

China

**ADD** (no change)

Consensus ratings\*: Buy 42 Hold 9 Sell 1

Current price:	US\$39.99
Target price:	US\$138.0
Previous target:	US\$135.0
Up/downside:	245.1%
CGI / Consensus:	42.0%
Reuters:	PDD.O
Bloomberg:	PDD US
Market cap:	US\$50,119m
	US\$50,119m
Average daily turnover:	US\$532.9m
	US\$532.9m
Current shares o/s:	1,446m
Free float:	25.5%

\*Source: Bloomberg

**Key changes in this note**

- FY22F net profit increased by 118%.
- FY23F net profit increased by 16%.



Source: Bloomberg

<b>Price performance</b>	1M	3M	12M
Absolute (%)	-28.6	-32.6	-71.8
Relative (%)	-31.1	-28.8	-85.8

<b>Major shareholders</b>	% held
Zheng Huang	29.4
Tencent	16.5

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# Pinduoduo Inc

## Slower top-line growth, but improving profit

- PDD's 4Q21 revenue was Rmb27.2bn, up 3% yoy, below our expectation, mainly because PDD largely reduced its 1P business. Excluding the 1P business, revenue grew by 28% yoy. PDD achieved a non-GAAP net profit of Rmb7.6bn for the quarter, above our expectation, driven by a lower selling and marketing expenses ratio and a one-off rebate from one of PDD's service providers.
- Management said PDD is in the process of adjusting its growth strategy, so we may see some short-term fluctuation in user numbers. We expect PDD's profitability to improve, along with a lower selling and marketing expenses ratio.
- PDD's investment in agriculture should generate long-term quality growth, but it will take time to bear fruit.
- Reiterate Add with a new DCF-based TP of US\$138.

### Margins above expectation, but spending expected to continue

PDD achieved 19% yoy growth in online marketing services revenue and 108% yoy growth in transaction services revenue in 4Q21. Its gross margin for the quarter was 76.1%, up 19.5% pts yoy and 6.6% pts qoq, mainly because of a lower contribution from its 1P business and a one-off rebate from one of its service providers. Without the one-off rebate, management does not expect the high margin level in 4Q21 to persist in the next few quarters. The sales and marketing expenses ratio fell to 41.7% (4Q20: 55.4%; 3Q21: 46.7%), as PDD shifted its spending focus from selling and marketing to R&D and technology investment. PDD will continue to invest in agricultural technology and infrastructure to improve the overall digitalization of the agriculture industry.

### User growth slowed down but purchase frequency kept improving

At the end of 4Q21, PDD had 868.7m annual active users (AAU), up by 10.2% yoy and 0.2% qoq; and 733.4m monthly active users (MAU), up by 1.9% yoy but down 1.1% qoq. Management said PDD is in the process of adjusting its growth strategy, so we may see some short-term fluctuation in user numbers. Its annual monetization rate was up 28.1 bps yoy to 3.8%, driven mainly by a 23.2 bps increase in the monetization rate in transaction services. The annual purchase frequency improved by 44.5% yoy to 70.2 times per user, indicating stronger user stickiness. PDD saw order volume of agricultural products, which usually have a lower average order value (AOV), increase significantly. The overall platform AOV dropped by 8.1% yoy to Rmb40.0 in FY21. We now expect total revenue to maintain solid growth of 22% and 26% yoy in FY22F and FY23F.

### Investment in agriculture should result in long-term quality growth

PDD's "10 Billion Agriculture Initiative" is more of a project-based investment fund to improve digitalization in the agriculture industry and rural areas. With the discovery of more suitable projects, PDD will step up R&D spending in the next few quarters. Since most of the projects (e.g. converting the results of agriculture technology research into practical applications) are expected to take time, we expect PDD's investment in agriculture to provide long-term quality growth, but it will take time to bear fruit.

### Reiterate Add with a new DCF-based TP of US\$138

We cut our revenue forecasts in FY22-23F by 24.4% and 29.4%, respectively, as we expect top-line growth to slow down and the results from its agriculture investment to take time to develop. But we raised our earnings forecast by 117.5% and 16.1%, respectively, since PDD's margin has improved for several consecutive quarters with a lower selling and marketing expenses ratio, as it has become more prudent in control the ROI for its spending. We believe PDD has great potential to improve its margins in the long run. The key risks are 1) the Alibaba and JD threat in lower-tier markets, 2) competition from live broadcasting platforms, and 3) regulatory risks.

