[SY] So-Young International Inc.
Q2 2024 Earnings Conference Call
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Mona Qiao, Investor Relations
Xing Jin, Co-Founder, Chairman, CEO
Nick Zhao, CFO

Analysts
Chloe Wei, CICC
Nelson Cheung, Citibank
Patrick He, CITIC Securities
Joey Han, Jefferies
Ivy Li, Haitong

Presentation

Operator: Ladies and gentlemen, thank you for standing by for So-Young's Second Quarter 2024 Earnings Conference Call. (Operator Instructions). After management gives their prepared remarks, there will be a question-and-answer session. As a reminder, today's conference call is being recorded.

I would now like to turn the conference over to your host for today's call, Ms. Mona Qiao. Please go ahead, Ms. Mona.

Mona Qiao: Thank you, operator. And thank you everyone for joining So-Young's second quarter 2024 earnings conference call. Joining me today on the call is Mr. Xing Jin, our Co-Founder, Chairman and CEO, and Mr. Nick Zhao, CFO.

Please note that the discussion today will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities and Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations.

Potential risks and uncertainties include, but are not limited to, those outlined in our public filings with the SEC, including our Annual Report on Form 20-F. So-Young does not undertake any obligation to update any forward-looking statement, except as required under applicable law.

At this time, I'd like to turn the call over to Mr. Xing Jin.

Xing Jin: (Speaking foreign language).

(Translated).

Hello everyone, welcome to today's earnings call. Our performance during the second quarter was solid, with total revenue of RMB407.4 million, exceeding the top end of our guidance. Non-GAAP net profit was RMB22.2 million, up 43.1% year-over-year, showcasing our high-quality growth and the effectiveness of industry integration.

We capitalized on industry trends, executed on our strategy and made impressive progress during the quarter. Specifically, our new business segments continued to grow rapidly, with revenue from the sales of medical products and maintenance services reaching RMB106 million, up 22.6% year-over-year.

Product shipments in our upstream supply chain business increased as our chain of clinics expanded, both contributing significantly to growth. We are the only platform covering the upstream, midstream and downstream segments of the entire aesthetic medical industry and are leading the industry into a new era of high-quality and sustainable development.

Leveraging the synergies created by the vertical integration, we are enhancing industry transparency and operational efficiency across the value chain. This closely aligns the industry value chain with evolving consumer needs, ensures a diverse range of high-quality and affordable products, optimizes the customer experience, and redefines standards for medical aesthetic services.

Now, let's have a closer look at our Q2 business performance. We continue to drive high-quality development in our POP segment and strengthen our competitive advantage in the mid-to-high-end market by refining operations and deploying targeted user subsidies. With client demand for premium customized products growing, we adjusted our strategy and upgraded SKUs, ensuring their authenticity, and further enriched the categories offered by our leading partner institutions.

We also strengthened support for high-quality institutional partners by integrating our POP business with our chain of clinics to create deeper and greater synergies, enabling us to better meet the evolving and diverse medical aesthetic needs of mid-to-high-end users. In the second quarter, GMV from medical aesthetic products and services reached RMB428 million on over 230,000 verified orders, up around 17% and 8% respectively.

We continue to optimize our traffic acquisition strategy by reallocating budget away from low-ROI online channels to our private domains. Refining multi-channel private domain operations allows us to cultivate and retain a targeted user base and improve user engagement and monetization efficiency. In the second quarter, the users of private domains reached 810,000, up 14% quarter-on-quarter.

Let's move on to So-Young Prime. Currently, we have opened 14 clinics in prime commercial areas in 8 core cities including Beijing, Shanghai, Shenzhen, Hangzhou, Chengdu, Wuhan, Chongqing and Changsha. All of these clinics are fully operational and performing in line with expectations. Leveraging our strong user base, the reputational strength of our brand and standardized fulfillment capabilities, the number of verified customers increased by 85% quarter-on-quarter, the repeat purchase rates exceeded 50% and customer satisfaction improved to reach an impressive 4.97 out of 5.

