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EXECUTIVES

Reg Chai
Investor Relations Associate Director

Xueji Wang
Founder, CEO & Director

Yao Liu
CFO & Director

ANALYSTS

Yang Liu
Morgan Stanley, Research Division

Hongjie Li
CICC, Research Division

John Wang
Goldman Sachs, Research Division

Presentation

Operator

Good morning, and good evening, ladies and gentlemen. Thank you for standing by, and welcome to Tuya Inc.'s Second Quarter 2022 Earnings Conference Call. [Operator Instructions]

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

Reg Chai
Investor Relations Associate Director

Thank you. Hello, everyone. Welcome to our second quarter 2022 earnings call. Joining us today are founder and CEO of Tuya, Mr.Jerry Wang and our CFO, Ms. Jessie Liu. The first quarter 2022 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 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 corresponding English translations.

Xueji Wang
Founder, CEO & Director

Hello everyone and thank you for joining us on our second quarter 2022 earnings call. This is also our first earnings call after our dual primary listing in Hong Kong.

In the second quarter, our total revenue was $62.5 million, in line with the mid-point of our previous guidance range. Sequentially, we grew our total revenue by 13.1%. However, on a year-over-year basis, we recorded a 26.1% revenue decline as we lapped a period of robust growth across the IoT industry in 2021. In particular, our IoT PaaS business revenue increased to $47.6 million, up 13.9% sequentially but down significantly year-over-year. During the second quarter, global inflation continued to rise while the Russian-Ukrainian conflict raged on, triggering a tsunami that dramatically impacted the world economy. Although the latest CPI from the US came in at 8.5% in July-- lower than June and better than expected-- the number itself was still high.

High inflation impacts the economy, the industry value chain, and consumers' wallets, changing people's lifestyles and consumption habits. These changes have a long-term impact on the consumer discretionary sector. A recovery in consumer electronics will take an extended period. Meanwhile, we note that the downstream players in the IoT device industry chain, including IoT device brands, OEMs, and distribution channels, face massive inventory pressure from supply mismatches, which are expected to take longer to fix. As a result, our IoT PaaS business DBNER as of the end of the second quarter declined to 84%.

However, our other core business, the 2B-focused “SaaS and others” segment, remained strong for the sixth consecutive quarter since we completed our public listing, with revenue reaching $7.2 million, up 114.3% year-over-year. Our SaaS and others segment has sustained a year-over-year growth rate of over 110% for 10 consecutive quarters, despite the recent turbulence in the global economy.

Our gross margin in the second quarter was 42.8%. Our IoT PaaS gross margin was 42.5%, representing a slight improvement over the same period last year, and remained at a healthy level despite the headwinds.

Since the beginning of the second quarter, we have implemented several operational and business optimizations, as well as product and technology iterations. I will share some highlights here.

We also expanded our global brand customer base. For example, we added a Fortune 500 German business group, whose DIY retail channel private label shipments cover a wide range of segments such as electrical, lighting, outdoor and small appliances. Another customer is a leading U.S. consumer platform and listed company that offers more than a dozen consumer brands. We also partnered with a Top-tier Korean HVAC manufacturer with distribution in Europe, America, Asia, and the Middle East. In Mexico, we worked with a leading Mexican air conditioning brand that has integrated its suppliers and product systems to develop smart home appliances.

The number of our IoT PaaS premium customers, mainly existing customers, was 267 in the second quarter, down from 285 in the same period last year. The decrease was due to the issues I mentioned earlier as well as seasonality. This resulted in certain customers reducing their orders, thus falling below the premium customer revenue contribution threshold, which is $100,000 in the last 12 months. However, we also have new customers qualifying, including a top brand from North America that we announced in the fourth quarter last year, whose primary business is outdoor travel. The new customer has completed the product development and testing processes for various products, started trial production and shipments in the first quarter, and completed hundreds of thousands of units in the second quarter.

Next, I will share some updates on our SaaS and others segment.

