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Coupang, Inc. (CPNG)

Q2 2024 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Hello, everyone. My name is Krista and I will be your conference operator today. At this time, I would like to welcome everyone to the Coupang 2024 Second Quarter Earnings Conference Call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. [Operator Instructions]

Now, I'd like to turn the call over to Mike Parker, Vice President of Investor Relations. You may begin your conference.

Michael Parker
Vice President & Head-Investor Relations, Coupang, Inc.

Thanks, Operator. Welcome, everyone to Coupang's second quarter 2024 earnings conference call. I'm pleased to be joined on the call today by our Founder and CEO, Bom Kim; and our CFO, Gaurav Anand. The following discussion, including responses to your questions, reflects management's views as of today's date only. We do not undertake any obligation to update or revise this information, except as required by law. Certain statements made on today's call include forward-looking statements. Actual results may differ materially. Additional information about factors that could potentially impact our financial results is included in today's press release and in our filings with the SEC, including our most recent Annual Report on Form 10-K and subsequent filings.

During today's call, we may present both GAAP and non-GAAP financial measures. Additional disclosures regarding these non-GAAP measures, including reconciliations of these measures to the most comparable GAAP measures, are included in our earnings release, our slides accompanying this webcast, and our SEC filings, which are posted on the company's Investor Relations website.

And now, I'll turn the call over to Bom.

Bom Kim

Founder, Chairman & Chief Executive Officer, Coupang, Inc.

Thanks, everyone, for joining us today. Before we dive into the results for Q2, here are three takeaways from another strong quarter. First, our results continue to be driven by years of investment and innovation to provide what we believe is the best retail customer experience on the planet. Second, our focus on innovation, and operational excellence helps us break traditional trade-offs, so we can provide that superior customer experience at the lowest cost. And in turn, strengthen growth and profitability. One example, we deliver the vast majority of our fresh orders using eco bags that replaced almost all of the delivery related disposable packaging. That saves us packaging cost, helps the environment and allows us to provide free delivery within hours and do so profitably. That's just one example of how we strive to provide the best customer experience at the lowest cost, and generate growth while expanding profitability, not one at the expense of the other.

Third, our developing offerings are generating strong growth and exciting momentum for the future. Our historical investments in Product Commerce were misunderstood at the time, but today helped generate the strong growth and cash flows you see each quarter. We believe our investments in developing offerings are building the next set of offerings that will further compound our growth and cash flow generation in the future.

Now, a few numbers to highlight from our second quarter performance. This quarter, we grew constant currency revenues 30% over last year or 23% excluding Farfetch, which we acquired in Q1 of this year. And adjusting for the fulfillment and logistics by Coupang or FLC accounting change we began in Q2 of last year, the growth would have been 660 bps higher than the 23% constant currency growth rate, excluding Farfetch.

Our Product Commerce active customers grew 12% year-over-year. It's important to note, however, that while new customers contribute to future growth, our growth today and tomorrow is powered primarily by the increasing spend of our existing customers, and we believe our future growth opportunity is massive, and largely untapped, because we still account for a small percentage of overall retail spend, even of our oldest and best customer cohorts. That's why all of our customer cohorts continue to increase their spend, even our oldest and highest spending cohorts. We can't stress enough how small a share we are of the massive and highly fragmented $560 billion commerce opportunity in the market and how early we are in that journey.

This quarter, we saw the growth in our marketplace, which includes both third party and FLC, significantly outpace the growth of our overall business, for the 13th consecutive quarter, our marketplace sales have grown faster than our first party sales. Marketplace sellers are not only growing faster than our first party, they're also growing exponentially faster than the overall Korean retail market. Many of these marketplace sellers who have enjoyed this tremendous growth are SMEs, and that doesn't include sellers who were once SMEs but are now large businesses, thanks to the growth they've enjoyed on Coupang. We're proud that we've helped over 9,000 SMEs graduate from SME status since 2020. We continue to invest in services that power that marketplace growth and FLC's growth trajectory is worth highlighting. In Q2, the number of sellers joining FLC grew 25% quarter-over-quarter and over 150% year-over-year.

Now, a few words on Developing Offerings. We continue to be pleased with the progress and momentum we're seeing in Eats, where customer adoption continues on its strong trajectory since we launched our WOW free delivery program last quarter. And merchants are benefiting from that growth. In just three months, restaurants on Coupang on average have seen a nearly 30% growth in volumes. In Taiwan, we're focused on breaking the same trade-offs for the Taiwanese customer that we did for the Korean customer to win their loyalty and trust. Our conviction of the potential in Taiwan is as strong as ever.

