

10 - 25 - 2023

Perfect Corp

Third Quarter 2023 Earnings Conference Call

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CORPORATE SPEAKERS:

Alice Chang

Perfect Corp; Founder, Chairwoman & Chief Executive Officer

Louis Chen

Perfect Corp; Executive Vice President & Chief Strategy Officer

Iris Chen

Perfect Corp.; Vice President of Finance and Accounting

Rick Lee

Perfect Corp; 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.'s Earnings Conference Call. (Operator Instructions) Please note that today's event is being recorded.

I will now turn the conference over to the first speaker for today, Mr. Rick Lee, Vice President of IR of the company. Please go ahead, sir.

Rick Lee^ Thank you, Ellie. Hello, everyone, and welcome to Perfect Corp.'s Q3 Earnings Call. With us today are Ms. Alice Chang, Founder, Chairwoman and Chief Executive Officer; Mr. Louis Chen, our Executive Vice President and Chief Strategy Officer; and Mrs. Iris Chen, VP of Finance and Accounting.

You can refer to our third quarter 2023 financial results on our IR website or in the Form 6-K we filed with the SEC earlier. You can later access a replay of this call on our IR website shortly after the conclusion of this call.

For today's call, management will provide their prepared remarks first. Then we will host a Q&A session.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which is also applies to this call, as this call may contain forward-looking statements regarding Perfect Corporation's performance, anticipated plans, operational results, and objectives.

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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 statements, 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.

Without further ado, I will now turn the call to our first speaker today, our CEO, Ms. Alice Chang.

Alice Chang^ Hi, everyone. Thank you, Rick, and welcome to Perfect Corp.'s 2023 Third Quarter Earnings Call. We have some exciting news to share today, so let's get started.

In the third quarter of 2023, our growth momentum from quarter two persisted, resulting in a total revenue of \$14.5 million. This marked a 13.2% increase in revenue compared to the same period last year, and a 14.7% increase when compared to the previous quarter. The primary drivers of this growth remained from our AI/AR cloud solutions for enterprise brands business (B2B) and the subscription services for our mobile beauty apps business (B2C). We have seen very promising new developments in our AI skincare solutions and AI hairstyle for brands, and other innovative app features powered by Gen AI, which I will elaborate more shortly. For the bottom line, our net income for the third quarter of 2023 was positive, standing at \$3.5 million on an unadjusted basis, and \$2.7 million when adjusted, underscoring our commitment to effective cost management while growing top line revenue.

Overall, we are very encouraged by our continued top-line growth and improvement in profitability as a result of our continuous efforts to optimize our business in both B2B and B2C. Our strategic development focused in Generative AI has already shown a strong demand from both brand customers and consumers. Generative AI unlocks many new possibilities in visual imaging, video, BeautyTech, SkinTech, and FashionTech, different use cases.

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These new use cases will extend our reach into an even bigger total addressable market. In a rapidly evolving digital landscape where brands are investing more and more into Digital Transformation. Perfect is well positioned to help our brand partners with the latest in Generative AI models in addition to a complete line of BeautyTech, SkinTech and FashionTech offerings.

Finally, our consistent rollout of a wide range of innovative features driven by Gen AI technology has maintained the strong growth of our mobile app subscription business. These new AI features have not only drawn in new mobile app installations, but have also effectively converted users into premium subscribers. Perfect is ready to capitalize on this new opportunity, and we are positioning ourselves as “The Beautiful AI Company” for both B2B and for B2C.

Now let's shift our focus to the operational outcomes of the third quarter and discuss our most recent advancements. In the third quarter, on the B2B side, we secured several sizable new and renewals with beauty brands, some of which included upsell opportunities, such as expanding their SKU offerings and extending to additional countries. These renewals not only underscore the growing reliance of these brands on our solutions to meet their evolving needs, but also reaffirm our leadership in the field of color cosmetics, which continues to be a key differentiator and core competence for our company.

To that front, we have continued to reinforce our omnichannel strategy through the expansion of strategic alliance with various distribution channels of beauty, skincare and fashion products to ensure comprehensive coverage of all customer touchpoints. For example, we teamed up with Dufry, a key player in global travel retail, to provide both in-store and web-based virtual makeup try-on experiences for 15 beauty brands in airports across 27 countries worldwide.