During the first half of 2022, our commercial lighting and property SaaS achieved year-over-year growth of around 100% in the number of new brand owners acquired, new customer projects served, and new devices interfaced. The addition of these partners has effectively complemented our business further. For example, the factory of Aptiv, a leading global supplier of mobile electronics and automotive systems, completed an intelligent transformation through our commercial lighting SaaS. The transformation saves Aptiv at least 900 kWh of electricity per day with an energy-saving efficiency of over 70%. In addition, it enabled the factory to refine its lighting management in accordance with the different needs and working hours of each workshop. As such, the factory was able to improve the productivity of its production lines while saving energy. The commercial lighting segment itself has significant energy-saving potential. Going forward, carbon accounting, theoretical energy consumption analysis, events hub, and other similar functions will be our products' and business's key development direction.

Now let’s turn to the progress of our hotel & apartment SaaS sector. In the second quarter, we developed a baseline version of our domestic hotel SaaS that integrates voice and central control. On the foundation of the baseline version, we expanded our business to the new digital commercial circle vertical and optimized our products with more cost-effective features, such as room monitoring, e-gaming hotel, and advanced construction. For the overseas hotel SaaS, we started to scale our SaaS coverage, adding over a thousand new rooms. The hotel and rental segment is a market with clear industry leaders but is otherwise highly fragmented. Looking ahead, we will focus on industry-leading service providers and hotel groups, improve our product offerings, expand model use cases, and continue penetrating the industry leaders.

The real estate downturn in China during the second quarter affected our smart office and smart community SaaS solutions. However, by leveraging our solid software products and hardware device eco-system, the intellectualization projects being implemented by various real estate group customers that signed contracts with us before maintained smooth operations.

Moreover, we achieved solid progress in the smart industrial vertical. One of our new customers, LankJan Group, is a large enterprise specializing in the production of high- and low-voltage electric control sets. LankJan has been a long-term material supplier and high-quality partner of large-scale industrial enterprises. LankJan utilized our industry equipment management system to monitor and collect equipment operation data, such as temperature, current, and voltage of power distribution equipment, in order to assess electrical stability and safety and receive timely malfunction warnings. We also helped LankJan develop the power distribution energy efficiency management platform that can analyze the power distribution equipment's current, voltage, power factors, active energy, and other operating parameters. Based on the analysis, the jointly developed platform establishes a distribution energy efficiency model to conduct statistical analysis of electricity consumption for various purposes to improve the electrical parameters, effectively saving 6%-15% of electricity. Recently, when serving customers in factories and industrial parks, LankJan also developed needs for managing new energy sources such as photovoltaics in addition to utility power management. With our access and application expansion capabilities, we are currently helping LankJan build a full-suite energy management platform.

As for value-added services, our 2C VAS maintained its solid performance in the quarter, at the same time, demand for 2B VAS is also on the rise. For example, our OEM App and value-added services, such as the App function enhancement and related services as well as voice capability generation and launch services, grew more than 100% or even higher year over year. In addition, services such as "IOT certification" and "cloud development framework product" have also delivered solid performance. Such results indicate that in the current macro environment, customers and brands are still investing and are confident in the smart business.

Moving on to our smart private cloud product.

As of the second quarter, we have acquired exemplary private cloud customers such as a prominent Chinese integrated industrial investment group and a multinational electrical, electronics and automotive brand headquartered in Southeast Asia with one of the world's most extensive manufacturing and R&D facilities. The IoT project with China Gas that we previously announced is also progressing steadily as planned. Since its launch, we have achieved several milestones, such as completing the building of things model for gas solutions, rolling out a demo version, and introducing the development standards and instructions. As we expand our customer base, we see tremendous business opportunities from these industrial customers in their pursuit of smart solutions, and we will strive to convert them to our customers.

As one of our core long-term strategies, Cube smart private cloud underwent a series of product technology upgrades in the second quarter. We completed the optimization of the NB-IoT protocol for Cube. The protocol will help us better serve our industry customers as it features lower power consumption and higher coverage. It has been widely used in over 10 industries, including public utilities, logistics, warehousing, properties, and manufacturing. We also packaged the UI business into the SDK of the Cube App, which significantly accelerated customers' new App development process.