**Financial Summary**

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue (Rmbm)	59,492	93,950	114,773	145,980	178,111
Operating EBITDA (Rmbm)	(8,733)	7,521	12,823	23,191	32,818
Net Profit (Rmbm)	(2,965)	13,830	15,784	22,313	29,822
Core EPS (Rmb)	(2.49)	9.56	10.91	15.43	20.62
Core EPS Growth	(32.5%)		14.1%	41.4%	33.7%
FD Core P/E (x)	NA	26.58	23.29	16.47	12.32
DPS (Rmb)	-	-	-	-	-
Dividend Yield	0%	0%	0%	0%	0%
EV/EBITDA (x)	NA	30.15	15.84	7.27	3.87
P/FCFE (x)	80.39	NA	15.43	10.59	8.76
Net Gearing	(205%)	(187%)	(189%)	(192%)	(188%)
P/BV (x)	5.04	4.89	4.23	3.55	2.87
ROE	(7.0%)	20.4%	19.5%	23.4%	25.8%
% Change In Core EPS Estimates			118%	16%	
CGI/consensus EPS (x)			1.30	0.99	0.68

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

# Slower top-line growth, but improving profit

**Figure 1: PDD earnings review**

(RMB m)	4Q20	4Q21	yoy	2020	2021	yoy
Online marketing services	18,922	22,425	18.5%	47,954	72,563	51.3%
Transaction services	2,268	4,724	108.3%	5,787	14,140	144.3%
Merchandise sales	5,358	82	-98.5%	5,751	7,246	26.0%
<b>Total revenue</b>	<b>26,548</b>	<b>27,231</b>	<b>2.6%</b>	<b>59,492</b>	<b>93,950</b>	<b>57.9%</b>
Payment processing fees	-	-	N/A	(1,546)	(2,543)	64.5%
Costs associated with the operation of our platform	(11,526)	(6,516)	-43.5%	(17,733)	(29,175)	64.5%
<b>Costs of revenues</b>	<b>(11,526)</b>	<b>(6,516)</b>	<b>-43.5%</b>	<b>(19,279)</b>	<b>(31,718)</b>	<b>64.5%</b>
<b>Gross profit</b>	<b>15,022</b>	<b>20,715</b>	<b>37.9%</b>	<b>40,213</b>	<b>62,232</b>	<b>54.8%</b>
<b>GP margin</b>	<b>56.6%</b>	<b>76.1%</b>	<b>19% pts</b>	<b>67.6%</b>	<b>66.2%</b>	<b>-1% pts</b>
Sales and marketing expenses	(14,713)	(11,366)	-22.7%	(41,195)	(44,802)	8.8%
General and administrative expenses	(406)	(420)	3.5%	(1,507)	(1,541)	2.2%
Research and development expenses	(1,951)	(2,023)	3.7%	(6,892)	(8,993)	30.5%
<b>Operating loss</b>	<b>(2,048)</b>	<b>6,907</b>	<b>N/A</b>	<b>(9,380)</b>	<b>6,897</b>	<b>N/A</b>
<b>OP margin</b>	<b>-7.7%</b>	<b>25.4%</b>	<b>33% pts</b>	<b>-15.8%</b>	<b>7.3%</b>	<b>23% pts</b>
Interest and investment gain, net	671	915	36.2%	2,455	3,062	24.7%
Interest expense	(278)	(303)	9.0%	(757)	(1,231)	62.5%
Foreign exchange (loss)/gain	149	48	-67.7%	225	72	-68.1%
Other income/(loss), net	81	115	41.8%	194	656	238.8%
<b>Loss before income tax</b>	<b>(1,424)</b>	<b>7,682</b>	<b>N/A</b>	<b>(7,263)</b>	<b>9,455</b>	<b>N/A</b>
Income tax expenses	-	(1,934)	N/A	-	(1,934)	N/A
Share of results of equity investees	48	17	-65.3%	84	247	195.1%
<b>Net income</b>	<b>(1,376)</b>	<b>5,765</b>	<b>N/A</b>	<b>(7,180)</b>	<b>7,769</b>	<b>N/A</b>
Non-controlling interests	-	-	N/A	-	-	N/A
<b>Net income attributable to shareholders</b>	<b>(1,376)</b>	<b>5,765</b>	<b>N/A</b>	<b>(7,180)</b>	<b>7,769</b>	<b>N/A</b>
<b>Net income attributable to ordinary shareholders</b>	<b>(1,376)</b>	<b>5,765</b>	<b>N/A</b>	<b>(7,180)</b>	<b>7,769</b>	<b>N/A</b>
<b>NP margin</b>	<b>-5.2%</b>	<b>21.2%</b>	<b>26% pts</b>	<b>-12.1%</b>	<b>8.3%</b>	<b>20% pts</b>
Non-GAAP adjustments	1,192	1,825	53.1%	4,215	6,061	43.8%
<b>Non-GAAP net income</b>	<b>(184)</b>	<b>7,590</b>	<b>N/A</b>	<b>(2,965)</b>	<b>13,830</b>	<b>N/A</b>
<b>Non-GAAP NP margin</b>	<b>-0.7%</b>	<b>27.9%</b>	<b>29% pts</b>	<b>-5.0%</b>	<b>14.7%</b>	<b>20% pts</b>

