

## JD.com Inc. (JD): First Take: A solid beat with stabilizing growth and expanding margins

**JD.com (JD)** reported better-than-expected 4Q18 results and provided above-Street guidance (vs. Bloomberg) for 1Q19 revenue and FY19 net margin at the mid-point. We provide **key highlights from its results call**, where management provided extensive discussions into targeting further user growth into 2019.

- **Revenue** growth of +22% came **above** GSe/Bloomberg consensus of +20%/+20% (towards high-end of guidance of 18-23%).
- **GMV** of +28% came **significantly above** our estimate of +23% (vs. +31% in 3Q18), and outpaced overall China online retail goods sales growth of +21% in the quarter, driven by **over 40% GMV growth** at its 3P marketplace.
- **Annual active customer accounts** grew +4% yoy and flat qoq, **below** our estimate of +11%, vs. +15%/+29% in 3Q18/4Q17. However, management provided quarterly active customer account growth metrics for the first time, at +20%/+22% yoy in 4Q18/3Q18, with a 6% qoq increase, indicating healthy user growth in recent two quarters.
- **Non-GAAP operating margin** printed at 0.2%, **significantly above** our expectations (GSe: -0.7%), underpinned by higher-than-expected gross margin, fulfilment and technology & content expenses. Operating margin of JD Mall came in at 1.1%, vs. 0.6%/2.2% in 4Q17/3Q18;
- **Guidance:** Management expects 1Q19 revenue to reach Rmb118bn-122bn, +18-22% yoy, vs. GSe/Bloomberg consensus of +20%/+19%. On the call, **management guided for FY2019 net margin of 0.8%-1.2%**, in line with GSe of 1.0% at the mid-point and above Bloomberg consensus median of 0.8%.

We have a **Buy** rating on JD with a 12-month SOTP-based TP of US\$41.

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**Exhibit 1: JD 4Q results snapshot**

RMB mn	Act / Guidance	% yoy	GSe	Consensus	Act vs. Est	Act vs. Cons
4Q18 Revenue	134,833	22%	132,722	132,430	1.6%	1.8%
4Q18 non-GAAP EPS (RMB)	0.51	66%	(0.18)	(0.21)	69c	72c
1Q19E Revenue	120,000	20%	120,144	119,162	-0.1%	0.7%

Source: Company data, Bloomberg, Goldman Sachs Global Investment Research

**Key numbers**

- **4Q18 net revenues** were Rmb134.8bn with yoy growth of 22% (vs. GSe/Bloomberg consensus of +20%/+20%). Net product revenues (direct online sales) grew 20% yoy, while net services revenues grew 46% yoy, slightly slowing from +49% in 3Q18. **GMV came in at Rmb514.4bn, +28% yoy** (vs. GSe: +23%), compared with +31% yoy in 3Q18 and industry growth of +21% in 4Q18 (as per National Bureau of Statistics). Management disclosed that they will no longer provide quarterly GMV disclosures from 2019, in line with industry peers, while they will continue to disclose annual GMV end of each fiscal year.
- **Annual active customer accounts** as of trailing twelve months slowed to +4% yoy, flat qoq to reach 305.3mn, vs. +15%/+29% in 3Q18/4Q17, implying a **significant step-up in GMV per customer** in the quarter. Management provided quarterly active customer growth of +20%/+22% for 4Q18/3Q18. On the results call, management commented their strategies in growing further users by **(1)** retaining existing users through category expansion and personalization, **(2)** growing new users via providing the right product offerings to lower tier city users (e.g., with its ongoing investment into JD team purchase “Pingou”), expand touchpoints including communities and campuses, and with more effective marketing.
- **4Q18 non-GAAP group operating margin** came in at 0.2%, higher than GSe of -0.7%, on higher than expected gross margin, fulfilment and technology & content expenses. Specifically, the increase in gross margin (+121bps yoy) was driven by +60 bps improvement at JD Mall (where +38bps was from 1P, together with solid advertising margins driven by scale economies in key categories) and more normalized pricing for JD Logistics. JD Mall operating margin before unallocated items was up 50bp yoy to 1.1%, from 0.6% in 4Q17.
- **1Q19 revenue guidance:** Management expects 1Q19 revenue to reach Rmb118bn-122bn, +18-22% yoy, vs. GSe/Bloomberg consensus of +20%/+19%. On the call, management also guided for **FY2019 net margin of 0.8%-1.2%**, exceeding Bloomberg consensus of 0.8% at the midpoint, to be driven by ongoing JD Mall margin expansion and reduced losses at JD Logistics.
- **Cash flows:** As of end-4Q 2018, the company’s **cash and cash equivalents, restricted cash and short-term investments** totaled Rmb39.5bn. **Net cash provided by operating activities from continuing operations** was Rmb6.0bn (compared with Rmb3.4bn in 4Q17), and the impact from JD Digital Technology related credit products was Rmb-5.8bn (compared with Rmb-2.9bn in 4Q17). **Capital expenditures** totaled Rmb4.2bn (compared with Rmb2.2bn in 4Q17), and **free cash flow** was Rmb-4.0bn (compared with Rmb-1.7bn in 4Q17). On the results call, management expects improved further operating cashflow from higher

