Vinda International Holdings Limited
2021 Q3 Results Conference Call
9:00 am HKT, 22 October 2021

Speakers

Ms. Karen Li, CEO (KL)
Ms. Vicky Tan, CFO & Company Secretary (VT)
Ms. Elaine Yuan, FPRHK IR Team (FPR)

Presentation

FPR: Good morning ladies and gentlemen, welcome to Vinda International's 2021 third quarter results update call.

On the line we have our CEO, Ms. Karen Li, CFO, Ms. Vicky Tan, and Senior IR Manager, Mr. Benjamin Zhao. Today's call will last for about 30 minutes. Karen will first present the results and then 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.

Now I would like to pass the time to Karen. Karen, please.

KL: Good morning everyone. Thank you for dialing in and I will now present our Q3 results and Vicky will join me in answering your Q&A after my presentation. Our 3rd quarter results reflect a volatile and challenging market environment. Q3 comparison were impacted by lower GDP and consumption growth in China, changes in the retail channel, commodity inflation pressures, as well as supply chain disruptions in Southeast Asia due to COVID. However, our market position remains strong and we have managed to continue to gain market share across Asia.

Q3 net sales were up to the level of 4.1 billion HKD, up by 7.2%, and this represents a 2% growth organically compared to a year ago. Volume growth was slower than anticipated for China tissue business. During this period, competition remained intense while we have fully implemented our 2nd round of price increase, we have not yet to seen any significant price movements from other competitors and this indeed had an impact on our volume growth. However, we continue to execute Vinda's core strategy of premiumization and focus in brand building. We will not deeply involved in price promotions but instead to maintain a healthy pricing level and defend our profits into the long term.

Despite the lower than anticipated volume growth, Vinda continues to outperform the market by continuing to gain shares. And more importantly, we continued to outperform our peers, especially on pricing. Both our internal data and external market research data shows that our pricing level is still sitting at the highest price point and even have some improvement coming into the Q3, while other competitors pricing either have stayed the same or even going down. For overseas market, our Malaysia business was heavily affected by factory and social lockdown in Q3 due to COVID and the related mandatory actions required by the local governments. However, the business recovering very well come into Q4 as vaccination rates have reached over 90% for our factory employees and all of the restrictions in Malaysia have been lifted.

Gross profit margin for the period is 35%, which is 1.9% lower than the same period last year. During the period, we've experienced some cost side challenges, especially coming from high raw material costs, energy costs and packaging costs , which have led to a lower gross margin by nearly 3 points. However, we are able to offset some of these impacts by having a positive impact coming from a pricing and product mix improvement, which is about 1 point positive impact for Q3 this year compared to the same period last year. At the same time, a gross profit margin during the period is also impacted by lower utilization in China and a lower utilization in Malaysia factory due to the COVID lockdown. And of course, higher freight costs and material costs in overseas market also had some slight negative impact on our cost margin.

Operating profit margin is lower in Q3 by about 5 points compared to the same period last year, but 4.8points lower than last year, if we take out the FX impact during the period. During the period, we've had some one-off upfront spending, especially in marketing in brand building, so that is more of AMP phasing that just happened and happen in Q3 and that is one of in the nature. During the period, we've also incurred some additional investment in new channels and new categories. This year we think that there are some changes, especially in the E-commerce channel. There are some new customers and new peers coming into the E-commerce world, such as TikTok, being one of the obvious example and we have also stepped up our investment in these channels to ensure that we sustain our leadership position on E-commerce and also for future robust growth. We are also committed to investing in our feminine care business as we have communicated time over time before to ensure that we can continue the very high growth that we are seeing in our feminine care business in China, which is clearly also paying off during the period. Expense ratio remained quite stable on a sequential basis, and that is the case despite a lower volume in Q3. Our Group revenue for the first nine months end of September is up by 15.1% and this represents 8% on organic growth. Segment mix remained stable, with tissue being 81% of our total business and 19% being personal care.

As I touched on before this year has been very challenging, we have reached about 8% organic growth YTD, which is largely on track with our yearly growth ambition. Despite all the challenges that we have mentioned before, we are not deviated from our long term targets, our core strategies are being well executed, especially on premium products and personal care business. Our premium category continued to perform very well in the quarter. For example, our Tempo brand grow 35%, the TORK brand grew 15% and wet wipes grow more than 40%. Our premium offerings across all brands now accounted for over 35% of the Group's total tissue as we speak, compared to 30% a year ago.

Segment mix remained stable, especially for personal care continues to perform very strongly, in particular, our feminine care brand in China as I talked about before, Libresse VIA, quarter over quarter is continued very strong momentum. In Q3, we have recorded another very successful quarter for our feminine care business in China with over 100% growth.

