

Perfect Corp.(Q1 2023 Earnings)

April 26, 2023

Corporate Speakers:

- Alice Chang; Perfect Corporation; Founder, Chairwoman, and Chief Executive Officer
- Louis Chen; Perfect Corporation; Executive Vice President & Chief Strategy Officer
- Iris Chen; Perfect Corporation; Vice President of Finance and Accounting
- Rick Lee; Perfect Corporation; Vice President of Investor Relations

PRESENTATION

Operator^ Good morning and good evening ladies and gentlemen. Thank you for standing by and welcome to Perfect Corp Earnings Conference Call. At this time, all participants are in a listen-only mode. We will be hosting a question-and-answer session after management's prepared remarks. Please note that today's event is being recorded. I will now turn the conference over to the first speaker today, Mr. Rick Lee, VP of IR of the Company. Please go ahead, sir.

Rick Lee^ Thank you, Pauly. Hello, everyone, and welcome to Perfect Corp earnings call. With us today, are Ms. Alice Chang, our Founder, Chairwoman and CEO, Mr. Louis Chen, our EVP and Chief Strategy Officer, and Ms. Iris Chen, VP of Finance and Accounting. You can refer to our first quarter 2023 financial results on our IR website, at ir.perfectcorp.com or in the Form-6k we furnished to the SEC yesterday afternoon. You can also access the replay of this call on our IR website when it becomes available a few hours after its conclusion. For today's call, management will provide their prepared remarks first, and then we will be hosting a question-and-answer session.

Before we continue, I would like to refer you to our Safe Harbor statement in our earnings press release, which also applies to this call, as this call may contain forward-looking statements regarding Perfect Corp's performance, anticipated plans, operational results and objectives. Forward-looking statements are based on management's expectations and are subject to a number of risks and uncertainties that could cause actual results to differ materially from those expressed or implied on our call today. Perfect Corp undertakes no obligation to update any forward-looking statement except as required by law after the date of this call.

Please note that all numbers stated in the following management's prepared remarks are in U.S. dollar terms, and we will discuss non-IFRS measures today, which are more thoroughly compared and reconciled to the most comparable measures reported in our earnings release and Form-6K furnished to the SEC.

I will now turn the call to our first speaker today, Founder, Chairwoman, and CEO of Perfect. Ms. Chang.

Alice Chang^ Thank you Rick, and welcome everyone to Perfect Corp first quarter 2023 earnings conference call. We kick off 2023 with \$12.1 million in total revenue for the first quarter, representing quarter over quarter growth of 9.7% and year-over-year growth of 0.9%. The nominal growth reflects a strategic shift in prioritizing our new subscription-based cloud business driven by much stronger market demand. Specifically, our AI/AR cloud solutions and subscription revenue, which historically accounted for two thirds of total revenue grew by 18.7% year-over-year in the first quarter.

This is a key area of future growth for Perfect. Although we are still impacted by a longer sales cycle, our value proposition to our clients and our market leadership in AI/AR solution continue to be strong. We saw very stable renewals with existing brand customers in the first quarter. We also managed to acquire more new logos from expanded pipeline as we fine-tuned our strategies to counter the impact of the prolonged sales cycle. These new clients will need time to grow to make meaningful impact to our top line revenue.

Meanwhile, we continued to invest in AI skincare technology, as it is an untapped market with great growth potential. Lastly, our mobile beauty app subscription business powered by AI capabilities such as AIGC continues to experience strong growth momentum, helping to stabilize and balance our revenue streams.

During the first quarter of 2023, we continue to make strategic adjustments like those we disclosed in last earning calls as we navigated a challenging business environment. We would like to take the opportunity here to provide some business update and share with you our latest industry observations, along with insights on how our technology and the partnership with brands have helped shape the industry.

First, color cosmetics remain a very resilient and attractive category. We saw more luxury fashion brands offer color cosmetics products to consumers in an attempt to attract younger shoppers, as well as to diversify their revenue mix. Perfect is the leader in the color cosmetics beauty tech field. And we are well positioned to support new group of brands.

One of the most exciting developments for this quarter is our new partnership with a global top luxury fashion brand from Europe. We will be launching their first ever makeup virtual try-on on its.com website across multiple countries, and also on Taobao, which is China's biggest online shopping platform. This is a very significant milestone for this client, as they are relatively new to the makeup category. We expect that the virtual try-on feature will drive and enhance customer engagement and increase sales conversions for the brands.

