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EXECUTIVES

Reg Chai

Investor Relations Director

Xueji Wang

Founder, CEO & Director

Yao Liu

CFO & Director

ANALYSTS

Mingran Li

CICC, Research Division

Yang Liu

Morgan Stanley, Research Division

Timothy Zhao

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 2023 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, sir.

Reg Chai

Investor Relations Director

Thank you. Hello, everyone. Welcome to our Third Quarter 2023 Earnings Call. Joining us today are founder and CEO of Tuya, Mr. Jerry Wang; and our CFO, Ms. Jessie Liu.

The third quarter 2023 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 translation.

Xueji Wang

Founder, CEO & Director

Hello everyone, thank you for joining Tuya's 2023 Q3 earnings conference call.

Total revenue for the third quarter of 2023 reached \$61.1 million, marking a return to year-over-year growth since the industry and economic downturn at the end of 2021. Revenue grew an impressive 35.7% year over year, or approximately 43% when adjusting for exchange rate fluctuations. We again achieved a record overall gross margin of 46.7% for the second consecutive quarter. Our firm focus on cost reduction and operating efficiency improvement resulted in a 26.2% year over year decline in non-GAAP total operating expenses in Q3. More importantly, our non-GAAP net profit soared to \$10.1 million, an increase of almost 5.7 times sequentially, representing a net profit margin of 16.5%. Net cash flow from operations improved both year-over-year and sequentially, with a net inflow of about \$16.1 million. Our net cash position at quarter's end was a strong \$961 million, underpinning our long-term strategic development. Overall, the third quarter saw robust improvement across all key financial metrics, signaling a positive turning point as we navigate out of the industry's cyclical downturn. Despite persistent challenges like fluctuating exchange rates and subdued consumer spending, our impressive performance in Q3 underscores our readiness for the post-de-stocking cycle and a broader recovery in the IoT sector. As we look ahead, we are committed to expanding our quality customer base, enhancing product strength, and venturing into new markets beyond consumer electronics.

Let me now share more details about developments since the start of the third quarter. In terms of our customer base and competitive positioning, our IoT PaaS business has weathered nearly two years of industry downturn. During this challenging period, several competitors, particularly IoT divisions of large enterprises, exited the market due to limited competitiveness of their products and uncertain investment returns. This shift opened opportunities for Tuya, as we feel that we now have better global influence and competitiveness compared to two years ago, to attract more leading brands seeking efficiency, improved margins, and cost-effectiveness in third-party IoT platforms. We forged new collaborations with top-tier customers such as Midea for its overseas home appliance business, Haier and Bull for new energy product IoT platforms, and Bosch for smart door lock solutions.

Meanwhile, we won and serviced customers worldwide through differential strategies and innovative products. This approach solidified our competitive standing globally and enabled us to effectively cater to unique market demands. The integrated hardware and software solution product strategy we initiated this year is already yielding strategic new customer wins and scalable revenue growth. For example, like Europe, America, and Japan. We actively participate in the board of Matter and, with technology and products as our focus, are at the forefront of the global application and commercialization of Matter, complementing our IoT ecosystem and expanding our global influence in the IoT 2B services race.

In emerging markets like Saudi Arabia, our ability to provide cost-effective, customized solutions led to breakthroughs with two major operators. In Africa, our Net-Zero software and hardware integrated solutions, tailored to unique electricity pricing challenges, led to a POC order from a renowned supermarket chain with over 200 stores in South Africa. Importantly, our initial success in Africa can be repeated across the region. Furthermore, in South America, the Tuya developer platform successfully replicated our Chinese OEM model to support local manufacturing in Brazil, with leading thermostat and water purifier factories seeking our software solutions for device management systems.

We are optimistic about the e-commerce channel as a huge market for practical consumer electronic devices like smart electricals, sensors, and outdoor products, helping these lightweight categories achieve rapid promotion, distribution, and end-user aggregation. Over the past two years, we've consistently supported potential Chinese e-commerce brands in growing into leading brands. For instance, several Tuya customers are now prominent in Amazon's top 10 in smart sockets, outdoor sockets, and Bluetooth mini locks.