Additionally, we are very excited to announce our partnership with Walmart, the world's largest retailer, to initially offer makeup virtual try-on experience for more than 1,400 beauty products in Walmart mobile app. This level of integration is made possible thanks to our existing relationships with over 600 global brands, enabling the effortless distribution of these brands' virtual product offerings across diverse retail platforms. As we look to the future, it is clear that virtual try-on technology is becoming essential for

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all beauty and fashion brands and retailers in engaging with customers and delivering personalized shopping experiences for all.

In the third quarter, a significant highlight was the accelerated penetration of the skincare market, marked by a notable increase in new deal flow from the skincare sector. We believe the skincare industry is going through a transformational change to adopt more digital technology and to offer consumers user-friendly and objective-driven diagnostic results.

Our AI skincare technology distinguishes itself by delivering an unparalleled AI-powered skin analysis that encompasses 14 different skin concerns in real-time, providing users with comprehensive and instant feedback on their skincare progress.

Secondly, we have introduced a new range of subscription plans tailored specifically for small and mid-size skincare brands and Med Spa on our website. This expanded strategy on skincare enables us to engage with a larger potential customer base of all sizes. By providing tiered subscription plans, we not only make our skincare technology more accessible but also streamline the sales process. This approach will lead to a larger install base for our AI Skincare services.

Another new use case we launched in the market is our GenAI hairstyle. We upgraded our AI Hairstyle solution by replacing the previous generation AI model to the latest Diffusion Generative AI model, and the result is amazingly good. The realism of the hairstyle images is now hyper-realistic, and the generative style variations unlock more choices for consumers to visualize more styles to choose from.

Under the Hairstyle AI development, we announced our partnership with TRESemmé, a Unilever brand for hair products, to offer AI Hairstyle generation for their consumers. And the possibility is ever expanding. We are also targeting broader hair brand markets such as wig visualization and hair extension with the latest GenAI upgrades. This is a testament to the versatility and broad applicability of our GenAI-powered virtual try-on technologies, demonstrating their potential to cater to a diverse range of market needs.

Another cutting-edge AI innovation we just launched in the third quarter is a high-quality automated 2D to 3D SKU conversion tool for jewelry and watches VTO, this

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result can quickly enlarge the total number of SKUs our brand customers can offer on their website in a cost-effective and speedy way. Moreover, this new 2D to 3D tech can help us expand to broader jewelry try-on market.

Now let's shift focus to our B2C mobile beauty apps business. We had another strong quarter for our app business as evidenced by the 62.5% year-over-year increase in our mobile beauty app active subscribers to 835,000. This sustained strong growth serves as a testament to the increasing demand and market expansion in the realm of photo, video, and camera applications including image and video creation, beautification and enhancement. With our suite of YouCam apps, we are diversifying our product offerings and expanding our avenues for monetization. To fully capitalize on the app market expansion trend, we have implemented the following strategies.

First, our team created a very rich roadmap of premium features for subscribers. We introduced multiple AI-driven premium features by GenAI, such as AI Avatar, AI Fashion, AI Hairstyle, AI Selfie, and more to come, offering our mobile users with a wide range of photo and video beautification and enhancement solutions. We have an active roadmap to include AI in all our products and services, it will transform the whole industry with the power of beautiful AI.

Second, we have strengthened our cross promotional initiatives across our suite of mobile apps and executed marketing programs to increase our app discoverability to new users. The consumer App market is a very large and growing market, more and more global consumers are opting in to paying subscription for premium features, and Perfect is focusing to gain more market share in our B2C mobile app business.

Third, we have expanded our B2C monetization opportunities by introducing a new app, YouCam AI Pro. It is a GenAI tool for AI text to image creation and all other GenAI features. This new app has a very rich roadmap to include many of our future GenAI innovations from our Perfect Labs.

Fourth, we have also optimized our mobile app subscription prices, maintaining competitiveness while increasing our revenue in several markets.

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Collectively, these efforts have been instrumental in driving the impressive expansion of our mobile app business. We are committed to sustaining these efforts to enhance the visibility and reputation of our YouCam apps in the mobile app sector, while positioning ourselves favorably for future expansion.

In summary, our third quarter was robust, featuring double-digit revenue growth and positive net earnings. Our observations suggest that we are well-positioned to meet the revenue growth targets we shared in quarter two. Consequently, we reaffirm our projected revenue growth for 2023, which is expected to range from 11.5% to 14.5% year-over-year, in comparison to 2022.

With that, I have now concluded my remarks, and will be handing the call over to Louis, who will discuss our 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 third quarter of 2023 versus the comparable period in 2022, and that on top of IFRS measures, we will also discuss non-IFRS measures to provide greater clarity on the trends in our actual operations.