Second, as China reopens its border, brands are coming back and then investing in digital solutions to target shoppers in China. In addition, consumers have resumed their color

cosmetics applications and skincare routines since the face mask mandate was lifted. We have seen good recovery momentum for both our WeChat and Taobao solutions in China.

Third, in the first quarter, we secured several skincare deals, including one of a prestigious cosmetic/skincare group in Japan, and another with a U.S. based healthcare conglomerate, to newly launched Perfect's AI skin analysis. This partnership enabled us to deliver our cutting-edge skin technology of skin diagnosis to a wider range of users, providing personalized recommendations for a diverse range of skin types and skin concerns. As we continue to innovate, we're excited to bring some more AI skincare diagnostics and recommendation services to brands and retailers around the world.

Fourth, we saw digitization has arrived in the jewelry and watch industry. Watches and jewelry brands have finally caught up with virtual try-on technology. Two more notable new wins in this quarter are from Europe based luxury fashion groups, which officially rolled out their watch and jewelry VTOs on their website across multiple countries using Perfect jewelry VTO technology. As more brands create 3D digital assets, we expect to see wider VTO deployments across all channels, including websites, apps and WeChat.

Fifth, interactive AR advertisements started to become attractive in a very new way for brands to target more consumers. In a new partnership, Perfect and Teads have joined forces to deliver the first native Virtual Try-On AR ads format onto Teads' ads platform. These joint solutions enable brands to offer a state-of-the-art VTO experience across makeup, watches, and all other AR VTO categories in popular media around the globe. We helped two global luxury fashion brands feature their watches in AR media campaign using our AR ads. And also we offer AR ads to several other cosmetic companies. Through this type of collaboration, jewelries and the beauty brands can reach out to millions of potential end consumers through AR ads which is a brand-new form.

Another good news to share here our mobile beauty apps business has been growing quite strongly. With the injection of more AI features, we have recently seen a robust surge in growth. Our mobile beauty apps active subscribers increased by 15% from the previous quarter, and increased 50% from the same period last year. This strong growth can be attributed to our efforts in improving digital marketing, developing and monetizing more attractive AI features. One of the example to share, we recently introduced a new product feature called Magic Avatar by AI to enhance our YouCam mobile beauty app. This powerful AI tool built upon advanced AI Generated Content, AIGC technology, and custom stable diffusion models can produce fun and realistic digital avatars, which app users can use to express themselves in their online social community. This positive user feedback we have received for this feature has helped drive conversions to our mobile app subscriptions. This is just one of our many R&D initiatives that leverage the latest AI technologies for product innovation. We will keep on investing in AI development for both beauty brands and the beauty consumers and this unique synergy of business models, where our core technology is developed once and it can monetize in both brand business and also consumer beauty apps, offers Perfect a very valuable insight and a very unique cost advantage.

The surge in digital commerce pushed the transaction far beyond the traditional offline store. Sales are increasingly happening online in apps, in social platform, via content services and even in search, and brands are rolling out their strategy in omnichannel more than ever. This larger mix of channels is what makes Perfect so valuable in any environment and across every sales channel. Our strength is our ability to build all the right tools for commerce to happen in every place. This is why brand customers are building their future digital strategies with Perfect.

To sum up, despite the uncertainty in a macro, we believe that our value proposition to beauty brands and the beauty consumers remain intact. Our dedication in AI/AR innovations and continued investment in the latest AIGC technologies and AI talent and AI skincare technologies will better position Perfect in the competitive landscape.

Looking to the rest of 2023, as brands continue to undergo digital transformation, AI and AR technology is a crucial component of creating immersive, personalized, omni-channel shopping experience across omni-channels, which provides very good business opportunity for us. In addition, because of our renewed focus on online services, our AI/AR cloud solution and mobile app subscription business will grow more rapidly versus the previous year, and their revenue contribution will be more prominent. As more and more brands look to improve sales efficiency, operate more sustainably and reduce product waste, we remain committed to driving top line growth while focusing on profitability. Benefitted from the strong signs of growth in each respective area as I mentioned, and a very healthy market demand, we are very confident to deliver strong growth in 2023.

With that, I will now turn the call over to Louis to go over the financial details with you.

Louis Chen^ Thank you, Alice. Before I go into the details of our financial results, please note that all comparisons are on a year-over-year basis, that the reporting period is the first quarter of 2023 versus the comparable period in 2022, and that on top of the IFRS measures, we will be also discussing non-IFRS measures to provide greater clarity on the trends in our actual operations.

