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Call Participants

EXECUTIVES

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Investor Relations Director

Xueji (Jerry) Wang

Founder, CEO & Director

Yi (Alex) Yang

Co-Founder, CFO & Director

ANALYSTS

Tom Tang

Morgan Stanley, Analyst

Timothy Zhao

Goldman Sachs, Analyst

Kai Xiao

CICC, Analyst

John Roy

Water Tower Research, Analyst

Presentation

Operator

Good morning, and good evening, ladies and gentlemen. Thank you for standing by, and welcome to Tuya Inc.'s Third quarter 2024 earnings conference call.

I will now turn the call over to the first speaker today, Mr. Reg Chai, Investor Relations Director of Tuya. Please go ahead, Reg.

Reg Chai

Investor Relations Director

Thank you. Hello, everyone. Welcome to our third quarter 2024 earnings call. Joining us today are Founder and CEO of Tuya, Mr. Jerry Wang; our CFO, Mr. Alex Yang.

The third quarter 2024 financial results and webcast of this conference call are available at ir.tuya.com. A replay of this call will also be available on our IR website in a few hours. Before we continue, I refer you to our Safe Harbor statement in our earnings press release, which applies to this call, as we will make forward-looking statements.

With that, I will now turn the call to our Founder and CEO, Mr. Jerry Wang. Jerry will deliver his remarks in Chinese, which will be followed by a corresponding English translation. Jerry, please.

Xueji Wang

Founder, CEO & Director

Hello everyone, thank you for joining Tuya's Q3 2024 earnings call.

In the third quarter, we achieved our performance goals by prioritizing practical strategies and focusing on execution. Revenue growth accelerated to a 34% year-over-year increase. We maintained high operating efficiency, thus achieving a non-GAAP operating margin of around 9%. Our substantial interest income added to the bottom line, resulting in non-GAAP net profit margin of around 25%. These results were underpinned by the effective execution of our business strategies, coupled with ongoing efficiency initiatives that tightly controlled budgets and expenses, sustaining operating leverage as we did in last quarter. Next, I will dive into some details on our business performance in the quarter.

In the third quarter, all three of our business segments delivered solid revenue performance. IoT PaaS revenue increased by over 26% year-over-year, maintaining the steady recovery momentum. The Smart Solutions segment achieved over 100% year-over-year revenue growth. This was driven by strong market demand, particularly in the home appliance category, where we have consistently observed robust global demand throughout the year, aligning well with our product planning and market expectation. Our focus on energy-efficient products and solutions has significantly contributed to this revenue growth. Additionally, our close collaboration with key customers has enabled them to align their product planning and launches with market trends. Lastly, revenue from the SaaS and Other segment grew by approximately 17% year-over-year, with our core cloud software value-added services increasing by over 50% year-over-year.

In the consumer market, it is imperative for businesses to thoroughly understand and capture the core needs of end-users. We are dedicated to continuously launching innovative and competitive products, understanding our customers' business objectives, and building even closer partnerships. At the recently concluded 2024 IFA in Berlin, we unveiled numerous new product capabilities. By leveraging cloud-based dynamic algorithms and generative AI, we aim to significantly enhance the user experience and value of smart

products in terms of interaction, efficiency, and functionality. Additionally, in line with our philosophy of cultivating and understanding the industry, we have iterated and expanded a wide range of solutions and product portfolios across various home and commercial use cases. These encompass home energy efficiency, comfortable living spaces, pet care, [correction] safety and protection, sports and healthcare, entertainment and education, convenient mobility, and more.

Our global customer collaborations and expansion efforts progressed steadily in the third quarter. Our Dollar-Based Net Expansion Rate, which measures growth among existing customers, stood at 124%, a healthy and stable level. Our largest market, Europe, exhibited stable demand with smooth progress in partnerships with both new and existing clients. In other regions, we secured several key regional customers, including a leading private-label brand in Canada covering categories such as seasonal lighting and pet products, a top home appliance group in emerging markets like Brazil, and a well-known consumer safety brand in Chile. All of these are leveraging the Tuya platform for their strategic initiatives. Furthermore, in more mature markets the Tuya platform remains the preferred choice for enterprises aiming to enhance operational efficiency or transitioning from traditional systems to third-party platforms. We believe these customer-level developments exemplify the value and capability of the Tuya platform and reflect the favorable competitive landscape in which we operate.

