



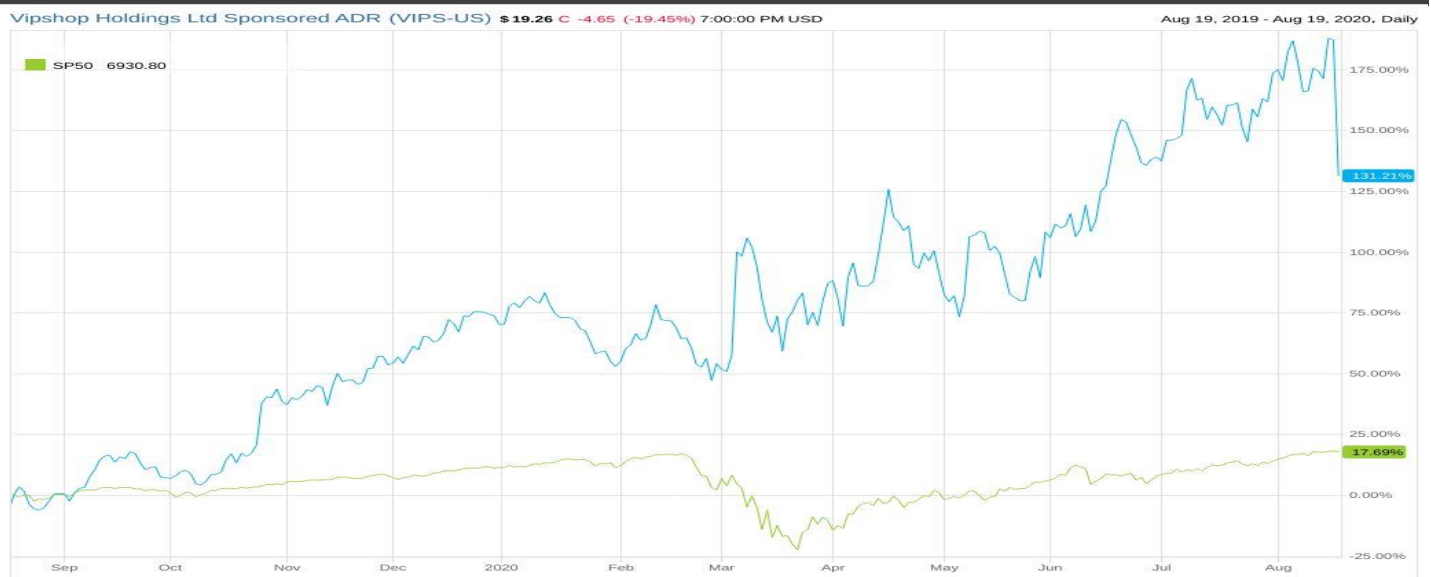
# Vipshop (VIPS US) Dangerous Curve Ahead

Asia Internet/e-Commerce

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Returns (%)	1M	3M	6M	YTD	1Y	3Y	5Y	10Y	20Y	IPO
VIPS-US	(8)	21	41	36	131	25	2	53	53	53
SP50	5	16	1	6	18	14	14	13	13	13

## Vipshop Income Statement (Factset Consensus Estimates)

	Dec '19	Mar '20	Jun '20	Sep '20E	Dec '20E	Dec '20E	Dec '21E
	Q1	Q2	Q3	Q4			
Sales	92,994	18,793	24,111	21,823	33,017	97,234	110,036
Cost of Sales	72,314	15,176	18,731	16,945	25,293	76,440	85,235
Gross Income	20,680	3,617	4,940	4,950	7,597	20,890	24,241
SG&A Expense	13,400	-	-	1,619	1,916	10,396	11,276
EBITDA – Adjusted (Non-GAAP)	6,758	1,283	2,236	2,211	3,630	8,506	10,408
EBITDA - Reported	-	-	-	-	-	-	-
Depr. & Amort.	1,023	-	-	222	222	1,350	1,488
EBIT – Adjusted (Non-GAAP)	5,754	1,047	1,494	1,918	3,340	7,130	8,907
EBIT - Reported	4,773	782	1,240	1,487	2,737	6,074	7,920
Interest Expense	86	35	21	34	30	94	72
Pretax Income – Adjusted (Non-GAAP)	5,924	-	-	1,865	3,626	7,463	8,402
Pretax Income - Reported	4,935	-	-	-	-	6,636	6,977
Tax Expense	984	173	325	340	606	1,326	1,690
Net Income – Adjusted (Non-GAAP)	5,000	986	1,321	1,434	2,474	6,003	7,343
Net Income - Reported	3,986	685	1,537	1,234	2,241	5,266	6,558

