, we have 7 regional operation centers, 67 city-level operation stations, over 200 thousand merchants registered as buyers or sellers on PJT Marketplace, and a sales team of nearly 500 people to promote PJT Marketplace. These form a solid foundation for the integration of our offline and online capabilities within each local market. We aim to expand consumer reach and to provide premium consumer services through AHS stores and Paipai Selection stores, while attracting an incremental supply of goods locally.

We believe this strategy is meaningful in four aspects.

First, city-level service integration can effectively drive business growth. We will be able to evaluate growth performance and market potential at a micro level. The analysis could dive deep into each of the business offerings in specific cities, leading to more effective operational optimization.

Secondly, we can optimize team structure and personnel, improve resource allocation, and enhance the synergy between all three business offerings, further improving operational efficiency and our cost control.

Thirdly, this new management matrix enhances our management and structure capabilities. We are able to review the financials of each city unit to ensure fair incentive mechanisms.

Last but not least, the strategy sharpens our competitive edge. The pre-owned consumer electronics industry is not purely online. It requires both online traffic and offline operational capabilities. Over the years, we have invested in offline consumer reach and accumulated profound technological capabilities. Carrying out refined management within each city unit will fortify our moat.

In the past few months, we have established initial proof-of-concept for our city-level service integration strategy. Since July, we tested the model with our two pilot cities in Langfang of Hebei Province and Huzhou of Zhejiang Province. In terms of GMV, growth rate in the pilot cities during October significantly outgrew that of the national level. We are delighted to see the efficacy of our city-level service integration and are optimistic about its future results.

Three years ago, we proposed a strategic goal of "establishing a thousand stores across 100 cities". As of today, our total number of offline stores has already exceeded 1,000. Having achieved this milestone, we are setting a new strategic goal of achieving "100 billion GMV per year." In 2022, we will roll out "city-level service integration" in 50 cities. In the next 3 to 4 years, we will gradually expand its implementation to over 100 cities. We seek to secure scalable GMV growth to exceed 100 billion RMB by 2025.

Further, on November 15th, we made an announcement regarding changing the name of the Company from AiHuiShou International to ATRenew, which stands for “All Things Renew”, and updated the domain of our corporate and IR websites to atrenew.com. Following our initiative to unify our brand at home and abroad, we continue to actively engage with both domestic and international stakeholders in a timely and transparent manner. With great zest, we also continue to devote ourselves to long-term value creation for the environment and for society along with the development of circular economy in China.

With that, I will hand the call over to our CFO Rex to go over the financials.

Rex Chen:
Thanks, Kerry. We are excited to report another strong quarter. Our growth momentum continued with beyond-expectation scale and revenue growth, as well as sequential improvement in revenue mix and margins. We would like to share with you some financial highlights before we go into a more detailed look at the numbers. Please note that all amounts are in RMB and all comparisons are on a year-over-year basis unless otherwise stated.
We maintained strong financial growth with total net revenue increasing by 48%, exceeding the high end of our previous guidance range. Services revenues as a percentage of total revenue improved to 15.2% from 14.2% in the previous quarter. Total GMV grew by over 56%, while our non-GAAP operating loss further narrowed to RMB28.5 million.

Gross margin for our 1P product sales business remained stable at 13.3% compared with the previous quarter. Going forward, we will focus on consumer electronic categories including smartphones for our 1P business, reinforce the supply side of high-quality pre-owned products, and continue to improve customer services. In addition, we will expand our retail footprint rationally and improve the operating efficiency of our offline stores.

For platform services, the average take rate continues to improve, rising to 4.6% in the third quarter. In addition, our B2B platform enhanced its service capabilities to small-and mid-sized merchants, and lowered the threshold of conducting trade-in services for those merchants in lower-tier markets, and upgraded services to improve user experiences. Moreover, we also optimized our B2C consignment service capabilities with GMV for consignment model contributing to 20% of the total Paipai GMV.

Non-GAAP fulfilled gross margin remained stable at 12.8%. This number has been around 13% for 6 quarters. We aim to further cut down fulfillment expenses leveraging automation technology and advanced system.

Now let’s take a look at the detailed financials. In the third quarter, total revenues increased by 48% to RMB1,962 million. Total GMV increased by 56.6% to RMB8.3 billion.

