

Cosmo Lady (2298.HK) Teleconference Q&A Summary

Hong Kong | Consumer | Company report

We had a conference call with Cosmo Lady's CFO Vincent Loo on 24 Jan 2017. Below is the Q&A record:

1、Cosmo Lady issued profit warning on 20 Jan. What were factors that led to the increase in operating expenses as a percentage of revenue?

The plan we made at the beginning of 2016 was relatively aggressive. We expected sales would grow well, so we were aggressive in opening shops and procurement. Sales in 2016 dropped slightly, but GP margin in 2016 may be better than 2015. When we made the 2016 plan, we didn't expect the economy to be weak and we didn't expect the whole market to change so much. As a result we overspent. The increase in costs included the increase in rental fees, labor costs and advertising costs, resulting in unsatisfactory 2016 results.

We need to tighten cost controls in 2017. We began to close some stores in order to save rental fees and labor costs in 2H2016. When closing the shops we need to make corresponding compensation, and the previous renovation costs were going to be amortized over several years, but now the unamortized part need to be expended in one go. Therefore, the benefits of closing the stores would not appear in 2H2016, but might show in 2017. For the shops we didn't close because of good performance, we will negotiate with the owners for the possibility to reduce the rental fees. For the shops we didn't close, we may save more than 20 million RMB rental fees in 2017. As for advertising costs, the television media advertising costs are high but the effect is not good, so we may focus more on the Internet advertising in the future. In addition, we cooperated with Disney and Hello Kitty but sales was not so good, we will stop cooperating with them and save some costs in this area. The controllable costs are expected to be reduced greatly.

2、What does the structural adjustment in the mainland China intimate wear industry mean in the announcement?

The structural adjustment means changes in channels. The past success of the company is partly due to the opening of a lot of shops. But in 2016 some of the shops didn't perform well, especially shops in the department stores and shops in the same street competing against one another. The corresponding ways to solve the problem is to close the shops with poor performance. We found that the shops in shopping malls perform well and we plan to open about 300 shops in shopping malls. We will increase e-commerce investment, and we are planning to lower the inventory level by e-commerce channels. Moreover, the company has hired an institution to provide advice on how to improve the image of the stores (the fifth generation image). On the other hand, we will open outlets in Tier 3 and Tier 4 districts in the future, where the consumer groups are more likely to accept past-season products. We may also develop Southeast Asian markets in the future.

The structural adjustment also means change of user demand for the products. In the past steel ring products accounted for most of the products, but now wireless products are more popular. At the beginning of 2016 because of wrong estimation, the easy selling products were out of stock while the products not easy to sell had too many stocks. We will do more market research to know the market demand better in the future and focus on developing the products the market needs.

There're also some changes in supply chain management. The method of placing orders changes to a more flexible way. For example, 40%-50% of the orders can be placed first. Then according to the actual sales decide whether to increase or reduce the remaining orders.

3、How are company's WeChat platform and online sales?

Online sales is not only through WeChat. We mainly develop our online sales through Tmall.com and VIP.com.

4、How is the change in same-store sales? In 1H2016 the company reduced the number of franchisees. Will the company focus on self-managed stores? Will it affect the future development in Tier 3 and Tier 4 cities?

We will open shops in places such as shopping malls and communities. We are opening and closing franchisees as well as self-managed stores. We will also open some joint-operation shops of which the operation pattern is somewhere in between. Same-store sales doesn't change much throughout the year.

5、 How is the impact of e-commerce?

The company's reputation is relatively higher. Its e-commerce market share ranks No.4 in 2016 and is expected to be higher in 2017. E-commerce sales accounts for over 7% of the total revenue and it's expected to maintain rapid growth in the future. However, the e-commerce business can't fully replace the offline sales because of the products' unique character that people need to try.

6、 What do you think of the competition with foreign brands such as Victoria's Secret?

The price of Victoria's Secret is relatively high. But most of the company's products are mid-range products. Consumer groups are different. In addition, the company's "Ordifen" is a high-end brand.

7、 How is the GP margin compared with 2015?

2016 GP margin may be better than 2015. First it's because the product structure changes, there are different products in mid-range products and more high GP margin products are sold. Moreover, there are also some changes in the supply chain.

2017 GP margin is difficult to judge, because the effect of outlets and the overseas development are temporarily difficult to judge. In addition, the price of packaging materials rose a lot, because China has increased efforts on environmental protection. However, since we signed the contracts before the price increases, there's little impact in 1H2017.

8、 How is the revenue in 2016 and 2017? How will the SG&A/revenue ratio change in the future?

In the condition of tightening cost controls, the expense ratio is expected to decrease significantly in 2017. There're controllable costs and non-controllable costs. Hopefully the controllable costs will return to 2015 level. We will also try to improve sales in the future.

9、 Is the operational philosophy "small profits but quick returns"?

We don't want to change to a low-end brand from the mid-range brand. And the rise in packaging material prices may cause slight price increase.

10、 Does the company have a market share target? What is the contribution of inner growth and outer acquisition to market share?

The industry is very fragmented. According to a third-party report the company is the industry leader. Although changes in the market and packaging material prices have negative impact to the company, it can also accelerate the extinction of small businesses. The company may have higher market share and more M&A opportunities then.

11、 How is the effect of Lin Chi-ling and Huang Xiaoming as advertising spokespersons? Will the company increase investment in this area in the future?

The company is controlling costs. Their contracts will end in a year. The plan of 2018 is still uncertain.

12、 Do the fees of the mega annual intimate wear fashion show and celebrity endorsements account for a large proportion of the revenue? Is the fashion show a single large-scale activity or many other brands also hold such kind of shows?

We will continue to hold the intimate wear fashion show on 8 April this year. The contracts were signed a few years ago, endorsement costs accounted for a small proportion of sales. The main costs of the company is rental fees, labor costs and other advertising costs. The fashion show is the largest event for the domestic brands.

13、 The seamless and wireless products were short of storage in 1H2016. How will the company respond to the rapid changes in consumer demand in the future?

We hired some experienced team members to keep a close watch on the market changes. We will also put more effort on product development and do more market research to deal with market changes.

14、 Will China`s mass market maintain rapid growth in the future and help to improve the company`s future performance?

We don`t know yet, but we think that the consumer market of China won`t go backwards.

15、 How is the future CAPEX/revenue ratio?

There won`t be significant change unless there is M&A activity.

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