Vipshop Holdings
Fourth Quarter and Full Year 2012 Earnings Conference Call Script
February 22, 2013

Operator:

Good day everyone and welcome to Vipshop Holdings' fourth quarter and full year 2012 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 4Q and FY 2012 earnings conference call. Before we begin, I will read the forward-looking 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 earnings conference call.

We are very proud to announce that we have achieved another major milestone for our Company by reaching GAAP profitability in the fourth quarter of 2012. This achievement, which came in well ahead of our initial schedule, further validated our strategy of balancing top-line growth while improving profitability at the same time.

Over the past year of being a public company, we have successfully and consistently executed upon a **new** and hugely successful e-commerce model that is **very different** from other industry players. As compared to conventional e-commerce business models like Ebay's or Amazon's, we have successfully proven there is a **new, third** e-commerce model that can provide **huge scale and** able to generate strong profit growth. By providing special offers and deep discounts on branded products, we have pioneered the online discount retail model in China and become the expert and leader trusted by our customers and brand partners alike. From our very beginning, we have focused on providing special offers that will delight our customers, building up a custom made end to end logistics and ERP system that ensures consistent on time delivery to our customers as well as a rapid cycle of inventory sell down to cash return for our brand partners. This early focus on building a scalable logistics platform, ERP, merchandising capabilities and trusted partnerships with the brands, as well as our major expansion in each of these areas over the past year since our IPO, we have created a huge lead ahead of any potential competitors looking to copy our new model.

The success of our model is clearly shown by the fact that we more than tripled our revenues to over US$692 million. This was driven by several factors including: total active customers were up more than 175% to over 4.1 million shoppers, total orders up over 200% to more than 21.9 million, of which we experienced a very high and stable rate of orders from repeat customers accounting for over 93% of all orders.

These are very powerful numbers underlying the strength of our business model, execution capabilities and industry growth dynamics.

At this point, let me hand over the call to our CFO, Donghao Yang so that he may discuss the general market and this quarter's achievements in greater detail.

Donghao Yang:

Thanks Eric and hello everyone. To begin with, I would like to elaborate on four highlights as we discuss the quarter in greater details.

Firstly, our solid results for the quarter and increased business scale;
Secondly, our proven strategy reflected in our improved operational efficiency and increasing leverage, and
Lastly, our logistics expansion strategy going forward.

To begin with, I would like to discuss our strong quarterly results. We are pleased with our exceptional growth in both top line and bottom line, which exceeded our prior expectations and consensus estimates. Net revenues for the fourth quarter of 2012 increased by 185% to US$299.6 million from a year ago. Moreover, we achieved a net income of $6.3 million during the quarter, reaching GAAP profitability for the first time in our company's history. This robust growth was driven by our concerted efforts in optimizing and expanding brand and product selection, sales events increase, as well as regional expansion with warehouse capacity built-out and sub-site additions.

We were able to further leverage the scale effects inherent in our business by attracting online shoppers as well as the brands aiming to target them. Looking at our two key drivers specifically, for the fourth quarter 2012, we grew our total active customers by 177% to 2.6 million and the number of total orders by 191% to 8.8 million. We continued to expand our brand partner base in a bid to increase our SKU portfolio while improving users' shopping experience. As of the end of 2012, we increased the number of brands on our sites to over 5,800 with top 10 brand partners accounting for less than 13% of our total revenues. This well-diversified brand base demonstrates our accepted value by many brands as an efficient platform to liquidate excess inventories while preserving the brands value.

More importantly, we are very pleased to see continued improvement in operational efficiency and leverage further demonstrating the effectiveness of our growth strategy and its execution. To give you an example, in the fourth quarter of 2012, we further expanded our repeat customers as a percentage of total active customers to over a new high of 72% from 69% a year ago. We believe these numbers truly reflected our high user stickiness and improving customer satisfaction as well as the rising brand awareness of the Vipshop platform.

Heading into the new year, we plan to leverage this strong foundation and remain focused on improving our special offers and shopping experience for customers, expanding our logistics platform that is unique to our business model, cementing brand partnerships, and increasing our specialized merchandising expertise. These advantages will further increase the significant barriers to entry and expand our leadership in China's booming online retail market.

Looking forward, we see expanding market opportunities ahead of us driven by China's growing population of online shoppers eager to buy branded products at bargain prices. Through our increased scale and improved operational efficiency, we remain confident in our capabilities to benefit from this surging demand, while delivering sustainable growth going forward.

Moving on to our quarterly financial highlights:

Net revenues for the fourth quarter of 2012 increased by 185% to US$299.6 million from US$105.2 million in the prior year. This tremendous growth was primarily attributable to a 177% increase in the number of total active customers to 2.6 million and a 191% increase in the number of total orders to 8.8 million over the quarter.

This user growth increase was primarily due to the Company's continued efforts to optimize and expanding brand and product selections, increase the number of sales events and increase the number of SKUs available on our websites. In addition, our regional warehouse expansion into Shanghai, Chengdu and Beijing has enhanced our ability to accommodate increased demand from end customers. With our distributed logistics facilities and regional sub-sites targeting specific markets, we have significantly improved our ability to target many shoppers in the underserved second and third tier cities, further increasing our market scale and footprint.

Like Eric highlighted earlier, this growth continues to demonstrate the network and scale effects associated with the value we provide to our growing base of brand partners and customers. As the market leader and a partner with a history of strong performance, Vipshop is able to negotiate gradually larger discounts, further decreasing product acquisition costs.