SOURCES: CGIS RESEARCH, COMPANY DATA

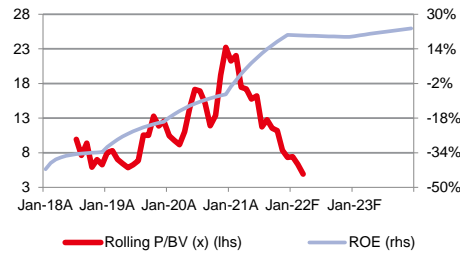
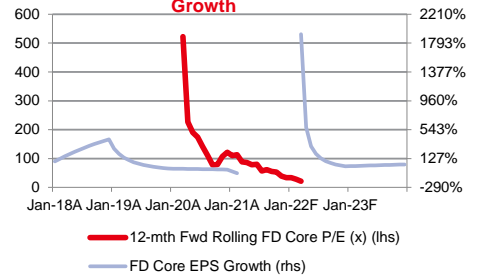
**Figure 2: PDD earnings revisions**

(Rmb m)	FY22F			FY23F			FY24F		
	Old	New	% change	Old	New	% change	Old	New	% change
Revenue	151,774	114,773	-24.4%	206,767	145,980	-29.4%	N/A	178,111	N/A
Gross margin	59.7%	65.4%	5.7% pts	60.7%	65.4%	4.7% pts	N/A	64.6%	N/A
Operating margin	1.0%	10.3%	9.3% pts	8.0%	15.2%	7.2% pts	N/A	17.9%	N/A
Net income	3,401	11,684	243.5%	14,369	16,813	17.0%	N/A	24,322	N/A
Non-GAAP net income	7,501	15,784	110.4%	19,869	22,313	12.3%	N/A	29,822	N/A
EPS (Rmb)	5.02	10.91	117.5%	13.29	15.43	16.1%	N/A	20.62	N/A

SOURCES: CGIS RESEARCH

**Figure 3: PDD DCF valuation**

(RMB m)	FY22E	FY23E	FY24E	FY25E	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
EBIT	11,823	22,253	31,905	44,029	58,119	76,717	101,266	133,671	176,446	232,908	307,439
Add: Depreciation & amortization	1,000	938	913	922	931	940	950	959	969	979	988
Less: Tax	-	(5,571)	(8,074)	(11,142)	(14,707)	(19,414)	(25,626)	(33,827)	(44,651)	(58,940)	(77,800)
Less: Capex	(100)	(100)	(100)	(101)	(102)	(103)	(104)	(105)	(106)	(107)	(108)
Less: Net change in working capital	(11,036)	(16,856)	(16,619)	(16,785)	(16,953)	(17,122)	(17,294)	(17,466)	(17,641)	(17,818)	(17,996)
Unlevered FCF	23,759	45,518	57,411	72,777	90,608	114,090	145,031	185,818	239,601	310,537	404,115
Terminal value											10,419,530
DCF	23,759	41,732	48,257	56,085	64,019	73,905	86,134	101,178	119,611	142,128	169,573
<b>Assumptions</b>											
PV for the forecasted period	902,623		Risk-free Rate of Return				3.0%				
PV for the terminal value	4,372,210		Equity Risk Premium				7.0%				
Enterprise Value	5,274,834		Company Beta				0.88				
Minus: Net debt + Minority interest	7,754		Cost of Equity				9.2%				
NPV to equity shareholders	5,267,079		Pre-tax Cost of Debt				4.8%				
Divided by: # of shares outstanding	5,784		Tax Rate				0%				
NPV per share to equity shareholders (RMB)	911		After-tax Cost of Debt				4.8%				
US\$/CNY	6.60		Target debt to total capital				2%				
<b>NPV per share to equity shareholders (US\$)</b>	<b>138</b>		WACC				9.1%				
			Terminal growth ("g")				5%				
SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG											