	Dec '19	Dec '20E	Dec '21E	Dec '22E
Price/Earnings (x)	13.3	15.2	12.5	11.3
PEG Ratio (x)	0.6	0.7	0.6	0.5
Price/Book Value (x)	3.0	3.2	2.6	2.2
Price/Tangible Book Value (x)	-	-	-	-
Price/Cash Flow (x)	9.8	13.6	11.0	8.8
Price/Free Cash Flow (x)	8.4	12.1	11.4	9.7
Price/Sales (x)	0.7	0.9	0.8	0.7
Enterprise Value/Sales (x)	0.6	0.9	0.8	0.7
Enterprise Value/EBITDA (x)	9.4	11.5	9.1	8.1
Enterprise Value/EBIT (x)	12.5	13.9	10.6	9.4
Enterprise Value/FCF (x)	7.0	18.2	14.4	10.8

## Vipshop (VIPS US): Dangerous Curve Ahead

- Vipshop shares fell 19% in the US trading day after the company reported its 2Q20 results that broadly met consensus top-line growth expectations (and beat on margins), but the uncertain outlook for future growth took a toll on the stock, in our view.
- Even after today's correction, VIPS shares are up 132% in the last 12 months. We believe there is further downside risk. The stock was already trading near 18 x forward P/E, which implied continued low double-digit topline growth and maintaining operating profit margin of 5%+.
- We flagged in our previous two reports (these are not posted but please let me know if you would like a copy) that the VIPS shares face downside risks as high expectations for continued operational improvements were built into the price.
- All the stars did not align in 2Q20 for VIPS. The company's results were in sharp contrast to JD.com's (JD US) more robust quarter reported last week.
- With the company recording just 6% growth after a decline of 12% YoY in the first quarter – which was written off because of COVID-19 – but the results and the management conference call did nothing to calm the nerve, in our view.



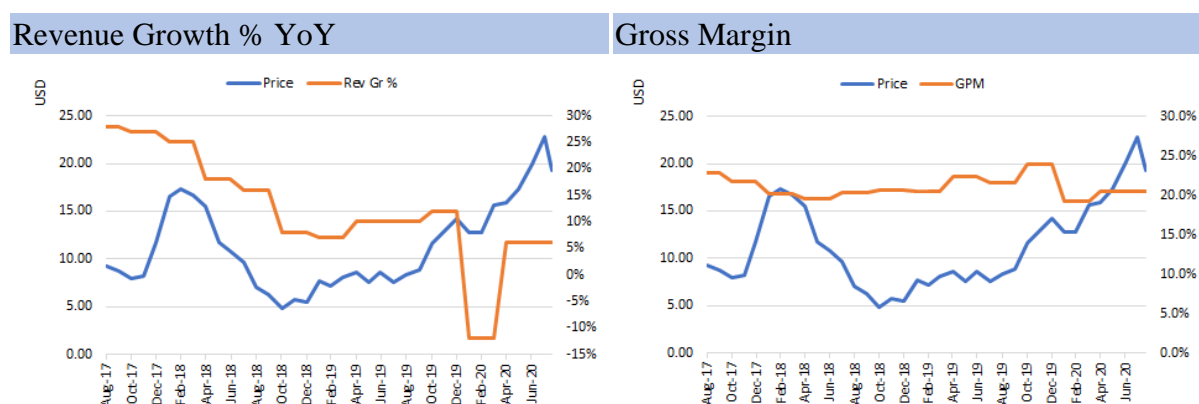
## Two things that warrant caution even after the 19% correction

China retail online spending (cumulative YTD) grew 14% YoY, but online apparel purchases still fell 3% YoY. 70% of VIPS' GMV comes from apparel. Third quarter is a soft season for apparel, and the fourth is a heavy promotion quarter with Single's Day on November 11. Consensus forecast calls for 12% YoY growth in 2H20 whereas management has guided for 5-10% growth YoY in 3Q20. There is downside risk.

Gross margin fell by 1.9% points. The company used coupons and discounts aggressively in late April to June as they saw demand recovering. Active customer base grew 17%, nearly at the 2H19 level, but it did not translate into revenue growth because ARPU (Average Revenue Per User) fell 10%. If top line growth becomes more challenging, there is a risk of management spending more aggressively. We have seen this scenario before in 2H18.

We flag that the stock had de-rated to nearly 8x forward P/E and USD4.50 in November 2018, proactively pricing in the historic low 8% revenue growth, a gross margin of 20.6% and 13% active customer growth YoY. Management is targeting 5-10% revenue growth for 3Q20.

