[SY] So-Young International Inc.
Q3 2024 Earnings Conference Call
November 20, 2024 7:00 AM ET.

Executives
Mona Qiao, Investor Relations
Xing Jin, Co-Founder, Chairman, CEO
Nick Zhao, CFO

Analysts
Ivy Li, Haitong Securities
Daisy Li, Guolian Securities
Nelson Cheung, Citibank
Lucy Zhao, Penghua Funds
Harry Zhao, Deutsche Bank

Presentation

Operator: Ladies and gentlemen, thank you for standing by for So-Young's Third 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 meeting over to your host for today's call, Ms. Mona Qiao. Please proceed, Mona.

Mona Qiao: Thank you, operator. And thank you, everyone, for joining So-Young's third 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 SEC, including our Annual Report on Form 20-F. So-Young does not undertake any obligation to update any forward-looking statements, 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 business continued to develop robustly during the third quarter with total revenue reaching RMB372 million, once again surpassing the upper end of our guidance range.

Net income attributable to So-Young was RMB20.3 million, up 11.2% year-over-year while non-GAAP net income attributable to So-Young came in at RMB22.2 million, up 133.1% year-over-year, demonstrating the effectiveness of our continued investment across the industry value chain.

In the third quarter, we made significant progress in our chain of clinics, expanding the number of stores to 17 currently from 8 last quarter as we penetrated into more cities. All of our clinics are located in prime commercial areas, which further strengthened our market coverage and competitiveness. This business is gradually becoming the key growth driver for us. Its revenue grew by 67% quarter-over-quarter, with gross margins improving significantly. Notably, all eight of the new clinics opened during the quarter are generating positive operating cash flow, and four are already profitable at the store level.

In addition, despite of the slowdown in consumer spending, our upstream business continues to deliver satisfactory performance. We continue to optimize the structure of our business, with our POP business serving as a solid foundation for the rapid development of these new businesses, creating strong synergies with our chain of clinics and upstream businesses. This provides critical support for our development in the medical aesthetics market.

As anticipated, the Chinese medical aesthetics market is polarizing with two distinct trends. On the one hand, mass consumers are gradually releasing their demands for cost-effective and convenient medical aesthetics products and services, during the iteration of medical aesthetics technologies and product diversification. On the other hand, middle-to high-income consumers remain willing to pay a premium for high-quality and personalized services while seeking cost effectiveness, pushing the medical aesthetics market towards higher quality and standards.

We are closely following these industry trends and accelerating and deepening our end-to-end integration across the industry value chain, especially in our upstream and clinic businesses. During the quarter, our new business segments continues to grow rapidly, with revenue from the sales of medical products and maintenance services reaching RMB89.3 million, up 18.7% year-over-year.

Now, let me give you a closer look at our Q3 business performance. We have made big progress with our chain of clinics business, with 17 clinics fully operational across 9 core cities as of today, including Beijing, Shanghai, Guangzhou, Shenzhen, Hangzhou, Chengdu, Wuhan, Chongqing and Changsha. Among them, 14 recorded positive monthly operating cash flow in September. This demonstrates our sustainable operational capabilities, supported by our user base and strong brand influence.

To share a few key metrics, our customer retention rates was maintained at 60%. The overall customer satisfaction at our clinics reached 4.98 out of 5 according to our data, reflecting our customer-centric operational philosophy and efficient service fulfillment capabilities. Moreover, average customer acquisition costs are now significantly lower than the industry average, highlighting the competitive advantages in marketing and operational efficiency. Our private domain user base continues to expand, now at around 900,000 users, which provides a solid foundation for us to expand in the future.

Within our chain of clinics businesses, a number of key initiatives have delivered robust growth that I'd like to highlight. For example, our high-end Master Injector Team project achieved 104% sequential revenue increase, and average customer spend of nearly RMB50,000. Its customer satisfaction rates were also exceptional, proving that our tactic of carefully selecting injection doctors is highly appreciated by consumers.

Additionally, we have actively expanded partnerships with mainstream platforms. Our clinics are now on many traffic platforms such as Meituan and Tmall, further expanding our market coverage. Moreover, So-Young Clinic serves as the focal point in the process of vertical integration, and has given us notable cost and price advantages.

For our ultrasound program, leveraging private domain operations to reduce marketing costs and proprietary branded devices to lower consumable costs, achieved remarkable results. Its online orders exceeded 7,000 in the first month immediately after its launch.

We plan to further expand our presence in five core cities including Beijing, Shanghai, Guangzhou, Shenzhen and Hangzhou, and accelerate the rollout of franchises in order to quickly replicate our successful, standardized chain operations model to more cities, further scaling up our business.

