

Operator:

Ladies and gentlemen, good day everyone and welcome to Vipshop Holdings Limited's first quarter 2017 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. Hello everyone and thank you for joining Vipshop's first quarter 2017 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 chief executive officer, and Donghao Yang, our chief financial officer. 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 first quarter 2017 earnings conference call. We are pleased to have reported solid results in the first quarter of 2017. Our total active customers for the trailing twelve months ending with March 2017 increased by 38% to over 55 million.

Our user penetration in China's online shopping population is still small. Therefore, we continue to believe that there is plenty of room to grow our customer base in the years ahead. We continue to make efforts to improve our user stickiness. Recently, we tested a new Super VIP paid membership program, which offers exclusive or early access to promotional events, special savings, and free shipping and returns. Early results show significant improvements in average order frequency and average revenue per user for those who joined the program.

As always, we care a lot about product quality and merchandising improvements. On one hand, we added more sub-categories to our existing portfolio and increased the daily average SKUs online by 161% to 1.7 million compared to the same period last year. On the other hand, we remain focused on bringing in high quality international brands such as Giorgio Armani, Guess, and Versace. We are also preparing for more custom-made and exclusive SKUs that will only be available on Vipshop and are very excited about the opportunities.

In addition, we remain focused on new technologies to improve our efficiency and lower our costs. For example, we are in the process of developing intelligent customer service chatbots that provide shopping guides before purchase and after-sales services. We also added a number of

warehouse automation and intelligent logistics initiatives during the quarter, which Donghao will discuss later on.

Overall, we are pleased to have started 2017 on a strong note both financially and operationally. Over the past few years, we gained trust from our customers and suppliers as we scaled our business and delivered on our promises. We have become an important partner for brands to manage their product life cycle, which leads to more high-quality and diversified merchandise to our growing user base.

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 past quarter, we delivered robust results with solid topline growth while balancing our profit margins. Importantly, we continued to generate sustainable, healthy cash flow in the first quarter of 2017 with free cash flow of 0.43 billion RMB. Our free cash flow trailing twelve months ended March 31, 2017 remained positive at 3.26 billion RMB.

Moving on, we are pleased to announce that our Board of Directors authorized the Company to explore a proposed spin-off of our Internet finance business into a dedicated entity. The objective of the proposed spin-off is to shift any associated incentives and risks to this dedicated entity and alleviate the Internet finance business' financial impact on our core e-commerce business. Additionally, it may enable the Internet finance business to accelerate its growth as an independent entity going forward. It has been proposed that Vipshop will inject all of our Internet finance business and related assets into the dedicated entity and restructure the existing variable interest entity arrangement with that dedicated entity. Certain key members of the Internet finance business' management may acquire minority equity interests in the dedicated entity. Our Board of Directors has authorized our directors and officers to further explore, negotiate, and finalize the terms and arrangements of the proposed spin-off for its final approval.

Our Board of Directors also authorized the formation of a new entity dedicated to our logistics business, aiming to open up our logistics services to a broader market. This will lower costs for both Vipshop and our business partners by accelerating increased economies of scale in this part of our business, as well as enable us to explore a new initiative of online and offline retail integration and provide consistent delivery services with a more comprehensive nationwide network coverage.

During the first quarter of 2017, we duly notified all holders of our 1.50% convertible senior notes due 2019 of their one-time put right under the terms of the indenture for the notes, of which US\$632.5 million aggregate principal amount was outstanding at the time of the notification. Approximately US\$3.1 million aggregate principal amount of the notes were validly and timely surrendered and not withdrawn and we accepted all of these notes for repurchase. We believe the result of the put right exercise of our notes is an endorsement of our financial strength and high credit quality. It also represents a vote of confidence from the capital markets for our future growth prospects and market potential.

On the logistics side, we added around 160,000 square meters of warehouse space in Jianyang, China in the first quarter and currently have approximately 2.1 million square meters of warehouse capacity nationwide. In order to be closer to our customers, shorten delivery time, and improve the efficiency of our distribution, in addition to our five regional and centralized warehouses, we expanded our local warehouses to include two facilities in Guiyang and Kunming in China, increasing the total number of local warehouses to seven as of March 31, 2017. We plan to have one local warehouse in each major province by the end of 2017.