## Two Key Stock Drivers for Vipshop Shares



Source: Company data, Factset

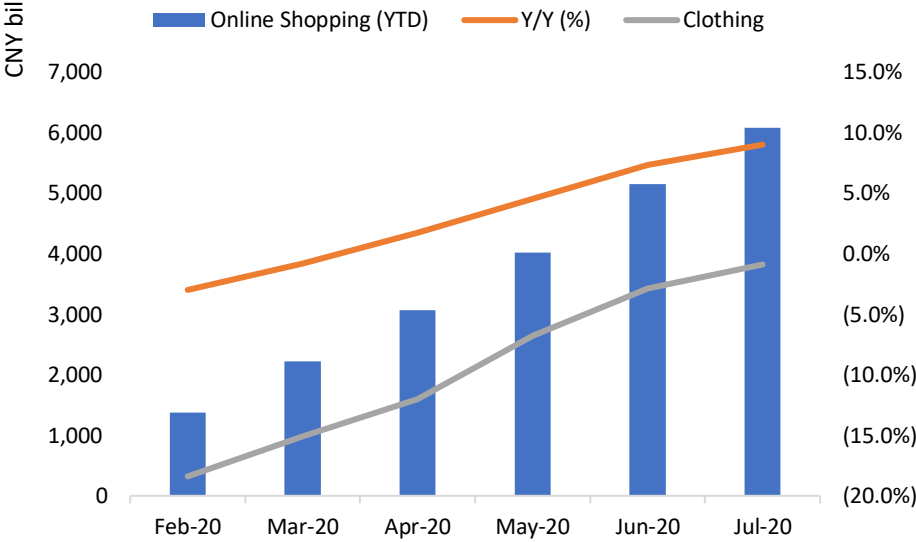
(Sources for all the charts in this report are company data unless otherwise stated.)

## Vipshop 2Q20 Results: Uncertain Growth Outlook

(CNY m)	2Q19	1Q20	2Q20	Y/Y (%)	Q/Q (%)	Consensus	vs Con
<b>Revenue</b>	22,744	18,793	24,111	6%	28%	24,018	0%
<b>Gross Profit (GAAP)</b>	5,089	3,617	4,940	(3%)	37%	5,259	(6%)
<b>Operating Profit (GAAP)</b>	965	782	1,240	28%	59%	782	59%
<b>Operating Profit (Non-GAAP)</b>	1,175	1,047	1,494	27%	43%		
<b>Net Profit (GAAP)</b>	818	681	1,539	88%	126%	1,310	18%
<b>Net Profit (Non-GAAP)</b>	1,067	982	1,323	24%	35%		
<b>EPS (GAAP)</b>	1.29	1.00	2.24	73%	124%	1.5	51%
<b>EPS (Non-GAAP)</b>	1.64	1.44	1.92	17%	34%		
<b>Total active users (m)</b>	33.1	29.6	38.8	17%	31%		
<b>Total orders (m)</b>	147.8	121.7	170.5	15%	40%		
<b>ARPU (CNY)</b>	687	635	621	(10%)	(2%)		
<b>AOPU (Orders/User)</b>	4.5	4.1	4.4	(2%)	7%		
<b>ARPO (CNY)</b>	154	154	141	(8%)	(8%)		
<b>Shipping &amp; Handling/Order (CNY)</b>	8.2	6.6	4.7	(43%)	(29%)		
<b>Margins</b>				<b>% pt Chg</b>	<b>% pt Chg</b>		
<b>Gross Margin, GAAP</b>	22.4%	19.2%	20.5%	(1.9%)	1.2%	21.9%	(1.4%)
<b>Operating Margin, GAAP</b>	4.2%	4.2%	5.1%	0.9%	1.0%	3.3%	1.9%
<b>Operating Profit (Non-GAAP)</b>	5.2%	5.6%	6.2%				
<b>Net Margin, GAAP</b>	3.6%	3.6%	6.4%	2.8%	2.8%	5.5%	0.9%
<b>Net Margin (Non-GAAP)</b>	4.7%	5.2%	5.5%	0.8%	0.3%	0.0%	5.5%
<b>Costs % of Revenue</b>				<b>% pt Chg</b>	<b>% pt Chg</b>		
<b>Fulfilment</b>	9.5%	7.3%	6.8%	(2.7%)	(0.4%)		
<b>Marketing</b>	4.4%	5.4%	4.2%	(0.2%)	(1.2%)		
<b>Technology and content</b>	1.6%	1.6%	1.1%	(0.5%)	(0.5%)		
<b>General and administrative</b>	2.7%	3.6%	2.6%	(0.0%)	(0.9%)		

VIPS has been refocusing on the apparel category which has been its bread and butter business. This renewed focus led to more effective customer acquisitions and improved operating margin, in our view. However, the apparel category has been growing at a much slower pace than the overall online spending (Figure 1). Vipshop’s weakness has been exposed in the time of COVID-19 as consumers has been pushing back their apparel purchases. We believe growth will become even more challenging in the second half of the year as the third quarter is a seasonally low volume quarter and the fourth quarter will become intensely competitive due to the Singles’ Day.

