Vipshop Holdings
Third Quarter 2013 Earnings Conference Call Script
November 12, 2013

Operator:

Good day everyone and welcome to Vipshop Holdings' third quarter 2013 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 3Q13 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 third quarter 2013 earnings conference call.

We are proud to report another solid quarter of strong revenue growth and margin expansion. Total active customers increased by 132% year-over-year to 4 million and total orders increased by 116% year-over-year to 11.7 million This drove a 146% year-over-year increase in our total sales to 384 million dollars. Moreover, despite the third quarter traditionally being a slow season, we were still able to continue to expand our gross margin and increase our overall profitability.

At the same time, we continued to make solid improvements in scale, warehousing capacity, merchandizing and logistical expertise and mobile capabilities, further strengthening the foundation of our distinguished discount retail platform.

Looking ahead, we will continue to focus on strengthening our market leadership and expertise in online discount retail and capitalize on the robust growth of online retail sector in China. We are very confident in our ability to leverage our assets to embrace future opportunities and are committed to ensuring Vipshop is a long-standing leader in China's discount retail market.

At this point, let me hand over the call to our CFO, Donghao Yang so that he may discuss some new growth initiatives as well as this quarter's financial achievements.

Donghao Yang:

Thanks Eric and hello everyone.

We are extremely pleased about our solid financial and operational results. As Eric discussed, although the third quarter is a seasonally low season, we were still able to expand our gross margin to 24.2% thanks to the pronounced scale effects in our growing business. Moreover, since we achieved positive non-GAAP net income one year ago, we have continued to successfully increase our profitability, achieving 3.9% non-GAAP net margin this quarter. We believe these results are a testament to the strength of our reputation as a channel for brand partners to monetize overstocked products and for customers to purchase discounted quality products, as well as our improving ability to control costs and achieve greater operational efficiency.

Moving on, I would like to update you with our progress in some key growth areas/initiatives.

I'd like to start by highlighting some of the progress we have had on the mobile front, a key initiative we have been building out for the past few quarters. Our mobile sales as a percentage of total revenues have increased to 15% in the third quarter, up from 12% last quarter. As discussed in last quarter's earnings, strong growth on this platform is due to two key underlying factors: first, the nature of the flash sale model is well-suited for mobile shoppers making quick on-the-go decisions, and second, our improved aesthetic interface provides users with an easy to use and reliable way of quickly purchasing products. Such improvements have further helped to increase overall customer interaction and stickiness on our platform. We will continue to invest in building-out and refining this platform, and place a greater focus on improving the integration of our partners' e-payment solutions in order to increase orders and mitigate payment risk.

In addition, in order to keep up with our rapid growth, we are moving forward with expanding warehouse capacity. We recently moved our North China warehouse from Beijing to a more spacious facility in Tianjin, and also relocated our Chengdu warehouse to another facility for the same purpose. These relocation initiatives have put us at approximately 290 thousand square meters of warehouse capacity across our 4 regional warehouses in China. Looking beyond 2013, we recently commissioned GLP to construct a 130 thousand square meter build-to-suit warehouse facility, which we will lease, in Kunshan, a city near Shanghai. We are planning to commence construction on two additional warehouses in early 2014, in Guangdong and Hubei, providing us another 300 thousand square meters and allowing us to increase overall warehouse capacity to 700 thousand square meters by 2016. The Guangzhou and Hubei facilities will be built to own and we estimate they will require a capex of approximately $200 million USD over the next 3 years. This is an important investment to allow us to increase the scale of our operations as we continue to see greater demand for products over our platform and improve the efficiency of our logistics for both incoming and outgoing inventory. This expansion in our fulfillment system will also allow us to further strengthen our fulfillment and warehousing management expertise, which we believe will remain as one of the key barriers to entry and competitive advantages our company enjoys over our competitors and any new entrants.

To conclude, we believe that our strong internal capabilities and multifaceted growth strategies coupled with the large, macro-trends of middle class expansion and e-commerce growth in China position us optimally to achieve sustainable long-term growth.

Now, moving on to our quarterly financial highlights:

Before I get started, I'd like to clarify that all the financial numbers we are presenting today are in USD amounts and all the percentage changes refer to year-over-year changes, unless otherwise noted.

Total net revenues for the third quarter of 2013 increased by 146.1% to 383.7 million. This tremendous growth was primarily driven by a 131.7% increase in the number of total active customers to 4 million and a 115.6% increase in the number of total orders to 11.7 million.

Gross margin for this quarter further expanded to 24.2% from 22.3% in the prior year period, and gross profit increased by 167.4% to 93.0 million. This improvement was driven by the increased scale of our business leading to greater bargaining power with our suppliers. Moreover, as we discussed earlier, 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 103.2% to 44.1 million for the third quarter of 2013. As a percentage of total net revenues, fulfillment expenses decreased to 11.5% from 13.9% in the prior year period. This cost reduction was primarily due to the successful implementation of our distributed warehouse strategy as well as our ongoing shift to high-quality regional and local couriers, both lowering our fulfillment cost and shortening delivery times to our end customers.
- **Marketing expenses** increased by 137.7% to 17.4 million. As a percentage of total net revenues, marketing expenses decreased to 4.5% from 4.7% in the prior year period. Despite some one-time marketing spending on brand advertising surrounding our sales event in July, we still remain focused on word-of-mouth referrals. Going forward, we will continue to take a disciplined approach to managing our marketing expenses, leveraging the benefit of this low-cost solution which brings a higher ROI.
- **Technology and content expenses** increased to 9.6 million. As a percentage of total net revenues, technology and content expenses were 2.5%, compared with 2.1% in the prior year period. This increase reflects our accelerating efforts to improve our IT infrastructure and build-out our mobile ecommerce platform to better support future growth.
- **General and administrative expenses** increased to 11.9 million. As a percentage of total net revenues, general and administrative expenses decreased to 3.1% from 4.1% in the prior year period. 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 cost control, **income from operations** increased to 12 million for the third quarter of 2013. This is compared to a loss from operations of 3.3 million in the prior year period. Operating income margin was 3.1%, compared to an operating loss margin of 2.1% in the prior year period.

Non-GAAP income from operations, which excludes share-based compensation expenses, increased to 15.1 million, compared to a non-GAAP loss from operations of US$1.2 million in the prior year period. Non-GAAP operating income margin increased to 3.9%, compared to a non-GAAP operating loss margin of 0.7% in the prior year period.

Our **net income** for the third quarter of 2013 was 12 million, compared to a net loss of US$1.5 million in the prior year period. **Net income margin** increased to 3.1%, from a net loss margin of 0.9% in the prior year period. Net income per diluted ADS increased to 21 US cents, from a net loss per diluted ADS of 3 US cents in the prior year period.

Non-GAAP net income increased to 15.1 million from a non-GAAP net gain of US$0.6 million in the prior year period. Non-GAAP net income margin increased to 3.9% from 0.4% in the prior year period. Non-GAAP net income per diluted ADS increased to 26 US cents in the third quarter of 2013 from 1 US cent in the prior year period.

As of September 30, 2013, our Company had cash and cash equivalents of 279 million and held-to-maturity securities of 202.7 million. For the third quarter of 2013, **net cash from operating activities** was 98.6 million.

Looking at our business outlook. For the fourth quarter of 2013, we expect our total net revenues to be between 580 million and 590 million, representing a year-over-year growth rate of approximately 94% to 97%. These forecasts 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.

Closing Remarks from Donghao Yang:

Thank you for taking the time to join us and we look forward to speaking with you next quarter!