Vinda International Holdings Limited
2019 Q1 Results Conference Call
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Speakers

Mr. Christoph Michalski, CEO **(CM)**
Ms. Vicky Tan, CFO & Company Secretary **(VT)**
Ms. Venus Wong, Assistant Corporate Affairs Manager **(VW)**

Presentation

VW: Good Morning ladies and gentlemen, welcome to Vinda's briefing call for Q1 of 2019. I am Venus, Assistant Corporate Affairs Manager. 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 first present the results and then we will open for Q&A. Earlier this morning, we have sent you the presentation. Please check your email box or download it from our website if you missed it. Now I'll pass the time to Christoph.

CM: Good morning ladies and gentlemen. Thank you for joining our results call. Before I start, I would like to remind you that we only publish very few indicators for Q1 and Q3 considering that we have full publication of results for the first half, second half, and the full year. I think overall we had very good Q1. On slide 2, basically summaries of our key figures in the announcement and I will take it one by one in the rest of the presentation. But I think, in summary, I can say despite the challenging environment and relatively high pressure of raw materials, we still managed to achieve double-digit topline growth, and this was really thanks to continuous effort in mix enhancement, new launches and, on the profit side, it was basically our cost saving initiatives and careful spending on sales and marketing, which has driven our performance.

Let me elaborate one by one on page 3. You basically see our revenues. Overall revenue has grown by 7.9% Y-o-Y to HK$4.1 billion, corresponding to an organic growth rate (constant exchange rate) at 13.4%. Just to remind you, this was the highest growth rate we had over the last 5 quarters. Strong growth was driven by key marketing activities in Q1, particularly in China. During or prior to the Chinese New Year, we had very good performance as well as after Chinese New Year. We had good growth also in the other regions, in particular Hong Kong with also double-digit performance. Tissue particularly grew well in this quarter and accounted to 83%. The main driver of this has been Tempo and 4D Deluxe our more of premium products.

If you look at page 4, you see the gross profit development here. Clearly we're still suffering a little bit from the high pulp prices, which the pulp we purchased in Q3 last year. As you know, we had about four months of stock of pulp and the pulp prices only kind of reduced a little bit since November/December last year. So that is why we still have a relatively low gross margin driven by higher pulp prices, but you can also see the gross margin has stabilized and while it's lower compared to Q1 last year. Actually it's the same level as Q4 last year. So going forward, we see situation inversing a little bit. As you know, pulp prices decreased since October and November last year and that would flow in continuously in our performance in Q2.

The other things we still continue to do at the gross margin level, but also on the operating profit margin level. We will continue our cost savings. We will continue our portfolio management. As I mentioned already, Tempo and 4D Deluxe have grown particularly well. We are focusing on all the higher-added categories like softpack and wet wipes, and kitchen towels. And all these measures have basically allowed us not to have even stronger decline in gross margin while pulp prices were very high. And I think in the quarters to come we should see some of the benefits of these strategies.

Let's go to page 5. We see the operating profit. We have very good movement here is basically very similar in terms of margin to Q1 2018, significantly improved from Q4 2018. We moved from 6.1% in Q4 last year to 8.3%. This is basically all due to our very systematic approach to marketing expense. We have had good control of administrative expenses, and basically both declined not only as a percentage of sales, but also in absolute terms.

For the EBITDA, there seems stability from 7.7% improvement between Q1 2019 and Q1 2018, and basically a very similar margin than last year, but very significant improvement if you compare this to Q4, the EBITDA margin was only 11.9% and now improved to 15%, or 3.1 percentage points improved.

Revenue by channel, as you know, we continue to grow significantly in E-commerce, but for the first time, for a long time, all channels – key accounts, B2B, e-commerce have double-digit growth and distributors was positive, so I think we see across all channels very good evolution. If you look at the number of Q1 2019, e-commerce presented 25% and corresponded approximately 31% of e-commerce in China.

So let's conclude my presentation which is relatively short, due to the limited amount of the data that we published for the Q1 results. But as I said before, we are a bit aware of how the pulp situation has changed compared to last year. And I think even for Q2 we have a very good track to continue with strong performance to 2019, so I would like to handover to Venus for Q&A.

VW: Thank you Christoph. So we are ready for Q&A session.

<u>Q&A Section</u>

Anson Chan (AC) from Daiwa

AC: Thank you. Good morning Chris, Vicky and Venus. One simple question and one more complex. On the simple one, can you give us some breakdown in terms of volume or ASP trend in the Q1? And the second one is, given that we have seen lower pulp cost from Q2 onward and at the same time I think our competitors also have similar trend, so how will we price our products in the coming quarter? Thank you.

CM: I think in simple term you can say that our sales growth is very much in line with our volume growth. Unlike previous quarters, where we did some price increases and had some basic stability in volume. This quarter was a little bit already like the beginning in Q4 last year, a very good alignment between the volume growth and value growth. That is normal because we didn't do any further price changes in Q1.

If you look at the second question about the evolution of pulp prices. As we know we have I think the highest level of pulp was in October 2018 where basically if you look at the pulp price in RMB, was close to RMB$6,700 or around US$980 for long fiber and aboutUS$860 for short fiber. This has declined very significantly from October onwards, the lowest level we have recorded was January, where short fiber was US$650 and long fiber was US$710. We don't expect to be so low. You probably heard the market said there was a bit of speculation going on and very few volumes were sold in October, November, December. But I think the market has come down very significantly. We expect to take up very slightly in Q2 and Q3. However, as you know, we have about 4 months of stock. So basically from now on, we see cheaper pulp coming into our production which could have positive effect on our gross margin evolution in Q2.