We are currently replicating the capabilities of the 9 mature categories under the Tuya public cloud system to the Cube solution to further enrich customers' device ecosystem choices and solution diversity. We completed the independent operation and maintenance system, which fully covers the IoT infrastructure, mid-operations, and business operations under the Cube solution, enabling the technical staff to better understand Cube's operations to quickly locate and solve problems.

As a cloud-neutral product, we have the advantage of addressing and optimizing the complex architectural adaptability for cross-cloud deployment in the standardization process. In addition, the security of setting up a cloud platform on different IaaS layers is also a challenge. In this regard, we replicated our experience with the Tuya cloud system and further enhanced the WAF and JVM reinforcement capabilities to give our customers a world-class security experience.

Lastly, it is worth noting that on July 12, ioXT, along with various authoritative experts, released the 2022 Global IoT Security White Paper, in which Tuya was nominated as the best security practice in the IoT industry. This nomination illustrated the industry recognition of our ongoing efforts in security compliance and further highlighted security compliance as one of the core competitive advantages of our platform.

These are our business progress and strategy developments in the second quarter. Overall, the severe challenges throughout the quarter are persisting, and we do not expect the economic downturn, high global inflation, supply chain inventory, and other issues to improve soon. However, our mission is unchanged: to actively leverage Tuya's technology and product strengths to explore new opportunities.

Finally on our internal management, the efficiency-centric initiatives we previously announced are already having a positive impact on our financial results, which our CFO Jessie will discuss in more detail.

Yao Liu
CFO & Director

That concludes the remarks by Jerry. Before I begin, please note that all amounts are in US dollars and all comparisons are on a year-over-year basis, unless otherwise stated.

As Jerry just mentioned, we continued to face a series of unprecedented challenges. Specifically, global inflation, a COVID resurgence in mainland China caused significant business disruptions and inconvenience, and macroeconomic headwinds further exacerbated downstream inventory backlog issues. Despite these challenges, we continue to focus on executing our efficiency improvement strategies towards our goal of prioritizing profitability and leverage our competitiveness to explore new long-term opportunities in the IoT industry.

Now I will provide a closer look into our financial results. For the second quarter of 2022, our total revenue was 62.5 million, within our previous guidance range and down 26.1% year over year. The decline was driven by a 38.1% year-over-year decrease in our IoT PaaS revenue, which was down to 47.6 million for the quarter.

Based on our own estimates gleaned from downstream and consumer discretionary industry sources, broad-based demand declined in a consistent trend with our revenue decline. Major markets, notably the U.S. and Europe, slowed significantly, whereas China grew slightly versus last year.

The smart consumer electronic sector is subject to fast-changing short-term demand, which is thus more susceptible to a slowing economy versus other sectors such as industrial, agriculture, automobile, and new energy, in which companies, especially those with large scale or in the electric vehicle sector, are more resistant to short-term downside risks. We are actively exploring opportunities to enter a wider range of these stable industries by leveraging our competitiveness and existing technology and ecosystem advantages.
Total gross margin and IoT PaaS gross margin for the quarter was stable at 42.8% and 42.5%, respectively, as we effectively implemented a series of business management and efficiency improvement initiatives.

Now, let's focus on our operating activities and the related expenses. Please note that we are presenting our operating expenses on a non-GAAP basis by excluding share-based compensation expenses from our GAAP numbers to provide better clarity on the trends of our actual operating-based expenses, so that you can review performance in the same way as our management team.

During the quarter, non-GAAP total operating expenses decreased by 21.1% to 49.1 million, from 62.2 million in the same quarter of 2021. Specifically, non-GAAP R&D, sales and marketing, and G&A expenses decreased to 33.8 million, 13.2 million, and 5.3 million, respectively, and other operating income, net, was 3.2 million. The significant improvement in the non-GAAP operating expenses was mainly due to the large decrease in the basic employee-related costs, such as payroll and benefits, partially offset by one-off additional costs arising from, for example, headcount optimization, and restoration and indemnification related to rental termination.