During the first quarter of 2023, our total revenue increased from \$12 million in the same period of last year to \$12.1 million, representing quarter over quarter growth of 9.7% and year-over-year growth of 0.9%. Our AR/AI cloud solutions and subscription revenue, which now contribute 85.4% of our total revenue in quarter one, grew by 18.7% year-over-year, showing strong grow momentum in our core business. Meanwhile, legacy licensing revenue for physical store, which accounted for 12.3% of our total revenue declined by 47.1%. This trend not only show our new prioritization in investing online services, but also reflect customer preference in investing more in AR/AI cloud solutions and subscriptions instead of the legacy offline SDK services, which are the main component of the licensing revenue.

Moving to our customer order expansion and acquisition. During the first quarter renewal rate for existing subscriptions remain as strong and healthy as in the previous cycle, and

customer continues to be active on our platform. Furthermore, our ability to acquire new customers is improving via larger funnel and inbound leads for prospects. However, it will take some time for this new customer to grow sizable revenues to us.

Among our revenue sources, AR/AI cloud solution and subscription revenue grew by 18.7% to \$10.4 million, mainly due to the strong, stable demand for online virtual try-on solutions for brand customers, as well as strong growth in a mobile beauty app subscriptions. Our mobile beauty app active subscribers grew by 53.3% year-over-year, reaching a historical high of over 694,000 active subscribers at the end of the first quarter of 2023. This increase demonstrate the robust growth momentum of our suite of mobile app.

Licensing revenue, which is mostly generated from a more traditional offline services, was \$1.5 million, representing 12.3% of our total revenue, primarily driven by brand customer demand and more interest in e-commerce rather than traditional physical store deployment.

The strong growth momentum in AR/AI solutions and subscription revenue, and a decrease in license revenue aligned with management expectation and is a result of a strategy to prioritize AR innovation and to invest in new cloud-based subscription services. The strategic shift in revenue mix, show that the AR/AI cloud solution and subscription business will continue to drive revenue growth and become a primary growth engine in the future. As we direct our resources in online business going forward, we encourage investor to closely observe the future growth trajectory of our AR/AI cloud solution and subscription services.

Gross profit was \$9.6 million, while gross margin was 78.8%, compared to 86.2% for the same period of last year. This was due to a change in cost of goods sold, which was driven by the growth in mobile beauty app subscription that generated higher platform fees paid to third party digital distribution platforms, such as Apple and Google.

Total operating expenses decreases by 0.9% to \$11.1 million from \$11.2 million for the same period of last year, demonstrating management's successful efforts to control costs and enhance productivity.

To break down operating expenses, sales and marketing expense remain flat as \$6 million, representing 49.6% of our total revenue, on par with the same ratio during the same period of last year. This again showed the effective cost control measure put by the management.

Research and Development expenses decreased by 3.1% from \$2.7 million to \$2.6 million representing 21.6% of our total revenue, compared to 22.5% in the same period of last year. The decrease was mainly due to the foreign exchange gain from the strong U.S. dollar versus NT dollars as the majority of our R&D expenses are incurred in Taiwan.

General and administrative expenses decreased by 1.8% from \$2.5 million to \$2.4 million, or 19.9% of total revenue, compared to 20.4% in the same period of last year, showing that there were no significant changes during the quarter.

All expense categories reflect the effective cost control carried out by the management team to increase our team productivity and under such a challenging macroeconomic and inflationary environment.

Net income turned positive to \$0.7 million from a net loss of \$0.5 million in the same period of last year, mainly due to \$2.2 million interest income during the quarter.

Excluding non-cash share-based compensation, foreign exchange impact, one-time non-recurring costs associated with our de-SPAC deal, adjusted net income was \$1.4 million, compared to adjusted net income of \$1.2 million during the same period of last year.

Turning to our balance sheet, as of March 31, 2023, our company held \$196.1 million in cash, cash equivalents and time deposits six months and longer, compared to \$192.6 million as of December 31, 2022, that's \$3.5 million, or 1.8% quarter over quarter increase. The company's cash position remains healthy, and we do not have any exposure to Silicon Valley Bank, or any other U.S. regional banks or Credit Suisse.

