JCAP

TMT
China

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# VIPShop Holdings (VIPS US)

# Just Getting Started

- **Some 25% of reported revenue in VIPShop** comes from a briefcase company sitting in the middle of a marketplace on Hengqin Island in Guangdong Province, a few steps from Macau and known as a center of money laundering. VIPShop has no physical operations in the area. Although VIPS may defend the operation as a tax haven, we believe the company structure suggests otherwise, and we wonder whether the USD 928 mln booked through Hengqin is actually revenue. The company's own disclosures suggest that it is not.

- **VIPShop's financial reports filed** with the Chinese government were revised after publication of J Capital's May 13 report. The files indicate a range of revenue for VIPShop that could be as much as half of what was reported to the SEC. Even post-revision, the revenue falls short of what was reported.

- **VIPShop owns a logistics company** called Pinjun Express that claims to employ 20,000 people. Why has the company not been disclosed to investors? We suspect that this and other undisclosed companies may hide costs and staff that belong in VIPS' SEC accounts.

- **VIPShop claims that 70% of its products** are delivered by owned logistics companies. Yet in dozens of interviews with truckers leaving the VIPShop logistics center, we have not found one who said his or her company was owned by VIPShop.

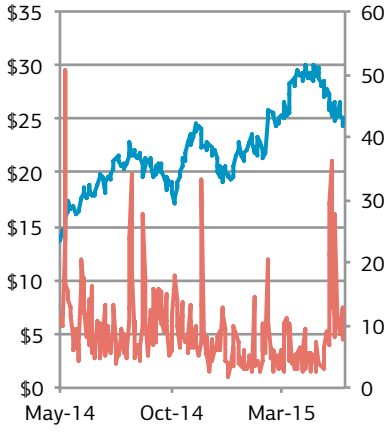
- **We find many paths for diversion of funds,** from a real estate agency owned by Eric Shen to an import-export company trading in cell phone components belonging to Arthur Hong. We have identified several dozen undisclosed subsidiaries or related-party companies.

- **We reiterate our view that the company is fraudulent.**

**VIPShop Holdings (VIPS US)**

| | |
|---|---|
| Price | USD 24.21 |
| **Rating** | **SELL** |
| **Price Target** | **USD 0** |
| Market Cap | USD 14.1 bln |
| Avg. Volume | 15.1 mln |
| P/E | 84.6x |

VIPShop Holdings (VIPS US) last share price in USD (blue) and volume (pink, in mln shares)




Source: Bloomberg June 2, 2015

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# The Top Line

On May 13, we published a report on VIPShop laying out our view that the company is misleading investors as to the scale of its revenue and profit and the scope of investment in fixed assets.

We now reiterate that point of view. We believe that VIPShop is overstating its revenue and diverting capital investment into companies that have not been reported to the investors and in some cases are privately owned by members of the management team.

VIPShop has implied in its statements to investors and in carefully worded U.S. filings that it is investing heavily in fixed assets to support an owned logistics network. Our work instead leads us to conclude that the company is not purchasing property and equipment but instead diverting cash into undisclosed companies.

## How Big is VIPShop?

Our report alleged that VIPShop has reported to the Chinese government only about one-tenth of the revenue it reports to the U.S. government. On May 15, the company issued a press release refuting this claim and stating that ". . . [E]ven the revenue of Vipshop (China) Co., Ltd., one of the wholly-owned subsidiaries of the Company, is approximately RMB 11.1 billion (US$1.79 billion) for 2014 as reported in its publicly available SAIC filing." Management invited investors to examine the allegedly public financial reports that the company has made with the Administration of Industry and commerce (AIC).

Our work leads us to conclude that VIPShop is not purchasing property and equipment but instead diverting cash into its undiclosed companies.

But on May 20, public records indicate that VIPShop changed the filings it had made in early April for that same company. Companies may choose whether they want their filings to be accessible to the public, and VIPShop had elected not to divulge the original filings, as is indicated on the website of the Guangdong Province AIC. While IR told some investors that the company had not filed for 2014, the website clearly states that VIPShop (China) Co. Ltd. filed its 2014 annual report on April 2, 2015. A screenshot is at the top of the next page.