We are also committed to building our developer community by striving to ensure that every developer interested in smart technology has access to the latest cutting-edge information. In the third quarter, we hosted two major developer conferences. The first was the inaugural European edition of the Tuya Global Developer Conference, held at the Berlin Exhibition Center during the IFA event, themed "Smart by Nature: Exploring the Synergy of AI and Sustainability." Partners such as AWS, and Tink, which is a well-known European e-commerce platform for comprehensive smart home solutions, discussed innovative applications of generative AI and practical implementations of sustainabilities. These discussions garnered significant attention from developers. Vestel, as one of Turkey's largest home appliance manufacturers, also shared success case studies.

At the end of September, during our Global Developer Conference in Suzhou, industry leaders such as Siemens and Haier Smart Home shared their visions of the future. They showcased how they leverage the Tuya Cloud Development Platform to build intelligent ecosystems, bringing green, digital, and smart home living experiences to users. By the end of the third quarter, the number of registered developers on the Tuya platform further increased, reaching approximately 1.26 million. Moving forward, we will continue to gain insights into market demands, consistently empower developers, and deliver more smart products that meet consumer expectations.

In the industrial and specialized channel markets, we continue to make progress as planned by developing and replicating benchmark projects. For example, our business model for telecom operators this year involves leveraging our Cube intelligent private cloud solution to initiate collaborations, combined with the delivery of core smart device categories. This approach is aligning with our expectations and has begun to see continuous implementation. The [correction] deployment among our telecom operator customer base is advancing steadily. We have signed new agreements with two leading operators in Thailand and Vietnam and are receiving consistent reorders for smart devices from existing customers who have already deployed our solutions. Additionally, our Home Energy Management System business has achieved substantial progress. We successfully secured the benchmark project with the Singapore Housing & Development Board, and over the next few quarters we will officially enter the product implementation and delivery phases for this project.

Overall, the third quarter of 2024 was a period of steady progress for Tuya as we executed on our established growth strategies to deliver robust financial results. This commitment has also brought us shareholder-level recognition. You may have seen yesterday's announcement. Over the weekend, 65 Equity Partners, an independently managed wholly-owned investment platform of Temasek, entered into an agreement with New Enterprise Associate, one of Tuya's key shareholders since our founding in 2014, to purchase approximately 13% of Tuya's total issued shares. This investment reflects their strong confidence in Tuya's vision and aligns closely with our international expansion strategy. The Asia-Pacific region, particularly Southeast Asia, is a rapidly growing emerging market, presenting enormous opportunities for us. We remain committed to seizing growth opportunities in international markets, advancing global AIoT, smart devices, and commercial and industrial applications, and delivering value to all our long-term shareholders. We are thrilled to welcome 65 Equity Partners, the investment platform of Temasek, as a significant shareholder of Tuya.

Lastly, we welcome our current Vice President of Finance, Claire Yan ZHANG, to the Board of Directors as an Executive Director. With her extensive experience in financial management and Big Four accounting firm Ernst & Young, Claire will bring valuable expertise to the Board, aligning with Tuya's commitment to diversity.

Now, I'll hand it over to Alex to provide further financial details.

Yi (Alex) Yang

Co-Founder, CFO & Director

Thank you, Jerry. Hello everyone, this is Alex. Now, I will discuss our financial results and provide more detail on the numbers not covered by Jerry. Please note that all figures are in US dollars and all comparisons are year-over-year unless stated otherwise.

In the third quarter of this year, our total revenue reached \$81.6 million, up 33.6% year over year. Most importantly, our P&L continued the trends established in Q2. Each business segment maintained a solid gross margin, reflecting the value of our products. This led to attractive gross profit growth alongside revenue growth. At the same time, we executed our business operations and product strategies with streamlined and limited operating costs and expenses. As a result, we achieved a solid non-GAAP operating margin, expanding from the break-even level of Q2.