We are unwavering in our commitment to product focus, innovation, and improvement. In the third quarter, after 18 months of development, our laser sweeping robot vacuum solution reached mass production. Our low-power audio-video solution for smart door locks, benchmarked against industry leaders, also achieved mass production, with the pro version of our home door lock products' Q3 deployment volume increasing by over 100% year over year. We've also enhanced our overseas central control product line such as the U.S.-spec product matrix, and added industry capabilities for pre-installed market engineering installations in China. Our smart central control large screen, integrating local building intercom and cloud intercom capabilities, innovatively bridges indoor and outdoor intelligence.

We continue to strengthen our traditionally strong categories like smart electrical, which will remain significant contributor to the IoT consumer electronics sector in the long term. We're seeing downstream demand recover for these smart, light, practical IoT devices, and we're committed to helping customers seize opportunities. For example, we released a dual-band router smart socket solution to address the common issue of mixed-band routers, significantly improving the network pairing success rate and experience. Eightree, a customer of this solution, has seen its brand sales explode, now ranking in Top 10 on Amazon's platform.

We're actively working to expand beyond the field of consumer electronics, bringing Tuya's mature IoT capabilities to more specialized areas. In Q3, we further refined our new energy and outdoor transportation products. For new energy, we released an integrated APP supporting the storage, charge, and use of solar power, completing the energy management use case from "energy monitoring" to "energy load linked scheduling." Global leading photovoltaic brands like Aiko Solar and DMEGC (Hengdian Dong Ci Group) have chosen Tuya's IoT PaaS for their new energy storage businesses. In HVAC integrated products, Tuya's industry subsystems have basically achieved full functionality for mainstream industry demands and will soon form its closed-looped solution with its system hardware. As for outdoor products, our 4G cellular VCU central control product has landed on E-bike products.

Besides focusing on high-quality, innovative, and valuable products as our core competitiveness, we are meeting the emerging needs of large group private clouds through our Cube smart private cloud comprehensive solution. For example, we've made good progress in Southeast Asian real estate field.

Lastly, let's talk about the continuous growth of Tuya's foundational developer platform and ecosystem. In the third quarter, we focused intently on the foundational pillars of PaaS 2.0. These pillars encompass full-category interconnectivity, seamless interoperability, rigorous security standards, independent and manageable development processes, and distinct product differentiation. Our efforts were

channeled towards refining the developer experience, significantly enhancing both usability and operational efficiency. This strategic move has further empowered developers, granting them greater independence from the need for direct support from Tuya. In line with this, we have unified and restructured our official website, developer platform “iot.tuya.com”, developer site “developer.tuya.com”, and developer documentation center. Additionally, we launched a vibrant new developer forum at “www.tuyaos.com.” This platform acts as a dynamic hub, offering extensive resources and collaborative spaces where developers can exchange ideas, troubleshoot challenges, and unleash their creative potential. Marking a significant milestone, the number of developers registered with Tuya soared to about 909,000 by quarter end, reflecting an impressive year-over-year growth of approximately 40.5%.

We also emphasize the application and empowerment of the developer platform in the commercial sector. This approach is designed to empower our brand clients, enabling them to craft and refine bespoke “to B” solutions. A prime example of this strategy in action was at our Developer Conference this September, hosted at the Zhongshan station in China. During this event, we signed a cooperation agreement with Osram. With the advanced commercial functionalities of the Tuya IoT developer platform at our disposal, we are collaboratively guiding Osram in developing their own distinctive hardware and software integration. This Osram-branded solution encompasses areas such as entire homes and real estate, hotels, rentals, commercial lighting, and building management, among others.