On a side note, while Korean products are just part of the assortment that we offer to customers in Taiwan, we're enabling tens of thousands of Korean companies to get their products to Taiwanese consumers. And our growth has helped triple their total sales volumes this year, over last year.

On Farfetch, as we stated last quarter, our goal is to generate close to positive adjusted EBITDA on a run rate basis by the end of the calendar year. We're executing to plan and it's on track to achieve these goals for the year so far. Though we're still in the very early stages of our journey, we're excited about Farfetch's progress and potential. It's important to highlight that in the markets we serve, we see massive potential that is still largely untapped, and our strategy to capture that potential has been unwavering, disciplined investment and operational excellence, to deliver customer WOW, the best selection, service and savings for our customers.

We believe to our core that the happiness of our customers is the key to maximizing opportunities in the long term for our suppliers, merchants, employees and shareholders.

Now, I'll turn the call over to Gaurav to review our results in greater detail.

Gaurav Anand

Chief Financial Officer, Coupang, Inc.

Thanks, Bom. This quarter, we saw a continuation of the strong momentum across our business that we reported in Q1. In Q2, we again delivered robust growth in revenue, Product Commerce active customers, gross profit, and adjusted EBITDA. As we go through the numbers, I want to remind everyone of our acquisition of Farfetch that was completed at the end of January this year. Q2 represents the first quarter, consolidating three full months of Farfetch operating results with no Farfetch financials included in the prior year comp. Wherever possible, I will provide results for the quarter with and without Farfetch to highlight the performance of our existing business and the impact from the Farfetch acquisition.

Our total net revenues grew 25% year-over-year in Q2 or 18%, excluding the impact of Farfetch. Adjusting for the effects of changes in foreign currency, total net revenue grew 30% or 23%, excluding Farfetch. As a reminder, beginning in Q2 last year, we made certain changes to FLC revenue accounting, changing the accounting from gross to net on a prospective basis. Adjusting for the impact of this change, the growth would have been 660 bps higher than the 23% constant currency growth rate, excluding Farfetch.

Within our Product Commerce segment, Q2 revenues grew 13% year-over-year or 18% in constant currency. This growth rate would have been 680 bps higher after adjusting for the FLC accounting change. With the total retail spend in Korea growing at just 1%, Coupang continues to be a growing value destination for consumers, and the primary source of consistent growth for sellers and suppliers in Korea. Net revenues for Product Commerce active customers grew 5% year-over-year in constant currency. This includes the short-term dilutive impact of the large number of new Product Commerce active customers we have added over the last few quarters, as well as the impact of the FLC accounting change. The impact of new customers is dilutive, because new customers spend less initially, but we have seen their spend levels grow in line with the trajectory of older cohorts over time.

It's important to note that the vast majority of our growth is powered by increasing spend of our existing customers. We continue to see the spend levels of all our cohorts increase, even our oldest, and highest spending. We believe there is still a long runway for growth, given that we account for a small percentage of their overall retail spend. As we have said previously, we believe we have a significant opportunity to grow that small percentage of overall retail spend to much higher levels by improving our selection, service and savings for customers.

As Bom noted, we continue to be encouraged by the progress we are seeing within our Developing Offerings segment. Developing Offerings revenue grew over 470% year-over-year or 177% excluding Farfetch. On a constant currency basis, Developing Offerings segment revenue grew over 480% or 188%, excluding Farfetch. Given the evolving mix of the various offering, services and channels within our business, we believe a primary indicator of the underlying growth in our business is gross profit. This quarter we again delivered a record quarter of gross profit, reaching over $2.1 billion, growing over 40% year-over-year with a gross margin of 29.3%. Excluding Farfetch, we delivered $1.9 billion in gross profit for a growth rate of 27%, and a margin of 28.3%. This represents an improvement of 220 basis points year-over-year, accelerating even faster than the growth we saw last quarter.

Product Commerce gross profit increased 26% year-over-year to over $1.9 billion, and a record gross profit margin of 30.3%. This represents a 310 basis points improvement over last year and 200 basis points over last quarter. Our margin improvement this quarter was driven by strong growth rates in categories with higher margin composition, as well as higher efficiencies across operations, including benefits from greater utilization of automation and technology, including AI. We also continue to benefit from further optimization in our supply chain, and the scaling of margin accretive offerings. We expect these drivers to continue contributing to further margin expansion over the quarters and years to come.