Our IoT PaaS revenue in the third quarter was \$57.9 million, representing a year-over-year growth of 26.4%. Looking at product categories, our focus on home appliances enabled impressive year-over-year growth of around 40%, while other categories remained stable. Geographically, our global revenue structure was well-balanced. However, driven by increased energy-saving orders, Europe's revenue contribution saw a slight uptick this quarter. On the customer side, the scale of customers we served increased slightly compared to the same period last year, aligning with our focused strategy on customer expansion and service. As of the end of Q3 2024, our Dollar-Based Net Expansion Rate stood at a healthy 124%. We believe this demonstrates strong demand from our existing customer base for Tuya's products, providing a solid foundation for revenue growth and allowing us to confidently pursue new customers.

Q3's gross margin was 46%, remaining at a stable and healthy level compared to the same period of 2023. Since overall gross margin reflects the structural mix of margins across our business segments, it is influenced by the revenue composition of each segment. Looking at the components, the gross margins for all three of our revenue segments remained consistent with previous levels. The slight increase in PaaS gross margin and the slight decline in Smart Solutions gross margin were primarily due to product mix changes. We'll consider that as a regular one.

Regarding operating activities and expenses, I will provide a detailed view on a non-GAAP basis, which excludes certain non-business-related items to give a clearer picture of our operational efficiency. We continue to present our operating expenses primarily on a non-GAAP basis.

Before discussing non-GAAP operating expenses, I'd like to mention that in early September, following our Q2 operational profitability milestone, we adjusted the exercise price of options held by all employees to the current [correction] nominal value of our shares. We did this to thank our colleagues for their unwavering support as we navigated through cycles and reached new milestones. This one-time adjustment resulted in approximately \$10 million in additional one-time equity incentive expenses, of which \$9.5 million was recognized in this quarter's operating expenses, with the remainder to be amortized over the coming quarters.

Turning to operating expenses, in Q3 2024, our non-GAAP total operating expenses decreased by 5.9% to \$30.1 million from \$32 million a year ago. Following the near completion of team structure adjustments in the second half of 2023, our non-GAAP expenses have since stabilized year-over-year. Sequentially, our operating expenses in this Q3 increased by approximately \$2.3 million compared to Q2, primarily due to typical fluctuation in items on the expenses side and income side, such as tax refunds. As revenue grows year-over-year, we will adjust the budget accordingly as needed. Other non-personnel operating expenses, such as marketing and travel, have remained at relatively balanced levels.

Overall, we remain committed to efficient and focused business expansion to maximize and stabilize Tuya's profitability at this stage. This quarter, we achieved a non-GAAP operating margin of 9.1% and a non-GAAP net margin of 24.7%. Net margin exceeded operating margin due to the contribution of interest income, which is substantial due to our large net cash balance. While fluctuations in operating expenses may cause slight profit margin variations, we are pleased with our current profit levels and are optimistic about further improving operating leverage in the future.

In terms of cash, Q3's operating cash flow was a net inflow of \$23.9 million, reflecting our strong cash leverage. Our net cash balance increased to \$1,023.9 million, further strengthening Tuya's financial reserves and preparing us for future shareholder returns.

This concludes my presentation on the company's financial performance. With that, operator, we are now ready to take questions. Thank you.

Question and Answer

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) We will now take our first question from the line of Tom Tang from Morgan Stanley. Please ask your question, Tom.

Tom Tang

Morgan Stanley, Analyst

So thanks management for the questions and congratulations on a very strong result for the quarter. So I have two questions. First one is on the outlook for the fourth quarter. So if you could share some more color on it and if we have seen any changes in the customer behaviors after potential tariff increases in the US. And the second question is on the GPM. So our smart solution is a quite sizable amount in terms of our total revenue now. So do we expect GPM to stay stable over the next few quarters or if there's going to be some further changes due to the product mix changes? Thank you.