Net product revenues increased by 45% to RMB1,665 million while GMV for our 1P business increased by 58.3% to RMB1.9 billion. The increase was mainly driven by the rapid growth in our trade-in business collaboration with JD as well as the opening of new stores nationwide.

The iPhone13 lineup came to market in late September and thus showed no significant growth driving force in Q3 revenues, but in Q4. Even so, our trade-in business grew by 79.2% in Q3. In addition, fast sales growth of 1P devices on Paipai also contributed.

Net service revenues increased by 67.3% to RMB297.3 million while GMV for the marketplaces, including PJT and Paipai, increased by 56.1% to RMB6.4 billion. This was mainly driven by strong demand from consumers and merchants alike, and the continued expansion of our platform's network effects.

As our platform’s service capabilities improved, the overall service take rate of our marketplaces grew to 4.6% and the service revenue accounts for a larger proportion at 15.2%, compared with 13.4% in the third quarter 2020. Thus, our revenue mix continues to develop in a more beneficial direction.

Next, turning to our operating expenses. Operating costs and expenses increased by 49.5% to RMB2,123 million. To provide greater clarity on the trends in our actual operating-based expenses, we will 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 49.1% to RMB2,001.5 million. Before we go into details, I’d like to mention that we did not have any share-based compensation expenses in the third quarter 2020.

Merchandise costs increased by 46.8% to RMB1,443 million. This was in line with the growth of our 1P product business. We didn’t have any adjustment to merchandise costs.

Fulfillment expenses increased by 61.7% to RMB273.4 million. This increase was primarily due to, first, an increase in personnel cost in connection with the Company’s growing business, especially the upfront investments in the expansion of AHS store number and city-level operation station network; and second, the increases in logistics expenses and operation center-related expenses which were in line with the increase in sales of pre-owned consumer electronics. Excluding share-based compensation expenses, the non-GAAP fulfillment expenses increased by 57.7% to RMB266.6 million.

Selling and marketing expenses increased by 59.8% to RMB299 million. This increase was mainly due to, first, an increase in sales promotion and coupon expenses in connection with our 2C business development; and second, an increase in personnel cost in connection with the Company's growing business; and third, an increase in sales commissions in connection with traffic acquisition and sourcing of pre-owned devices.

Non-GAAP selling and marketing expenses, excluding share-based compensation expenses and amortization of intangible assets resulting from business acquisitions, increased by 85.5% year-over-year to RMB205.6 million. Non-GAAP selling and marketing expenses account for 10.5% of total revenue, decreased by approximately 1% sequentially.

General and administrative expenses decreased by 0.2% to RMB42 million. There was no significant change compared with the previous quarter. Excluding the share-based compensation expenses, non-GAAP G&A expenses decreased by 37.8% to RMB26.2 million. The decrease in G&A expenses reflected an improved cost efficiency in our middle and back offices.

Technology and content expenses increased by 71.1% to RMB65.2 million. The increase was primarily due to the increase in personnel cost in connection to the expansion of the Company's research and development activities. Non-GAAP technology and content expenses, excluding SBC and amortization of intangible assets, increased by 62.3% to RMB59.3 million. As a result, our non-GAAP operating loss was narrowed to RMB28.5 million in the third quarter 2021. Non-GAAP operating margin was negative 1.5%, compared with negative 0.5% in the same period last year.

As of September 30, 2021, cash and cash equivalents, short-term investments and funds receivable from third party payment service providers increased to RMB2,538 million, compared with RMB1,140 million as of December 31, 2020. Of note, in September, we procured pre-owned devices in preparation for the shopping festivals during China's National Day and Golden Week and Single's Day, and topped up the balances to third party payment service providers in preparation for peak period of recycling during the Golden Week. We have gradually recovered these funds as of now. 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 target for the fiscal year 2021 to remain unchanged. Second, for the fourth quarter of 2021, the Company currently expects its total revenues to be between RMB2.3 billion and RMB2.35 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 for questions.

Questions and Answers

Operator: Thank you. We will now begin the Question-and-Answer session. (Operator Instructions). Today's first question comes from Joyce Ju with BofA. Please go ahead.