We've also achieved solid operational efficiencies. For example, our Beijing clinic generated revenue of 6.2 million in June, with pretax profit of 1.3 million and a profit margin of around 20%. The repeat purchase rate hit 67%, higher than the industry average.

Notably, both unit area efficiency and monthly revenue per doctor outperformed traditional clinics. The experience we have accumulated from this provides us with valuable insights that we will apply to other new clinics to accelerate their growth. We are very optimistic about the future of light medical aesthetic clinics, and plan to begin franchising our chain of clinics in the second half of this year, in order to rapidly expand our footprint by replicating this proven standardized model in the target cities.

Lastly, I will provide updates on our supply chain business. Leveraging our brand, extensive consumer behavior data, and experienced team, we are building full-category upstream medical aesthetic manufacturing capabilities for our broader ecosystem. With over a decade of operations, we have accumulated a wealth of consumer behavior data and user demand insights, laying a solid foundation for the development and customization of our products.

In addition, leveraging our extensive institutional coverage and strong customer marketing capabilities, we are able to rapidly strengthen the competitiveness of new products using our clinics to ensure a steady stream of sales. Our core team is composed of professionals from top domestic and international manufacturers, each possessing an average of 5 to 10 years of industry experience and strong expertise in product selection and sales. In the second half of the year, we will continue to expand this team with the goal of reaching 100 members by the end of the year.

Additionally, we've seen a continuous increase in shipments of Truelift, our newly launched non-surgical anti-aging ultrasound device reflecting its strong potential to be a market hit. Meanwhile, the Korean brand Elasty has maintained strong growth momentum, with second quarter shipments exceeding 40,000 units, up 76% quarter-on-quarter and 113% year-over-year.

Revenue from the sale of injectables grew by 65% quarter-on-quarter and 117% year-over-year. As of the second quarter of 2024, we partnered with 780 institutions for the sale of injectables.

Despite the soft recovery in consumption and the macroeconomic challenges over the near term, we believe that the Chinese medical aesthetic market still has enormous potential in the long term. As the industry begins reshuffling and enters a period of consolidation, leading brands like So-Young, with a unique ecosystem and full-category advantages, are well-positioned to capitalize on new opportunities, expand their market share and sales potential, and solidify their position as market leaders. We believe our POP business is ideally suited to meet demand for non-standardized treatments, while our chain of clinics can service standardized treatments.

Supporting both of these businesses with a steady stream of exclusive products is our upstream business, which will also benefit from 2C and 2B opportunities and guaranteed sales offered by both downstream businesses. Combined, these three business segments create enormous synergies and form our iron triangle. We strongly believe that vertically integrating the industry value chain will drive innovation, effectively ensure the quality of services, and open up new growth opportunities for So-Young going forward.

I'll let our CFO Nick take over now to go through the second quarter's financial results. After that, we'll open up for questions.

Nick Zhao: Hello, this is Nick. Please be reminded that all amounts quoted here will be in RMB. Please also refer to our earnings release for detailed information of our comparative financial performances on a year-over-year basis.

Total revenues during the quarter were RMB407.4 million, down 1.1% year-over-year, exceeding the high end of our guidance on the back of a 22.6% year-over-year increase in sales of medical products and maintenance services.

Information services and other revenues were RMB279.2 million, down 6.6% year-over-year, primarily due to a decrease in the number of medical service providers subscribing to information services in our platform. Reservation services revenues decreased 16.9% year-over-year to RMB22.4 million, primarily due to policy changes for commission rates and subsidies.

Cost of revenues was RMB155.1 million, up 3.1% year-over-year, primarily due to an increase in costs associated with sales of cosmetic products.

Within cost of revenues, cost of services and others were RMB101.9 million, down 4.4% year-over-year, primarily due to a decrease in costs associated with So-Young Prime. Cost of medical products sold and maintenance services were RMB53.2 million, up 21.3% year-over-year, primarily due to an increase in costs associated with the sales of cosmetic products.

Total operating expenses were RMB245.6 million, down 13% year-over-year.

Sales and marketing expenses were RMB132.3 million, down 4.1% year-over-year, primarily due to a decrease in expenses associated with branding and user acquisition activities.