In conclusion, I've shared with you today the concrete outcomes of our strategic initiatives in business and product development. These accomplishments are a testament to Tuya's dynamic response and strategic recalibration in response to the challenges we've faced over the past two years. As we approach the final stages of inventory normalization and witness the IoT consumer electronics sector steadily finding its footing, we're confident that our persistent efforts will yield sustained positive results. These strategies are expected to guide Tuya back to a path of healthy growth, ensuring we are profitable and efficient. Going forward, we are focused on striking a balance between growth and profitability, thus ensuring we create enduring value for our customers, the wider industry, our shareholders, and our dedicated employees.

That concludes my remarks. Next, I will hand over to our CFO Jessie to introduce our financial data.

Yao Liu

CFO & Director

That concludes the remarks by Jerry. As I review our results and provide more colors on the numbers, please note that all amounts are in US dollars and all comparisons are on a year-over-year basis, unless otherwise stated.

In the third quarter of 2023, our total revenue reached 61.1 million, up 35.7% year over year, and continued to show a strong sequential improvement over the past four consecutive quarters. Similarly, during the quarter, we were still under depreciation impact of the RMB against the USD, which adversely hit our total revenue by 7.3 percentage points.

Our IoT PaaS revenue in the third quarter was 45.8 million, a year-over-year increase of 48.1%. In terms of categories, in the third quarter, the most impacted discretionary consumer electronics categories over the past two years - smart lighting and electrical products - constituted the main force of this year-over-year rebound, with the segment revenue growing about 140% year over year. Small and big home appliance grew by 50% year over year. The third quarter of last year was the most severe time for downstream de-stocking, and the growth of this quarter benefited greatly from the end of the de-stocking cycle. Moreover, with the execution of product focus and enhancement strategies, our core product lines, such as vacuum robots, breakers, and home locks with technological depth, have grown by approximately 100% to 180% year over year.

Regarding customers, our third-quarter revenue primarily driven by the recovery in customer order size and improved customer revenue efficiency. Taking our main IoT PaaS business as an example, our premium customer's IoT PaaS revenue per customer in the third quarter increased by 56% year over year, and the same metric for ordinary customers also grew by about 49%. Overall, our platform and products served over 3,000 customers in the third quarter, with an average revenue per customer exceeding \$20,000, setting a new historical high.

Our Smart Device Distribution business - now maybe more aptly called IoT Smart Device Solution - achieved a revenue of 6.8 million in the third quarter, a year-over-year increase of 32.1%. With the continuous advancement and implementation of the smart device solution strategy, we are now quite proficient in this business model and continue to generate robust, scalable revenue. For instance, the Smart Watch solution alone secured about \$3 million of orders in the form of finished devices in Japan since this Q3, to be delivered according to customer demand schedules; the Smart Tag Locator solution also contributed significantly to orders and revenue, and so on.

Our SaaS and Others business had a revenue of 8.5 million in the third quarter, reflecting a 5% year-over-year decline. Excluding the exchange rate impact, the segment's revenue in the third quarter was relatively stable, showing a flat increasing trend year-over-year. As a collection of Cube smart private cloud, value-added services, and customized software and also various sub-segments of SaaS showed different trends according to business strategy and execution. For example, cloud storage value-added services contributed about \$2.5 million in revenue in the third quarter, maintaining a robust and continuous month-over-month growth; the acceptance and delivery of the Cube Private Cloud project generated over RMB5 million in revenue; custom development and some other “new customer number” based one-time value-added services decreased by about 15 to 20% year-over-year under the execution of our customer focus strategy. We focusing on expanding high-quality customers. Going forward, we anticipate a gradual shift in SaaS and Others business segment towards a more core-business-centric structure.

Regarding the overall revenue recovery in different regions, we have observed healthy growth in Europe, Southeast Asia, and Latin America.

Our blended gross margin in the third quarter was 46.7%, sustaining the historical high level for the second quarter. Each of the three business segments exhibited strong margin profiles. Notably, the gross margin of the Smart Device Distribution segment in the third quarter reached 26.9%, a substantial increase from 12.9% in the same period last year, setting a new historical high. We believe that gross margin is the most direct reflection of the value of our Smart Device Solution.