In total, our customer base had a net increase of 16 brand clients since the end of 2022, achieving a total of 525 brand clients, with over 590,000 SKUs for makeup, skincare, eyewear, jewelry product as of March 31, 2023. In this quarter, we grew our key customer to 158 from 152 at the end of 2022. The new acquisition came from the expanded pipeline, as we fine-tuned strategies to counter the impact of a prolonged sales cycle.

While the present business environment is full of uncertainties, we believe the macro situation may improve in the quarters to come. Despite these difficulties, our solid customer base, effective cost management, and expansion into new categories and geographies, leave us well positioned to seize future growth opportunities.

That concludes my prepared remarks. Operator, let's open up our call for questions.

QUESTIONS AND ANSWERS

Operator^ Thank you. And we will now begin the question and answer session. (Operator Instructions) And your first question comes from the line of Timothy Zhao from Goldman Sachs. Your line is open.

Timothy Zhao^ Yes, thank you management for taking my question. Two questions from my side. First I noticed that on your balance sheet there's over 30% quarter on quarter growth of contract liabilities, which is actually quite strong relative to the revenue growth either on a Q-on-Q or year-on-year growth basis. Just wondering if management could

share more detail color behind this very strong increase in the contract liabilities. Shall we interpret that going forward we should be able to see accelerating quarterly revenue growth for the rest of this year and that will be my first question.

And secondly I think for your prepared remarks as well as in the press release. I think you mentioned the company is fine tuning the sales marketing strategy in the context of prolonged sales cycle and also macro uncertainties. But I saw, I think in the first quarter, the sales marketing expenses was quite flattish stable year-on-year. Just wondering if management have any guidance for the sales marketing expenses for the rest of this year. Thank you.

Louis Chen^ Hi, Timothy. This is Louis. Great to talk to you again. Yes, so the contract liabilities certainly is an advanced indicator that the company is gaining more contract with the customers. As we said, we are prioritizing our subscription business model and as part of the accounting, any subscription contract would take time to be fully recognized.

So yes. So you see a significant sizable growth in the contract liability. It certainly reflects the part -- the nature of the business. On your second question, again, we are always running a very efficient team whether it's in sales marketing or R&D. So even reaching to new geography, participating a lot more trade shows and also expanding in our digital marketing, we managed to get our costs very well under control. We're able to enlarge our funnel. I think it is an early result of what we will see. One of the measures that the management has put together in the last six months already and it seems to be starting to work out the results.

Timothy Zhao^ Got it. Thank you, Louis.

Operator^ Your next question comes from the line of Clarke Jefferies from Piper Sandler. Your line is open.

Clarke Jefferies^ Hello. Thank you for taking the question. I want -- I wanted to dig into the brief mention of generative A.I. and just more broadly how do you expect some of the recent innovation that's been made available to be applied to the platform? Certainly encouraging to hear about the magic avatar functionality. Does that offer new revenue opportunities in sort of charging for consumption for some of those sort of creations by users or do you see it as a user acquisition or retention tool within the mobile app product? And then I have one follow up.

Louis Chen^ Hi, Clarke. This is Louis. So the way that we introduced the magic avatar feature in our YouCam Perfect app, it is an add-on service on top of the subscription. Consumers can decide to just opt-in for this feature. So I think we charge them \$2.99 for 50 avatars or \$3.99 for 100 avatars.

The current active subscriber, they can also opt-in to do that at a discounted rate. So basically I think the first benefit of that is we see increase in the ARPU. So allow us to

increase the average order value of the customer or lifetime value of the customer. As well we are seeing this to attract new type of customer who are not traditional part of our app.

So we certainly -- it's still too early, we launched this in early March. So it just made it for the first month. Our early results show prominent potentials to both increase the value of existing subscribers but also to attract new subscribers.

Alice Chang^ I'd like to add something about AIGC that we are developed. And first features is that, what you saw, in the YouCam app -- mobile app that's Magic Avatar. This is only one of the AIGC applications we are developing. We already developed and released, and a lot more.

And this one is for B to C app first. A lot more AIGC with -- we are thinking how we can apply that not only on app but also to brands with different fashion styles, hair styles.

So I -- we truly are excited to see AIGC through this new AI technology developed it to the market and then open up a new -- a new way to engaged with consumers. And also the brand can leverage it to engage with their customers.

Always we have new technology to add on our apps, user beauty apps to try the market with the users directly. If the feedback is very positive and always we will bring to our brands for them to imagine how they can leverage it and engage with their beauty consumers.