Joyce Ju: (Speaking foreign language). The first question is related to the 1P gross margin. We see that one 1P gross margin declined slightly year-over-year. So I would like to know is it because of the competitive pressure or any other like additional reasons?

My second question was related to the strong growth momentum we -- like the company had and also the guidance. Just trying to understand what's the volume and AOV behind it is like strong growth GMV momentum? And how we should understand like AOV and, you know, number of devices or transaction volume which one should be the main drivers of the future growth? And how should we understand the trend? Thanks.

Kerry Chen: (Speaking foreign language).
(Translated). So thank you for your questions. Firstly, I would like to address your question regarding the gross profit of our 1P business. Supply constraints have become headwinds of the pre-owned industry. We ensured accessibility to resources of premium pre-owned devices by investing in top-up coupons. As coupons increased the cost of procuring pre-owned devices, such investments are reflected in the increase in merchandise cost which directly impacts the gross profit.

In addition, there were adjustments to the recycling channels. To ensure healthy growth, the company lowered the proportion of low ASP but high gross margin cooperation from other channels, thus impacting the gross margin. We think that the gross margin for 1P business will remain stable with modest improvement. We tend to increase the recycling price for the betterment of users at the recycling end along with higher sales price.

In the future, the improvement of the company's overall gross margin will majorly come from the growing contribution of service revenue, while 1P business continues its contribution.

So, to address your question regarding the competitive landscape, regarding competition overall, ATRenew has strong growth momentum. This is seen in GMV growth of 1P business and 3P business as well. There is a steady expanding overall take rate of marketplaces as well as narrowing non-GAAP operating loss. Our business operation has limit impact from pure players. This is backed by results from our data provider.

We firmly believe that the pre-owned industry is driven by the supply chain capabilities. We believe that our all-around development of supply chain capabilities suffices as competitive edge. Through third-party data providers, we noticed decreases in traffic of peer players in the second half of 2021 as reduced marketing investments in the third quarter. We are confident that PJT Marketplace is an attractive platform to mid-and-small business owners, and that the negative impact to PJT Marketplace from its peer players remain limited, even though the peer player platforms take negligible service fees.

I'd like to mention that the city-level service integration that we are implementing will give better play to our offline capabilities and structural management advantages and will further widen the gap with our peer players.

To address your question regarding the number of consumer products transacted in the third quarter, so the number actually increased[corrected] by 23.4% year-over-year as you can tell from the earnings release. To clarify, there were decreases in contribution from Paipai Fun Bidding, namely Paipai Duobaodao (拍拍夺宝岛). Paipai Fun Bidding is an innovative project to attract traffic to Paipai

Marketplace with lower ASP bidding from RMB1. This is no longer an operation with key investment to the operations.

Although in the third quarter, there were 150,000 transactions on Paipai Fun Bidding compared with 850,000 in the same period of 2020, the business has minimal impact on GMV as ASP was about RMB50. The pro forma increase in 3P transactions was 38.7% increase year-over-year.

Joyce Ju: Thank you.

Operator: Lucy Li at Goldman Sachs.

Lucy Li: (Speaking foreign language). Congrats, management, for the results and thank you for sharing. I have two questions in here. Firstly, I would like to learn more about the city-level operation model in terms of our implementation steps, and how do we measure success? What's the kind of investment we are looking at and whether this means that we're shifting our business focus to offline? And the second question is on the business update with Kuaishou. Thank you.

Kerry Chen: (Speaking foreign language).
(Translated). So to clarify that, implementing our city-level service integration does not mean that we are transferring our strategic emphasis purely to the offline model.

Actually, over the years, we have accumulated ample resources for rolling out city-level service integration, including 1,000 AHS stores on the supply side, 500 B2B sales and service specialists for merchants. On processing, there are 67 city-level operation stations for localized quality control and operational support. On distribution, we integrate online sales channels, including Paipai marketplace and live-streaming sales channels and the offline display and sales channel through Paipai selection stores. These resources, when re-arranged locally, not only improve service agility for local merchants, but also reduce cross-regional shipping and processing which ultimately optimize the inventory turnover.

So in terms of the implementation, there are four priorities.

First, on management, city managers will be in charge of local operation and management. We are developing a new performance review and incentive mechanism to keep city managers engaged while reviewing the local business progress of each offering in detail.