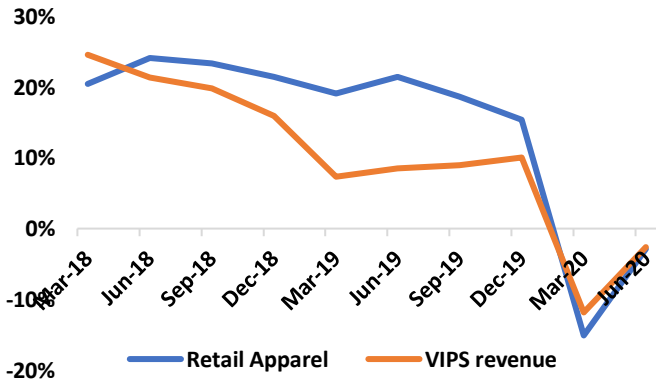
**Figure 1: Apparel spending lags China’s online retail growth**



Source: NBS (National Bureau of Statistics)

Even within the online apparel segment, VIPS’s growth is lagging that of the overall online apparel growth. Discounted brand is a well-protected niche but VIPS is up against another formidable competitor in Alibaba (BABA US).

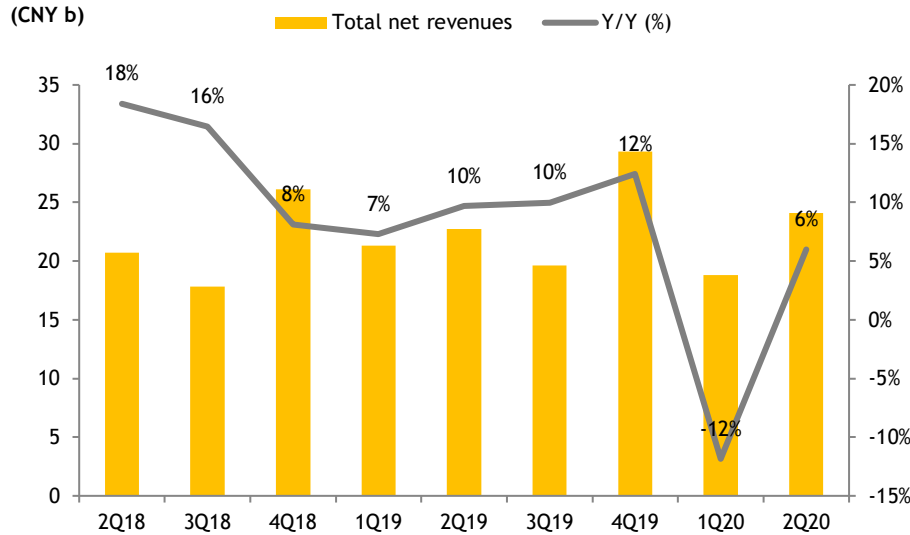
**Figure 2: VIPS’s quarterly sales growth has been lagging the overall online apparel GMV growth until 2020**



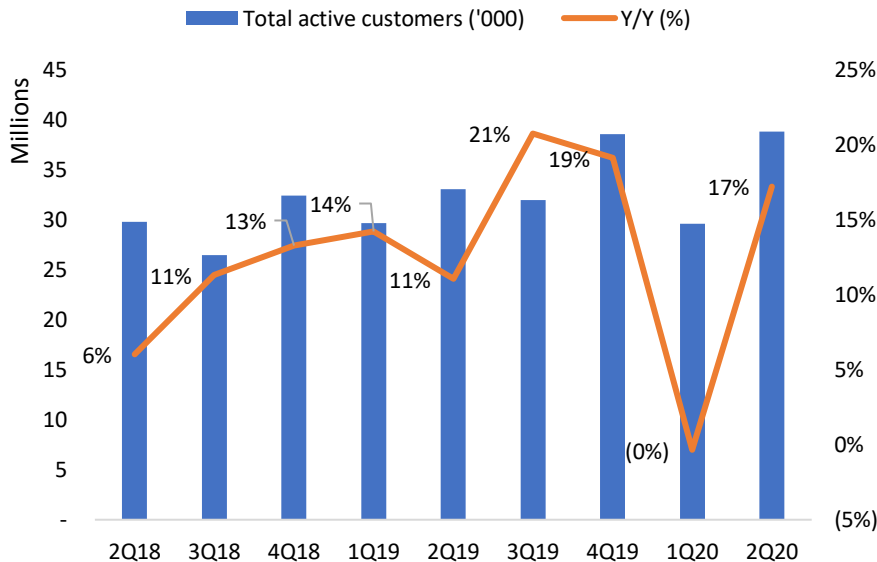
Source: Company data, NBS

VIPS shares are up 132% in the last 12 months even after today's 19% drop reflecting the reaccelerated revenue growth from 1Q19. Recent struggles could reverse the gear. Even after spending incremental 1.9% points of revenues on coupons and discounts (Figure 5), revenue growth YoY came in at a muted 6%.