The company changed the content of that filing on May 20, one week after our report was issued. Prior to the changes, the detailed financial data had not been made available to the public. The change may have been merely to make the data publicly available, but since we do not know what the

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## VIPShop (China) Filed Its Annual Report on April 2, 2015

全国企业信用信息公示系统（广东）

唯品会（中国）有限公司

年报信息 | 行政许可信息 | 股东及出资信息 | 知识产权出质信息 | 行政处罚信息 | 股权变更信息

工商公示信息

基本信息

| 序号 | 报送年度 | 发布日期 | |
|---|---|---|---|
| 1 | 2014年度报告 | 2015年04月02日 | |
| 2 | 2013年度报告 | 2014年06月10日 | |

Source: Guangzhou AIC website

numbers were before the revision, we cannot know if they were different.

变更信息

| 序号 | 变更事项 | 变更前内容 | 变更后内容 | 变更日期 |
|---|---|---|---|---|
| 1 | 利润总额是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 2 | 从业人数是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 3 | 负债总额是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 4 | 所有者权益是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 5 | 纳税总额是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 6 | 销售总额是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 7 | 主营业务收入是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 8 | 资产总额是否公示 | 不公示 | 公示 | 2015年05月20日 |
| 9 | 净利润是否公示 | 不公示 | 公示 | 2015年05月20日 |

Click to open original

**"Date of change" is the right-hand column**

Source: Guangzhou AIC website

The same was done for Guangzhou VIPShop Information Technology Co. Ltd., the company allegedly responsible for the vast majority of revenue.

变更信息

| 序号 | 变更事项 | 变更前内容 | 变更后内容 | 变更日期 |
|---|---|---|---|---|
| 1 | 从业人数是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 2 | 利润总额是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 3 | 纳税总额是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 4 | 主营业务收入是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 5 | 净利润是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 6 | 资产总额是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 7 | 负债总额是否公示 | 不公示 | 公示 | 2016年06月20日 |
| 8 | 所有者权益是否公示 | 不公示 | 公示 | 2016年06月20日 |

Source here

Before the 2014 20-F was published, changes were made to filings for other subsidiaries, raising the revenue, assets, and liabilities. Below is a record of how the company replaced AIC records for its Vipshop (Jianyang) E-Commerce Co., Ltd. subsidiary.

VIPS has recently reported $862 mln in Guangzhou VIPShop Information revenues to the Chinese government. VIPS also tells US investors that the VIEs (this company plus Lefeng) account for 83.9% of revenues. Is the company saying that total 2014 revenues were actually just a bit over $1 bln?

Jianyang's AIC is unusual in that it displays numbers before and after changes are made. Here is a translation of the table representing some of the changes made to a 2014 Jianyang annual filing for VIPS on March 16, 2015:

## Table 1. VIPShop (Jianyang) E-Commerce Co. Ltd.

| In RMB | Before the Change | After the Change | Date of Change |
|---|---|---|---|
| **Shareholder and Investor Information** | None | Investor: VIPShop (China) Co. Ltd. Capital: 5 million Investment made in: cash | 16-Mar-15 |
| **Total Assets** | 262,235,100 | 1,327,249,100 | 16-Mar-15 |
| **Total Liabilities** | 147,958,800 | 1,162,249,000 | 16-Mar-15 |
| **Revenue** | 2,186,561,300 | 5,060,892,000 | 16-Mar-15 |

Source: Jianyang AIC website. The name of the company must be entered into the query box to yield the correct page.

The screenshot of the Jianyang filing is below.

修改记录

| 序号 | 修改事项 | 修改前 | 修改后 | 修改日期 |
|---|---|---|---|---|
| 6 | 股东及出资信息 | 无 | 认缴出资股东（发起人）姓名或名称：唯品会（中国）有限公司 单位（万元）<br>认缴出资额：500；出资方式：货币 更多 | 2015年3月16日 |
| 7 | 资产总额 | 26223.51 | 132724.91 | 2015年3月16日 |
| 8 | 负债总额 | 14795.88 | 116224.9 | 2015年3月16日 |
| 9 | 营业总收入 | 218656.13 | 506089.2 | 2015年3月16日 |
| 10 | 销售总额中主营业务收入 | 218656.13 | 506089.2 | 2015年3月16日 |

Source: Jianyang AIC website, most recently accessed on June 2, 2015

In other words, a previously submitted filing reported total assets of RMB 262 mln and revenue of RMB 2.186 bln, or USD 352 mln. The updated filing on 16 March 2015 shows RMB 1.327 bln of assets and RMB 5 bln (USD 806 mln) in revenue. Why the large change? And when were the "Before the change" numbers filed?