G&A expenses were RMB70.8 million, down 23.3% year-over-year, primarily due to decreases in share-based compensation expenses and professional consulting fees.

R&D expenses were RMB42.5 million, down 18.5% year-over-year, primarily attributable to improvements in staff efficiency.

Income tax benefits were RMB2.6 million, compared with income tax benefits of RMB0.8 million in the same period of 2023.

Net income attributable to So-Young was RMB18.9 million, compared with a net loss of RMB2.6 million during the same period last year. Non-GAAP net income attributable to So-Young was RMB22.2 million, compared with RMB15.5 million in the same period of 2023.

Basic and diluted earnings per ADS attributable to ordinary shareholders were RMB0.18 and RMB0.18, respectively, compared with basic and diluted loss per ADS attributable to ordinary shareholders of RMB0.02 and RMB0.02, respectively, during the same period of 2023.

We have maintained a robust cash position, with cash and cash equivalents, restricted cash and term deposits, term deposits and short-term investments totaling RMB1.25 billion as of June 30, 2024

Moving to our outlook, given the relatively soft macro conditions, especially with respect to discretionary spending, for the third quarter of 2024, we expect total revenues to be between RMB350 million and RMB370 million. This outlook also takes into account the uncertainties of the pace of clinic openings and ramping up, as we are in the early stages of our clinic expansion and our business transformation.

That being said, we are confident our strategic initiatives integrating the upstream and downstream of the aesthetic medical industry value chain will ideally position us for long-term growth. These initiatives will enable us to capture a significantly larger share of the market, and establish a solid foundation of profitability. As our clinics mature and market conditions stabilize, we expect our financial performance to gradually improve.

This concludes our key remarks. I will now turn over the call to the operator and open the call for Q-A. Operator, we are ready to take questions. Thank you.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Chloe Wei with CICC.

Chloe Wei: (Speaking foreign language).

(Translated). So let me translate myself. Firstly, congratulations on the solid results. The revenue continued to exceed the high end and really strong bottom line, and my question is about the overall trend. So entering the second half of this year, we have seen signs of slowdown in most consumer companies guidance, say the online platforms, tourisms and etc., so I understand that's mostly due to the macro headwind. But can management share more color on the trends we have seen in July and August from the consumers and also from advertiser side? And looking into the second half, are there anything we would like to share with the market about how we plan to adapt to the new changes?

Xing Jin: (Speaking foreign language).

(Translated).

The current state of the medical aesthetic industry isn't quite where we thought it would be at the beginning of the year. According to data from the NBS, the retail sales of consumer goods in China increased by 3.7% year-over-year in the first 6 months of 2024, a deceleration compared to the first quarter of 2024 and the last quarter of 2023. Despite weak consumer confidence and discretionary spending, the medical aesthetics market continues to grow and offer significant structural opportunities.

Market share of light medical aesthetic services is expanding, driven by strong consumer demand for minimally-invasive and convenient services. Meanwhile, the upstream supply chain is experiencing a surge in growth, fueled by innovations and supply chain optimizations that are propelling the industry's overall advancement.

Our industry research highlights two key forecasts that will shape the future of the industry. First, we expect to see the standardization of light medical aesthetic services gain momentum. This will lead to emergence of large chain brands and enhance market norms and efficiency, resulting in a more mature sector.

Second, over the next 4 to 5 years, we anticipate that leading chains will dominate the market, significantly accelerating industry concentration. As top brands capture larger share of market, new opportunities will be created for investors and entrepreneurs. To capitalize on this trend, we plan to begin franchising our chain of clinics in the second half of the year. This will not only contribute to the industry's expansion, but also position us for success in a rapidly-evolving market. Thank you.

Operator: Nelson Cheung with Citibank.

Nelson Cheung: (Speaking foreign language). My question is regarding the POP business. And wondering what would be the company's outlook on the positioning of the POP business in your future development? And are there any new business strategies that can be shared with us?

Xing Jin: (Speaking foreign language).

(Translated). The POP business remains a vital component of our growth strategy, and we will continue to focus on its development. As we've said before, we believe that the Chinese medical aesthetics market will become increasingly polarized. Consumer spending on standardized treatments is becoming more value-driven, while spending on non-standardized treatments is becoming more selective, with consumers willing to pay a premium for the highest quality care.

