Vinda International Holdings Limited
2017 Q3 Results Conference Call
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Speakers
Mr. Christoph Michalski, CEO **(CM)**
Ms. Vicky Tan, CFO & Company Secretary **(VT)**
Ms. Joey Wan, IR Director **(JW)**

Presentation

JW: Good Morning ladies and gentlemen, welcome to Vinda's third quarter briefing call. I am Joey Wan, IR director. On the line we also have our CEO, Mr. Christoph Michalski, and CFO, Ms. Vicky Tan. Today's call will last for about 30 minutes. Christoph will present the results and we will open for Q&A. Just a reminder, we have sent you a presentation deck this morning. Please check your email box or download it from our website if you have not received it. Now I'll pass the time to Christoph.

CM: Good morning ladies and gentlemen. I will brief you very quickly on our results. As you know, for Q1 and Q3, we only published very few data, because we have our half year and annual year results.

On slide 2 on your deck, you will basically find all the key numbers that we had published.
Overall speaking, Q3 has a very satisfactory growth rate, despite the competition we've still seen in China in tissue.

Despite the very strong increases in pulp, we actually managed to hold onto the majority of our gross margin and also operating profit. And this is really the combination of cost saving, portfolio management and we've started slight price increases that we will now carriy on to the end of the year.

Let me go through and brief you a little bit more in detail.

Group organic growth back to double digit, 11%, we are very happy with that. You can see on slide 3, basically quarter by quarter on our growth.

So we have 7 % for Q3, 7% for Q2, now 11%. We hope that we are carefully optimistic that the double, this trend, will continue. We definitely aim for double digit growth from China which we have also achieved this quarter. And then depends a little bit on how our more mature markets, SE Asia and Korea and Taiwan and Hong Kong will perform.

What led to the stronger growth this quarter? I think we see two things in China. First, the rising pulp price has put the smaller players a little bit under pressure. And I think the big players including our competitors Hengan, APP, C&S, etc. will be profiting from that trend.

Secondly, we have very very strong marketing plan and marketing activities in Q3. It is generally, for us, a little bit lower quarter because of less e-commerce activities. You are aware our e-commerce presence is very strong. Nevertheless, we had a very good revenue growth.

Maybe we talk to you about gross profit. Gross profit increased 5.8% year on year, below our revenue growth rate. But that is basically driven by the very significant price increase in pulp. So if you compare, for example short fiber, between the Q3 2017 and Q3 2016, short fiber price has increased 37%, and for long fiber around 60%.

When I talked to you in Q2, we were quite optimistic that these price would soften a little bit in the second half of the year, but that was also the reason why initial price increases in the beginning of May, I think we try once, were not very successful, because the market forwarded that pulp price to soften again. It hasn’t.

Now I think the market we see some initial timid steps and other people also playing on the price. So we are pretty confident that we can also recover some by price increases.

Secondly, as you know we have the strategy of portfolio management, so we are really focusing all our activity items on high margin brand like Tempo and the more premium side of the Vinda brand as well as on the right product category. So again, softpack has been very strong growth this quarter.

Then the third element of our programme, that it is not just relevant for the gross margin but also between gross margin and the operating profit. We are managing our cost very carefully and have a number of programmes in place, both in SE Asia and in China.

In Q4, we hope the positive sales trend will continue. You are aware that we have 11-11 coming up in which we are a very significant player, so we expect that to grow well. But a little bit of a careful sign, we think that our growth margin with stay under pressure with the price increases.
I think in October, the price alone up 12-13% in pulp and we do not expect that big jump in Q4, but clearly we will have some pressure in Q4 and now Q1 as well.

To mitigate, as I said price increase, portfolio management and we also expected in Q4 most of the cost saving projects that we started in China particularly will have full impact.

I think H2 should be alright with a good start in Q3 and we are looking carefully optimistic for H1 for 2018. However, please keep in mind that the current price hike in pulp will affect us the first half of next year despite all these things that we are doing.

EBITDA has been grown by 12.5% year on year to 460 million. We have a good cash generation, and margin has even increased by 0.2% year on year, again reflecting our cost saving programme in the year.

Operating profit has increased 8.2 % year on year, stands now 7.4 points, little bit impacted by pulp, but we have basically a good control over cost.

If you look at, for example, our sales and marketing expense has been stable over the last two quarters, which is good. And we have the administrative expense again, came down 1%, and that clearly had a good effect.

We have a very small increase of foreign exchange, 5 million, which also had a good impact on operating profit.