OG&A expense as a percentage of revenue this quarter increased 600 basis points versus last year. This change was primarily due to the inclusion of Farfetch and its related restructuring costs, as well as the estimated $121 million administrative fine that we accrued as announced by the Korea Fair Trade Commission. We generated $3 million of income before income taxes and a $77 million of net loss attributable to Coupang stockholders this quarter. This resulted in diluted loss per share of $0.04. Excluding Farfetch and estimated accrued fine, net income attributable to Coupang's stockholders was approximately $124 million for the quarter, and diluted earnings per share was $0.07.

Our consolidated business reported $330 million of adjusted EBITDA this quarter, which excludes the one-time costs relating to the restructuring activities in Farfetch, as well as the accrued fine. This resulted in an adjusted EBITDA margin of 4.5%. The trailing 12 month adjusted EBITDA was $1.1 billion, with a margin of 4.2%. Excluding Farfetch, we recorded $361 million of adjusted EBITDA this quarter and $1.2 billion over the trailing 12 months, with a trailing 12 month adjusted EBITDA margin of 4.6%. We remain confident in our ability to continue expanding consolidated margins on an annual basis going forward.

Product Commerce segment delivered $530 million of adjusted EBITDA with a record margin of 8.2%. This represents a margin expansion of over 100 basis points over the last year. This growth in margin was driven by the expansion in gross profit margin, as well as the benefit from further improvements in operational efficiency. Our segment adjusted EBITDA in Developing Offerings was a $200 million loss for the quarter, relatively flat to the last quarter and increasing $93 million year-over-year. This increase was driven by additional investment in these early stage opportunities, as well as a $31 million impact from the consolidation of Farfetch. We remain encouraged by the progress we are making in Farfetch. Our team is focused on doing one of the things we do best at Coupang, driving operational efficiencies through discipline and process improvement. We remain convinced of the ability for Farfetch to get close to positive adjusted EBITDA run rate by the end of this year.

Our ending cash balance at the end of Q2 was roughly $5.8 billion, increasing 22% over the last year. We generated $2.2 billion in operating cash flow and $1.5 billion of free cash flow over the trailing 12 months. As we guided to last quarter, in Q2, we saw an increase in the effective income tax rate driven by consolidation of pre-tax losses in Farfetch, and nondeductible expenses. As a reminder, this is just an accounting tax rate as we expect our cash tax obligation this year to be closer to 20% to 25%, excluding Farfetch losses.

Operator, we are now ready to begin the Q&A.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Stanley Yang. Your line is open.

Stanley Yang
Analyst, JPMorgan Securities Far East Ltd. (South Korea)

Q

Thanks for the opportunity to ask the question. I have – congratulation on the strong result on major core metrics line items. My first question is about the Product Commerce margin. We saw strong expansion – margin expansion in the second quarter. Can you please provide more color on the margin drivers in the second quarter?

And also overall in 2024, what are the current major tailwind and headwind for your Product Commerce margin trend is, is [ph] roughly (17:57) growing FLC increasingly margin accretive? My second question is about the Eats, Eats side. So, the Eats market share gain momentum seems to be even stronger in the second quarter. Is Eats standalone margin improving with the economies of scale? That's my first question on this [ph] note (18:19) – sub-question on the first question, the second question. And going forward, will you prioritize top line focused margin – market share gains strategy going forward or do you look for more balanced strategy between the growth and profitability?

Bom Kim
Founder, Chairman & Chief Executive Officer, Coupang, Inc.

A

Hi, Stanley. Thanks for the questions. On Product Commerce, as you mentioned, Q2, we generated – we recorded significant improvements, generating nearly $2 billion of gross profit, margin of 30%, which represents an improvement of over 300 bps year-over-year. The drivers of that margin expansion continue to be the same that we've seen over the last several quarters and years. These are improvements, continuous improvements in our operations and supply chain, scaling of margin accretive offerings, greater utilization of automation technology, including AI. And we still have a lot of opportunity to improve on these variables. That's one reason why we provided the long-term guidance of over 10% adjusted EBITDA. And we pointed this out in the past, margins may be uneven quarter-to-quarter, but we expect our profit margin to continue its march upwards over time towards that target.

On Eats, as you point out, we continued to see strong momentum there, great adoption and increasing frequency from WOW members who are discovering Eats because of our unlimited free delivery benefit. It's important to note that we're doing that while also continuing to improve our cost structure. That's aided by the benefits of scale, our focus on operational excellence. Eats is currently unit economics positive, and we see that only continuing to improve as Eats scales. And as is the case with Product Commerce, we're obsessed with providing customers with selection, service, and savings, not one at the expense of the other. We'll continue to focus on breaking trade-offs between selection service savings, between growth and economics, to provide the best experience in restaurant delivery and commerce more broadly.