For the third quarter of 2023, our total revenue increased to \$14.5 million from \$12.9 million in the same period of last year, representing a year-over-year double-digit growth of 13.2%.

Among our revenue sources, AR/AI cloud solutions and subscription revenue, which constitutes 78.3% of our total revenue, grew by 24.8% to \$11.4 million in the third quarter of 2023. This impressive expansion can be attributed to the strong demand for our online virtual product try on solutions among brand customers and the robust growth in our mobile beauty app subscriptions. In the current quarter, we have successfully renewed contracts with prominent beauty brands, with some renewals offering upsell opportunities to expand SKU offerings or extend deployment to cover more regions. We also acquired several new customers in this quarter, including Walmart.

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Notably, our mobile beauty app business, active subscribers have surged by 62.5% year over year, reaching an all-time high of over 835,000 by the end of the third quarter of 2023. This significant expansion underscores the increasing demand for photo and video editing applications and the widespread acclaim of our innovative generative AI features within our suite of mobile beauty apps. These premium AI features not only expand our mobile beauty app user base but also capture the attention of enterprise users, resulting in a growing synergy between our mobile apps and enterprise operations that may bring more revenue streams into our business.

Licensing revenue, which is now mostly from our traditional offline services, decreased by 13.6% from \$3.3 million to \$2.8 million, representing 19.5% of our total revenue, compared to 25.5% of total revenue in the third quarter of 2022. The lower revenue contribution from licensing not only aligns with management's expectation, but also underscores customers' continuous elevated interests for online services rather than legacy offline offerings.

Gross profit was \$11.8 million, while gross margin was 81.2%, compared to 85.3% for the same period of last year. This change in gross margin primarily stemmed from higher platform fees paid to third-party digital distribution platforms Apple and Google, which can be attributed to the Company's expanding subscriptions for its mobile beauty app business.

Compared with the 80.6% gross margin for the second quarter of 2023, that for the third quarter was 81.2%, showing a quarter-over-quarter improvement.

Total operating expenses increased by 13.3% to \$12.7 million from \$11.2 million for the same period of last year.

To break down operating expenses, sales and marketing expenses were \$6.4 million, representing 44.3% of our total revenue, compared to \$6.1 million and 47.8% of total revenue during the same period last year. The 4.9% year-over-year change was primarily due to the increase in marketing and user acquisition costs.

Research and development expenses were \$3.0 million, representing 20.9% of total revenue, compared to \$2.6 million and 19.9% of total revenue during the same period

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last year. The 18.9% year-over-year change was resulted from an increase in R&D head count expenses.

General and administrative expenses were \$3.2 million, representing 21.8% of total revenue, compared to \$2.5 million and 19.3% of total revenue during the same period last year. The 28.1% year-over-year change was primarily due to an increase in public company-related costs.

The change in expense categories signify a major increase in spending, a necessary step as our business expands and seeks to grow our revenue. Looking ahead, we will maintain cautious oversight and implement effective expense control measures to ensure that our spending remains responsible and aligns with our growth objectives.

Net income was \$3.5 million for the third quarter of 2023, compared to a net income of \$1.6 million during the same period of 2022, showing a 126.7% year-over-year increase in our bottom line.

Excluding non-cash share-based compensation, foreign exchange impact, and one-time non-recurring costs associated with our de-SPAC deal, adjusted net income was \$2.7 million for the third quarter of 2023, compared to adjusted net income of \$2.3 million in the same period of 2022.

Turning to our balance sheet. As of September 30, 2023, our company held \$201.3 million in cash and cash equivalents and six-month time deposits, compared to \$198.0 million as of June 30, 2023, reflecting a \$3.3 million, or 1.7%, quarter-over-quarter increase. The company's cash position remains sound and healthy.

In total, our customer base had a net increase of 26 new brand clients since the end of last quarter, achieving a total of 627 brand clients, with over 678,000 SKUs for makeup, skincare, eyewear, and jewelry products as of September 30, 2023.

In this quarter, we grew our Key Customers from 163 at the end of last quarter to 169. The additions not only came from our new wins of more beauty and fashion brands, but also benefited from our successful penetration into skincare, jewelries, and hair markets in the last quarter.

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In the third quarter of 2023, our total revenues have consistently exhibited strong growth, primarily driven by the impressive momentum in our AR/AI cloud solutions and mobile app subscription for premium features and AI-powered apps, including the newly-launched YouCam AI Pro.