**Figure 3: VIPS revenue growth hit a roadblock**



**Figure 4: VIPS' customer base growth was strong...**

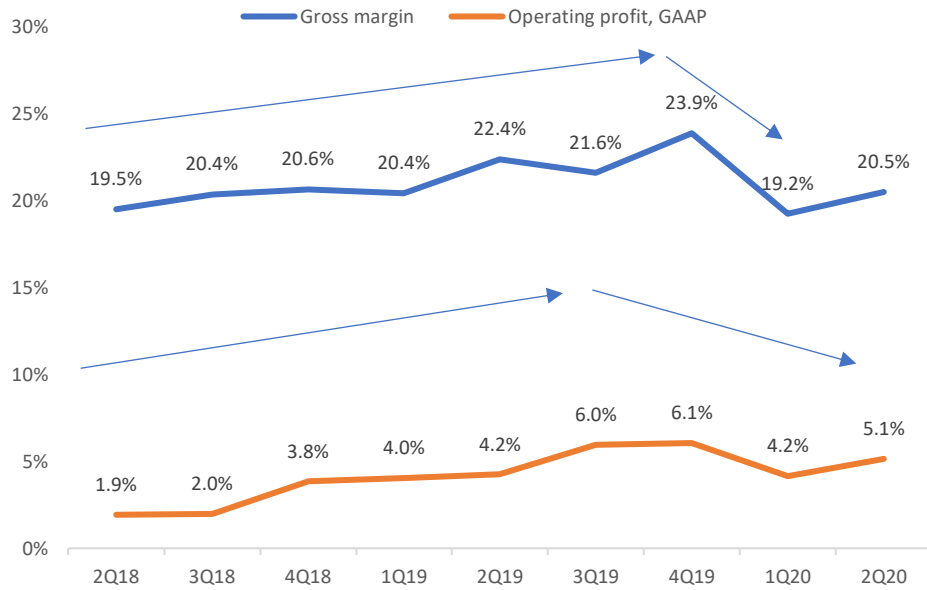


**VIPS' customer base growth resumed at a high growth rate.** The management's focus on customer acquisition was evident both in the lower gross margin and higher marketing spending. The last time the management aggressively attempt to drive growth through customer acquisitions, gross margin took a hit. The company needs to acquire customers cost-effectively to grow while preserving margins. The

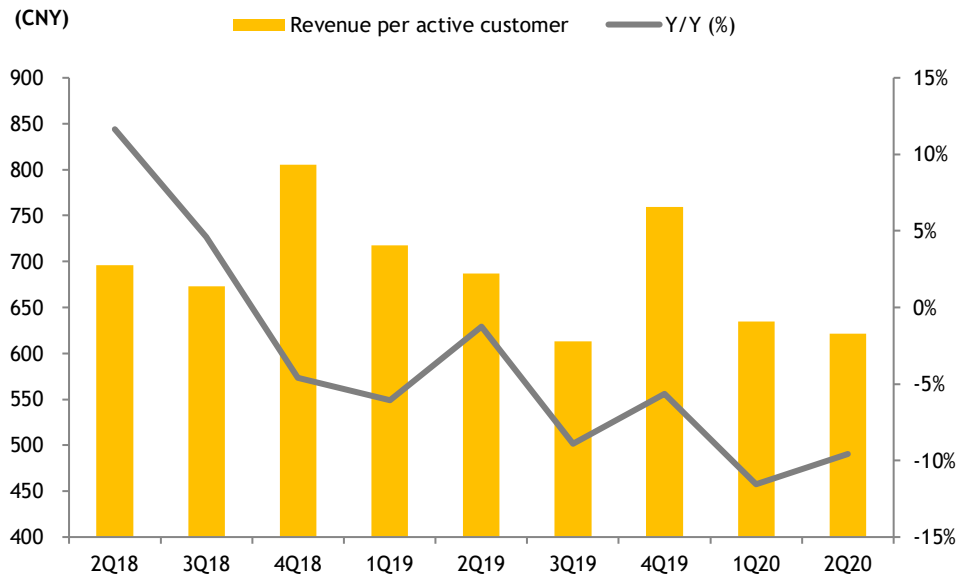
market was excited in 2019 because the company's margins were rising concurrently with stronger customer acquisition (Figure 4) and revenue growth (Figure 3) for the last three quarters in 2019.

VIPS has been successful at customer acquisition but new customers on average are spending less (Figure 6). They are ordering less frequently (Figure 7) and buying lower ticket items (Figure 8). The upside case for VIPS is if ARPU rises with stronger customer loyalty. However, this has not been the case in the last two years.

