Vipshop Holdings
Second Quarter 2014 Earnings Conference Call Script
August 14, 2014

Operator:

Good day everyone and welcome to Vipshop Holdings' second quarter 2014 earnings conference call.

At this point, I would like to turn the call to Ms. Millicent Tu, Vipshop's Director of Investor Relations. Please proceed.

Millicent Tu:

Thank you, operator. Hi everyone and thank you for joining Vipshop's 2Q14 earnings conference call. Before we begin, I will read the Safe Harbor statement.

During this conference call, we will make "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 that are based on our current expectations, assumptions, estimates and projections about Vipshop Holdings Limited and its industry. All statements other than statements of historical fact we may make during this call are forward-looking statements. In some cases, these forward-looking statements can be identified by words or phrases such as "anticipate," "believe," "continue," "estimate," "expect," "intend," "is/are likely to," "may," "plan," "should," "will," "aim," "potential," or other similar expressions. These forward-looking statements speak only as of the date hereof and are subject to change at any time, and we have no obligation to update these forward-looking statements.

Joining us on today's call are Eric Shen, Chairman, the company's CEO and Co-Founder, and Donghao Yang, the company's Chief Financial Officer. At this time, I would now like to turn the conference call over to Eric Shen.

Eric Shen:

Hello everyone. Welcome to our second quarter 2014 earnings conference call.

We are happy to share our second quarter 2014 earnings results, which demonstrate our continued stellar growth both operationally and financially.

- We grew revenue by 136 percent year-over-year to 829 million,
- And we added 4.1 million new customers, closing out the quarter with 9.3 million total active customers
- Total orders on our platform also continued to grow in line with revenues to over 26 million in the second quarter.

Our chief focus in 2014 is to gain market share. Our success in growing both our customer base and total orders reflects our initial success for the first half of the year. Acquiring Lefeng fits into this strategy and has supported this push for greater market share. The integration with Lefeng has proceeded smoothly, and Lefeng contributed nearly 2.0 million total orders, and more than 1.3 million total active customers in the second quarter. We will continue to make disciplined investments in order to grow our business and market share both organically and through acquisitions when opportunities arise.

In accordance with our goal of expanding market share, we remain committed to improving our mobile offering. This reflects our long-held belief that our flash sales model is extremely well-suited for mobile.

With that in mind, we recently launched our first U.S. R&D center in San Jose. This facility will allow us to tap the deep talent pool of mobile and data mining engineers in Silicon Valley. By improving our R&D capabilities in the areas of Big Data, data mining, and machine-to-machine learning, we can focus on better tailoring and optimizing the shopping experience on our mobile platform.

At this point, let me hand over the call to our CFO, Donghao Yang, so that he may discuss our plans to further improve our operations and customer experience as well as this quarter's financial achievements.

Donghao Yang:

Thanks Eric and hello everyone.

Along with continuing to deliver strong growth in the second quarter, we have concurrently been working to further optimize our platform for customers and brands alike to support our goal of driving market share expansion in 2014. In line with our efforts of investing in R&D to optimize our mobile offering, we are also aggressively expanding head count in our IT team.. These investments reflect our strong belief that technology is key to expanding market share and scaling our business.

Furthermore, we are investing heavily in improving our fulfillment capabilities from both total capacity and automation perspectives. On the capacity side, we have reached a total warehouse capacity of 540,000 square meters and we are on track to meet our goal of reaching 700,000 square meters by the end of 2016. As we ramp up our technology investments and expand our IT team, we are keen to improve automation, reduce labor costs and shorten our inventory turnover cycle at our fulfillment centers.

As part of our overall commitment to customer satisfaction, we will continue to make strides in improving delivery times, optimizing brand portfolios and ensuring a customer friendly return policy. This theme has been particularly evident in the way in which we have built out our market place segment. In this new lucrative segment, we have closely monitored customer feedback and accordingly increased the bar for suppliers to sell on our platform in order to guarantee a high level of satisfaction that is in line with our established market reputation in our traditional business.