Our average salaried employee headcount during the quarter decreased by approximately 23% year over year. Dynamic adjustments will be made based on the current scale and the overall organization objectives to achieve further improvement, if any.

We optimized operations during the quarter, especially with two major initiatives to improve our technology research and development efficiency. Let me give you some examples. First, we established an R&D project review committee to carefully re-evaluate each of our R&D projects, and developed an itemized evaluation system to conduct value management from the aspect of "internal efficiency improvement", "key and core capability construction" and "opportunities and revenue generation". Approvals from the committee led by our CTO and heads of business units along with their refined budget models are required for projects be executed. Second, we completed the classification of R&D team resources into four types in order to allocate resources by type to our R&D objectives, thus managing R&D more efficiently.

We also optimized other aspects of operations. For example, in terms of inventory, we retired more than a thousand redundant material codes, improving the speed of system processes and laying a good data foundation for further in-depth operating analysis. We also launched a system function to collect service fees to recover the internal time costs incurred in executing less cost-effective mini orders, so as to promote order bundling and improve customer service efficiency.

Regarding employees, we launched an action plan named "100 Day Sprint" (in Chinese "百日火山"), to encourage our people to make accelerated progress. We also launched a "Project 360" evaluation project to help most potential employees to achieve outstanding improvement in workplace.

Now, turning to bottom line. Our non-GAAP loss from operations narrowed by 15.9% to 22.3 million in the quarter from 26.5 million in the same period of 2021, and our non-GAAP net loss narrowed by 19.1% to 18.7 million in the quarter from 23.1 million in the same period of 2021.

Our non-GAAP operating margin and non-GAAP net margin in the quarter were negative 35.6% and negative 29.9%, compared to negative 31.3% and negative 27.3% in the same period of 2021, respectively.

If we further exclude the one-time additional expenses related to operating efficiency improvement initiatives and expenses that were irrelevant to daily business operating activities, our non-GAAP operating margin and non-GAAP net margin for the quarter would improve to negative 31.2% and negative 22.7%, respectively, after a sequential decreases during last 3 quarters. This indicates that our measures to address market headwinds are showing early success.

Moving on to the cash. You can refer to our earnings release of operating cashflows during this quarter. Our operating cash flow, excluding the cash received from ADS Sharing program, has improved greatly to an outflow of 1.5 million in this quarter compared to the outflow of 7.2 million, 46.1 million, 53.2 million and 57.4 million for each quarter since last Q2 to this Q1. As of June 30, 2022, cash, cash equivalents, and short-term investments were 951.5 million. We believe this balance is sufficient to meet our liquidity and working capital needs for the foreseeable future. The sufficient capital reserves are one of our greatest advantages, giving us resilience to navigate adverse macro environments.

Finally, turning to our share repurchase program. During the second quarter, we repurchased approximately 11.2 million ADSs on the open market at a cost of approximately 30.0 million. Today is the end date of our share repurchase plan authorized on August 30, 2021. We have totally bought back 23.1 million of ADSs with total cost of US$109 million, which represents our commitment to shareholders and the market and shows our high confidence in Tuya's long-term growth prospects.

Before I close, I would like to emphasize that the global consumer discretionary industry and consumer spending are expected to be challenging in the second half, due to softening economic conditions, high global inflation, the downstream inventory glut, and greater competition brought on by technology iteration in the IoT industry or other factors that are outside of our control. You can refer to business outlook section in our earnings release for more details. Despite these challenges, we are confident in our long-term growth prospects and are committed to iterating our products and services, further enhancing our software and embedded hardware capabilities, expanding our customer base, diversifying our revenue streams, and further optimizing operating efficiency.

With that, operator, we are now ready to take questions. Thank you.

Question and Answer

Operator
[Operator Instructions] Our first question comes from Yang Liu from Morgan Stanley. Please go ahead.

Yang Liu
Morgan Stanley, Research Division

My first question is, what is the management's outlook in terms of the demand turning point based on the conversation with key customers, their business plan and inventory level. My second questions is, given the current demand is weak, is there any chance for Tuya to see a better demand helped by market share gains?