Secondly, on operational metrics, our city-level operational metrics will be reviewed as a localized extension to the operational review of our 3 main business lines. As such, we are able to evaluate our offerings, aggregate empowerment to local play owned transaction markets and local retail stores. Our long-term goal is to exploit local market penetration.

Thirdly, on local collaboration, we aim to attract more qualified partners and obtain premium sources of supply locally through opening up the franchise of AHS stores, city-level operation station, Paipai selection stores and the supplier qualification to consignment sellers on Paipai Marketplace.

On business synergy, we aim to realize all local scenarios recycling through leading online orders to offline AHS stores and empower existing retailers within each city. We provide quality inspection and grading services through city-level operation stations. By leveraging Paipai's consignment model and franchised retail stores, we prioritize the distribution of premium goods to consumers. In addition, PJT Marketplace backs up and guarantees fast distribution. Through such synergized mechanism, we further increase the efficiency of transactions and turnover.

So we preliminarily verified city-level service integration model through testing. From July to October, the sequential increases in GMV of Langfang and Huzhou, our 2 pilot cities, outperformed the national level. We plan to roll out this strategy in more cities in the fourth quarter, such as Chongqing and Suzhou. We plan to gradually set up test runs in 50 cities in 2022. In 3 to 4 years, the city-level service integration will be our fourth growth strategy. We plan to roll it out in hundreds of cities in China so as to drive our business growth to the next level.

There have been some personnel changes at Kuaishou recently, but we have gradually rolled out the exclusive cooperation. One implementation is that the exclusive corporation portal was launched on Kuaishop in July. And we are also actively promoting the recycling business. Currently, on Kuaishou through live streaming distribution (and including recycling) from consumers, there could be approximately RMB20 million in terms of GMV per month.

Lucy Li: Thank you.

Operator: Sam Lee at China Renaissance.

Sam Lee: (Speaking foreign language). My first question is what are the main reasons behind the increase in the sales and marketing costs in the third quarter? Did you increase the spending on new sales channels? How is new sales channel performing so far?

And also in terms of the fulfillment cost, it has also increased billing [inaudible] this quarter. And we noticed that you have opened more offline stores and also city-level distribution centers. Could you discuss the performance of this newly-opened facility so far? What's your opening target for the coming quarters?

Rex Chen: Okay, thanks Sam. Selling and marketing expenses mainly included personnel expenses for our B2B sales team, channel fee and the commission fees paid to JD, as well as promotion and marketing fees for each different business lines.

And yes, you're correct, the year-over-year growth of the selling and marketing expense was mainly due to the expansion of our Paipai 2C business, including the consignment business and the new channel sales. But new channel sales and the consignment business contributed higher take rate, so they can cover the higher selling expenses compared to the other POP businesses.

And as you can see, the sequential selling and marketing expenses decreased compared with Q2 2021, which was due to the reasons that we began to take more control over the distribution of the coupons to reduce certain marketing promotion activities. As we leverage multiple marketing approaches, we believe non-GAAP operating profit closely reflects our views on the performance of the business. Once we can meet our internal target of the non-GAAP operating margin rate, we will invest more selling expenses and resources to expand our business and the scale.

For your question related to the fulfillment expenses, the increase was primarily due to the expansion of new self-operated stores and city-level operating stations. There were 56 newly opened self-operated stores and 11 new city-level stations in the third quarter which were not fully utilized by the end of Q3. Such additional costs totaled RMB8 million. The labor costs also increased due to more stores and operating centers opened in this quarter. This is expected to decrease in the following quarters once new stores and our operating stations become mature.

And if we look at the UE (unit economics) of the mature stores and the operation centers, the UE is stable in the store level. We also aim to further cut down fulfillment expenses by leveraging the automation technology and advanced systems in the coming quarters.

Sam Lee: Thank you.

Operator: Thank you. And ladies and gentlemen, this concludes our question-and-answer session. I'd like to turn the conference back over to our management for closing remarks.

Jeremy Ji: Thank you. Thank you again for joining the call. A replay of today's call will be available on our IR website. If you have any additional questions, please feel free to contact us or request through the mailbox, ir@atrenew.com. We look forward to speaking with you in our next earnings call. Have a nice day.

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.