Moving on to our operating activities and the related expenses, we are presenting our operating expenses on a non-GAAP basis by excluding share-based compensation expenses and credit-related impairment loss from our GAAP numbers. We believe this provides better clarity on the trends of our operating expenses, aligning with how our management team reviews our performance.

In the second quarter of 2023, our non-GAAP total operating expenses decreased by 26.2% to 32.0 million from 43.4 million in the same period last year.

Our employee-related costs, excluding share-based compensation, declined by 28.9% year over year in Q3, and costs related to office and property leasing concurrently decreased by 13.9%. Collectively, these costs represented about 74% of the total of our non-GAAP operating expenses in Q3. As of now, our team size has been adjusted to a relatively stable state at just under 1,500 headcounts.

Marketing and promotion expenses decreased by 23.9% year over year. This disciplined approach to cost control of promotion expenses, coupled with the noteworthy rebound in revenue, serves as a testament to the importance of operating with efficiency. Travel-related expenses also decreased 20.4% year over year. As revenue returned to growth, we are ready to make investments in the business as needed to further pursue business opportunities, but the overarching premise is always to maintain a balance between business investment and profitability.

Additionally, in the third quarter, non-GAAP G&A related expenses overall increased, mainly due to routine compliance-related professional service projects, such as consulting fees, legal advisory fees, etc.

In the third quarter, we obtained about 13.1 million in financial income, mainly interest income. Our net cash included cash, bank demand deposits, as well as time deposits recorded as short-term and long-term investments, totaling 961.0 million. We believe these funds can well balance the company's short-term business working capital needs and long-term development requirements. For

example, we are evaluating some feasible plans related to our own office buildings and land use rights with the objective of achieving long-term cost savings and supporting the company's long-term operational needs.

Finally, as a result of our consistent efforts over several quarters, the Company's non-GAAP net income expanded significantly by 567% to \$10 million in the third quarter, a substantial turnaround from the negative 15.3 million in the same period last year. Similarly, our net operating cash flow also showed the same trend, increasing by 114% to 16.0 million in the third quarter, a huge improvement from the spend of 13.5 million in the same period last year.

Overall, the comprehensively improved financial results not only means that the major strategic direction we set last year and this year has helped us achieve continuous improvement in quarterly financial results, but also indicates that the Company is on the right track.

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

Question and Answer

Operator

[Operator Instructions] Our first question comes from Mingran Li from CICC. Please go ahead.

Mingran Li

CICC, Research Division

Thank you management for taking my questions. First off, congrats your strong performance. My query primarily concerns that the demand side and my questions are as follows. First is about the outlook for downstream demand in next year. And second is about PaaS, in PaaS which category showed the most growth potential and in our SaaS which downstream scenarios are comparatively more promising. My third question is that, what are the strategic strength and growth outlook across different global regions, thank you.

Yao Liu

CFO & Director

Okay, thank you. Firstly, overall, we have found that IoT consumer electronics are highly sensitive to inflation. During the year, high inflation from last year to earlier this year, the growth trend in discretionary electronic consumption which including IoT devices slowed down significantly compared to 2021. Afterward, although it reached a relatively stable new balance as inflation slowed, it was suppressed again, with a sharp rebound of inflation in like July, August, and September this year.

However, at present, we observe the end purchase of consumer electronics is in a moderately positive direction, which is in line with our expectation for long-term growth in IoT penetration. From the perspective of end sales specifically by region and categories, we observe the following. By categories, since October end the sales in all categories have recovered to some extent with household appliances especially robotic vacuum cleaners and security sensors, performing very well. Electrical product also showed a good recovery trend. However, lighting devices are still in a pretty weak demand situation.

In terms of the region, we found out Southeast Asia, South America, and also in Europe, the safety products are doing pretty well. And also other categories are gradually recovering in a pretty healthy direction. In China apart from home appliance and robotic vacuum, other categories are relatively weak. But the trend is upward since Q4. The US region shows overall relatively weak performance, but electrical and security categories are showing good signs of recovery.