AC: I think I mean is that something I'm seeing more cost but at the same time, I think our competitors will also enjoy similar benefit. So what we want to know is that are we going to lower our price or do you think our competitors will lower their product price?

CM: I cannot really speak for our competitors, so I think my view is that we have a very clear pricing policy that we tend to not change prices, because of raw materials changes except there are very dramatic as we had to do last year. So we will maintain our price level and our promotional level as far as competition allows us to do and we need to see in the coming months what is happening. I think when it comes to the overall industry as you know a lot of our competitors did not raise prices to the level we did, and therefore I don't see them in a situation to be able to reduce pulp prices quite significantly. What we've seen in the market is a very competitive market, but when I look at our sales performance in Q1 this year, I think our price level at the moment is quite sustainable.

AC: I see. Thank you.

Dustin Wei (DW) from Morgan Stanley
DW: Thank you management. My first question is related to the pulp. What's your stance about the pulp inventory onshore in China or offshore now?

CM: So when it comes to the industry, you are probably aware that there's a significant inventory in the China pulp industry. I saw some data recently that the stocks are very high in China. When it comes to us, we do not have active policy of pre-buying, we try to manage our working capital in a responsible way. Therefore, our stock levels are very much in line with the average stock level. To date, the turnover of pulp in stock is not significantly different than it would be historically.

DW: Understood. Why do you think that the pulp inventory would keep piling up? My understanding about upstream is that there's no incremental supply from big pulp makers, but in fact because the general demand has been lower or, you know, for paper-board makers, they need less pulp, or some of them are under the policy changes in China. So what is the driver for the little bit imbalance between supply and demand on the pulp side?

CM: Yes as you know tissue represents about 30% of pulp usage in the market, and the rest is the paper, packaging and all this type of things. Clearly in the past, the pulp price increase had been very much driven by generally a very good economic outlook in the first half of 2018, and then by the fact that there were some major changes in the waste paper import legislation in China. And that basically has led to the very very significant price increase of pulp. What we see going forward is the following, first of all, I think the economic outlook, generally speaking on the global level, is a little bit less optimistic, which takes a bit out of pressure out of the pulp market like most of the raw materials.

Second thing, we are seeing on the other side, or more from the supply side, we do not see many significant new projects on pulp right now, which will hit the market between now and 2021, so that it would basically limit the supply to some extent. And then we don't know yet what will really happen to prices with the merger of Fibria and Suzano, which has very high market share in China.

So if you take all these aspects together, I realized how bad I am generally in predicting pulp prices. We basically think that we have reached the bottom of the market right now. And from now on to Q2, Q3 and Q4, pulp prices will be stable but all slightly on the way up. So I think that it is just our planning assumption going forward. Whatever happens, if prices go further down, then it clearly does have very short-term effect on our profitability. If prices go up significantly faster than we expected then again we have to see what we can do with pricing and promotion, or things like that. But I think we do not expect the roller coaster we had last year going forward in 2019. When you look at the medium-term outlook, I think again, it will be very much driven by economic development and supply is pretty visible or whatever is happening there. So that would tend to a slight increase again in 2020 before new capacity might be available in 2021 and 2022.

DW: Okay. Thank you. On pricing, may Iclarify because I remember Vinda last year did two rounds of price increases. I think one is in Q1 and the second one in Q2 also. You just mentioned in the Q1 your price was relatively stable YoY. I'm just thinking is there any sort of tailwind like the price increase in the Q2 last year that kind of benefits your ASP general for first quarter this year?

CM: I think sorry that there was a misunderstanding, so we did not do any price changes this quarter compared to last quarter, but clearly compared to Q1 last year, we have a little bit of an average price increase compared to Q1. I think if you look at the data during the year, pulp prices went up between I think October/November 18 to October/November 17 by still around 10 to 12%, which is quite significant. And in RMB even higher. And as you know for the price increases, the first one was in Q1, 4-5%, and we did the second one in Q2. Both price increases were not very well-followed into the market and we took some steps in Q3 in order to promote a little bit more. And I think overall our pricing strategy allowed us to regain momentum in Q4 last year, continued this quarter. Also if we hadn't done any price increases, our gross margin would have dropped much more significantly. So I think, overall we have the right strategy. This is clearly not depending on timing. But I expect that if the pulp prices, or I expect in Q2, at least some of the benefits of lower pulp prices to flow directly to better gross margin.

DM: Thank you very much. Just to follow up Anson's question on competition. I'm not too worried about competition from the top four, but you know like the platform like Pinduoduo or other e-commerce platforms might focus on more low-end type of competition. Would you think that could be a potential threat to the industry pricing amidst the lower pulp cost?

CW: If you look at our market share, I mean we have gained market share since last year. So I think we are very happy about that. I think our competitors, some of them also gained shares, some of them lost. When I look at the market share of the top four players, it's around 52% and it's relatively stable went up 0.3%. This is Kantar data just for your information. So it's stability. I do not see a very significant threat by much smaller players. Pinduoduo is mainly a volume-driven platform and most consumers buying products there might not be interested in added value brands. If I see the brands in China, I still think there's enormous opportunity for growth as you can see in our numbers. But I assume you have also seen the yearly results of competitors. So I think overall the market is as competitive as ever. But I don't see any structural change because of these e-commerce platforms.

DW: Thank you very much.

Closing

CM: OK. I think there is no further question, so thank you very much for your time listening to us and following Vinda. I'm looking forward to hopefully seeing some of you in H1 results in July. And as I said before, we have a very good quarter and we expect next quarter to further improve some of our performance indicators and looking forward to seeing you in July for H1 results. Thank you very much.