Revenue by segment has not much change, I think we are pretty stable now. In the first 9 months, it's 20% personal care and 80% tissue, coming up from 16% and 84% respectively in 2016 first 9 months. That's clearly the effect of acquisition as well as a very strong growth that we have in China, about 30%, so it's growing very fast in China.

Finally, e-commerce remains strong. 20% of the total group level, but more than 25% in China. Therefore, for us Q4 is a very important quarter with all the e-commerce big festivals coming up. You also can see that in B2B we have an increase in % in relative size which basically shows you robust growth of that channel. We work on the channel with 2 brands, very high margin brands, Tork and Vinda Professional for more paper products.

I think I will leave it here that summarizes our results. In summary, goods topline development and better gross margin than expected, mitigating the impact from pulp. We expect both to continue, i.e., good growth in Q4 and still some pressure on gross margin despite all the activities. We will mitigate the very significant pulp price increase.

Thank you. I will hand over back to Joey.

JW: Thank you Christoph. Operator, we are ready for Q&A.

Question and Answer section

Operator: Our first question is Anson Chan from Daiwa Capital, please go ahead.

Anson Chan (AC) from Daiwa Capital

AC: Hi, thank you for picking up my question and thank you for the update. The question is about the ASP hike, you mentioned that you have directly raise the price at the end of the quarter, so how much is it and is it a company-wise raise in all products? Do you see the competitiveness/competitors taking similar price hike?

CM: So what we have done is basically since the 1st of October, we are rising our price basically every month. So we have mentioned to the trade. I think all of our trade partners understand that. Because clearly they also know what the pulp is going to the wrong way, basically there are much more expensive. It is a little bit early to say what our competitors would do. I mean we had probably already a little bit in the quarter three less of a promotion, so people didn't rise prices but to put the promotion element back, which is indirectly auto-price increase.

My understanding is generally with this type of price increases, like as I said since Q3 2016, that 37% in short fiber is so significant that no player can continue like that. If you look at the price of mother reel, some of other competitors are selling, they had increased very consistently over the last few months. So my expectation is that the whole market will follow that trend. The question is at what type, level and timing of the increase.

AC: A quick follow up, can you share how much you have increased in percentage term? Or just a rough idea?

CM: Actually, this is a little bit difficult because clearly depending on the product categories and the brands, we have very different policies. But I think we are talking low single digit every month. So it depends on how long the price increases in pulp will continue. But also we are very clearly concerned that we do not want to give shares away. So we have a very prudent policy in prices, which over time will totally eat up the cost of the pulp increase, but we will do it in steps.

Dawei (DW) from CLSA

DW: Hi Chris, Vicky and Joey,

Congrats on the strong third quarter. You mentioned that the bigger guys are gaining shares and the smaller guy sees a bit of pressure or more pressure. Could you give me a bit more details on what evidence you see on these and what is your view on the next few quarters? Your view on this is cyclical or this is more structural? And also on price hike, assuming competitor is not following, do we have a plan B or any contingency plan? What options do we have right now?

CM: Okay, so maybe let me talk very quickly about the market capacity. So I think first of all we saw a little uptick on market growth, we were more on 4-point something growth previously now. it looks like the market has grown first quarter more like around 5.5, which clearly helps. And that correspondent bound if we take it on a yearly basis, 1.5 million capacity. And then you have a lot of shut downs. You have permanent shut down when it comes really to the polluting mills' operating license get withdrawn, and the challenges access to capital. The second point you have shut down of players who relatively have lower price product. And they can actually not implement fast enough if price increases, so they tend to just stop operating with such net loss of pulp price. And then it depends on would they come back once pulp price goes down and when pulp price go down. And currently we do not have a view or indicator that this will happen soon, at least not on the level of quarter three 2016. And then you have, I will say the seasonal effect. Clearly the loss will be incredibly under pressure again in October, November and December because of pollution. And I think when you listen to the government Congress, the pressure on environment will continue, and actually will increase. So some of them will either modernised or disappear from the market. So we are preparing ourselves to have enough capacity for 2018, to make sure that we don't miss the opportunity of smaller players' disappearance, so I expect the market consolidation would slow down a little bit in 2016, and accelerate in 2017 and 2018.

DW: Okay, how about the price hike and then our follow up plans, ABC, you know different contingence plan depends on how the market react?

CM: I think I cannot speak for my competitors. But I wouldn't know they would manage the profitability decreases as they don't do anything. So I think it's very unlikely that there will not be price increases by all players in the market, that's number one. The second one, you have seen our number that actually we have been quite successful despite the lack of price increase in the first half of the year even in quarter 3, to manage through other means we are cost saving, we are portfolio management, our gross margin hasn't suffered at all at the level that it should have suffered if the pulp price would have come through. That why we always remain plan B and basically it is also part of plan A because we will continue the cost saving effort. That's no reason why we wouldn't. But otherwise if I think you can say both cost saving, portfolio management and reasonable price increase should protect us from the hike which we currently see.