When we comes to our revenue by channels, it's very clear that E-commerce contribution is still growing and we are seeing some changes in the E-commerce channel for the Group. While E-commerce grew very strong in all regions for us, China E-commerce is obviously still the biggest revenue contributor for E-commerce, and we'll give you some information in the next slide.

China’s E-commerce and retail environment has been very dynamic and very fast changing, and even more so in 2021 the post pandemic area. As the market leader in E-commerce in our category, in this year we have stepped up our investment in new platforms and channels such as TikTok and private domain channels. We're doing that to ensure that we continue our growth momentum and of course to sustain our leadership position in E-commerce. This will take a while as we entering the platforms in E-commerce, but as we quickly build up our scale in this new channels not only will be able to capture new growth opportunities, but we also believe that return on investments for these new customers will quickly improve as we speak. For example, we have recorded a very successful sale in new channels, for example, TikTok channel only within months of starting up, it is now already one of our top 5 E-commerce customers. And in Q3, we have

recorded over 80% growth in TikTok compared to the last quarter.
A little bit more detail for gross profit in the next slide. Gross profit margin remained quite stable for Q3 and one of the important impact is of course coming from pulp. As you can see that pulp price has come down quite significantly during the period. We believe that pulp price will continue to be in the downtrend coming into Q4.

Gross margin as I talked about before for Q3 is 35% very stable compared to the last quarter. Well, it's very difficult comparison compared to last year because we had a lot of COVID related special circumstances in last year. But again, I would like to reiterate that quarter over quarter we have managed to keep our gross margin at a stable level despite all the inflationary pressures that we're seeing coming from raw materials. Due to the foreseeable pulp and other cost pressures, we have been taking very decisive actions to manage these pressures. For sample price increase, and continuing to increase our high margin product sales we have talked about before, and also, of course, to continue to improve our mix improvement. And this actions will continue into the foreseeable future in order for us to manage our gross profit margin pressure. I think our Q3 profit margin level is a very good testimony that we are able to counter act these cost pressures by taking different decisive actions as we have taken out throughout the year.

I will not go into details in operating profit and EBITDA margin. I think I have touched on some points before and will now open the Q&A to the floor. Thank you.

VT: This is kind remind that because we are only announcing few numbers for our Q3 results, so we may not be able to comment in a very specific and detailed where regarding to some financial questions. Now we can open for the Q&A session. Thank you.

FPR: Thank you, Karen. Now we come to Q&A session. Operator, please make an instruction for Q&A.

Q&A Session

Lina Yan (LY) from HSBC

LY: Hi management, thanks for taking my questions. I have a question regarding Q4 because I know you probably cannot come and see exactly what's going to happen in Q4, but we look at the Q4 last year, there was a very high base in terms of sales in RMB in China, so would it be fair to say like given all the market dynamics and their work are very disciplined on our GP margin and the price increase, it’s kind of unlikely for us to achieve a higher revenue in China like in Q4 last year. This is the first question. And secondly considering all the margin dynamics and possible revenue growth in Q4, should we expect like similar kind of OP margin trend in Q4? Thank you, that's my questions.

KL: OK, maybe I'll take the momentum question and then Vicky would take the OP margin question. Coming into Q4, I think for those of you who are familiar with Vinda, Q4 has always been a higher selling season for Vinda, especially double 11 being the most important shopping festival in Q4 in the past 8 to 10 years. We have always been the leader at double 11 and we have always managed to gain shares and we have always managed to sustain our position in double 11 and I see no reason this year being an exception. We're fully prepared. We have all the plans in place that it's probably already starting up, so we actually quite confident about double 11 this year. So last year we had a high base but for us internally our full year ambition has not changed, we've had such a good track record for double 11. And I don't see this year being exception.

Yes, we are seeing that there are some uncertainties coming into Q4. I mean that is something that we also discussed internally. Mainly coming from the pricing environment and I think I touched on before that I wouldn't say surprised, but we were the only one to try a few times to raise the price and this did have a little bit impact on our volume and coming into Q4, at least for double 11, it is a festival that focused a lot on volume and so we also adjusted some of our strategies to maintain our competitiveness for double 11. So, for double 11 I think our priority has not changed and that is for sure to sustain our market position, preferably to even gain shares.

But at the same time, pricing is only one factor in terms of the whole competition game, but more importantly, we feel very comfortable about our premium offerings. The premium offering is now already 35% of our total business within the group. So we have a good ambition for our mass products, but a very, very high ambition for our premium products. So that is not, of course, only good for our profit line, but it's also very good for our value growth as well. And I think I didn't mention it before, but for Q3 and despite you know, a lower volume than anticipated, but we still have managed to outgrow the market gaining shares, and we were the only one among the other competitors who are able to realize a higher value growth and volume growth.