**BY THE NUMBERS**
**P/BV vs ROE**

**12-mth Fwd FD Core P/E vs FD Core EPS Growth**

**Profit & Loss**

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
<b>Total Net Revenues</b>	<b>59,492</b>	<b>93,950</b>	<b>114,773</b>	<b>145,980</b>	<b>178,111</b>
<b>Gross Profit</b>	<b>40,213</b>	<b>62,232</b>	<b>75,109</b>	<b>95,447</b>	<b>114,976</b>
<b>Operating EBITDA</b>	<b>(8,733)</b>	<b>7,521</b>	<b>12,823</b>	<b>23,191</b>	<b>32,818</b>
Depreciation And Amortisation	(647)	(625)	(1,000)	(938)	(913)
<b>Operating EBIT</b>	<b>(9,380)</b>	<b>6,897</b>	<b>11,823</b>	<b>22,253</b>	<b>31,905</b>
Financial Income/(Expense)	1,698	1,831	(389)	(119)	240
Pretax Income/(Loss) from Assoc.	0	0	0	0	0
Non-Operating Income/(Expense)	503	975	250	250	250
<b>Profit Before Tax (pre-EI)</b>	<b>(7,180)</b>	<b>9,702</b>	<b>11,684</b>	<b>22,384</b>	<b>32,396</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>(7,180)</b>	<b>9,702</b>	<b>11,684</b>	<b>22,384</b>	<b>32,396</b>
Taxation	0	(1,934)	0	(5,571)	(8,074)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>(7,180)</b>	<b>7,769</b>	<b>11,684</b>	<b>16,813</b>	<b>24,322</b>
Minority Interests	0	0	0	0	0
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax	4,215	6,061	4,100	5,500	5,500
<b>Net Profit</b>	<b>(2,965)</b>	<b>13,830</b>	<b>15,784</b>	<b>22,313</b>	<b>29,822</b>
Recurring Net Profit	(2,965)	13,830	15,784	22,313	29,822
<b>Fully Diluted Recurring Net Profit</b>	<b>(2,965)</b>	<b>13,830</b>	<b>15,784</b>	<b>22,313</b>	<b>29,822</b>

**Cash Flow**

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
<b>EBITDA</b>	<b>(8,733)</b>	<b>7,521</b>	<b>12,823</b>	<b>23,191</b>	<b>32,818</b>
Cash Flow from Inv. & Assoc.					
Change In Working Capital	31,050	4,162	11,036	16,856	16,619
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense	719	625	1,000	938	913
Other Operating Cashflow	3,463	16,578	(750)	(688)	(663)
Net Interest (Paid)/Received	1,698	1,831	(389)	(119)	240
Tax Paid	0	(1,934)	0	(5,571)	(8,074)
<b>Cashflow From Operations</b>	<b>28,197</b>	<b>28,783</b>	<b>23,720</b>	<b>34,608</b>	<b>41,853</b>
Capex	(43)	(2,050)	(100)	(100)	(100)
Disposals Of FAs/subsidiaries	55,083	0	0	0	0
Acq. Of Subsidiaries/investments	(93,398)	(21,966)	0	0	0
Other Investing Cashflow	0	(11,547)	0	0	0
<b>Cash Flow From Investing</b>	<b>(38,358)</b>	<b>(35,562)</b>	<b>(100)</b>	<b>(100)</b>	<b>(100)</b>
Debt Raised/(repaid)	13,930	0	200	200	200
Proceeds From Issue Of Shares	37,869	0	0	0	0
Shares Repurchased					
Dividends Paid					
Preferred Dividends					
Other Financing Cashflow	(0)	(1,875)	0	0	0
<b>Cash Flow From Financing</b>	<b>51,799</b>	<b>(1,875)</b>	<b>200</b>	<b>200</b>	<b>200</b>
Total Cash Generated	41,638	(8,655)	23,820	34,708	41,953
<b>Free Cashflow To Equity</b>	<b>3,769</b>	<b>(6,779)</b>	<b>23,820</b>	<b>34,708</b>	<b>41,953</b>
<b>Free Cashflow To Firm</b>	<b>(9,404)</b>	<b>(5,548)</b>	<b>24,768</b>	<b>35,670</b>	<b>42,929</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**BY THE NUMBERS... cont'd**
**Balance Sheet**