On May 7 and May 21, we were able to obtain two alternative filings for the Jianyang company, both purporting to be from the AIC in Jianyang. One file was reportedly submitted by the company on April 23, 2015 and reported RMB 246 mln in revenue. The second was reportedly obtained from the AIC in late May and reported RMB 636 mln in revenue.

## Consolidation Headaches

Several alternative versions of the companies' statutory financial statements have come to light through various channels; we attempt in our Ap-

pendix A to explain some of the reasons behind these alternatives. None of the alternative records now emerging, including the company's own press release, supports VIPShop's claim to the SEC that 2014 revenue amounted to USD 3.7 bln.

The differences hinge on principles of consolidation. The company basically maintains that what's mine is mine and what's yours is mine—it can consolidate into its SEC statements results of companies the shareholders do not own. This is the essence of the Variable Interest Entity (VIE) structure and is not uncommon among Chinese companies. But it makes it literally impossible for third parties to verify numbers; they can only take VIPShop's word for it. Since Guangzhou Vipshop Information Technology Co. Ltd., the VIE, itself has subsidiaries, and the VIE's principles of consolidation are not discussed, the company can plausibly come up with any number it wants.

It is important here to note that among the VIE's subsidiaries is a veritable empire of logistics entities.

The gross revenue figure we obtained for the VIE company for 2014 was USD 168 mln. **The currently reported revenue figure for the company on the website of the Guangdong Province Administration of Industry and Commerce (AIC) is US 862 mln, a number that was made public and possibly changed on May 20.** The financials on this government website also indicate that the company lost USD 56 mln in 2014, **directly contradicting the company's report on page F-14 of its 2014 20-F. On that page, VIPShop reports that the VIE had USD 3.066 bln in revenues and USD 26 mln in profit.**

## Screenshot from the Guangdong AIC Website Showing RMB 5.34 bln in 2014 Revenue for Guangzhou Vipshop Information Technology Co. Ltd.[1]

企业资产状况信息

| 序号 | 资产总额(万元) | 负债总额(万元) | 销售(营业)收入(万元) | 其中主营业务收入(万元) | 利润总额(万元) | 净利润(万元) | 纳税总额(万元) | 所有者权益合计(万元) |
|---|---|---|---|---|---|---|---|---|
| 1 | 144144.402491 | 231799.388406 | 企业选择不公示 | 534434.099097 | -34955.653255 | -37413.233121 | 19148.905386 | -87654.9859 |

Source here

On its quarterly call, the company responded to our suggestion that revenues might be only 10% of what was stated by suggesting that we may have invented data. Following the call, VIPShop stated that its wholly foreign-owned holding company, VIPShop (China) Co. Ltd., reported USD

[1] 广州唯品会信息科技有限公司

1.79 bln in revenue in 2014. According to the company's own disclosures on principles of consolidation, all but USD 700 mln of that money has to have come from the VIE company, because VIPS says that the VIE has about USD 3 bln in revenue and that all that revenue is consolidated to the parent. With USD 3.7 bln in revenue, there is only room for another USD 700 mln, not USD 1.7 bln.

Specifically, the company says that all the profits from its principal VIE, Vipshop Information, are paid to VIPShop (China) Co. Ltd., its China holding company. It says the VIEs' revenue (VIPShop Information and Lefeng) amount to 83.9% of the company's total revenue.[2] We believe Lefeng revenue is small.

To reiterate:

- VIPShop states that its VIE company is responsible for 83.9% of company revenues.
- VIPShop states that its VIE company had USD 3.066 bln in 2014 revenues.
- VIPShop states that its China holding company, VIPShop (China) Co. Ltd., had 2014 revenues of USD 1.7 bln.
- Since 3.066 plus 1.7 is 4.76, and the company reported 3.7 in revenue, USD 1 bln of that revenue must be duplicative and have been consolidated out at the parent level, leaving USD 700 mln in net revenues in the holding company.
- Therefore, any revenues from subsidiaries like the logistics subsid-

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[2] The two relevant disclosures are as follows: On page F-11 of the 2014 20-F, the company states that it consolidates revenue from both the VIE and the directly owned holding company (the "WFOE"). The statement is as follows:

> "The consolidated financial statements include the financial statements of the Company, its subsidiaries and VIE for which it is deemed the primary beneficiary. All intercompany transactions, balances and unrealized profit and losses have been eliminated on consolidation."