Gaurav Anand
Chief Financial Officer, Coupang, Inc.

A

Stanley had one more question in between on healthy margins, so I'll jump in here. But as Bom has mentioned in his note, we are excited about the progress FLC is making. In Q2, the number of sellers joining FLC grew 25% quarter-over-quarter and over 150% year-over-year. So overall FLC is accretive from margin perspective, but there are still many areas that need improvement. We are making investments to onboard merchants and we'll continue to improve our suboptimal processes and fix systems there.

Operator: Your next question comes from the line of Eric Cha. Your line is open.

Eric Cha
Analyst, Goldman Sachs (Asia) LLC (South Korea)

Q

Yeah, thank you. Thank you for the opportunity to ask questions. I have two. The first question is on Developing Offering. So, I've noticed the Developing Offering loss has increased to $20 million (sic) [$200 million] in second quarter. So, just simply extrapolating this for the year, would you say there's a potential for Coupang to go meaningfully go over $750 million loss guidance for Developing Offerings? And it would be helpful if you could elaborate a little bit more on the key – the moving parts for the bigger loss, compared to the first quarter.

And my second question is around G&A for Product Commerce. It seems like gross profit margin increase has been the key driver for the adjusted EBITDA margin improvement for Product Commerce, lately. And we don't really have much insights into the cadence of G&A for Product Commerce going forward. So, could you explain on what the drivers are for the G&A increase, and when we could expect some operating leverage coming from this line? Thank you.

Gaurav Anand
Chief Financial Officer, Coupang, Inc.

A

Yeah, Eric, thanks for your questions. So, on Developing Offerings last quarter, we updated our full year guidance of adjusted EBITDA losses of roughly $750 million this year, including Farfetch. So, while the timing of these expenses within the various components of Developing Offerings may fluctuate quarter-to-quarter, we still believe our full year actual results will be in line with the guidance that we have previously provided.

On overhead expenses, our expenses as a percentage of revenue this quarter increased versus last year. This was primarily due to the inclusion of Farfetch and its related restructuring costs, the increase in investments in Developing Offerings and as well as estimated $121 million administrative fine that we previously mentioned.

Within our core operations, we are also investing in technology and infrastructure to build a stronger foundation for future scalability. While these investments may temporarily decrease our operating margins in the near-term, we will leverage on these costs in the next couple of years, and we believe they will create long-term value as they help us better serve customers and support our future growth.

Operator: The next question is from Seyon Park from Morgan Stanley. Your line is open.

Seyon Park
Analyst, Morgan Stanley & Co. International Plc (South Korea)

Q

Hi. Thank you for the opportunity. I also have two questions. First of all, just to follow up on what Stanley had asked. I think this quarter, the gross profit margin improvement for Product Commerce was particularly more impressive. And so, maybe, I know that the three – the mix of operational efficiencies and the faster growth of higher margin products is the drivers. Could you maybe share just a little bit more color as to – for this quarter within that – within those drivers, what was particularly more evident?

My second question is with regards to Taiwan. And I'm very cognizant that management would not like to give any forward-looking, I guess, guidance on Taiwan. But at least looking back, can we at least get a sense as to how far Coupang services have been rolled out in Taiwan, what is available, what is not available, what kind of coverage you have next morning delivery? Is that available in Taiwan and to most residents? Can we get some sense on that, please? Thank you.

Bom Kim
Founder, Chairman & Chief Executive Officer, Coupang, Inc.

A

Hi, Seyon, thanks for the questions. I think on – I think it's important to highlight that on our margin expansion that we really are early on these variables – on our improvement journey, on these variables. There's still a lot of room. It's the reason why you continue to see these margin improvements happen over the last few years, I think on a continuous basis now. There are fluctuations quarter-to-quarter. The improvement is not always in a straight line, but we believe we're on a long-term trajectory to continue to improve all of these variables over time, to achieve our long-term guidance of over 10% adjusted EBITDA.

On Taiwan, there – it's too early to share details, but I can share that we continue to be very encouraged by the momentum and progress we're seeing there. Our customer experience, selection, service, savings, none of them are quite at the levels that we've now built in Korea yet. But we are able to start in a much better place. And that strong start is in part due to the fact that we're able to leverage in Taiwan a lot of what we built in Korea. We started in a very different place on our selection, processes, fulfillment and logistics optimization, supply chain management, our technology stack. All of these things we've invested in and refined over a decade. We're fortunate to be able to leverage a lot of that in Taiwan. So while we are early in the journey and the experience is not where we'd like to be yet, both on the customer experience and operational excellence, we're very excited about the momentum and progress we're making, and we'll continue to be very disciplined and with any increased level of spend, investing only when we're convinced about the returns we can generate. We're also pleased that we won't have to make the same kind of investments in many areas, because we're able to leverage the investments we've already made in the Korean market.