Further, after adding around 3,000 last mile delivery staff in the quarter, we now have more than 23,000 last mile delivery staff in total. Currently, we have approximately 2,800 self-operated delivery stations and are able to deliver more than 93% of our orders through our last mile network as compared with 83% in the prior year period, covering all provinces in China. In addition, we further strengthened our logistics services by having our own delivery staff pick up returns from our customers directly, which currently covers 67% of our total returns, up from 30% from the same period in 2016.

We are excited to share with you that in the first quarter, we also made progress in improving the automation and technology of our warehouses, aiming to improve our logistics efficiency and reduce our costs. Specifically, we introduced automated systems in our central and southern warehouse facilities, including conveyor belts and automatic systems for product sorting and storage. Moreover, we scaled up the application of intelligent transportation robot system in our southern warehouse and rolled out our proprietary Warehouse Control System in our southern and central warehouses.

Lastly, as of March 31, 2017, the total balance of credit outstanding to customers was approximately 2.59 billion RMB and the total balance of credit outstanding to suppliers was 746.1 million RMB.

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 first quarter of 2017 increased by 31.1% to 15.95 billion, primarily attributable to a 32% year-over-year increase in the number of active customers which grew to 26.0 million and a 23% year-over-year increase in total orders to 72.1 million.

Gross profit for the first quarter of 2017 increased by 25.0% to 3.69 billion, primarily driven by the expanding scale of the business. **Gross margin** for the first quarter was 23.2% as compared with 24.3% in the prior year period. We expect our gross margin to remain stable in the short term as we balance our promotional activities and sales with our marketing expenses.

- **Fulfillment expenses** for the first quarter of 2017 were 1.44 billion, as compared with 1.08 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 were 9.0% as compared with 8.9% in the prior year period, primarily attributable to our expansion to support an increase in our last mile business outside of the Vipshop platform.
- **Marketing expenses** for the first quarter of 2017 were 730 million, as compared with 604 million in the prior year period, reflecting our strategy to drive long-term growth through sustainable investments in strengthening our brand awareness, attracting new users and

expanding our market share. As a percentage of total net revenue, marketing expenses decreased to 4.6% from 5.0% in the prior year period, primarily attributable to our strategic balance between promotional activities and sales with our broader marketing efforts.

- **Technology and content expenses** for the first quarter of 2017 were 420 million, as compared with 327 million in the prior year period, reflecting our continuing efforts to invest in human capital, advanced technologies such as data analytics as well as new business opportunities including our Internet finance business. As a percentage of total net revenue, technology and content expenses decreased to 2.6% from 2.7% in the prior year period.
- **General and administrative expenses** for the first quarter of 2017 were 542 million, as compared with 382 million in the prior year period. As a percentage of total net revenue, general and administrative expenses were 3.4% as compared with 3.1% in the prior year period, primarily attributable to an increase in share based compensation as well as the impact from building out the Internet finance business.

Our **income from operations** increased by 23.6% to 737 million for the first quarter of 2017. **Operating margin** was 4.6% as compared with 4.9% 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, increased by 31.2% to 1.00 billion from 765 million in the prior year period. Non-GAAP operating income margin remained stable at 6.3% year over year.

Our **net income attributable to Vipshop's shareholders** for the first quarter of 2017 increased by 16.3% to 552 million from 475 million in the prior year period. **Net margin attributable to Vipshop's shareholders** was 3.5% as compared with 3.9% in the prior year period. Net income per diluted ADS increased to 0.92 RMB from 0.80 RMB in the prior year period.

Non-GAAP net income attributable to Vipshop's shareholders, which excludes share-based compensation expenses, impairment loss of investment, and amortization of intangible assets resulting from business acquisitions and equity method investments, increased by 28.2% to 799 million from 623 million in the prior year period. **Non-GAAP net margin attributable to Vipshop's shareholders** was 5.0% as compared with 5.1% in the prior year period. Non-GAAP net income per diluted ADS increased to 1.31 RMB from 1.04 RMB in the prior year period.

As of March 31, 2017, our company had cash and cash equivalents of 4.43 billion and held-to-maturity securities of 746 million. For the first quarter of 2017, net cash from operating activities was 0.74 billion.

Looking at our business outlook for the second quarter of 2017, we expect our total net revenue to be between 17.0 billion and 17.5 billion, representing a year-over-year growth rate of approximately 26% to 30%.

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.