**Figure 5: But at the expense of margins**

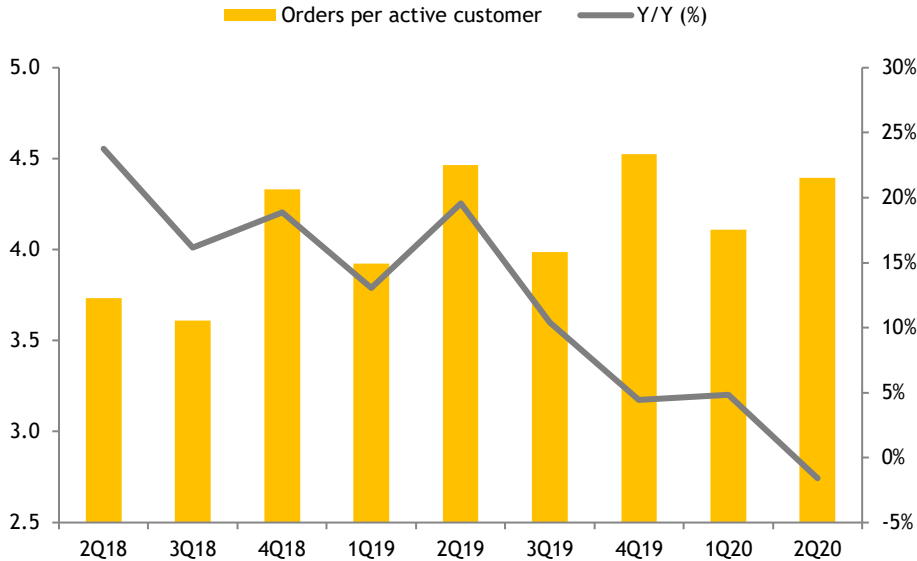


**Figure 6: ... More buyers but less spending**

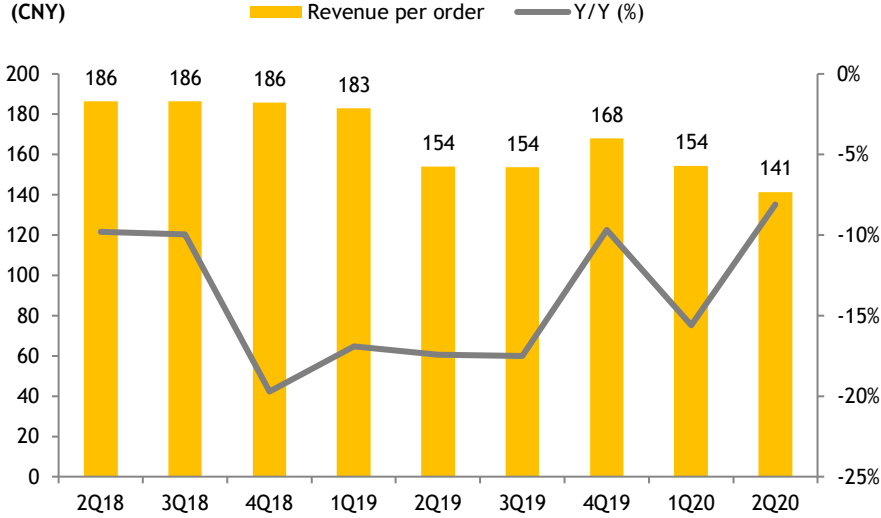




**Figure 7: Ave customer made fewer orders**

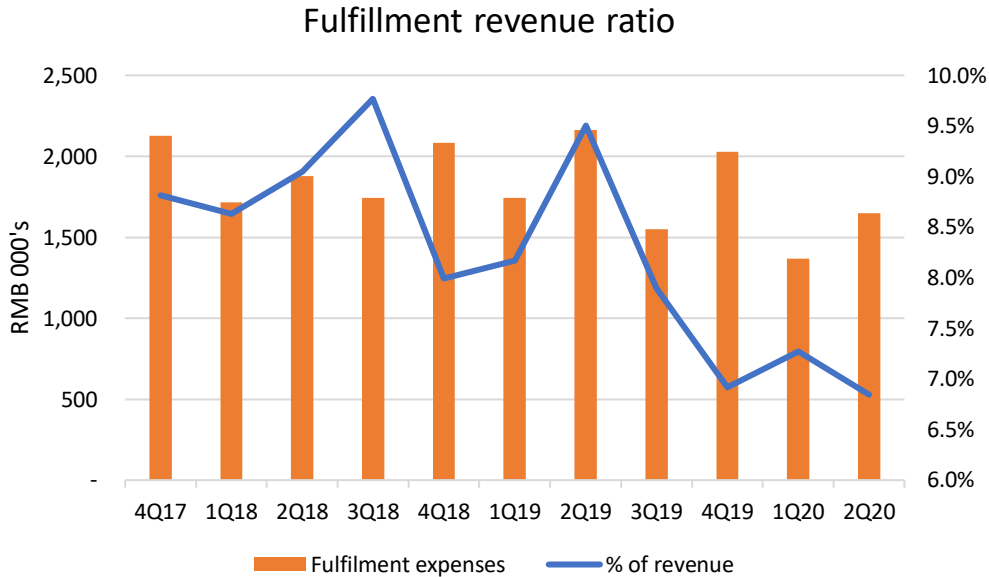


**Figure 8: ... and bought lower ticket items**

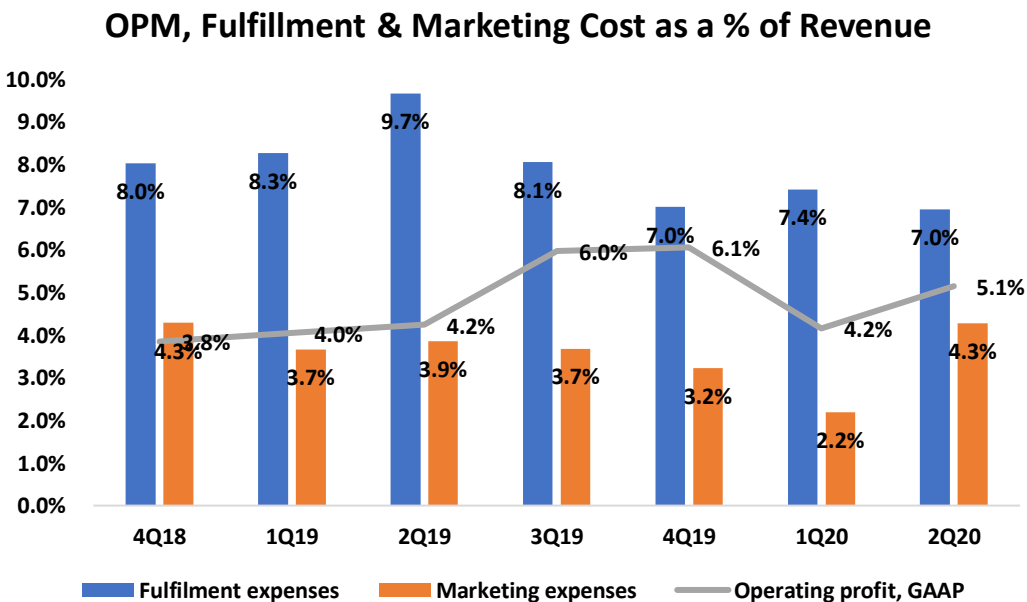


