

Tidefall Capital LP
Q2 2024
July 16, 2024

| | Q2 2024 | Year to Date | Since Inception (Jan 21, 2020) | Since Inception CAGR |
|--------------------------|---------|--------------|-----------------------------------|-------------------------|
| TIDEFALL LP (Net) | 2.4% | 6.9% | 212.8% | 29.3% |
| S&P (TR) | 4.3% | 15.3% | 76.0% | 13.6% |
| TSX (TR) | -0.5% | 6.0% | 43.0% | 8.4% |

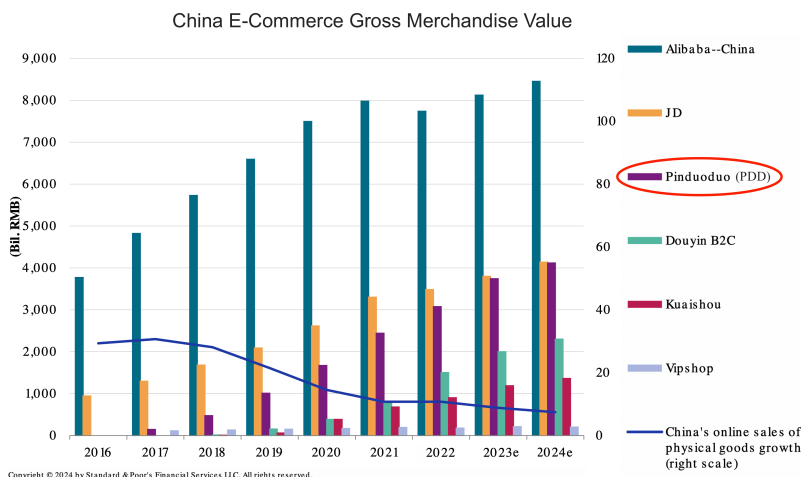
There are few words that investment partners would like to hear less in 2024 than “we recently purchased a Chinese stock”, yet here we are. As a Western investor, China is well known for its high level of geopolitical risk and more recently its weakening economy and property market. However, we believe there is one investment that is so compelling that it makes the risk worth the potential reward.

Pinduoduo (NYSE: PDD) is an online market place that is unlike anything we have ever seen before in terms of efficiency, viral growth and cut throat capitalism. PDD is growing so fast that a dedicated sell side analyst admitted in their latest quarterly report, which saw PDD grow revenue by 131% and net income by 202%, that it was likely the ‘biggest beat’ that they had ever seen in their career.

Started in 2015, PDD’s initial platform innovated ‘team buying’ via social media, whereby the more friends you added to a purchase, the lower the price would become. PDD turned their buyers into their marketers which not only dramatically lowered their customer acquisition cost but also rapidly increased the purchasing volumes they could offer merchants. Furthermore, in a move that’s similar to TikTok, PDD leveraged its data to algorithmically adjust the product page to dramatically increase user engagement and retention. Instead of just searching for a product, the app had an uncanny ability to show consumers what they were most likely to buy, even if they didn’t know they needed it.

When PDD says they remain committed to providing customers with the lowest cost, they mean it. Instead of just promising a lowest price guarantee like Western retailers, PDD employs an automatic price tracking system that instantly lowers a seller’s price if it is found to be cheaper on another platform. Merchants tolerate such brutal tactics due to the large amount of volume that PDD offers with its approximately one billion active users. In less than a decade, PDD has grown into the second largest online retailer in China.

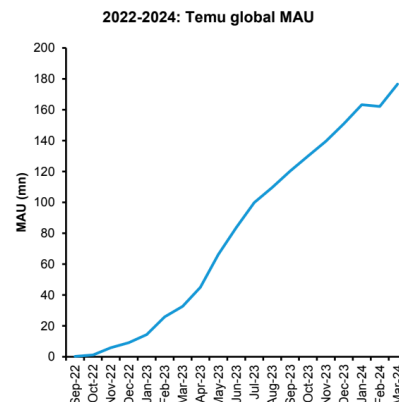
This is a stunning accomplishment given Alibaba’s strong lead in what is the most mature e-commerce market globally. PDD has an incredibly fast moving, flat management structure, with US\$35bn in sales and just 17,000 employees, it’s staying lean as it grows; its revenue per employee metric has quadrupled in the past five years.



What’s most interesting for Western investors was the September 2022 launch of Temu which was PDD’s move into international markets. Temu’s initial growth hack in the US was by shipping directly from China and keeping orders under \$800, it could avoid US tariffs that bulk semi-hosted peers like Amazon had to pay. A January 2023 Bernstein analysis showed a median 32% price savings on Temu vs Amazon for nearly identical items. The app went viral after Temu’s 2023 Super Bowl ad which told Americans that they could ‘shop like a billionaire’, a message that resonated strongly with lower income consumers. Similar to PDD’s initial China strategy, the app offered discounts for bringing on new users. The company continued to invest into their Temu fly-wheel with an estimated \$2bn in Facebook ads. Temu quickly became the most downloaded app in the US in 2023, a position it retains to this day. The marketing dollars appear well spent as Temu’s customer retention is double that of Walmart, Target and even direct Chinese peers like Shein. Temu wasn’t the first to identify the direct import loophole, (Shein and Wish had been taking advantage of it for over a decade), but Temu was able to execute best and became the biggest online discount retailer in the US in less than a year. Although the initial advertising campaign and generous subsidies at Temu meant that PDD was running their international operations at a loss, most analysts now believe the company is breaking even on a gross profit basis.

EXHIBIT 12: Temu MAU growth has continued at a high rate in the past year

There are certainly risks to owning a Chinese stock, especially as both US political candidates seem all but certain to significantly increase Chinese tariffs and even a potential Temu ban is not without question. We would counter that any tariff increase will be applied to all retailers, including Amazon. Secondly, Temu has been aggressively moving to a semi-hosted model (similar to Amazon) that does not rely on the tariff loophole and will greatly decrease shipping times. Interestingly, Amazon is now trying to copy Temu’s direct shipping strategy but we believe they will struggle to be as efficient as PDD and their consumers, trained for years to expect overnight shipping will be frustrated by the more than week long delivery times. Finally, although the US is Temu’s largest market, it is no longer the majority of its revenue and ultimately at today’s valuation and given the value of PDD’s aggressively expanding China business, investors are receiving Temu’s optionality at zero cost.



Source: Sensor Tower and Bernstein analysis.

As impressed as we are with the incredible execution of PDD, what made us willing to wade into the difficult waters of China was the incredible valuation of the shares. At the end of the second quarter and adjusting for current unrestricted cash, PDD was trading for just 8x 2025 GAAP estimates, with forecasted revenue growth of 29% and immense long term earnings potential as it increase its low ~6% take rate. While we are mindful of the risks, we view PDD as worthy of an appropriately sized position in the fund.

- Trevor Scott

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