DW: Okay, thanks. Just to clarify the price increase you mentioned it's actually like for like price increase, right?

I mean our price, our products, since 1st of October price increase.

CM: Our price increases are basically what we called our average selling price will increase now month over month in order to overcome some of the effects of the pulp increase, so basically we are trying very hard to get our gross margin up again.

DW: because I remember in Vinda recent history over the last decade, I think the last time we raised price was 2010, when the pulp price also had a very big spike. So wondering the level of our ASP increase for our like for like bases verses last round. Is it similar or is it a bit conservative versus last round?

CM: No, I think the strategies are very similar. But clearly our portfolio is much more diversified this stage, so you cannot just have a rule of thumb. But I think every month low simple digit should make a very significant improvement to our gross margin together with all the other activities that we are doing.

Never forget the China tissue market is super competitive and we would not allow ourselves to do activities which put the growth of our market share at risk.

Chen Lu (CL) from Bank of America Merrill Lynch

CL: Congratulations on the Q3 results. I've got a few quick follow up questions. Firstly, on the GP margin side, we have maintained 30% or a higher GP margin for quite some time. And given that we are seeing continuing rise in the wood pulp cost, but at the same time we are taking measures like price hike, portfolio management, cost saving, are we comfortable to maintain 30% GP Margin in the coming few quarters, or whether there is any downside risk?

CM: I don't manage the business by quarters as there's always a risk on next quarter, unforeseen things are happening, but if you look more from an annual or long-term perspective, clearly our objective is to keep GP margin over 30%. And as I said, actually our strategy is always permanently slightly increasing gross margin, not just with tissue, but also with effects on personal care business as it's coming in. So, that overall strategy hasn't changed. Now you will understand if you have a price increase on raw materials by 10% over couple of months or something, it's very hard to counter it on an immediate effect. But I think if you take two quarters or three quarters, there's no risk. There might be individual quarter, I hope not, that it could drop below 30%.

CL: And also a few quick questions on some numbers. So just now you mentioned that China achieved double digit organic growth in Q3. How about SE Asia?

CM: Well Asia, you aware that our big position on Malaysia, Singapore, Taiwan and Korea. And these are much more mature markets than clearly China in terms of market growth. And we have basically grown more or less in line with the market which we are holding there, low to middle-single digit. But China is clearly where we are driving Vinda prior to acquisition. In this part we are really driving to double digit growth, we are very close in Q2, very significantly above it in Q3, and the other markets have performed very well. We have even some good share gain in some of those markets.

VT: So if you look at total growth in China, it is double digit growth as well Other regions' growth are also very well in Q3.

CL: On the FS gain, which was 5 million HK dollar in Q3, can you give a break down between operating item and financial item?

Lina Yan (LY) from HSBC

LY: Firstly I would like to clarify on the price hike. Did you mean that since July, you are able to increase your ASP by low single digit months over months, for three months?

CM: No. From the third of October, this is our strategy. So there's no price increases in our figure in Q3. Q3 has cost saving programme and portfolio management.

LY: Second question is you are expecting the GP margin pressure to continue in the fourth quarter and in the first half next year. So if the pulp price stay at high level, considering all your cost saving measures. What kind of ASP increase is needed to bring you back to the 30 plus GP margin like next year?

CM: I think with our plan that we have basically January and February next year, we should recover the gross margin that we have previously so close to the numbers we had Q3 last year. I think there's a good chance that we go back there. I cannot give you details of the price increase level as you understand there's competitive nature in it. And secondly, we have very good effect in our cost saving and portfolio management. My intention is very clearly to go back to we have in last year and grow from there. So this is an unfortunate event on one end for the gross margin, but also very fortune event for Vinda as the smaller player cannot take this competitive price pressure. And therefore there is no growth for the big player in the market. So these are advantage and disadvantage. But we are ambitious to bring the gross margin very quickly back to where we were last year.

LY: Then lastly come to cost saving, we expect the benefit still come through like last year. Do you have a target on cost saving. For example, the targeting SG&A cost ratio?