Overall, each region according to its economy and the environment characteristics has different trends in end IoT electronics consumption. And we will continue to maintain communications with downstream customers to actually respond and seek opportunities according to different market situations.

However, it should be noted that our IoT PaaS revenue is affected by both the destocking cycle and end sales. We observe that the year-over-year performance of end sales in some categories is not completely align with our shipment downstream. For example, the lighting category showed relatively weak end sales in Q3 basically from our brands to consumers. But our shipments achieved a significant year-over-year growth in Q3 in terms of IoT PaaS. This is mainly due to the downstream repositioning their lighting inventory lighting products due to the large price difference between smart and non-smart versions were the most affected categories in terms of inventory destocking Q3 last year.

In terms of the downstream inventory, the overall situation is in line with our expectations. Combining Tuya's IoT PaaS shipments and sales in the same way as we previously did, we estimate that inventory held by downstream business, which includes OEMs, brands, and retail channels has decreased from over a year at its peak times to above four to five months now, and will further reduced by the end of this year, returning to a level of 2019. Therefore we feel that inventory destocking cycle is nearing its end and returning to a relatively normal state.

And in terms of the SaaS part, as we mentioned the SaaS and Others revenue has included several different products. We have seen great growth potential in Cube which we promoted this new product. It's a private cloud IoT software we prepared for large groups globally for those companies to realize their own IoT capabilities. This potential stems partly from Cube smart private cloud serving those large conglomerates. Allow it to reach revenue levels in million of US dollar when implemented to those large cooperates. Additionally, our cube strategic position is not only limited to just one-time private cloud to deployment. But in the long-term Cube is a tool and the bridge for establishing a long-term cooperation relationship with large key accounts for Tuya.

And once those large corporate installed the Cube cloud for themselves they would start to connect the IoT devices which all powered by Tuya to their own Cube. So we are confident that after the private IoT platform is built for those large corporates, we can unleash the value of Tuya's IoT capabilities and solutions generating subsequent long-term IoT services related revenues.

In SaaS and Others products, we are also optimistic about the hotel SaaS, commercial lighting SaaS, and smart real estate full-house SaaS product. The hotel industry with its massive room demand and the market segmentation offers immense potential for a vast number of non-luxury hotel brands seeking competitive differentiation. Smart hotel experiences such as intelligent ordering, contactless check-in, and room management are significant competitive advantages.

Commercial lighting given specific slightly needs and the potential for expansion beyond lighting to include energy-saving conservation and management undoubtedly has a huge market space. The real estate industry has been subdued in China in recent years. But looking abroad, leveraging our strong influence outside China, we have identified the demand for smart real estate and full home IoT solution needed this year in Southeast Asia and Australia markets. And we plan to start serving these regional customers next year with Cube products combined with full-house IoT solution and smart real estate solutions. And we have been signing contract with several large customers in Southeast Asia and Australia, including some very large distributor channels and the real estate conglomerate companies in those regions.

So this is my answer to the first question. Operator, you can move to next question.

Yang Liu

Morgan Stanley, Research Division

The first one is regarding the geographic breakdown. I would like to ask the management to provide more color on the contribution geographic contribution to Tuya, especially like the Southeast Asia, China, US and Latin America, Europe area. The second question is regarding the IoT SaaS business, because this quarter Tuya strategically give up some of the non-core SaaS and Others business. I would just like to confirm whether the approaches have come to an end or there is still some ongoing impact in fourth quarter. Thank you.

Yao Liu

CFO & Director

Okay, thank you, Yang. I'm happy to answer about regional revenue contribution question before that I want to give you a background. When we talk about the regional revenue contribution. We actually, the company do a lot of analysis to go through the the fundamental revenue contribution. For example, a European brand using Tuya's IoT PaaS to realize their IoT devices and then sell in European region, we will consider its ultimate revenue from Europe. But from the financial statement, because all the brands they provide orders, usually to China OEMs, and China OEMs give orders to us. From a financial statement, it will be a revenue from China OEM customers, but ultimately from Europe. So right now, when we're talking about the revenue contribution from region we're talking about the ultimate revenues from which region. So this is an analysis done by company, it's not 100% accurate, but it largely reflects the trend.