Our technology investments in mobile, R&D, headcount, and fulfillment characterize our overall product-centric strategy of expanding market share by offering the best possible experience in order to attract and retain customers. The superior customer experience we provide continues to drive our marketing through word-of-mouth referrals. However, in order to accelerate the growth of our customer base and take more market share we are also moderately increasing marketing spending in tandem with our technology investments, as we believe that our infrastructure can now scale and support accelerated customer growth.

Now moving on to our quarterly financial highlights, before I get started I would like to clarify that all the financial numbers presented today are in U.S. dollar amounts and all the percentage changes refer to year-over-year changes unless otherwise noted.

Total net revenues for the second quarter of 2014 increased by 136.1% to $829.4 million, the growth of which was primarily driven by a 167.9% increase in the number of total active customers and a 138.4% increase in the number of total orders.

Gross margin for this quarter further expanded to 24.8% from 23.5% in the prior year period and gross profit increased by 149.0% to 205.8 million. This improvement was driven by the increased scale of our business, leading to greater bargaining power with our suppliers as well as the development of our market place business. Moreover, we continued to see improvement in operating margins, as a result of improved economies of scale and increased operational leverage. More specifically:

- **Fulfillment expenses** increased by 95.8% to $83.8 million for the second quarter of 2014. As a percentage of total net revenues, fulfillment expenses decreased to 10.1% from 12.2% in the prior year period. The cost reduction was primarily due to our continued efforts to reduce warehousing and personnel costs, and negotiate better courier rates leveraging the growing order volume
- **Marketing expenses** increased by 196.7% to $44.8 million. As a percentage of total net revenues, market expenses increased to 5.4% compared with 4.3% in the prior year period, reflecting our strategy to continue expanding market share and building greater brand awareness.

- **Technology and content expenses** increased by 147.2% to $21.4 million. As a percentage of total net revenues, technology and content expenses remained stable at 2.6% compared with 2.5% in the prior year period.
- **General and administrative expenses** increased by 243.0% to $36.9 million. As a percentage of total net revenues, general and administrative expenses were 4.4% compared with 3.1% in the prior year period, primarily due to headcount expansion and the amortization of intangible assets resulting from the acquisition of Lefeng.

Driven by the growing scale of our company's operations, improved gross margin and cost control, **income from operations** increased by 251.3% to $23.7 million for the second quarter of 2014 from $6.7 million in the prior year period. **Operating income margin** increased to 2.9% from 1.9% in the prior year period.

Non-GAAP income from operations, which excludes share-based compensation expenses and amortization of intangible assets resulting from business acquisitions, increased by 349.4% to $42.9 million from $9.5 million in the prior year period. Non-GAAP operating income margin increased to 5.2% from 2.7% in the prior year period.

Our net income attributable to Vipshop's shareholders for the second quarter of 2014 increased by 192.1% to $26.4 million from $9.0 million in the prior year period. Net income margin attributable to Vipshop's shareholders, increased to 3.2% from 2.6% in the prior year period. Net income per diluted ADS increased to $0.44 from $0.16 in the prior year period.

Non-GAAP net income attributable to Vipshop's shareholders, which excludes share-based compensation expenses and amortization of intangible assets resulting from business acquisitions, increased by 263.6% to $43.0 million from $11.8 million in the prior year period. Non-GAAP net income margin increased to 5.2% from 3.4% in the prior year period. Non-GAAP net income per diluted ADS increased to $0.72 in the second quarter of 2014 from the $0.20 in the prior year period.

As of June 30, 2014, our company had cash and cash equivalents of $635.5 million and held-to-maturity securities of $558.9 million. For the second quarter of 2014, net cash from operating activities were $29.6 million.

Looking at our business outlook for the third quarter of 2014, we expect our total net revenues to be between $850 million and $860 million, representing a year-over-year growth rate of approximately 122% to 124%. These forecasts reflect our current and preliminary view on the market and operational conditions, which are subject to change.