Yi (Alex) Yang

Co-Founder, CFO & Director

Yeah, sure. Thank you for that. And so for the question one, firstly, that we will mention that for Q3 for us will be a steady season, a steady growing season, which proved that our strategy on the business side and also the efficiency of our operations. So we continue to do that. And for Q4, right now, we see that positive season. But it's only like the 40 days, since 40 day passed for Q4 and also we have a long vacation in China. So that influenced majority of the manufacturers. So I will not have the clear visibility about entire Q4. But when we see that Q4, it's also a stable and steady and regular season for us. We continue chasing on that. So we are optimistic about what we can have in Q4 even without a precise visibility.

And speaking of the tariff issues from the United States, what we see here is that it's not the first time about the tariff. So that thing has already been going on for a couple of years. And so, maybe two things. The first one is that what we see that in the past few years. So, even the geopolitical situation, what we see here is that the customers already starting to relocate the supply chain. So we're already supplying that, which means that we're not impacted directly, but the customers always need to trade, always need to source and buy the products from wherever they need it in the world. We are just fulfilling that. That would be one thing.

And the second thing what you see is that, even as [our customers] located – relocat[e] the supply chains, the world still needs China so much. So no matter what, significant amount of the Chinese components [are] still shipping to the global supply chain. So that will be something. We just follow the flow. We just keep serving our customers either locally or remotely to their suppliers in whichever countries they located. So I think that would be one thing. So demand is still steady because end-users continue to use that. So they'll purchase wherever they can to find the best cost point to locate their own supply chain. And I think that's for question one.

And for question two, yes, you see that our three business segments, they are actually in two different vertical. And so we have to follow different business and common senses in this industry. So for the smart solutions, it will be so deeply bounded with the hardware. which means that I can never compare their gross margin with the software. It's totally different model. And, we think that the smart solution is so valuable because we help the customer to provide differentiation and provide very competitive new cutting-edge products and experience to the market to continue to enable them become the leader. So we'll enlarge the portion of the smart solution for sure and we really see the potential.

So through that the overall gross margin of the company will decrease gradually, but we consider that a very healthy way because each of the segment is competitive. So we are more concerned about the segments, not the overall gross margin. And in the same time that the growth of each of the segments doesn't require a significant increase in our expenses and costs, which means that we still

maintain a very good leverage to grow our overall business. So even though the gross margin rate is declined a little bit in the long run, but in the same time, the total amount of the gross margin [profits] will be able to provide enough benefi[ts] and profitability for the Company. That's it.

Operator

Thank you. Next question comes from Timothy Zhao from Goldman Sachs. Please ask your question, Timothy.

Timothy Zhao

Goldman Sachs, Analyst

Thank you management for taking my question. I have two questions here. The first one is regarding the IoT PaaS business. Just wondering if you can give us any color on your outlook on the downstream demand for the IoT PaaS business and any demand difference across different vertical or segments? And secondly, I'm pretty glad to see that we have anchor investors coming in this quarter and given that your margin is very quite stable and the Company also has ample cash resources, just wondering if you can share some idea about the future shareholder return policies, that would be great. Thank you.

Yi (Alex) Yang

Co-Founder, CFO & Director

Yeah, thank you for that. So for the IoT PaaS, for momentum, what we see here is that this year will be a rebounding year because the majority of the consumer electronic players or companies in the world starting to walking out from the cycle of the inventory – over-inventory issues starting from 2021, 2022. So it's a rebounding year. And what we see - the momentum among our customers is that they're really trying to reinvest and re-kick off the multiple projects, I mean, among every customer for the IoT field. So ready for future competitions and expansion. That would be one thing. So while you have more investment and the resources coming in these verticals, pretty sure that they will continue to grow, for the customer side.