CM: I think you would see at the end of the year. We have made a lot of effort to decrease the administrative cost and general cost. We also made a lot of effort to control our sales and marketing cost as I said before. I think we have put a lot of things. Do we have a specific target? I think you could argue the target is more percentage to sales than overall amount, as we have invest quite significantly to achieve growth, we are very cost conscious when it comes to sales, administrative and general expenditure. We are very careful on how we invest our sales and marketing dollars. And then on the gross margin clearly there we have very strong program to reduce packaging to decrease cost. But also we have some gain, as there increase on carton price in China and things like that. So we are balancing a lot on cost increases, with clever way how we can manage the cost by changing physical products packaging.

LY: For the cost saving project, for example saving the packaging cost, do you have any target to share with us?

CM: No, we do not have a specific target on that, we are aiming for gross margin target, and we are aiming to get back to where we were last year. And our cost saving program have both long-term and short-term measures, it's hard to set a specific target. Because of our very modern manufacturing infrastructure, we do not have a legacy business to so easy to make cost saving in the way how we run factories. We are basically focusing on packaging, supplier, sourcing activities, and the general admin cost. Overhead for Vinda are relatively low.

Paul Yuan (PY) from CICC

PY: Morning, Chris, Vicky and Joey. My first question is actually regarding the margin breakdown. Can I have a margin breakdown of your GP margin 30.3% and OP margin 7.8% on both tissue and PC? And regard of the GP margin drop of tissue, it should be more than 1 percentage point. So may I roughly have a sense of breakdown like how much was affected by the cost inflation? How much was driven up by your mix, or price hike effort, or the low discount? Thank you.

VT: Our tissue gross margin and compare to personal care now is very comparable, very close to the personal care's gross margin. It's like a few percentage points difference. For operating margin, you will see tissue margin is still slightly higher because we are investing in A&P for personal care in China and some other countries. But for gross margin perspective, we see very good development for personal care's gross margin in the last few quarters. We have very good growth in personal care in China as well. For operating margin, everything is under control, we use the most cost-efficient way to develop our personal care business in China and invest very specifically in A&P for the personal care category. But when it comes to the detail breakdown numbers, sorry I think we don't disclose that for quarterly results. Maybe we can talk a little bit more when we announce the annual results.

PY: I think you have given the breakdown, the GP margin and the OP margin for the first half. Can I just roughly check the trend for the personal care business, is it sequentially on the improvement for both GP margin and OP margin's level?

VT: For personal care, it's improving gradually.

CM: I think as I have mentioned to you, in tissue in half year, we have absolutely critical mass and very good factory utilization and things like that. When it comes to personal care, because we are relatively small and have started to grow very fast, we have not just A&P investment but also we have a machine part which is not fully utilized yet nor have we sales level of critical mass that we can fully absorb all the A&P cost in China. So here what you will see over time is a very steady increase of gross margin which has more to do with factory utilization and critical mass. With that steady growth, you will have an increase dilution of the A&P cost and basically that will drive personal care both gross margin and operating profit.

PY: My second question is actually more details about your personal care products running to China market cost that is not disclosed separately. In terms of, like the performance of the napkin and incontinence, maybe diapers year-to-date? What is your longer term expectation of the sort of approach for these products in China? For Libresse, in more particular, since its launch in the second quarter, how is the performance over the past five to six months? Is it below or better than our expectation?

CM: As you know, we have a very clear strategy, we have number one focus is tissue in China, and number two is personal care in China. In personal care, the focus is number one priority is long term incontinence and the short term priority is more feminine. What we have done is we have grown very successfully, let me give you one number, our personal care growth in China is almost 30%. So it is growing really good. For incontinence care, we have own manufacturing and the Longyau factory starts to turn very well. In feminine care VIA brand, which continues to grow strongly and we have launched an e-commerce for the Libresse brand in May this year. For both Libero and Libresse, I think we are very happy how they are performing but it is a little bit too early to really give you a definite answer. We will see the autumn festival now in November 11, and the e-commerce festival is coming. Because these brands are so focused on e-commerce that would actually be more accent point. So we can talk about it a little bit more in January when we have seen how they have performed in November.

PY: Just try to have a clarification from you. You quoted a number, over 30% growth yoy as of year-to-date is for overall growth for personal care in China?

CM: I think we will talk a bit about that at the end of the year because we don't disclose normally in this quarter of all the detail segment numbers. I am very sorry. But just for you an indication, we are growing almost for 30% and overall we are very satisfied with that performance.
VT: I think for personal care, it will be more relevant if you look at the full year comparison, because you know quarter four is really important for e-commerce, and we have our significant part of personal care business came from the e-commerce channel.

Closing

JW: Thank you Christoph, Vicky and all of your participation this morning. We will post our transcript later on website. If you have missed certain part, you can refer to that.