**One area VIPS continues to do well is on fulfillment cost control.** The company has brought this cost down to about 7% or below in the last three quarters. This is a result of the company’s decision to contract with SF Holding for the last mile delivery instead of using its own delivery staff. This was a good decision, in our view. This has led to operating margin rising above 4%.

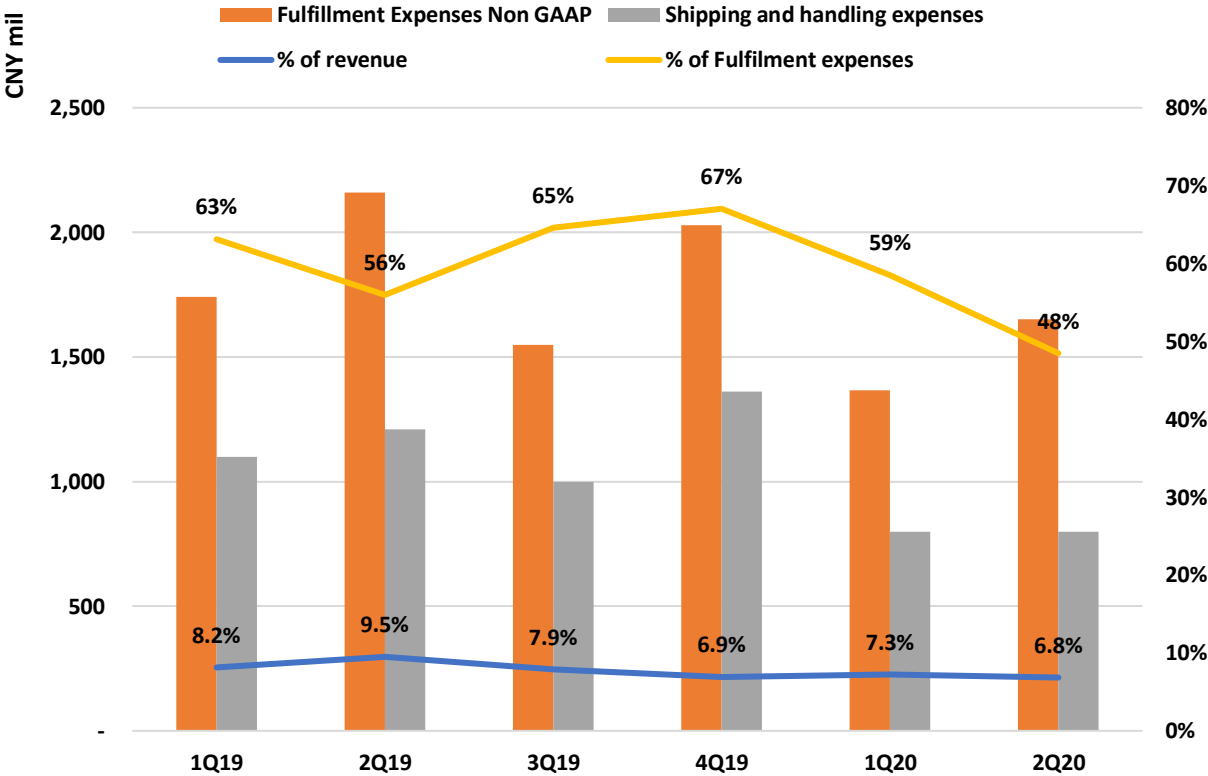
**Figure 9: Fulfillment is well under control**