operating profits in operations, lower capex vs. 2018 and cash inflow from its logistics asset fund.

- **JD Logistics and update on logistics assets core fund:** In February 2019, JDPM (JD Property Management Group, founded in 2018 for logistics facilities management) established **JD Logistics Properties Core Fund** together with GIC, and JD serves as a general partner with 20% stake. On Feb 27, JD entered into an agreement with the Fund that it will dispose a sum of **Rmb10.9bn in gross asset value** of modern logistics facilities to the fund (accounting for c.20% of JD's current warehouse portfolio). Management noted on the results call that the annual return on the mentioned warehouse investments (since 2012) would imply IRR of 17%. Meanwhile, on JD Logistics, management noted that the pricing for JD Logistics is moving towards a more normalised level after the end of the discounting phase for certain customers. As of end-4Q18, JD operated over 550 warehouses covering GFA of c. 12mn sqm in China.

### Other key takeaways

- **Merchant network and employees:** As of end-4Q18, JD had over 210k merchants on the online marketplace and c. 178k full-time employees.
- **JD Fresh** partnered with Japanese chemical manufacturer Mitsubishi Chemical and opened the largest hydroponic "plant factory" in China, offering both online and offline products at 7FRESH markets.
- As of end-4Q, **Dada-JD Daojia** had partnered with over 100k stores from supermarket brands such as Walmart, Yonghui, Carrefour and CR Vanguard and the delivery network covered more than 450 cities nationwide.
- In Feb 28 2019, **Farfetch announced the expansion of their strategic partnership with JD:** JD's *TOPLIFE* (luxury platform) will be merged into Farfetch China, and Farfetch will have level 1 access point on JD app, providing customers with access to more than 3,000 brands via its network.
- **JD-Tencent strategic agreement:** With JD and Tencent's existing 5-year strategic partnership expiring in 2Q19 and up for renegotiation, management commented that both parties are fully committed and more details will follow regarding the renewal process
- **It announced a US\$1bn share buy-back program:** As of Dec 31, 2018, the company had repurchased approximately 1.4 mn ADS for approximately US\$30mn.