Just generally the potential to create meaningful, differentiated – differentiation in customer experience, and meaningful returns to our shareholders, we think is extremely high and we're very excited about the opportunity we see in Taiwan.

Seyon Park
Analyst, Morgan Stanley & Co. International Plc (South Korea)

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Jiong Shao from Barclays. Your line is open.

Jiong Shao
Analyst, Barclays Capital, Inc.

Q

Thank you very much for taking my questions. First, I have a follow-up question about the margin. I think Bom just talk about your long-term target of EBITDA margin of 10% or more. I was wondering, could you talk about – just for your 1P business, do you think that's also achievable? And in that sort of the margin guide, the gross margin that still my peers have highlighted this quarter was particularly strong. Do you feel there's more room to go, the higher margin categories? Could you talk about what one of those categories are, the new categories you think – you can expect to further growth in those categories?

My second question is about the WOW membership fee increase. I was wondering – I know the fee – the higher fee kicked in beginning of August a few days ago for the existing members. But at the new members I think the higher fee kicked in three months ago. I was wondering if you could talk about in terms of the member – new members signing up or the existing member churn, if any, any comments will be appreciated. Thank you.

Bom Kim
Founder, Chairman & Chief Executive Officer, Coupang, Inc.

A

Hi, Jiong , thanks for the questions. We see a lot of opportunity. We're – I think both Gaurav and I mentioned earlier that we still represent a very small percentage of overall retail spend. It is – there's a lot of expansion potential that we see in spend in almost every category. So, that's just a general trend that I think we represent a very small percentage of a fragmented and massive $560 billion commerce opportunity. And that spend will go up as we increase selection across all those categories, improve our service, and continue to expand savings for our customers.

On WOW, we generally disclose our WOW membership numbers on an annual basis. So, we will share more at year end. And our focus continues to be on creating massive value surplus for our members. Maybe this is a good chance for us to expand a little bit on what value surplus is for our customers there. We create value surplus through WOW via 14 different benefits that we've built over the years and added to the program.

As an example, let me just take one of those benefits, free delivery savings, and parents with young children, some of the most time and resource constrained customers in the market. For a monthly fee, that's equivalent to roughly the cost of two deliveries. These customers save on 23 free deliveries a month. That's saving more than 10 times the amount they pay. And that's just from free delivery, not including the savings they get on free returns, exclusive discounts, free video streaming and not to mention hours they save from skipping trips to the store to better spend with their children. And we're really focused, laser focused on increasing these benefits and savings to serve our existing customers and to attract the tens of millions of retail shoppers who have yet to join WOW. And that's where our focus is, to continue to strive to make WOW the best deal on the planet for customers.

Operator: [Operator Instructions] The next question comes from the line of James Lee with Mizuho. Your line is open.

James Lee
Analyst, Mizuho Securities USA LLC

Q

Great. Thanks for taking my questions. Two here. One on food delivery. Now, given your market share gains, can you maybe talk about some of the competitor responses you've seen in the market? In terms of restaurant selections in general, just maybe help understand where do you plan to reach maybe parity with your number one peer in the market? And also, in terms of potential M&A, I was wondering under what conditions would kind of acquisition make sense in that space. Thanks.

Bom Kim
Founder, Chairman & Chief Executive Officer, Coupang, Inc.

A

Sorry, the second question when you said parity, James, could you clarify parity on what dimension?

James Lee
Analyst, Mizuho Securities USA LLC
Q

In terms of restaurant selection.

Bom Kim
Founder, Chairman & Chief Executive Officer, Coupang, Inc.
A

I see. We are – generally speaking, we are making – we have – we're continuing just to add selection. I would say that in some places, our selection is better. Probably some places, our selection is still has areas of improvement to go. I think the most important thing is that we continue to focus on all three of those pillars, not – selection, service, savings, delivering on all three pillars of that has been key to winning long-term customer loyalty, to continuing to unlock a lot of growth for the program. So, I think that generally is our focus. There are no plans for M&A. I think we just are focused on internal execution in that space.

James Lee
Analyst, Mizuho Securities USA LLC
Q

Great. Thanks.

Operator: There are no further questions. This concludes today's conference call. Thank you and you may now disconnect.