Vipshop Holdings
Third Quarter 2012 Earnings Conference Call Script
November 14, 2012

Operator:

Good day everyone and welcome to Vipshop Holdings' third quarter 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 3Q 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:

We are very excited to announce that we have achieved net income profitability on a non-GAAP basis for the first time in our company's history. Our success was led by our exceptional financial and operational results across the board, proving the value proposition we provided to our both consumers and brand partners. During this quarter, we continued to deliver robust operational growth with total orders growing by over 158% year over year to 5.4 million and active customers growing by over 174% to over 1.7 million. This incredible growth in our two key metrics continues to demonstrate the network and scale effects inherent in our flash sales model. As we continue to increase our sales events and product selections, we are able to attract more brands which want to partner with the biggest player, which in turn, further drives user traffic towards our sites.

Moreover, we believe that this achievement is a testament to our proven execution capabilities of not only rapidly expanding our business scale but also of consistently improving our bottom line. Through growing leverage in our business model and improved operational efficiencies, we continue to expand our gross margin and reduce operating expenses as a percentage of revenues even during this quarter, which is our seasonally low quarter. Donghao will give more details on this later.

As China's e-commerce ecosystem continues its rapid expansion, we remain focused on providing our retail partners efficient and top-notch experience in monetizing their merchandise while preserving their brand identities. As of October 2012, we have significantly increased the number of brands on our sites to over 5,000 from around 3,400 at the end of June. Having succeeded in emerging out of China's competitive e-commerce industry, Vipshop has become one of the premier sales channels for brands in China. Building upon our expanding business scale, which, in turn, is increasing the barriers to compete against us, we believe that Vipshop is poised to become China's premier e-Commerce destination for Chinese shoppers seeking branded products at attractive prices. .

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

Donghao Yang:

Thanks Eric and hello everyone. Today, I would like to share with you three highlights as we discuss the quarter in greater details.

Firstly, our expanding leadership position in China's evolving e-Commerce industry; Secondly, our solid results for the quarter and improved operational leverage, and lastly, our logistics expansion strategy going forward.

As Eric highlighted earlier, we reached a major milestone in achieving profitability this quarter, a rarity in China's competitive e-commerce space. During this summer, which is our seasonally low quarter, not only did our revenue growth exceed our expectations, but we were also able to further expand our gross margin to 22.3%, and reduce fulfillment expenses as percentage of revenues to 13.9%.

This growth has further demonstrated the strength and scalability of our business model. As brand savvy shoppers increasingly search for good deals on products from their favorite brands, Vipshop has increasingly become the default shopping destination for our 1.7 million customers. To give you an example, according to iResearch, for the first half of 2012, Vipshop had the highest monthly repeat purchase rate amongst all the e-Commerce companies in China at 82.4%. This is far ahead of the industry average and our closest competitors. Defined as the number of repeat customers as a percentage of total active customers, this metric clearly showcases the growing loyalty and satisfaction customers have towards our website.

In addition, the strong growth in traffic and sales volume has enabled us to continue to realize economic benefits as our business scales rapidly. With the right strategies in place, we continue to garner increased bargaining power with brand partners and logistic partners, as well as enhanced utilization of our warehouse capacity, resulting in further improvement in margins across the board.

As China's retail and e-Commerce industries continue to expand alongside its growing middle class, we remain well positioned to benefit from these long-term secular growth trends. By providing the increasingly affluent Chinese with their desired retail products at attractive prices as well as being a viable option for leading labels to quickly monetize their inventories, we are confident our market leadership will continue to strengthen.

Moving on to our quarterly financial highlights:

Net revenues for the third quarter of 2012 increased by 197% to US$155.9 million from US$52.5 million in the prior year. As Eric discussed earlier, this tremendous growth was led by the strength in our two key metrics. Specifically, total active customers increased by 174% to 1.7 million and the number of total orders increased by 158% to 5.4 million over the quarter.

This increase was primarily due to the Company's addition of several regional sub-sites in 2011, as well as continued efforts to optimize brand and product selections, increase the number of sales events and increase the number of SKUs available on our websites. In addition, the Company's 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 websites targeting specific markets, we have significantly improved our ability to access many underserved second and third tier cities greatly 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 22.3% from 19.0% in the third quarter last year and gross profit increasing by almost 250% to US$34.8 million.