## Exhibit 2: JD 4Q results overview

Rmb mn	4Q17	1Q18	2Q18	3Q18	Act. Vs GSe			
					4Q18A	4Q18E	vs. Est.	YoY(%)
<b>Total GMV</b>	<b>403,400</b>	<b>330,200</b>	<b>437,400</b>	<b>394,800</b>	<b>514,400</b>	<b>496,737</b>	<b>3.4%</b>	<b>28%</b>
Annual Active customer accounts (mn) (of last 12M)	293	302	314	305	305	324	-6.1%	4%
<b>Total net revenues</b>	<b>110,165</b>	<b>100,128</b>	<b>122,291</b>	<b>104,768</b>	<b>134,833</b>	<b>132,722</b>	<b>1.6%</b>	<b>22%</b>
Cost of goods sold	95,805	85,970	105,777	88,659	115,661	114,941	0.6%	21%
<b>Consolidated Gross profit</b>	<b>14,360</b>	<b>14,158</b>	<b>16,514</b>	<b>16,110</b>	<b>19,172</b>	<b>17,780</b>	<b>7.3%</b>	<b>34%</b>
Fulfillment, non-GAAP	7,805	7,048	8,060	7,591	8,724	9,205	-5.5%	12%
Marketing, non-GAAP	4,396	3,153	4,903	3,768	5,990	5,164	13.8%	36%
Technology and content, non-GAAP	1,846	2,213	2,465	3,077	3,128	3,445	-10.1%	69%
General and administrative, non-GAAP	708	673	746	814	803	720	10.4%	14%
<b>Operating profit, non-GAAP</b>	<b>(596)</b>	<b>848</b>	<b>113</b>	<b>616</b>	<b>313</b>	<b>(966)</b>	<b>408.8%</b>	<b>153%</b>
<b>Net profit from continuing operations, non-GAAP</b>	<b>449</b>	<b>1,047</b>	<b>478</b>	<b>1,184</b>	<b>750</b>	<b>(261)</b>	<b>134.8%</b>	<b>67%</b>
<b>Basic EPADS (RMB), non-GAAP</b>	<b>0.32</b>	<b>0.73</b>	<b>0.33</b>	<b>0.82</b>	<b>0.52</b>	<b>(0.18)</b>	<b>134.6%</b>	<b>64%</b>
<b>Diluted EPADS (RMB), non-GAAP</b>	<b>0.31</b>	<b>0.71</b>	<b>0.33</b>	<b>0.80</b>	<b>0.51</b>	<b>(0.18)</b>	<b>134.5%</b>	<b>66%</b>
<b>Margins</b>								
<b>Consolidated Gross margin</b>	<b>13.0%</b>	<b>14.1%</b>	<b>13.5%</b>	<b>15.4%</b>	<b>14.2%</b>	<b>13.4%</b>	<b>0.8</b>	<b>1.2</b>
<b>Operating margin, non-GAAP</b>	<b>-0.5%</b>	<b>0.8%</b>	<b>0.1%</b>	<b>0.6%</b>	<b>0.2%</b>	<b>-0.7%</b>	<b>1.0</b>	<b>0.8</b>
Net margin, GAAP	-0.9%	1.5%	-1.9%	2.7%	-3.6%	-1.5%	-2.1	-2.7
<b>Net margin, non-GAAP</b>	<b>0.4%</b>	<b>1.0%</b>	<b>0.4%</b>	<b>1.1%</b>	<b>0.6%</b>	<b>-0.2%</b>	<b>0.8</b>	<b>0.1</b>
<b>Net margin from continuing operations, non-GAAP</b>	<b>0.4%</b>	<b>1.0%</b>	<b>0.4%</b>	<b>1.1%</b>	<b>0.6%</b>	<b>-0.2%</b>	<b>0.8</b>	<b>0.1</b>

\* from Continuing Operations

Source: Company data, Goldman Sachs Global Investment Research

We have a **Buy** rating on JD with a 12m SOTP-based TP of US\$41.

**Key risks:** Online GMV slowdown and FMCG execution, capital allocation, key shareholder changes over the longer term, ongoing competition, tightening regulations, margin ramp-up trajectory.

JD	12m Price Target: <b>\$41.00</b>	Price: <b>\$25.97</b>	Upside: <b>57.9%</b>		
<b>Buy</b>	<b>GS Forecast</b>				
Market cap: \$38.3bn Enterprise value: \$33.1bn 3m ADTV: \$391.0mn China Asia Internet M&A Rank: 3	Revenue (Rmb mn)	12/17	12/18E	12/19E	12/20E
	362,331.8	459,908.9	555,978.6	676,531.5	
	EBITDA (Rmb mn)	7,078.3	5,529.3	7,965.2	14,731.6
	EPS (Rmb)	3.41	1.67	3.93	7.44
	P/E (X)	73.8	103.9	44.2	23.3
	P/B (X)	6.8	4.5	4.2	3.6
	Dividend yield (%)	0.0	0.0	0.0	0.0
	Net debt/EBITDA (X)	(3.6)	(6.6)	(5.0)	(3.3)
	CROCI (%)	2.6	9.6	8.0	16.3
	FCF yield (%)	6.0	0.5	4.0	6.4
	EPS (Rmb)	6/18	9/18E	12/18E	3/19E
	0.33	0.80	(0.18)	0.85	

Source: Company data, Goldman Sachs Research estimates, FactSet. Price as of 27 Feb 2019 close.

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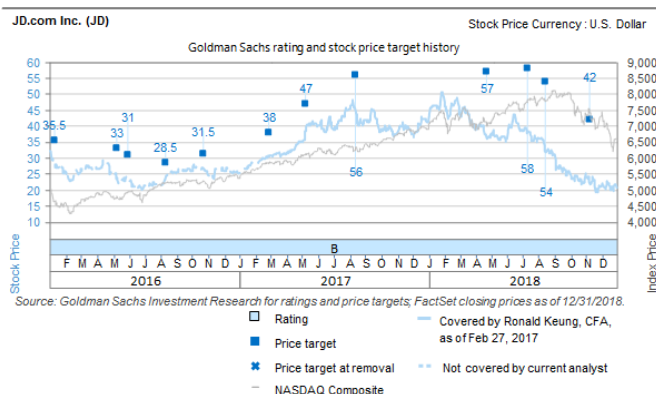
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