We have also made great progress in our upstream business, by building full-category upstream medical aesthetic manufacturing capabilities for our broader ecosystem. As of the end of the third quarter, we partnered with more than 970 institutions for the sale of injectables. Our injectable product Elasty saw a 22% year-over-year increase in shipments, reaching 43,000 units during the quarter. Sales of injectables grew by 21% year-over-year, further consolidating our competitive advantage in the upstream sector and underscoring the strong demand of our products.

Additionally, we partnered with Lancy Group for upstream products. Together, we aim at co-develop the Nature Oriental Lightweight Face project, which is already being offered in 90% of Lancy's aesthetics institutions after just 2 months, showcasing the strong synergies our business creates and leading product promotion capabilities.

Our traditional POP business is providing strong support for both our chain of clinics and upstream businesses. Moving forward, we will focus more on improving the experience for both medical aesthetics institutions and consumers. Our platform continues to help medical aesthetics institutions improve order conversion and sales through targeted advertising and traffic allocation. This has been highly recognized by institutions, demonstrating the effectiveness of advertising placements on our platform.

For consumers, we are committed to providing cost-effective products. In September, GMV facilitated by our platform grew by over 16% from the previous month. The per capita in-store GTV for the third quarter increased 22.9% year-over-year, reflecting the initial success of our upmarket shifting tactics in POP. We also enhanced our sales leads and conversion rates through commission rates reform and product optimization.

Our POP business has served the medical aesthetics industry for 11 years, establishing a strong brand presence and becoming top of mind for consumers. Over the past 3 years, we have invested over RMB1 billion in building our upstream supply chain and expanding our product offerings. We have now opened 17 clinics leveraging our organizational culture and central platform capabilities, gradually growing it in scale to deepen cost advantages and ensure consumers enjoy reliable, convenient, high-quality and high cost-effective services.

Looking forward, our focus is clear. Through upstream, middle and downstream integration, we aim to create multidimensional competitive advantages and become the most trusted medical aesthetics and healthcare service provider, fulfilling our mission of making medical aesthetics accessible for 100 million Chinese people.

Now, let me hand over to our CFO Nick, who will go through the financial results. After that, we will open 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 RMB371.8 million, down 3.5% year-over-year, exceeding the high end of our guidance, with sales of medical products and maintenance services growing by an impressive 18.7% year-over-year, primarily due to an increase in the order volumes for aesthetic ingestibles and medical equipment.

Information services and other revenues were RMB263.0 million, down 8% year-over-year, primarily due to a decrease in the number of medical service providers subscribing to information services on our platform. Reservation services revenues decreased 18.9% year-over-year to RMB19.6 million, primarily due to a decrease in consumer spending through our platform.

Cost of revenues was RMB142.2 million, down 0.3% year-over-year, primarily due to a decrease in the cost of services associated with the information services.

Within cost of revenues, cost of services and others were RMB98.6 million, down 4.7% year-over-year, primarily due to a decrease in the cost of services associated with information services. Cost of medical products sold and maintenance services were RMB43.5 million, up 11.3% year-over-year, primarily due to an increase in the costs associated with the sales of aesthetic injectables.

Total operating expenses were RMB225 million, down 8.1% year-over-year. Sales and marketing expenses were RMB114.9 million, down 20.1% year-over-year, mainly due to a decrease in expenses associated with branding and user acquisition activities.

G&A expenses were RMB69.9 million, up 39.1% year-over-year, primarily due to increases in share-based compensation expenses.

R&D expenses were RMB40.2 million, down 20.6% year-over-year, primarily attributable to improvements in staff efficiency.

Income tax expenses were RMB2.1 million, compared with income tax benefits of RMB2.2 million in the same period of 2023.

Net income attributable to So-Young was RMB20.3 million, compared with a net income of RMB18.3 million during the same period last year. Non-GAAP net income attributable to So-Young was RMB22.2 million, compared with RMB9.5 million in the same period of 2023.

Basic and diluted earnings per ADS attributable to ordinary shareholders were RMB0.2 and RMB0.2, respectively, compared with basic and diluted earnings per ADS attributable to ordinary shareholders of RMB0.18 and RMB0.18, 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 September 30, 2024.

Moving to our outlook. For the fourth 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 paces 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 for 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.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Ivy Li with Haitong Securities.

Ivy Li: I'd like to ask about the industry. From your current perspective, what new changes or trends are emerging in the medical aesthetics industry? And I'll translate myself. (Speaking foreign language).