Furthermore, our unwavering commitment to operational efficiency has resulted in a noteworthy uptick in our gross profit, showcasing our dedication to maintaining a balance between revenue expansion and profitability.

Concurrently, we have continued our investments in talent acquisition and technology innovation. Despite a rise in operating expenses, our net income remains robust. We firmly believe that our positioning within the thriving AI industry equips us to seize the opportunities ahead and deliver sustainable value to our shareholders.

That concludes my prepared remarks. Operator, please open up for call for questions.

Operator^ (Operator Instructions) Our first question comes from Clarke Jeffries from Piper Sandler.

Clarke Jeffries^ Hello. Thank you for taking the question. Couple of here. Louis, you mentioned some renewals at some large customers or renewals of opportunities. Wondering if you could speak to the spending trends in the top, say, five customer cohort? I know that was nearly a third of the business last year. Just wanted to get an update on how your spending with the largest customers has changed year-over-year? And then maybe a follow-up is, we've seen pretty promising brand and SKU growth at nearly 30% year over year, but brand revenues are maybe a little bit disconnected from that. Any expectation on whether we could see brand revenue accelerate here over the coming quarters, you know that licensing versus cloud revenue is a dynamic here, but hoping you could comment on any other factors that might play out such that brand and SKU growth would match revenue growth going forward. Thank you.

Louis Chen^ Thank you, Clarke, for your question. So we have seen the renewal for the large customers have been very, very healthy in this year. So I think the majority of all of the large customers have renewed their licenses with us on time. So I think that is a

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strong testament that the features, the functionality, the license is essential to their business. So they continue to offer the BeautyTech and SkinTech or FashionTech solutions that we provide. I think from that perspective, we remain quite confident about the results for this year and also for next year as the renewals are mostly 2023-2024.

I think in terms of a larger acceleration in the brand business, if that was your question. I think ultimately, you come from the future possible adoption of new AI innovations such as Gen AI and other beauty tech solutions that we bring to the market. I think the first half of this year was particularly more challenging for brands into looking into additional spending. And the good news is they are spending their current existing license as is. So there's not much impact in there. Renewal rates and churn rate has been very positive.

And then, again, we remain very cautiously optimistic. We have been introducing quite a lot of new solutions, especially in the GenAI space, to the brand, and look forward to materialize that into better deals and bigger deals for next year.

We certainly will encourage brands to onboard more SKUs in more territories. So I think that acceleration also is going through expansion to more distribution channel, as with Walmart and Amazon, allowing our brand partners to distribute their SKUs broader. So certainly, the investment, we believe that in the long term, it's going to pay off and accelerate our revenue once there's a massive scale of SKUs across all touch points and transform the way the user shops online forever.

Operator^ Our next question is going to come from Timothy Zhao from Goldman Sachs.

Timothy Zhao^ Great. Thanks for management for taking my questions. Two questions here. One is on the -- I think your revenue breakdown. Just wondering if your management can share what is the growth for each segment within the AI solutions, i.e., what is the growth rate like for the revenue 2B versus 2C? I think that will be very helpful.

And secondly, I think it seems that you reiterate the full year guidance, the revenue will be growing at around 11.5% to 14.5% for this year. Just wondering if there's any

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thoughts of the growth rate into next year? Should we expect a faster growth rate, as you mentioned, I believe, earlier this year, there's a delayed sales cycle or extended sales cycle because of macro environment. Just wondering how that has changed since then? Thank you.

Louis Chen^ Thank you Timothy for the question. We remain quite confident about our yearly guidance for this year, as we expressed. I think everything seems to be moving based on our plan. Certainly, the macro is still challenging to predict for a more longer term, another plan we are working internally is to better understand each client funnels and how we look into the next year. So that is not something that we have been able to complete yet. We are in the process. As soon as we have done, we'll certainly share broader publicly about our view for 2024.

I think if we look at the industry, it's moving in a positive direction, right? I think the digital transformation across all sectors is the trend and it's not stopping. So certain categories go faster, and others are a little bit more challenging, such as creating 3D SKUs, it takes more time to enable more brands, more SKUs in a short period of time.

That is something that, for example, what Alice mentioned about our 2D to 3D conversion, it's going to help. We believe that it's going to help and potentially change the way our industry typically operates. Our quality, the name of the company is called Perfect, where we want to deliver that perfection to the client, to be able to create automatically more SKUs. I think you will accelerate that and consequently, of course, you generate more revenue for us.