On page 72 of the same 20-F, the company says:

> "Under the amended and restated exclusive business cooperation agreement between Vipshop China and Vipshop Information, Vipshop Information agrees to engage Vipshop China as its exclusive provider of technical, consulting and other services in relation to its business operations. In consideration of such services, Vipshop Information will pay to Vipshop China service fees which amount to all of Vipshop Information's net income. The service fees may be adjusted at Vipshop China's sole discretion based on the services rendered and the operational needs of Vipshop Information. Vipshop Information contributed approximately 99.98%, 99.89% and 83.90%, respectively, of our total consolidated net revenues in the years ended December 31, 2012, 2013 and 2014."

iaries in Jianyang and Tianjin and Zhuhai must be consolidated into the VIE or the holding company and are irrelevant to this discussion.

## Statutory Filings

Since a regulatory change on March 1, 2014 that eliminated the requirement that companies provide audited financial statements to the Administration of Industry and Commerce (AIC), the reliability and public nature of data on company financial results have become much more controversial. Different government agencies collect different data, from the highly unreliable and self-reported data given to the National Bureau of Statistics to the granular information on operating results provided to the local Bureau of Finance. For four years now, our work has relied on the financial information available from the AIC via a network of agents who were licensed to access this data.

We believe that the files we originally accessed probably represent the numbers that VIPShop subsidiaries originally reported to local authorities. Those files reported net revenues for the VIPS disclosed subsidiaries at a total of USD 1.3 bln in 2014 if each subsidiary is separately counted and at only about USD 250 mln if justVIPShop Information (the main VIE)PShop Information and the Lefeng subsidiary are counted. However, we also believe that those operating results fail to consolidate income from subsidiaries and affiliates, which, if included, may boost the income significantly.

We have not been able to obtain financial reports for the Chongqing subsidiary, which is disclosed, and this could be contributing revenue we have not accounted for. For the new Lefeng subsidiary, whose results are probably not included in the VIE's accounts, we have obtained a net revenue number of USD 29.6 mln for 2014. VIPShop's disclosures on Lefeng suggest revenues of less than USD 65 mln in the year prior to acquisition, because USD 65 mln is the threshold for notification to the Chinese government of an M&A transaction, according to a report from Mithra Forensic Research, and no such report was made. We believe the Lefeng revenue is de minimis.

We have by now seen many alternative sets of financial data for the same companies, most of them contradictory.

We have by now seen many alternative sets of financial data for the same companies, most of them contradictory. We chose to focus on the disclosed subsidiaries and to access AIC reports via the legal channel that has been reliable in the past. After exhaustive due diligence, including interviews with AICs, tax offices, lawyers, agents, and auditors, we are genuinely unable to determine which reports best represent the financial results of the companies. We hope that VIPShop will disclose the true reported revenues for each subsidiary—information which the company claims is public any-

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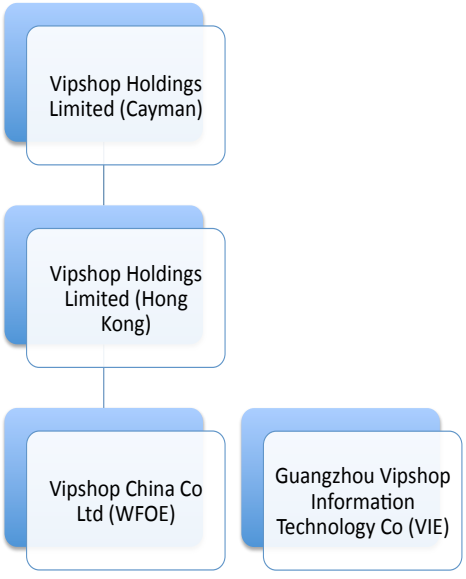
way.

Reasons we believe our original data set is probably reliable:

- The financials are consistent from year to year, representing incremental growth but increasing divergence from SEC data.
- Alternative AIC reports we have been able to obtain are incomplete. The year for which we obtained the most AIC reports is 2013, and the subsidiaries in that year, according to these alternative records, reported far more revenue than was reported to the SEC, clearly indicating a consolidation problem.
- We provide the full records for completeness but we believe that the VIE company, Guangzhou Vipshop Information Technology Co. Ltd., should be the legal recipient of the great majority of revenue, both because Chinese law requires that and because management discloses that to be true. If VIPS, as it claims, indeed takes possession of inventory and sells from its own warehouses, Chinese regulations would require that the VIE company, holding the license to engage in these activities, take the revenue and disburse net income to the WFOE holding company.
- We have been relying on the same methods for four years and have consistently found the reports to line up with reports obtained from other channels and with other information about the companies' operating results. In many cases, these AIC filings have yielded more revenue than reported to the SEC, which we have duly reported to our clients. In years past, we often saw paper documents with handwritten figures signed by the companies, but these documents are no longer available and in most localities have been supplanted with electronic systems.