So, I think this is again a piece of evidence that we are able to achieve a good growth, but also at the same time a valuable growth without sacrificing too much on pricing. So yes, in a nutshell we are very confident, but also there are a few points of uncertainties such as pricing, such as we don't know how COVID is going to develop and some potential mandatory shut down because of the actions required by the government. So there are some few uncertainties that we face in Q4. But we believe that with all the competitive advantages Vinda has, we are able to deliver a good Q4 results.

VT: And when it comes to the operating margin, I think Karen mentioned already that there will bemore uncertainties in the coming Q4 compared to the past years in the operating environment. However, we are quite confident we will deliver a solid Q4 results because we are quite confident to achieve a good result for the significant e-commerce season. And when it comes to operating margin, we believe that the scale in Q4 will definitely help with that, after our price increase in Q3 you see our volume growth in Q3 slowed down a bit, but still our gross profit margin remained relatively stable and with the higher scale which we believe we will achieve in Q4, I think our operating margin at the same time will remain relatively stable.

LY: Thank you Karen and Vicky.

Anson Chan (AC) from Daiwa Capital

AC: Hi, thank you Karen and Vicky picked my question. I want to ask a bit more on the selling cost side, as you mentioned, there's like some one-off AMP expenses for Q3 but how should we look at the full year cost ratio as we used to say that like we aim to contain SG&A costs ratio between the range of past two years and also can you give a bit comment on other parts of the selling costs like logistics and also their sales expenses, thank you.

VT: OK, when it comes to our selling expenses in Q3, there were few items which like one of our investment for the new brand ambassador and production costs of the advertisement that will affect probably around 1 point of our expense, which we believe will not happen again in the same year. When it comes to logistic cost, I think this year we have very good growth for our E-commerce flagship store and the new platform stores, that distribution model of this new platform of flagship stores, we are handling the logistics and transportation by ourselves, so that will drive up our logistic costs to some extent, and that will continue in Q4, but again those costs relatively grow with our scale.

So for that part logistic costs, I think as an expense ratio will remain relatively stable or slightly lower for Q4 because of the scale. All in all for Q4, the expense ratio will not change very significantly versus Q3 because we have better sales scale, and while we are very committed to continue to invest for the premium and personal care categories, those costs are relatively stable or fixed in in every quarters. So definitely the higher scale in Q4 will help with that as well. Thank you.

AC: Thank you, Karen and Vicky.

Emily Lee (EL) from Nomura

EL: Hi management and thanks for taking my question. Just 2 questions here. I just want to check on what was the price hike that we implemented in Q3 and we mentioned on volume actually slowed down a little bit. Just want to know what kind of percentage dropped that we see in the quarter. Secondly, I wanted to check on the monthly sales trend. Remember last quarter, we were able to give like a monthly sales trend for April to June. Just want to check if we can share something similar for this quarter as well because I want to see if there is a deteriorating trend on a monthly basis that we should be cautious of for Q4. Lastly, just want to check on pricing cause we're seeing, the pulp price coming down. And obviously we did implement it some price hike so just wanted to see what should we expect for the peers pricing level in Q4. Any potential for them to further conduct promotion so that that could actually hurt our pricing too? Thank you.

KL: Thank you. When it comes to volume, I cannot give you the exact number but I can tell you that our volume growth despite being slowed, but our volume growth is still higher than the market. Roughly about two points higher than the market growth if we look at external data comparison. That means that could be indicated the market did slow down little bit in quarter three but we still have managed to outgrow the market when it comes to volume, and the value growth is obviously slightly higher than the volume growth as I talked about before. While I can point to you that all the other major peers, their value growth is much lower than the volume growth, and in some cases it's even you know the volume growth is double of their value growth. So that is another indicator of the pricing trend from the peers and also our ability to grow volume at a reasonable pace despite keeping our pricing at a good level. Of course that was helped by a big portion of our premium offerings within our portfolio. That is the answer on volume and value.

KL: When it comes to month over month performance. What I can tell you that July and August have been challenging for us, but September has been a very good month for us in both in terms of sales and expenses. So that is significantly better than July and August. That is something I can share with you, and I think I also talked about it before coming into September. We are also seeing that price movement for us is notable. Meaning that we have been able to successfully implemented another price adjustment which was implemented starting from August. We're actually seeing that from our both internal data and external data indicating a clear increase in our overall pricing level.