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Cash And Equivalents	139,395	152,561	176,380	211,088	253,041
Total Debtors	730	674	2,761	1,608	3,723
Inventories					
Total Other Current Assets	9,400	7,675	8,100	8,567	9,082
<b>Total Current Assets</b>	<b>149,524</b>	<b>160,909</b>	<b>187,242</b>	<b>221,263</b>	<b>265,846</b>
Fixed Assets	203	2,203	1,553	872	161
Total Investments	0	0	0	0	0
Intangible Assets	1,277	701	452	295	193
Total Other Non-Current Assets	7,905	17,396	17,490	17,593	17,707
<b>Total Non-current Assets</b>	<b>9,385</b>	<b>20,301</b>	<b>19,495</b>	<b>18,760</b>	<b>18,060</b>
Short-term Debt	1,866	0	200	400	600
Current Portion of Long-Term Debt					
Total Creditors	53,834	62,510	75,012	90,014	108,017
Other Current Liabilities	28,182	31,220	32,360	33,632	34,991
<b>Total Current Liabilities</b>	<b>83,882</b>	<b>93,730</b>	<b>107,572</b>	<b>124,046</b>	<b>143,607</b>
Total Long-term Debt					
Hybrid Debt - Debt Component	14,433	11,789	11,789	11,789	11,789
Total Other Non-Current Liabilities	418	577	577	577	577
<b>Total Non-current Liabilities</b>	<b>14,851</b>	<b>12,365</b>	<b>12,365</b>	<b>12,365</b>	<b>12,365</b>
Total Provisions	0	0	0	0	0
<b>Total Liabilities</b>	<b>98,733</b>	<b>106,095</b>	<b>119,938</b>	<b>136,411</b>	<b>155,973</b>
Shareholders' Equity	60,176	75,115	86,798	103,611	127,933
Minority Interests	0	0	0	0	0
<b>Total Equity</b>	<b>60,176</b>	<b>75,115</b>	<b>86,798</b>	<b>103,611</b>	<b>127,933</b>

**Key Ratios**

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue Growth	97.4%	57.9%	22.2%	27.2%	22.0%
Operating EBITDA Growth	10.5%	N/A	70.5%	80.8%	41.5%
Operating EBITDA Margin	(14.7%)	8.0%	11.2%	15.9%	18.4%
Net Cash Per Share (Rmb)	103.3	97.3	113.7	137.5	166.4
BVPS (Rmb)	50.48	51.94	60.02	71.65	88.47
Gross Interest Cover	(12.39)	5.60	10.30	19.15	27.13
Effective Tax Rate	0.0%	19.9%	0.0%	24.9%	24.9%
Net Dividend Payout Ratio	NA	NA	NA	NA	NA
Accounts Receivables Days	5.48	2.73	5.46	5.46	5.48
Inventory Days	-	-	-	-	-
Accounts Payables Days	795.1	669.4	632.8	596.0	574.0
ROIC (%)	25.1%	(11.0%)	(18.2%)	(28.9%)	(33.7%)
ROCE (%)	(12.8%)	12.5%	13.7%	21.8%	26.1%
Return On Average Assets	(4.0%)	7.1%	8.3%	10.0%	11.3%

**Key Drivers**

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Annual active buyers growth (%)	34.7%	10.2%	8.0%	10.0%	8.0%
Average ticket size growth (%)	-14.8%	-8.1%	5.0%	5.0%	5.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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Distribution of stock ratings and investment banking clients for quarter ended on 31 Dec 2021		
619 companies under coverage for quarter ended on 31 Dec 2021		
	Rating Distribution (%)	Investment Banking clients (%)
Add	71.1%	1.5%
Hold	21.8%	0.0%
Reduce	7.1%	0.0%

**Spitzer Chart for stock being researched ( 2 year data )**

**Pinduoduo Inc (PDD US)**

## RECOMMENDATION FRAMEWORK

### Stock Ratings

#### Definition:

Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

*The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.*

### Sector Ratings

#### Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

### Country Ratings

#### Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

## Analyst Certification

The analyst who is primarily responsible for the content of this report, in whole or in part, certifies that with respect to the securities or issuer covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject, securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by the analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the securities covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the securities covered in this research report three business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong-listed companies covered in this report; and (4) have any financial interests in the Hong Kong-listed companies covered in this report.

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