As you can see, our top line growth has been quite strong, but at the same time, we have been able to tightly control our total operating expenses which increased by ONLY 39% year over year to US$38 million. More specifically:

- **Fulfillment expenses** increased by 90% to US$21.7 million for the third quarter of 2012 from US$11.4 million in the prior year period. This primarily reflecting the increase in sales volume and number of orders fulfilled. As a percentage of net revenues, fulfillment expenses decreased to 13.9% from 21.8% in the prior year period and 15.2% in the second quarter of 2012. As we discussed last quarter, 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. We have expanded 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 local couriers, lowering our fulfillment cost while improving delivery times to our end customers.

- **Marketing expenses** increased to US$7.3 million from US$4.6 million in the third quarter last year. As a percentage of net revenues, marketing expenses decreased to 4.7% from 8.7% in the third quarter last year and 4.9% in the second quarter of 2012. We believe this further proves the effectiveness of our marketing strategy in driving sales and traffic through a disciplined marketing spend approach. As Eric highlighted earlier, by maintaining customer satisfaction, we were able to realize the significant cost benefit of word-of-mouth referrals. This has allowed us grow our customer base with limited investment in sales and marketing while enhancing our brand reputation at the same time. In addition, we have been diligently evaluating the effectiveness of our various promotional measures to optimize our advertising ROI, whereas many of China's largest e-Commerce companies have to spend aggressively, eroding profitability in order to sustain their user traffic growth.

- **Technology and content expenses** increased to US$3.2 million from US$1.2 million in the prior year period. As a percentage of net revenues, technology and content expenses remained stable at 2.1% compared with 2.3% in the prior year period and 2.0% in the second quarter of 2012. 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$6.3 million from US$10.4 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 4.1% compared with 19.7% in the prior year period and 4.1% in the second quarter of 2012. The cost reduction reflected our Company's continued cost-control efforts and increased operational leverage.

Moving on, our **loss from operations** for the third quarter of 2012 was US$3.3 million, compared to a loss from operations of US$17.4 million in the prior year period reflecting the growing scale of our Company's operations, improved gross margin and costs control. Operating loss margin improved to only 2.1% from 33.2% in the prior year period and 4.0% in the second quarter of 2012.

Non-GAAP loss from operations, which excludes the impact of share-based compensation expense for the third quarter of 2012 decreased to US$1.2 million, from US$10.7 million in the third quarter of 2011.

Non-GAAP operating loss margin improved to only 0.7% from 20.3% in the prior year period and 2.8% in the second quarter of 2012.

Our **net loss attributable to ordinary shareholders** for the third quarter of 2012 decreased to US$1.5 million from US$17.5 million in the third quarter of 2011. **Net loss margin** improved to only 0.9% from 33.4% in the prior year period and from 4.3% from the second quarter of 2012. Net loss attributable to ordinary shareholders per diluted ADS was 3 US Cents compared to 76 US Cents in the prior year period.

Non-GAAP net income attributable to ordinary shareholders, which excludes share-based compensation expenses, was a positive US$641 thousand compared to a non-GAAP net loss of US$10.8 million in the third quarter of 2011. Non-GAAP net margin was 0.4% compared with a non-GAAP net loss margin of 20.6% in the third quarter of 2011 and a non-GAAP net loss margin of 3.1% from the second quarter of 2012. Non-GAAP net income attributable to ordinary shareholders per diluted ADS was 1 US Cent compared to a non-GAAP net loss of 47 US Cents in the prior year period.

As of September 30, 2012, the Company had **cash and cash equivalents** of US$91.9 million and short-term investments of US $40.1 million.

For the third quarter of 2012, **net cash from operating activities** was $17 million.

Lastly, I'd also like to update you on our warehouse capacity expansion strategy. We are already in the process of moving into the 80,000 square meter leased facility in Guangzhou, which more than doubles the size of our current warehouse in South China. In addition, to meet our growing demand in Eastern China, we currently plan to lease a 100,000 square meter warehouse in Shanghai, instead of building our own facility as we initially planned. At this stage of our expansion, we believe this is the most expedient and prudent way to obtain the large warehouse capacity we require in a short time period.

Looking at our business outlook. For the fourth quarter of 2012, we expect our net revenues to be between US$235 million and US$240 million, representing a year-over-year growth rate of approximately 123% to 128%. As a result, for the full year of 2012, we expect our net revenues to be between US$627 million and US$632 million, representing a year-over-year growth rate of approximately 176% to 178%. 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.