**Figure 10: Gross margin and fulfillment are a key reason for improved operating margin**



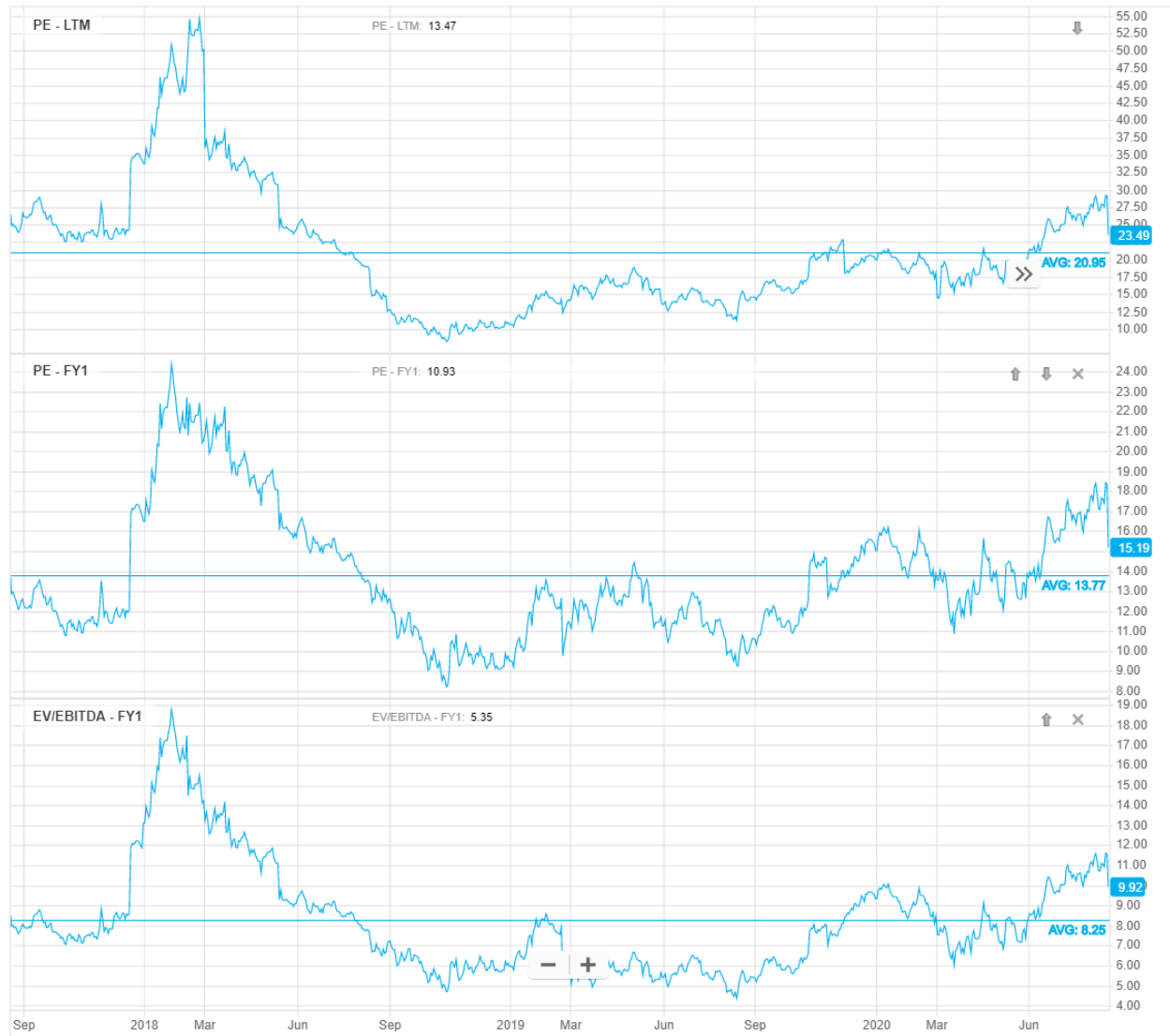
**Figure 11: Fulfillment costs fell with a 3<sup>rd</sup> party shipping and handling**



## Figure 12: Valuations Trends

Vipshop Holdings Ltd Sponsored ADR (VIPS-US)

Aug 21, 2017 - Aug 18, 2020, Daily



Source: Factset