To adapt to this market landscape, our strategy is twofold. One, so standardized treatments, we leverage the strength and service quality of our chain of clinics to meet client demand; and, two, for non-standardized treatments, we will rely on the diverse array of treatments that our POP business facilitates to satisfy various needs.

We're moving towards a curated model, just like Costco and Sam's Club. By selecting high-quality institutions, leading doctors and premium SKUs in each vertical, we aim to simplify consumer decision-making, increase SKU transaction value, and ultimately, strengthen our control over the supply side to enhance our pricing power.

Additionally, for partners who are strong technically, but lack operational expertise, we offer comprehensive operational services management. A prime example of this is our Master Injector Team, which consists of injectable specialists, each boasting an impressive track record of 10,000 treatments. We provide them with online operational support, enabling them to focus exclusively on delivering services to customers. Demand for this service has grown rapidly and received widespread positive feedback.

Going forward, our chain of clinics will create strong synergies with our POP business as it grows to scale. By identifying non-standardized treatments in demand by customers of our chain of clinics and promoting select high-quality institutions and doctors from POP, we are maximizing both customer satisfaction and commercial value. Thank you.

Operator: Patrick He with CITIC Securities.

Patrick He: (Speaking foreign language). Let me translate for myself. So I'm just wondering more questions about the clinical chain business. So I'm wondering what factors might constrain speed of the clinical chain expansion? And what are the unique advantages that So-Young have in addressing these constraints, so that we can address these constraints more effectively than our competitors?

And additionally, what are the current operating metrics for the chain of clinics, and for example, if our clinics have reached breakeven? And what is the future business trends?

Xing Jin: (Speaking foreign language).

(Translated).

In general, factors such as site selection, furniture and renovation, license application, staff recruitment, marketing and operational costs can impact how quickly new clinics can open up. Having said that, we've significantly improved new clinic opening efficiency by creating respective SOPs and implementing effective process management. This has helped us cut down the average time required to open up new clinics from about 5 months early to around 3 months now.

However, we believe the following factors are what truly determine how quickly we can scale our chain of clinics. One, the ability to acquire customers, if we cannot guarantee that we will simply incur losses; two, the ability to recruit a sufficient number of leading doctors and specialists; three, the strength of our supply chain, which is key to offering products at competitive price while keeping profit margins; four, whether there is strong enough standardized management and quality control to ensure that new stores maintain consistent service standards with existing ones; five, sufficient capital as the initial investment for each new clinic can cost millions of RMB; and six, the ability to obtain the necessary licenses.

We are already positioned to address each of these factors. We have solid customer acquisition capabilities that leverage our strong brand recognition at the expansive user base already on our platform. This is further enhanced by our contact and online marketing capabilities. Our strong brand recognition, scale of our business and compliance with regulations give us a significant advantage when recruiting professionals when compared to small and medium-sized institutions. On the supply chain side, our initiatives over the past few years are already beginning to yield positive results. As more of our products receive certification we expect our competitive advantage in this vertical to positively impact our financial performance more meaningfully.

By continuously enhancing our middle-platform capabilities through the So-Young Prime program over the past year, we are able to ensure standardized management across multiple clinics in different regions. We believe that the key to standardized management lies in the breadth and depth of digitalization, an area where we have a natural advantage as an internet company. We have ample capital to deploy in new clinics as well. The franchise model that are launching in the second half of the year will also allow us to expand without the need to invest our own capital.

In terms of license applications, aside from Beijing and Shanghai, obtaining license in other regions of China is relatively simple and fast. Having already set up clinics nationwide, we have accumulated experience in this area.

As of today's earnings call, we have opened 14 clinics in prime commercial areas. All of these clinics are fully operational and performing in line with our expectations. Our Beijing clinic has been operational for 15 months and has already become profitable, recouping its initial investment. Among the other clinics, three have been operational for 5 months with the remaining 10 for less than 3 months. They are following a similar growth trajectory, but will require a little more time to reach breakeven.