And for Tuya's side, we continue to provide two drivers for the business. So first one is the product. And on the PaaS side, so we continue to expand to [m]any type of new use cases and scenarios across our categories. But most importantly, that we're starting to deploy and we're starting to provide some of the AI-based services for the customers to help them to build some AI-empowered devices or AI-empowered use cases for the end-users. So that can be kind of the killer App or key differentiations, a new feature that you can see in the market. So that will be one thing. So we use the product to be the driver with a new innovation, new technology.

And the second driver for Tuya is the customer expansion, especially on the enterprise level. So for that part, as you can see that we started to incubating our SaaS business around three years. That type of the solution is more focused on the enterprise level. Other than the consumer companies, consumer-related companies, the enterprise type of company or industrial solution providers are different type of the players in the market. So through that, we continue to have more and more customers in that fields, including the telecom carriers that including the projects we just shared along with the Singapore HDB for the government public apartments, around 1.3 [million] apartments in Singapore, so et cetera. That kind of industrial players and enterprise-level of the players will become our new growing forces and drivers for Tuya as well. So we continue to expand more and to come in deeper.

So that will be the PaaS growth. We maintain the optimism on this field because we have a very steady customer base, as you can see our DBNER and premium customer amounts. In the same time we continue to cover wider with new fields on the enterprise solution level. So that would be one thing.

And for question two, for sure that for the past 10 years since the beginning of Tuya, we always take the shareholders return as a high priority when we're operating the Company. And in this, Q2 will be the first time we issued a dividend. It's a special dividend for the shareholders like I mentioned in last quarter and it's not a regular one because we don't hit the annual profitability yet. But we don't want the shareholder to wait another two quarters. So we issued a special dividend, even it's a special one. We will consider the

dividend as a regular basis. So every year that more based on the non-GAAP profitabilities, we use that as a benchmark to evaluate how much we can return to the shareholders as a dividend. That's it. Thank you.

Operator

Thank you. Our next question comes from Kai Xiao of CICC. Please ask your question, Kai.

Kai Xiao

CICC, Analyst

So this is Ben from CICC Research and I have two questions. And the first question is about the SaaS sector, whose revenue growth accelerates in Q3. So could you give us some color on the growth drivers and future outlook for the SaaS sector? And another question is regarding the artificial intelligence. Could you give us some updates on the Gen AI monetization and future plan? And if there are some revenue contribution guidance that will be great. Thank you.

Yi (Alex) Yang

Co-Founder, CFO & Director

Yeah, thank you for that. For the SaaS, the key part is that we continue to identify the potential verticals that AIoT can help -- can provide values to get in the pain point with reasonable cost level. I think that will be the key part. So we consider that as a PSF (Problem-Solution Fit) stage, so which means that so we keep evaluating the market and to identify and figure out the right solution that fits it. So for the SaaS side, so right now we really see several very potential and scalable market direction there, including the hospitality. As I mentioned that like the recent project that we signed contract with HDB in Singapore, it's a hospitality solution we provided and combined with energy management. And energy will be another one -- another sectors, and outdoor will be another one, including logistics. So that will be the verticals we find the potential. And we really have some standardized solution proven and worked with the strategic customers as a pilot program. For that part, I think the space and the ceilings will come whether we're looking forward to duplicate the use cases with a similar type of the strategic customers in new fields. So that would be one thing. That will be the key drivers for SaaS.

And speaking of the AI, what we see is that right now, we are working on providing two types of services through AI. So one is that we will integrate the AI capability along with the hardware. So essentially, it become not smart devices but AI devices. So one of the typical use cases is the bird feeder. It's a bird house and come along with a camera and with a food container. You put it in the backyard on the tree, and then whenever one bird come in and then you get a picture or you get a selfie of the bird. [When] combining that with the AI algorithms that we coupled with AWS called 'Rekognition' -- it's the algorithm provided by AWS -- we integrate that into application, so the feeder not only take photos about the bird, but also telling you what's species, what is the behavior of this bird, and then you will be able to easily either to educate your children -- okay, let's try to learn the birds -- or you can show off while any rare species coming to your house rather than your neighbor's. So that would be one thing, becoming a nature -- native AI device.