Yao Liu
CFO & Director

Thank you, Liu Yang. To address your questions, first, we haven't seen signs of a turning point of oversea demand for IoT device, consumer electronic device yet. We feel the turning point will only come when the inflation has significantly improved and the inventory backlog is cleared on the retailer and brand side. Let's take an overall look at the global economy and feedback from our customers.

In the United States, for example, according to the latest brand customer feedback, consumer electronics retail quantity is currently down 30% year over year on the retail side. The decline, combined with the retail channel and brand inventory backlog, pushed brands to a more conservative approach so they placed fewer orders to OEMs. It wasn't surprising to see OEM purchase orders from brands by quantity shrink as much as 50%.

In Europe, the European Central Bank raised interest rates by 50 basis points in late July to curb high inflation. This is Europe's first rate hike since 2011, just as Europe struggles with record inflation triggered by COVID, the war, and rising food and energy prices. According to Eurostat, Europe's annual inflation rate jumped to 8.9% in July, more than four times the ECB's inflation target of 2%. So we have seen that Europe is experiencing a significant weakening demand of discretionary product, which include IoT consumer electronic devices. So basically, our European customers are giving similar feedback as our U.S. customers.

In China, one of the more representative figures of Chinese consumer spending is the number of smartphone shipments. Based on the IDC report, shipments in the Chinese smartphone market declined by around 15% year over year in the second quarter. Also, based on numbers from the National Bureau of Statistics, total retail sales of consumer goods nationwide fell 4.6% year over year in the second quarter.

So overall, the global economy environment is becoming more complex and challenging. Energy and commodity prices were rising, and the imbalance between supply and demand is increasing, adding more downward pressure on the global economy. We think the weakening of demand for IoT consumer electronic devices will continue until inflation shows significant improvement. We will continue to work to improve our efficiency and continue to set break-even as one of our core priorities.

Regarding our business in China, we have highlighted several business opportunities earlier. Companies nationwide are facing challenges due to the resurgence of COVID during the second quarter. However, we still added many like-minded partners. For example, we helped the leading portable power energy storage brand Hello Tech Energy develop an outdoor portable power supply. We partnered with world-renowned smart energy system solution provider Chint Group to develop the prepaid electricity meter and management system. These partnerships will enrich our energy-saving related product capabilities from both software and hardware aspects. We believe these capabilities will further complement our core IoT business.

To fight against this quite negative environment of inflation and downward consumer demand, strategy is more to expand beyond consumer electronics. In terms of IoT PaaS, we are making progress in developing the business, for example, energy-related equipment IoT for commercial and industrial environments. In Q2, close to 2% of our current IoT PaaS shipments went to industrial equipment, outside of consumer electronics, including industrial sensing, professional lighting or commercial lighting, industrial energy reeservation prodcuts, commercial and industrial security products, and central HVAC equipment for large commercial buildings. At the same time, we are expanding our customer base beyond the consumer electronics devices industry through Cube and and multiple SaaS offerings. We believe that expanding beyond consumer electronics is a good strategy for the Company for the long term.

Operator
Thank you. Next question we have Hongjie Li from CICC. Please go ahead.

Hongjie Li
CICC, Research Division

In July, Tuya and Amazon Alexa lunched the Matter solution and expect to complete some operation test with other partners. So from the management's perspective, [inaudible] how do you see the potential impact on the industry? Thank you.

Yao Liu
CFO & Director

Thank you for the question. We can look at Matter from both a commercial and a technology development perspective.

As an early adopter of Matter and a key board member of the Connectivity Standards Alliance, Tuya has officially launched Matter-enabled solutions this year. Matter is a standard connectivity protocol that connects local smart home devices for common functionality. Simply put, using the Matter protocol, devices can be directly shared with the Apple Home kit or connected to different brands of smart speakers such as Alexa and Google Assistant without having to be interfaced in the development process to achieve basic local interaction. This will be very convenient for developers of IoT products. We believe such technological progress will further promote IoT penetration rate especially for smart home devices.