Coming into Q4, historically it has always been difficult to increase theprice significantly during double 11 because it is quite a heavy promotional festival for everyone. For us, we focus for double 11 is obviously not to increase the price, but it's really based on two things. One is to control our promotional spending. I mean to perhaps really take a good look at some of the low profit SKU or low profit customers. So we are very selective on who we invest in, how do we manage our pricing at stable level.

Over the past few quarters, we are seeing that because of the channels shift for example community buying things. Basically, we try really hard to manage our overall pricing to make sure that there is not too much collusion. But for the other peers that is something that we observed in the market as well. If you don't control your pricing in a good way, it's really easy that you drive the volume. But later on, you have some issues on theinternal pricing system. So that is something that obviously we want to avoid.

Another important mechanism for us is to drive a higher growth of our premium products. We talked about quarter over quarter before on our premium offerings. Their gross margin is 8 to 10% higher than the non-premium products. If we're able to drive a faster, higher growth for products such as Tempo, Tork and wet wipes which we have done successfully quarter over quarter, that is another mechanism or action that we're able to keep our pricing at a good level. Of course, I mean we might still have an opportunity after double 11 to pull up the price. That is something possible for us, but I guess it's a little bit early to say, but what I can tell you that if we see a window of opportunity, we will definitely do so.

EL: Thank you.

Louise Lee (LL) from Bank of America Security

LL: Hi Karen! Hi Vicky! Thank you for taking my questions. My first question is on the GP margin in Q3. So could you give us the breakdown for the GP margin? Maybe the lower GP margin versus the last year? For example, the raw material cost, or the lower utilization rate, or the intensified competition. So which one is more important for the GP margin trends here? So my second question is we have seen the power crunch in selective provinces, particularly in Guangdong province. Have you seen any impact from the positive side or the negative side? Have you seen any impact on the peers as well? Would that mean it is more likely for us to increase the price or the competition will become better? If this is not the case, why? This is my second question. Thirdly, we mentioned that we are participating into some new E-commerce platforms, for example TikTok. This kind of new channels, the margin is higher or lower. What is the trend in future? Thank you.

KL: When it comes to gross profit margin compared to the same period last year, we have roughlyabout three points that is coming from pulp and energy, packingand slightly lower utilizationWe have one point that positives coming from pricing and mix together. That is the something that we actually see quarter over quarter. Perhaps, another roughly about to have points coming from personal care.

Your second question on the power supply. Yes, we are seeing that coming towards the end of Q3. There are different government mandated shutdown policies. For now from what we know so far, the impact to us is insignificant. Yes, there are some measures and we are working with the local governments to work out the exact implementations. Of course, every provinces have different policies and different implementation speeds. But for us, I mean we don't see any significant impact to our utilization with what we know and but of course this can change, on a daily basis, on a weekly basis coming to Q4 which we don't know yet, but we actually feel quite confident. Despite you know the possible shutdowns, let's not forget that we have 10 factories across China. We are very flexible even in the case of local shutdown, we are able to ship goods around a lotwe have very good communication with local government, so we were quite comfortable with what we know so far and we are able to manage in a good way.

Of course. I mean this kind of a policy change from time over time and I think you asked very good questions on what if there is a massive mandated shutdown. If that is the case, we don't know which or whether they will happen. That will of course impact small companies first because they have less inventory to pay around. They have smaller room with the government negotiations, so that could be an opportunity for us to work on our pricing again if it would happen in coming Q4. But in the long term, I would say this could be a definitely good thing for big players, and even more so in the sense that it might be a good opportunity for the marketer consolidate, which is something that we have not been able to see in the past few years.

The last questions on the new channels.

VT: When it comes to some new platform channels, we start to invest, I think from second half of last year. For some of them like TikTok, we only started to make significant investments since Q2 this year. When it comes to profitability, we understand that we need to make some upfront investments when we entering into some new platforms or new channels. However, like Karen mentioned at the beginning, in Q3 we already seeing 80% growth of our TikTok sales compared to Q2. That's why we believe our return on investment through this platform and new channels will be improved very quickly in the coming quarters. On top of that, I think when it comes to the new channels and new platforms, we are promoting very selectively. We're pretty much not selling toilet tissue or the non-premium products through this new channel platforms. We use them to attract new traffic, so we promote our feminine products and premium products, like Tempo and wet wipes a lot using TikTok and similar platforms. So that's why we believe in time very soon that our profitability and return will be improved on these platforms. As I said before, we are investing for the future. Basically, in order to make sure we have a healthy and sustainable growth for the whole Group, I think we have to make these investment and take this upfront cost for ourselves. Thank you Louise.