Another direction is that, we're trying to provide some AI services on top of the device as a software-based level. So one thing is that when we combine Gen AI with pet devices, like the pet feeder in home, the feeders can [see] the behaviors of your pet, maybe your cat or your dog, and then and automatically generate different type of video footage and come along with the background music and then you will understand, okay, my cat and dogs in home right now, they're playing Game of Thrones, maybe Game of Paw. That type of interesting footage is generated by AI. So we can -- we'll start trying to provide that type of services on the software levels. And so with the existing what we call version one smart devices, we'll be able to have some AI-based experience. So that will be the two directions we're trying to pitch. And right now it's still in the pilot stage. So we still run some POC, still run some pilot customers, but not provide to everywhere. And also we consider very carefully about how we can monetize that, coming out naturally with the business model.

So in -- by end of this year or at the beginning of -- by end of this year and/or beginning of the 2025, and we'll be able to show more use cases, how we can turn the AI into application. And we believe that, that'll become one of the catalysts for Tuya and for overall IoT. And one of the key things uniqueness for Tuya is that right now, one of the largest challenge for AI is that what type of applications, what type of features is commercial, or has the space to commercialize. Because it's more like the -- right now, it's more like the trial tools, better to have, not must be. But an advantage for Tuya is that we have the device, we help the customer to build the device, so naturally, the device itself, when it's sold, you know that the end users buying that for the feature. And especially when the AI device come with a total different pricing point than the regular smart device, you know that people buying that for the AI. So since the beginning, we commercialized that. So I think that was a special one. So we try different type of the use cases and demonstrations and then we can easily testify that among my customers what type of things I can commercialize and bring that into scale. That's it. Thank you.

Operator

Thank you. Our next question comes from the line of John Roy from Water Tower Research. Please go ahead, John.

John Roy

Water Tower Research, Analyst

Thank you for taking my question and congratulations on a very strong quarter. If we could take a step back for a second, obviously, the revenue growth has been solid for the last couple of quarters and a lot of talk about enterprise. I was kind of wondering how long do you think this can continue? In other words, how much runway do you kind of see given the current markets do you have?

Yi (Alex) Yang

Co-Founder, CFO & Director

I think that, so talking about that, I would like to pull back a little bit about the visions why we started this company. And we believe that no matter it is IoT or AI, in the future, I mean, now around maybe after 10 years, it will be kind of fundamental technology, like the Internet right now, everything is Internet-connected. So -- and so when we're reviewing that the penetration of IoT or with AI, it's extremely low. So right now will be low single digit numbers. So if you have to ask me about the whether and how the business is going to moving forward to, I will say that in the next 10 years, maybe after 10 years, after 20 years, everything defaultly needs to be connected, needs to be smart. And we can imagine that.

So what we're doing is that we continue to enable those first-movers in their vertical fields to turn them into IoT-ready or into AIoT-ready. I think that will be the key driver for us. So that's why we -- all the investment we're doing is that how we can find the right use cases that make sense is for their vertical and we provide standardized easy-to-use toolkit for the developers and scale that. So I think that will be the key part.

John Roy

Water Tower Research, Analyst

Right. And as a follow-on to that, the investments you're making, do you feel like they're at a good level right now? Or do you feel like there's going to be a possible need to accelerate R&D in the coming years?

Yi (Alex) Yang

Co-Founder, CFO & Director

Yeah. So in the past two years, because we were facing a cycle back then. So we've already adjusted our strategies [correction] from a more aggressively invested expansion strategy into a more reasonable -- what we call micro-management. And so for this one, what

we've seen is that we've already stabilized our expenses and investment. So even inside the Company, we continue to invest in some new use cases, but it's still in a very reasonable level. And so we're looking forward to stabilize our profitability and our expenses rate.

Operator

Thank you. We've reached the end of the call, and I would now like to hand it back to the management team for any closing remarks.

Reg Chai

Investor Relations Director

Okay. Thank you again for joining our call today. If you have any further questions, please feel free to contact us or request through our IR website. We look forward to speaking with everyone in our next earnings call. Have a great day today. Thank you.

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