From a business and market perspective, there have been no significant technology or perception changes in the market over the past two years regarding connectivity protocols. Matter belongs to local general control, which cannot realize the cloud control and exclusive special functions with multi-device interaction, thus the experience differs greatly compared to the mature and mainstream Wi-Fi products nowadays. So, it is estimated that after the release of the specific speculation, it will take a period of time for adjustment and adaptation to evaluate its actual performance. Some of those IoT products with very simple, limited functions may choose Matter direct connection as the path to achieve IOT. Most products will have increasingly rich IOT capabilities and personalized demands, and thus cloud service will still be a rigid demand.

Overall, Tuya will incorporate Matter into our technology system based on Tuya's one-stop capabilities, including Wi-Fi, Thread, and especially Gateway and central controller, as well as our product-level solutions across all categories. While addressing the need for standard local connectivity features, our cloud-based IoT capabilities, software algorithms, and App capabilities will help make devices using the Matter protocol smart. In addition, our Matter solution will enable customers to achieve information transfer and OTA upgrades for stock devices directly through the Tuya IoT PaaS without having to re-build DCL servers.

Overall, we see Matter as a complement to the many protocols in the IoT industry. We have participated in various tests of Project Matter and brought first-hand information to our customers. We believe our customers will make the best choice for their products and businesses, which we can totally support. So this is our answer to the Matter question.

Operator
Thank you. Next question We have John Wang from Goldman Sachs. Please go ahead.

John Wang
Goldman Sachs, Research Division

We have been able to narrow the net loss under macro pressure, what's your plan for headcount in the second half this year and the cost control measures and also maybe can you refresh the roadmap and plan for net margin and [inaudible].

Yao Liu
CFO & Director

Thank you, John. In today's report we highlighted the impact of Q2 expenses on non-GAAP operating margin and non-GAAP net margin. Our efficiency and optimization initiatives in Q2 positively impacted the income statement and cash flow. Therefore, in the second half we will use the same approach to manage our operations and driving expense control, while exploring measures that can more efficiently support our operations, sales, products, and R&D systems.

Specifically, our organizational structure and internal adjustments are centered on the strategy we adopted at the beginning of 2022 to serve first the upgrade of product and research centered on the Cube smart private cloud offering, second the expansion of business in China, and third we formed the Tuya Plus iron triangle team structure to support our initiative to focus and get more KA customers. We have different goals and strategies for each stage of development.

We are also actively transforming and upgrading from a developer platform based on consumer electronics products, to using the accumulated experience and technical advantages of IoT PaaS. Platforms that serve the industrial, commercial, and industrial fields are targeted to implement key customer strategies. In the early stage of team restructuring and scale-up, we matched our personnel with positions based on general principles of suitability. After comprehensively evaluating factors such as business demands, stage of development, and demand characteristics, we assign teams and members with characteristics that provide targeted support and expansion. For example, with the private cloud, many customers need to combine many technical details with complex market needs, so we use an experienced sales manager, product manager and project manager together to systematically provide services from the perspective of pre-sales, solutions and delivery, breaking from the traditional conflict between personnel. We are following the same approach to R&D. More detailed efficiency measures have been discussed before, so I will not repeat them.

As for managing the other business units, the functions and teams of G&A are relatively simple to adjust. Improvements in human efficiency will in turn lower costs. On the other hand, because of our listing in Hong Kong this quarter, professional fees such as compliance and auditing will increase slightly in the future.

In general, in the future we strive to achieve an appropriate team size by operating and managing more efficiently, and through fine-tuning adjustments, while supporting our new strategies, developer platform products, basic capabilities, and R&D tasks. At our current scale, we will dynamically evaluate market demands and business expectations to ensure that efficiency, output and financial results are in line with our goal. So we will dynamically evaluate the size of the Company's employee number. So at the present, we still see a lot room to further optimize our operation efficiencies through different initiatives. And our goal to make the breakeven a top priority of the Company remain the same, so we will still work on all the different means to be able to achieve this goal as early as possible. Thank you. That's the answer to John's questions.

Operator

Thank you. I will now hand back to the management for closing remarks. Please go ahead.

Yao Liu
CFO & Director

OK. Thank you again for joining our call. 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 good day.