Vipshop Holdings
Second Quarter 2012 Earnings Conference Call Script
August 10, 2012

Operator:

Good day everyone and welcome to Vipshop Holdings' second 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 2Q 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're very pleased to announce our strong second quarter 2012 financial results. Total orders grew by over 242% year over year to 4.7 million and active customers grew by over 227% to over 1.5 million as brand savvy shoppers increasingly search for bargain deals on products from their favorite brands.

Operationally, we also delivered robust improvements, as our strong operational expertise and bargaining leverage with brands continues to grow and, as a result, our margins continued to improve across the board. Donghao will give more details on this later. But this clearly shows both the scalability of our platform as well as our ability to cement our leadership in China's e-commerce market for discounted branded products.

Our strategy of rolling out regional sub-sites last year has proven to be extremely effective in driving growth in both user traffic and sales volume. This strong growth in sales volume has enabled us to increasingly become the preferred partner for brands looking to monetize their excess inventory.

Looking ahead, we expect to leverage our increasing scale, expand our relationships with brand partners and focused on further streamlining fulfillment operations, which we believe will lead to further improvements in our bottom line performance. We believe that these efforts will further reinforce our market leadership in China's e-commerce market and growth capabilities over the long run.

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, China's evolving e-Commerce industry and how Vipshop stands out. Secondly, our solid results for the quarter and improving operational leverage. Lastly, Vipshop's focus going forward.

As many of you know, growth of retail ecommerce in China is being driven by two things shoppers love, branded products and attractive prices. Vipshop provides shoppers the perfect combination-- branded products **AT** discounted prices. Chinese shoppers increasing acceptance and comfort with shopping online are the basis of why many research houses are forecasting China's ecommerce sector will exceed the US' and Japan's over the next couple of years. This exponential growth has resulted in an intensely competitive market space as companies seek to benefit from the industry's rapid growth.

Even though economic growth in China continued to slow during the second quarter and competition among online retailers continued to intensify, the demand for discounted branded products on our platform grew quite strong, demonstrating the counter-cyclical nature of our business. Over the past quarter, we continued to witness price wars amongst many leading B2C ecommerce players as they attempt to build more market share. In addition, several high-profile companies are being forced to restructure or close their doors as their business models prove unsustainable. For Vipshop, not only have we established our leadership in flash sales, since our IPO, we have been able pull far ahead of any direct competitors. More importantly, we are proving the viability and sustainability of our business model and operational expertise. This is evidenced very clearly through our financial performance which I will discuss shortly. Our ability to dramatically expand revenue and margins is quiet remarkable especially in the booming yet highly competitive e-commerce market in China.

Moving on to our quarterly financial highlights:

Net revenues for the second quarter of 2012 increased by 233.5% to US$135.3 million from US$40.6 million in the prior year. As Eric discussed earlier, we achieved this tremendous growth because of the strength in our two key metrics, total active customers and total orders, both of which increased by well over 200 percent over the quarter. One thing I would like to point out too is that on a sequential basis, net revenues grew 33.6% in the second quarter of 2012. This was primarily due to seasonality associated with the pent up demand following the Chinese holiday season in the first quarter.

This growth continues to demonstrate the network and scale effects associated with the value we provide to our brand partners and customers. As we continue to attract more shoppers, our negotiating position with our brand partners improves. Brands want to partner with the biggest player. This means that 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 21.8% from 18.3% in the second quarter last year and gross profit increasing by almost 300% to US$29.6 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 31% year over year to US$35 million. More specifically:

- **Fulfillment expenses** increased year over year by 143.7% to US20.5 million from US$8.4 million in the second quarter last year. This primarily reflects the increases in sales volume and number of orders fulfilled. As a percentage of total net revenue, fulfillment expenses decreased to 15.2% in the second quarter of 2012 from 20.8% in the prior year period and 16.7% in the first 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$6.6 million from US$2.3 million in the second quarter last year. As a percentage of net revenues, marketing expenses decreased to 4.9% from 5.7% in the second quarter last year and 5.8% in the first quarter of 2012. This demonstrates our company's disciplined approach in controlling marketing expenses by focusing on word-of-mouth referrals. This type of advertising is inherent to the online flash retail model in China and has proven invaluable to us. We have needed to invest little in sales and marketing as the majority of our brand equity and consumer awareness has been built through the satisfaction of past customers. This is in stark contrast to many of China's largest e-commerce companies which have spent heavily on various marketing campaigns during the past quarter to continue trying to attract customers.

- **Technology and content expenses** increased to US$2.7 million from US$0.9 million in the prior year period. As a percentage of net revenues, technology and content expenses decreased slightly to 2.0% from 2.1% in the prior year period and 2.4% in the first 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$5.6 million from US$15.2 million in the prior year period. As a percentage of net revenues, general and administrative expenses decreased to 4.1% from 37.5% in the prior year period and 5.7% in the first quarter of 2012. The cost reduction was primarily due to decreased stock-based compensation expenses compared to the prior year period, as well as our continued cost-control efforts and increased operational leverage.

Moving on, our **loss from operations** for the second quarter of 2012 was US$5.4 million, compared to a loss from operations of US$19.3 million in the second quarter of 2011, reflecting the growing scale of our company's operations. Operating loss margin improved to only 4.0%, down substantially from 47.6% in the prior year period and 8.6% in the first quarter of 2012.

Non-GAAP loss from operations, which excludes the impact of share-based compensation expense for the second quarter of 2012 was US$3.8 million, compared to US$6.9 million in the second quarter of 2011. Non-GAAP operating loss margin improved to 2.8% down from 17.1% in the prior year period and 6.5% in the first quarter of 2011.

Our **net loss attributable to ordinary shareholders** for the second quarter of 2012 was US$5.8 million, compared to US$19.5 million in the second quarter of 2011. **Net loss margin** improved to 4.3% from 48.1% in the prior year period and from 8.5% in the first quarter of 2012. Net loss attributable to ordinary shareholders per diluted ADS was 11 US Cents compared to 85 US Cents in the prior year period.

Non-GAAP net loss attributable to ordinary shareholders, which excludes share-based compensation, was US$4.2 million, compared to US$7.1 million in the second quarter of 2011. **Non-GAAP net loss margin** improved to 3.1% from 17.6% in the second quarter last year and 6.4% from the first quarter of 2012.

As of June 30, 2012, the company had **cash and cash equivalents** of US$115.6 million.

For the second quarter of 2012, **net cash from operating activities** was $17.0 million.

Lastly, I'd also like to update you on our warehouse capacity expansion strategy. We are on track to expand our logistics capacity with our planned move into a 80,000 square meter leased facility in Guangzhou in Q4 2012. In addition, we are in negotiations with the government to secure a piece of land where we plan to build a 100,000 square meter warehouse in Shanghai and it is likely that we will begin construction sometime next year.

Looking at our business outlook. For the third quarter of 2012 we are expecting our net revenues to be between US$145 million and US$150 million, representing year over year growth of approximately 176% to 186%.

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