

Operator:

Ladies and gentlemen, good day everyone and welcome to Vipshop Holdings Limited's second quarter 2018 earnings conference call.

At this point, I would like to turn the call to Ms. Jessie Fan, Vipshop's Senior Manager of Investor Relations. Please proceed.

Jessie Fan:

Thank you, operator. Hello everyone and thank you for joining Vipshop's second quarter 2018 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, our co-founder, chairman, and CEO, and Donghao Yang, our CFO. At this time, I would like to turn the call over to Mr. Eric Shen.

Eric Shen:

Good morning and good evening, everyone. Welcome and thank you for joining our second quarter 2018 earnings conference call.

We are pleased that our active customers grew by 6% year over year in the second quarter, with continued improvement in customer stickiness. Our collaboration with Tencent and JD are starting to show initial results. New customers from these channels accounted for 24% of our total new customers in the second quarter. Our JD flagship store currently has around 1.5 million fans. And our WeChat mini-program is becoming a strong channel for new customer acquisition and dormant customer reactivation. New customers from the mini-program increased by over 5 times quarter over quarter. We are also pleased to see continuous improvement in its conversion rate.

Our core competency lies in discount retailing. Recently, we launched a few new initiatives to further deepen our expertise in this field. For example, we launched an app called "Weipin Cang," which is a specialized platform for wholesalers. Via "Weipin Cang," wholesalers and WeChat merchants can purchase off-season discounted inventory in bulk to be sold through their own channels. This is an extension of the discount retailer model, which will help Vipshop and our suppliers clear inventory more effectively. With "Weipin Cang," we can truly provide our brand partners with full product cycle inventory management services, helping them resolve their inventory issues more completely. Further, we added a new channel called "last steal," which hosts products at over 70% off. This is another step we're taking to bring products with great value to our customers.

At this point, let me hand over the call to our CFO, Donghao Yang, so that he may discuss our strategies in more detail and go over our operational and financial results.

Donghao Yang:

Thanks Eric and hello everyone.

In the second quarter of 2018, driven by the robust increase in shopping frequency, our average revenue per customer increased by 12% year over year. This is a testament of the loyalty of our customers and our operational capability. We're keenly focused on serving our customers and providing them with a superior shopping experience. Therefore, we are increasingly focused on our merchandising strategy. As we continue to offer differentiated products at great value, we are confident we will expand our market share in the long run.

During the quarter, our Super VIP loyalty program continued to expand its customer base, adding around 430,000 paid members. As of the end of June, around 1.9 million customers enrolled in our Super VIP program, which represents a 30% increase quarter over quarter. In addition, we recently launched a joint membership program with Tencent Video. Now our Super VIPs are able to enjoy Tencent Video's annual membership at a deep discount, offering them even more value.

In order to capture more growth opportunities within the WeChat ecosystem, we recently launched around 400 official WeChat mini-programs for our brand partners. Further, our initiatives to focus on male customers and post-90s customers are starting to bear fruit. In the second quarter, the number of male customers grew by over 35% year over year. Conversion rates for both male customers and post-90s customers increased by around 10% year over year, which was driven by more precise targeting as a result of our improved algorithm.

Turning to logistics, we continued to invest into our warehousing capacity in the second quarter, adding another regional logistics hub in Shenyang, China. With this addition, we currently have six regional logistics hubs, located in Guangdong, Jiangsu, Sichuan, Tianjin, Hubei, and Liaoning. As of June 30, 2018, we have approximately 2.9 million square meters of total warehousing space, of which around 1.8 million square meters is owned by the Company.

During the quarter, we delivered around 99% of orders through our own last mile delivery network, up from 95% in the prior year period. More than 81% of customer returns were handled directly by our in-house last mile delivery network, up from 68% in the prior year period.

Turning to our Internet finance business. Approximately 5.8 million active customers used our consumer financing during the quarter, which accounted for around 22% of GMV. As of June 30, 2018, the total balance of credit outstanding to customers was approximately 4.4 billion RMB, and the total balance of credit outstanding to suppliers was approximately 1.6 billion RMB.

Going forward, we will continue to work closely with Tencent and JD in order to realize the potential the partnership presents for all three companies. We are focused on our merchandising strategy, aiming to bring the best products to our customers at the most favorable costs. Over time, this will create more differentiation and further solidify our leading position in China's online discount retail space.

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 Renminbi amounts and all the percentage changes refer to year-over-year changes unless otherwise noted.

Total net revenue for the second quarter of 2018 increased by 18.4% to 20.7 billion, primarily driven by the growth in the number of total active customers and the improvement in average revenue per customer.

Gross profit for the second quarter of 2018 increased by 4.8% to 4.0 billion from 3.9 billion in the prior year period. **Gross margin** was 19.5% as compared with 22.0% in the prior year period, primarily attributable to our investment into promotional activities.

- **Fulfillment expenses** for the second quarter of 2018 were 1.9 billion, as compared with 1.6 billion in the prior year period, primarily reflecting an increase in sales volume and number of orders fulfilled. As a percentage of total net revenue, fulfillment expenses decreased to 9.1% from 9.4% in the prior year period.
- **Marketing expenses** for the second quarter of 2018 were 900 million, as compared with 752 million in the prior year period. As a percentage of total net revenue, marketing expenses remained stable at 4.3% year over year.
- **Technology and content expenses** for the second quarter of 2018 were 511 million, as compared with 448 million in the prior year period. As a percentage of total net revenue, technology and content expenses decreased to 2.5% from 2.6% in the prior year period.
- **General and administrative expenses** for the second quarter of 2018 were 615 million, as compared with 579 million in the prior year period. As a percentage of total net revenue, general and administrative expenses decreased to 3.0% from 3.3% in the prior year period.

Our **income from operations** for the second quarter of 2018 was 400 million, as compared with 622 million in the prior year period. **Operating margin** was 1.9% as compared with 3.5% 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, was 595 million as compared with 888 million in the prior year period. Non-GAAP operating income margin was 2.9% as compared with 5.1% in the prior year period.

Our **net income attributable to Vipshop's shareholders** for the second quarter of 2018 increased by 76.4% year over year to 682 million from 386 million in the prior year period. **Net margin attributable to Vipshop's shareholders** increased to 3.3% from 2.2% in the prior year period. Net income attributable to Vipshop's shareholders per diluted ADS increased to 0.99 RMB from 0.64 RMB in the prior year period.

Non-GAAP net income attributable to Vipshop's shareholders, which excludes share-based compensation expenses, impairment loss of investments, amortization of intangible assets resulting from business acquisitions and equity method investments, net of tax, and gain on disposal or revaluation of investments, net of tax, was 577 million as compared with 673 million in the prior year period. **Non-GAAP net margin attributable to Vipshop's shareholders** was

2.8% as compared with 3.8% in the prior year period. Non-GAAP net income attributable to Vipshop's shareholders per diluted ADS was 0.84 RMB as compared with 1.09 RMB in the prior year period.

As of June 30, 2018, our company had cash and cash equivalents and restricted cash of 6.4 billion and short term investments of 2.1 billion. For the second quarter of 2018, net cash used in operating activities was 502 million.

Looking at our business outlook for the third quarter of 2018, we expect our total net revenue to be between 17.3 billion and 18.1 billion, representing a year-over-year growth rate of approximately 13% to 18%.

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

Closing Remarks – Donghao Yang:

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