To provide some more context, our clinics typically follow a well-defined growth curve. They generally go through a 3-month trial period, followed by 9 months of accelerated growth. Maturity is usually reached after about 12 months of operations. For example, our Beijing clinic began to trial operations in May and officially opened in August last year. Since then, revenue has grown to RMB6.2 million in June this year with pretax profit of RMB1.3 million and a profit margin of around 20%.

This outstanding performance validates the effectiveness of our site selection, clinic opening and operational strategies, providing valuable insights that we will apply to other new clinics to accelerate their growth. By leveraging our middle-platform, we have reduced overall costs while ensuring standardized services delivery, allowing us to outperform other institutions. In the future, as procurement volume and use our self-branded products increase, cost across our chain of clinics will gradually fall and profit margin will increase.

Looking ahead, our future business plans are centered on expanding our clinics across target cities, with a focus on increasing the density of clinics within each city. By the end of 2024, we plan to open over 20 clinics. In the second half of the year, we will also launch our franchise model with external partners to leverage our self-operated clinics as training centers and flagship clinics. This will enable us to standardize and scale rapidly. We expect a significant year-over-year increase in the number of clinics, which will not only strengthen our market position, but also create new opportunities for revenue growth. Thank you.

Operator: Joey Han with Jefferies.

Joey Han: (Speaking foreign language). So let me translate myself. My question is how does So-Young upstream sector differentiate itself from other competitors? And could you elaborate on the management's perspective regarding the strategic position and the business plan for the upstream sector this year?

Xing Jin: (Speaking foreign language).

(Translated).

Unlike traditional manufacturers that rely on linear R&D to production to sales model, we capitalize our unique ecosystem and full-category advantage to create synergies with our existing business lines. The integrated approach allows us to amplify the strength of our brand, reputation among customers and network coverage through institutional partners. As a result, we can rapidly build market competitiveness for new products and achieve customer targeting through our app and media matrix, while using our clinics to ensure a steady stream of sales, a capability that sets us apart in the industry.

For example, Truelift, our non-surgical anti-aging ultrasound device, generated tremendous pre-order volumes and sales volumes beyond expectations when it launched not long ago. This performance showcases its potential to become a market hit and the capabilities of our team. Similarly, sales of the Korea brand Elasty continue to grow.

In addition, we have been actively expanding our pipelines with high growth potential. Our roadmap is robust with two new products ready for launch next year, and three more in 2026, all targeting popular segments of injectables and energy-based devices. We are confident these products will make significant contributions to revenue growth.

Leveraging our broad extensive consumer behavior data and experiments team, we are building full-category upstream capabilities for our broader ecosystem. In the second half of the year, we will continue to expand our team, which is currently composed of seasoned experts from leading domestic and international manufacturers. We aim to grow this team to a total of 100 members by the end of the year. Thank you.

Operator: Ivy Li with Haitong Securities.

Ivy Li: (Speaking foreign language). I'll translate myself. With current gross margins around 60% and could you provide some insights into the expected trend for the gross margin going forward?

Nick Zhao: Thanks for the question. Over the near term, macroeconomic risks, such as slowing global growth and inflationary pressures, continue to weigh on consumer sentiment. As a result, consumer willingness and capability to spend may be constrained, increasing market uncertainty. This is reflected in our third quarter revenue guidance.

As we transform our business beyond the POP business, our revenue structure is undergoing a shift alongside, which is impacting gross margin levels. While our traditional information and reservation services continue to enjoy high-gross margin, the increasing share of medical product sales, which have stable but lower margins, is affecting our overall margin profile. Furthermore, our chain of clinics, which is still in its early stages, has seen gross margin temporarily impacted by promotional activities. In the short term, we expect gross margins will continue to be impacted by the expansion of our chain of clinics and medical product sales.

However, as our upstream supply chain capability strengthen and operations across our clinics mature, we will anticipate a corresponding improvement in gross margin. Additionally, the introduction of our franchise model is expected to support gross margin through greater economies of scale, optimizing our profit structure even further. Thank you.

Operator: This concludes our question-and-answer session as well as our conference call for today. Thank you for attending today's presentation. You may now disconnect.