Xing Jin: (Speaking foreign language).

(Translated). In recent years, light medical aesthetics procedures have gained popularity due to their ease of operation, lower risk, and shorter recovery periods, attracting a growing number of consumers. However, the current market is dominated by small- and medium-sized institutions, lacking unified standards and quality control, leading to inconsistent service quality. There are around 20,000 medical aesthetics institutions nationwide, with over 95% being small institutions.

No national chain clinic brands have yet emerged in the market, indicating significant room for standardization and consolidation. With the continued growth in demand for light-medical aesthetics, we believe nationwide chain clinic brands will emerge in the future. South Korea serves as a prime example where the development of light-medical aesthetics chains have already reached maturity, with over 10 well-known brands.

If the Chinese market develops chain brands at a similar rate, the total number of light-medical aesthetics chain clinics could exceed 2,000, presenting significant marketing opportunities. Our goal is to benchmark against developed overseas markets and make medical aesthetics accessible and affordable to all. This is also the original intention behind establishing our own chain of clinics.

Currently, demand among Chinese medical aesthetics consumers is polarized. Customers seeking standardized procedures focus on authenticity, compliance, and cost effectiveness, whereas those interested in non-standardized services prefer top-tier doctors and personalized solutions. For this latter segment, we have introduced the Master Injector Team, a high-end customized service, which has received excellent user feedback and financial results. By precisely targeting different consumer needs, we aim to deliver exceptional experiences to various customer groups. We are optimistic about the growth potential of light medical aesthetics chain clinics and are enhancing our competitiveness through vertical integration and cost optimization.

By integrating our upstream supply chain and implementing a unified management and operation model, we aim to reduce operating and procurement costs across our clinics, thereby improving overall profitability. Given this promising market outlook, we are committed to expanding our footprint in the light-medical aesthetics market, aiming to become a leading domestic clinical chain brand. Thank you.

Operator: Thank you. Daisy Li with Guolian Securities.

Daisy Li: (Speaking foreign language). We've observed a decline in the POP business, particularly following the announcement of your chain expansion. Has there been a strategic shift for POP?

Xing Jin: (Speaking foreign language).

(Translated). We continue to place significant importance on POP, which remains a critical component of our operations. Similar to platforms like Didi or JD.com, we maintain a mix of self-operated and third-party partners. The light-medical aesthetics chain clinics are our self-operated business, developed to address intense market competition and traffic challenges. While our traffic quality is high, we face the risk of insufficient traffic compared to big internet platforms with higher traffic volume, which could potentially impact user and institutional retention over the long term.

We have drawn valuable insights from product category of Sam's Club and Pangdonglai, and are developing our light-medical aesthetics chain clinics with the aim for them to become new traffic drivers, attracting and retaining more users on our platform. This approach attracts more third-party medical institutions to join, offering more diverse products to meet users' diverse and personalized needs, and helping these institutions achieve greater benefits. Ultimately, it positions the platform to rapid growth.

Moving forward, we will place greater emphasis on the experience of institutions and consumers. On the institution side, our ROI for verified transactions improved steadily, with September showing ROI increase of 16% compared to June. Feedback from institutions has been positive. From the consumer perspective, we remain committed to providing cost-effective products. September's GMV increased by 16%.

Additionally, with the implementation of commission reforms and product optimization measures, the number of leads and the conversion rates from exposure to detail pages have been shown improvement. For example, during September's promotional activities, the conversion rate of DAU to detail pages increased by 4%, and the conversion rate from detail pages to transaction increased by 20% compared to June.

We are also adjusting our fee model, transitioning from the original advertising-based model to a service-fee based model, shifting from exposure-based charges on performance-based charges, placing greater emphasis on conversion effectiveness. Thank you.

Operator: Nelson Cheung with Citibank.

Nelson Cheung: (Speaking foreign language). Let me translate the question myself. My question is regarding the clinics. What are the considerations behind So-Young's move to implement a franchise model alongside the expansion of its national chain network?

Xing Jin: (Speaking foreign language).

(Translated). Our original goal was to address the issue of information asymmetry in the medical aesthetics industry through our community and platform, reducing the decision-making costs and risks. Despite the rapid growth and popularization of medical aesthetics over years, we found that services remain expensive, and truly trusted institutions are rare. We have always aspired to serve 100 million Chinese consumers, offering safe, convenient and high-quality services at reasonable prices.

Our goal is to become a national chain clinic brand, building long-term trust with consumers through high-quality, cost-effective services. By maintaining high customer retention, we can reduce marketing expenses, achieving significantly greater efficiency per employee and per square meter than traditional clinics, while delivering more value and benefits to consumers.