In terms of the segment, I think the skincare segment component is the one that is growing, both in the funnel that we received across different geographies. I think we see a lot more demand for SkinTech relatively compared to others. Of course, Color Cosmetics remain our core competence, and remain our key category there, right? It's about a little bit over half of our revenue coming from Color Cosmetics. But I think skincare, after investing in this field for three, four years now, we finally see some -- a good movement for brands of all sizes, not only the top global skincare brands. We also noticed a lot of regional or local beauty skincare brands also started to adopt the skin diagnosis segments.

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B2C, of course, is growing much, much stronger. You saw our number of active paying subscriber have grew year-over-year 60%-plus, which is very, very encouraging. There's still a lot of room to grow in that market. It's a huge market. We are kind of a latecomer in that market, but there's a lot of room for us to grow. Similar functionality type of app, they are in a much bigger scale. So we're just gaining market share quarter after quarter from them.

The AI segment is very promising, although it is new. So from a revenue contribution in this quarter, it is still relatively small, but I think this is where forward-looking -- we're always looking for new innovations that will generate consumer interest. So we are devoted and investing quite a lot in the development for Gen AI. So in our enrollment, I think we have more than a dozen products in Gen AI, some already launched and some will be coming out very soon into the market.

Operator^ Our next question comes from Brian Schwartz from Oppenheimer.

Camden Levy^ Hi. Good morning. This is Camden Levy sitting in for Brian Schwartz. Thanks for taking my question. Thinking about 2024 and your go-to-market and sales organization, do you anticipate any adjustments in terms of the investment cadence? Or just how should we be thinking about the sales and marketing line, heading into next year on the back of the Walmart partnership and the indie brand opportunity? Thanks.

Louis Chen^ I think for our enterprise sales process, right, it's the same formula we have been playing for years. I think certainly, the word of mouth is there, and as we get more brands starting to adopt, the sales cycle seems to be getting a little bit better compared to early this year. I think that's good news.

Of course, now we're addressing a broader market to go to new verticals like watches and jewelries and potentially others as well. For the investment, I think from an expense perspective for next year, we certainly want to increase and invest in R&D. I think that is an area very worthy to invest in.

On the sales and marketing side, I think we remain more cautious. I think our global team is capable of delivering and expanding our business for these new adjacent categories. So we are not looking at much increased internal sales and marketing

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headcount, for example. But engineering development will certainly remain a core competence that we need to invest now in creating this new roadmap to try to address a broader market for 2024.

So again, I think I said in our remarks, we always look into our top-line trend and when we are controlling our expenses to make sure that we are also delivering a positive profitability to investors, shareholders.

Camden Levy^ Perfect. Thank you so much. And then just one follow-up question. If we were to think about the emerging industries and verticals that you guys are going after with VTO and beauty tech. Is there -- if you were to stack rank, maybe your top three new categories in terms of growth catalysts, how would you define those categories? Or which ones are most likely to contribute to 2024 and 2025?

Louis Chen^ I think we certainly want to play around our target customers. Our primary target customers are always the female shoppers. So when we think about our roadmap and business expansion, we think about what shoppers, especially female, that are shopping online, what are the categories that they really need to try before they buy? And I think that will generate more of the value.

That's why years ago, we started with makeup, and then now expanding into jewelry and watches. So if you think about another line, I think accessories, apparel, like anything that you can wear on your body, on your face, on your hand and your body will be certainly in our radar. And rest assured, we are certainly working on many of these aspects.

But we also are cautious that we want to deliver the perfection. We don't want to rush in the market with an unfinished product or something that is not ready for prime time. So whenever we come to market, we really wow the consumer and the brands to offer something that they have never seen before. And I think that remains in our solid belief on how we approach the market, as I mentioned.

So I think in the broad way, I think AR commerce, we are strong believer in that. The one new area that is going to take a little bit more significance is certainly in our Generative AI. So that is something that was not possible before this technology existed. And now,

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with the power of Generative AI, I think there's a lot of new potential. For example, we talked about the hairstyle generation with TRESemmé, the Unilever brand. This is just one of the examples of how we're able to already create real use cases that bring real business benefits to the brand by harnessing the power of GenAI, and that will remain our core focus for now.

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

Rick Lee^ All right. Thank you, everyone, for joining our call today. Wish you have a good day. Bye-bye.

Alice Chang^ Thank you.