So based on our calculation analysis in Q3, Europe has becoming the largest revenue contribution region. It's around 30%. And China and the United States each contribute to just less than 20%, close to 20%. And Southeast Asia and also Australia, we call this region that basically excludes China, the Asia-Pacific, exclude China region has grown pretty well in Q3. And has grown to around 15% revenue contribution. And also the entire Latin America has shown pretty good trend in the last few years. So Latin America now contributes to the revenue just more than 10%. So that's the overall region contribution and we think this is a relatively balanced contribution. And we will continue to use our technology to serve the clients from all the regions and to have the corporates and consumers enjoy the value from the IoT technology.

In terms of the second question, the major transition in the SaaS businesses in the past, we have, we have certain revenue related to one-time customers needs. For example OEM APP, usually new brands, a huge percentage of new brands they would like to pay a one-time fee for OEM APP services. And also there is a customized software revenue from brand customers. So in the last two years, we have been focusing on, first is to focus on high-quality customers rather than huge numbers of new customers. So this one time new customer related OEM APP revenue decrease. And this will maybe continue one or two more quarters then will be stable. And in terms of the customization software revenue, we feel recurring software revenue, for example, like the cloud storage and SaaS revenue are more high-value software revenue we wanted. And also we want more developers to do the one-time customization work for brands for conglomerates customers. So we also have introducing those one-time revenue opportunities to developers. So that's why one-time revenue customize software income also decreasing. This is, this is pretty much stabilized right now. Going forward we believe when the the transition of SaaS and Others business stabilized, it will still continue a healthy growth.

So this is my answer to Yang's question.

Operator

Thank you. Next question comes from Timothy Zhao with Goldman Sachs. You may proceed.

Timothy Zhao

Goldman Sachs, Research Division

How does management see the competitive landscape in IoT industry and Tuya's competitive advantage and also the second question is what's the Company's plan in using of capital? Thank you.

Yao Liu

CFO & Director

Okay, thank you. We believe IoT market is vast with extensive future potentials. So we have been keep learning from the environment and improving our business model and we believe Tuya occupy a unique position in IoT industry and our advantages in the developer and open ecosystem primarily reflected the following aspects.

We broadly and inclusively support various devices types and the protocols cloud access models and OEM APP developments. Offering this to developers customers and partners with zero technical barriers for them, make it very user-friendly open for our customers and developers. So Tuya position as a neutral technology provider support customer and the brand in establishing their own IoT business and joining our huge ecosystems for interoperation user experiences. This comprehensiveness and the compatibility allowed Tuya to serve 95% of the global markets of independent commercial and brand customers.

We also tailor our own capabilities to customer needs. With a variety of products generating long-term revenue which this is our main product strategy. This approach is not confined to the OS-based model of cloud license module in IoT PaaS products, our key categories IoT device solutions nor is it limited to purely cloud development capabilities for SaaS development or private cloud deployments. Tuya prioritizes its platform ecosystem and the customer service strategy over rigid constraints of revenue model amounts our performance metrics. This allow us to cover a broader range of global customer with more diverse developer products, making the platform more user-friendly and open. So we believe this has been our key positioning and the value in terms of our accumulation in this industry for almost nine years.

And regarding the second question for the use of capital. In terms of capital usage, we maintain a rigorous approach in our operations, managing our funds and the budgets strictly and striving to preserve cash through safe, highly liquid fixed deposits or other monetary fund instruments, meeting the needs of daily operations and the long-term trend. Regarding capital expenditures, we will cautiously watch for suitable merger acquisition opportunities. Additionally, we might like other companies to invest in necessary fixed assets for long-term operations.

This is my answers to Goldman Sachs question. Operator, you can move to the next question.

Operator

There are no additional questions at this time. So I'll hand back to the management team for any closing remarks.

Yao Liu

CFO & Director

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 great day!