As a result, this led to **gross margins** further improving to 22.9% from 20.0% in the prior year period, and gross profit increasing by 227% to US$68.7 million.

Moreover, as we discussed earlier, we continued to see improvement in operating margins resulted from improved economies of scale and increased operational leverage with our business operation. More specifically:

- **Fulfillment expenses** increased by 91% to US$37.4 million for the fourth quarter of 2012 from US$19.6 million in the prior year period. This primarily reflects an increase in sales volume and number of orders fulfilled. As a percentage of net revenues, fulfillment expenses decreased to 12.5% from 18.6% in the prior year period and 13.9% in the third quarter of 2012. As we discussed over the last few quarters, this improvement is very noteworthy in that fulfillment expenses are not only the largest component of our operating expenses but also critical to the customer experience. This cost reduction was primarily due to the successful implementation of our distributed warehouse strategy and the strategy of shifting towards using regional and local delivery services. The sequential improvement in fulfillment expenses as a percentage of net revenues also reflected the seasonality associated with increased average revenue per order due to higher priced winter season products. We continued to expand our capacity to four warehouses which are strategically located in Shanghai, Beijing, Chengdu and Guangzhou. In addition, we continue to shift more fulfillment needs to high-quality regional and local couriers, lowering our fulfillment cost while shortening delivery times to our end customers.

- **Marketing expenses** increased to US$12.5 million from US$6.7 million in the prior year period. As a percentage of net revenues, marketing expenses decreased to 4.2% from 6.4% in the prior year period and 4.7% in the third quarter of 2012. As highlighted earlier, by maintaining customer satisfaction and high repeat customer demand, we are able to realize significant cost benefits associated with word-of-mouth referrals. In addition, with our disciplined marketing spend approach, we have been diligently evaluating the effectiveness of our various promotional measures to optimize our advertising ROI. We believe the continued decrease in market spending as a percentage of revenues further proves the effectiveness of our marketing strategy in driving sales and traffic.

- **Technology and content expenses** increased to US$6.3 million from US$3.0 million in the prior year period. As a percentage of net revenues, technology and content expenses remained stable at 2.1% compared with 2.8% in the prior year period and 2.1% in the last quarter. This is a part of our continued efforts to invest in our website and IT system to better support future growth.

- **General and administrative expenses** decreased to US$7.9 million from US$55.5 million in the prior year period, primarily due to decreased stock-based compensation expenses. As a percentage of net revenues, general and administrative expenses were 2.6% compared with 52.8% in the prior year period and 4.1% in the third quarter of 2012. The cost reduction reflected our Company's continued cost-control efforts and increased operational leverage.

Driven by the growing scale of our Company's operations, improved gross margin and costs control, we realized US$5.4 million in **income from operations** for the fourth quarter of 2012. This is compared to a loss from operations of US$63.5 million in the prior year period. Operating income margin was 1.8%, compared to an operating loss margin of 60.3% in the prior year period and an operating loss margin of 2.1% in the third quarter of 2012.

Non-GAAP income from operations, which excludes the impact of share-based compensation expense, was US$7.2 million, compared to a non-GAAP loss from operations of US$11.1 million in the prior year period. Non-GAAP operating income margin was 2.4%, compared to a non-GAAP operating loss margin of 10.6% in the prior year period and a non-GAAP operating loss margin of 0.7% in the third quarter of 2012.

Our **net income attributable to ordinary shareholders** for the fourth quarter of 2012 was a positive US$6.3 million, compared to a net loss attributable to ordinary shareholders of US$63.5 million in the prior year period. **Net income margin** was 2.1%, compared with a net loss margin of 60.4% in the prior year period and a net loss margin of 0.9% from the third quarter of 2012. Net income attributable to ordinary shareholders per diluted ADS was 12 US Cents compared to a net loss attributable to ordinary shareholders per diluted ADS of US$2.75 in the prior year period.

Non-GAAP net income attributable to ordinary shareholders, which excludes share-based compensation expenses, was US$8.1 million compared to a non-GAAP net loss of US$11.2 million in the prior year period. Non-GAAP net income margin was 2.7% compared with a non-GAAP net loss margin of 10.6% in the prior year period and a non-GAAP net income margin of 0.4% from the third quarter of 2012. Non-GAAP net income attributable to ordinary shareholders per diluted ADS was 16 US Cents compared to a non-GAAP net loss attributable to ordinary shareholders per diluted ADS of 48 US Cents in the prior year period.

As of December 31, 2012, the Company had **cash and cash equivalents** of US$124.5 million and Held-to-maturity securities of US$86.1 million.

For the fourth quarter of 2012, **net cash from operating activities** was US$86.0 million.

Lastly, I'd also like to update you on our warehouse capacity expansion strategy. We are in the process of moving into the new leased facility in Guangzhou. This move, once completed in the first half this year, will more than double our warehouse capacity for the southern China market to approximately 90,000 square meters. We are confident in our ability to carry out this continued expansion plan as we aim to keep up with growing demand for 2013.

Looking at our business outlook. For the first quarter of 2013, we expect our net revenues to be between US$265 million and US$270 million, representing a year-over-year growth rate of approximately 162% to 167%. These forecasts take into consideration the seasonality associated with the Chinese New Year holiday period and reflect our current and preliminary view on the market and operational conditions, which are subject to change.

With that, I would now like to open the call to Q&A.