So yes, we are keeping investing and developing our newest applications. And next quarter I believe we can share more of AIGC features and solutions with you.

Clarke Jefferies^ Yes. Perfect. Thank you, Alice. It's certainly -- the harder question is how do the B2B products change with generative AI. Just my follow-up in terms of the current operating environment. I was curious where do you see the most attractive return on your investment right now. Is that pursuing opportunities for expansion within the top 20? Is that growing outside of the top 20 beauty brands or is it maybe investing in the sort of digital marketing advertising accelerators for the B2C business?

Louis Chen^ I think we are starting to diversify a lot of this, as you have noted in our release. So I think B2B remains very strong core of our business and with all of our partners. And we continue to help and expand omnichannel, which means going to different retailers or retailer partners to distribute their SKUs, the AR experience in more geographies, in more platforms.

So that continues to be strong. Of course we see the long tail power of the beauty business starting to take off at a much faster pace. Right, virtual try-on is becoming very much the table steak for the e-commerce solution. That segment is continuing to grow well for online services. The mobile app subscription continues to be, as Alice

mentioned, we reached another record high quarter for active subscriber. I think that's another positive trend that we have seen in the business, also solidifying on that front.

The advertising business we've newly announced partnership with Teads and that's very new. But there's either way that we want to go beyond the traditional ecommerce and the brand as well, right. The virtual experience is such an engaging experience that is worth to be seen for more consumers and not only those who are visiting the e-commerce shopping cart, right.

So I think this will be a new way to offer engagement type of interactive advertising ads, right. So I think consumers are not satisfied with the traditional banners or video ad. We try to be part of that, and I think VTO on watches, or make-up does make sense.

And fundamentally I think one point worth noting is core technology are the same, right, we develop the engine whether it's AR or AIGC and we find these different use cases to apply both for consumer business but as well for brand business. So that is a very huge saving for us from a development cost perspective that we manage to run this engineering team, which only accounted about 20% of our revenue. I think that is a very efficient way to run that.

And at the same time once the technology we can pilot test that, promote in a test bed on the consumer side and that we gain feedback and understand how consumers are reacting to that. We are packaging this technology in a different form factors and different use cases and offer that to the beauty brand.

Clarke Jefferies^ Perfect. Thank you very much.

Operator^ (Operator Instructions). And your next question comes from the line of Chris Chia from Kendall Court. Your line is open.

Chris Chia^ Hi Louis, Alice. Good to hear you on the call. Thanks for this. I had a question on the competitive environment. Given what you observed in the last six months, given the longer sale cycle and the challenging macro condition, can you discuss a little bit about what you observed from a pricing and product differentiation strategy and how you think that that's going to evolve in the -- in the coming months. Thank you.

Alice Chang^ Yes, hi, Chris. This is Alice. From the competitive point of view, actually, we do not see any competitors, even stronger than us or far behind us right now. So, it's not competition, any risk so far. Just -- but we did as we said increase the pipeline, and it will take some time to make the revenue or keep the revenue, keep those brands in our pipeline to grow the revenue.

And for mobile apps, actually, there are a lot of competitor beauty apps. There are quite several beauty apps in there. But we do see -- since we leverage AI more last year, add more AI features that result turns out to be very attractive to the end user, very unique

features by AI. And the track and make those end user and new users not only on our app, but also very sticky, we increase the renewal rate, everything.

So, and just like Louis said, the core technology we apply to end user app first, and collect the feedback with good and then we approach and also introduced to this brand side. So, these new features -- AI features to the beauty app site, it's so attractive. Hopefully, that's our wish that we can leverage that and also give feedbacks to the brands and they can also use our technology to attract their own users.

You want add something Louis?

Louis Chen^ So, yes, essentially, I think the competitive landscape that we are remain pretty much the same, our position or value proposition to the brand remain very intact. As I mentioned, the renewal rates are pretty much -- pretty much the same as previous cycles. But we haven't seen really significant change in that landscape.

Chris Chia^ Okay, thank you.

Louis Chen^ You're welcome.

Operator^ As there are no further questions at this time, I'd like to hand the conference back to management for closing remarks.

Rick Lee^ All right, thank you again for joining our call today. If you have any further questions, please feel free to contact us or to request through our website. We look forward to speaking with everyone in our next call. Have a good day.

Alice Chang^ Thank you.

Operator^ This concludes today's conference call. You may now disconnect.