For the business itself, the success of a chain model relies on central platform support, which helps spread central platform costs over an expanding scale, maximizing cost efficiency. Our decision to launch the franchise model aims to capture development opportunities which exist in the light-medical aesthetics sector, accelerate the expansion of our clinic network, and effectively control costs. The operating data from our initial 10+ self-operated clinics have already validated this model's feasibility.

We believe that introducing franchise partners will further accelerate expansion, enhance brand influence, and secure resources and support from commercial property owners, customers and government agencies, allowing us to focus on building and enhancing central platform capabilities. Based on our rigorous financial and operational projections, we are confident in achieving rapid growth and profitability at the individual store level for our franchised clinics.

Our franchise model uses a fully managed approach to ensure high service standards and deep integration of the supply chain. The supervisors and doctors at all clinics are So-Young's registered employees, and information systems are centrally managed and controlled by headquarters, ensuring standardized operations across all chain clinics. Additionally, the asset-light franchise model offers financial advantages, promising greater profitability and sustainable growth potential for the company. Thank you.

Operator: Thank you. Harry Zhao with Deutsche Bank. Harry Zhao, your line has been unmuted. You may proceed with your question.

As there is no response from the line of Harry Zhao, we will proceed to the next question, which will be from the line of Lucy Zhao with Penghua Funds.

Lucy Zhao: The third quarter ER indicates effective expense control, with sales and marketing expenses down approximately 20% year-over-year. How has management team achieved lower expenses and improved profitability? (Speaking foreign language).

Nick Zhao: Thank you for your question. We believe profitability fundamentally comes from business growth. Our clinic chain business has proven its growth potential. And by optimizing (indiscernible) and back-office costs while maintaining expansion speed, there exists more room for profits. Additionally, the continuous expansion of our upstream product pipeline and the launch of new products will further enhance our profitability.

As one of the very few companies to successfully achieve vertical integration in the industry, we leverage our comprehensive advantages and forward-looking strategies to maintain long-term competitiveness and high-quality growth in the market. The reduction in sales and marketing expenses is the result of adjustments to our marketing strategy.

We recognize that the current medical aesthetics market is beyond pure traffic competition, and requires a professional platform with a deep understanding of the industry and user needs, offering consumers excellent experience and addressing their genuine concerns. This has led us to focus more on refined operations and cost effectiveness analysis, prioritizing the efficiency and precision of marketing investments, and making timely adjustments based on market conditions.

In terms of overall expense management, effective cost control has enabled us to maintain a well-managed expense ratio in Q3 2024, which stood at 60.5%, down 3% points year-over-year and 0.2 percentage points quarter-over-quarter. Thank you.

Lucy Zhao: Thank you.

Operator: Thank you. Harry Zhao with Deutsche Bank.

Harry Zhao: (Speaking foreign language). Let me just translate for myself. I want to ask a question about upstream business. What competitive advantages does So-Young have over traditional upstream companies to ensure success?

Xing Jin: (Speaking foreign language).

(Translated). We have already demonstrated clear advantage in the upstream business. For instance, Elasty has achieved a 3-year CAGR of 117% in shipments in the highly-competitive HA market. Additionally, as a new player in the ultrasound market, we have quickly risen to prominence, with cumulative shipments of our Truelift ultrasound device reaching over 200 units. This underscores the ecosystem-based operational advantage of our upstream business, allowing us to maintain a favorable position in a highly-competitive industry.

For upstream companies lacking marketing resources and capabilities, we provide targeted brand positioning and promotional support to enhance product visibility, and expand coverage among end consumers, medical aesthetics institutions, and doctors. This helps potential products grow into bestsellers and assists upstream manufacturers in establishing a solid market foundation and enhancing their influence in the industry.

Through our self-operated chain clinics, we have launched several top-performing products, setting a new standard in terms of industry marketing strategies. Currently, we have opened 17 clinics in 9 core cities, and we plan to accelerate our market coverage through a mix of self-operated and franchise models, further driving product sales and enhancing competitiveness.

Additionally, our participation as the only external shareholder of the Mevos International Congress of Medical Aesthetics, the largest industry event, will strengthen our upstream business by expanding influence among institutions and doctors, promoting innovation in the industry. With our competitive edge in marketing, data resources, and team expertise, we aim to become a full-category upstream medical aesthetics manufacturer within a robust ecosystem. Thank you.

Operator: This brings us to the end of our question-and-answer session. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.