**VIPShop Basic Structure**




Source: Company reports

In Appendix A, we have described the data available via AICs and the rules and regulations around obtaining the data.

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## The Mysterious Billion-Dollar Subsidiary

Within all the controversy around what data the AIC does and does not collect, there is one strange AIC report that we obtained with huge revenue in 2014 even though the subsidiary was formed only in July 2013. That AIC filing by the VIPS subsidiary in Zhuhai, Guangdong indicates USD 927 mln in revenue in 2014. We visited the office the week of May 13.
We visited the site,[3] spoke with local government offices, and can confirm the following:

**The first floor of the building housing VIPShop's Zhuhai subsidiary.** | Photo by J Capital, May 2015

- The registered office of VIPShop is in a small, eight-story building counting the ground floor.
- The first floor is a rural market and the floors above are rented to migrants or local workers. Their laundry is hanging outside.
- Local government officials said they had not seen anyone from VIPShop at the location and that the company has no warehouse on the

[3] The detailed address in Chinese is: 珠海市横琴新区宝中路 3 号 4004 室 -475. Government officials in the local zone management office told us that VIPShop simply had a registered office in the building but did not operate in Zhuhai. The Google Satellite coordinates are 22°06'54.3"N 113°32'39.9"E.

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island.

**The sixth floor of the building where VIPS is registered is rented to migrant workers. The door to the fourth floor, where VIPS is registered, was locked.** | Photo by J Capital, May 2015

We looked for a telephone number for the Zhuhai office and the only number we could find was for the Guangzhou office, which we telephoned.

Evidence suggests that this registered location is a hub for sketchy companies. We have discovered registered offices for several phantom companies on the same floor of the same building in Hengqin. Furthermore, in an April article published on the China Finance and Insurance Investment Network, a Chinese reporter exposes the company Boyuan Investments, recently delisted from the A-share market, as having fraudulent on-paper subsidiaries registered at the same address. The article says, "On two visits to Boyuan Investment's publicly registered address on March 29 and March 30, we found that the registered location was an old eight-story building with a sign saying 'Hengqin Cultural Station' and a vegetable market on the ground floor." The report specified that the "Hengqin Cultural Station" in March contained empty office locations for 4,030 companies.

## About Hengqin Island

The subsidiary is not simply in Zhuhai but in the very special zone of

Hengqin, a territory of 106 square kilometers with only a few thousand residents. Hengqin Island is a dark southern entrepot for fast money and junkets to the Macau casinos, which lie across the Lotus Bridge. The city fathers of Zhuhai have been promoting Hengqin as a special zone that could permit gambling, currently illegal on the Mainland, and gradually displace Macau. In the absence of permission to build casinos, Hengqin is trying to build a case for itself as a Mainland Cotai Strip, where spillover gamblers can sleep in five-star hotels while they cross into Macau to gamble in their waking hours. In 2012, Las Vegas Sands CEO Sheldon Adelson came under investigation in the United States for possible bribery associated with his plan to build a hotel and convention center on Henqin Island.

Hengqin has never managed to realize its economic plan and currently is a sleepy place with half-built hotels, a metals-trading exchange, and money brokers. The zone also offers a suite of preferential policies designed to attract businesses. Zhuhai city has piloted co-operation projects there that include exempting all overseas goods shipped to Hengqin from import duties and charging qualified companies a corporate tax rate of 15%, compared to the Mainland average of 25%.

More intriguing is the tariff-free status of the island.

VIPShop, then, may argue that it has obtained the right to move revenue through Hengqin in order to realize the 15% corporate income tax. The city of Zhuhai, in an announcement congratulating VIPShop on paying a lot of taxes, announced that the company had paid RMB 226 mln in the first seven months of 2014, saying that this represented a tax rate of 15%. But there are several problems with the tax argument. First, VIPS disclosures indicate that the company is already able to realize a 15% income tax rate in several other of its operating territories. Furthermore, financials for the Zhuhai company suggest that the taxes paid amounted to 23% of net profit, a higher rate than the company can obtain elsewhere. Business taxes in the financial statements are low and similar to those charged in other territories.

More intriguing is the tariff-free status of the island. Technically, the duty-free policy should attach only to goods sold on the island, not transshipped elsewhere on the Mainland, but such zones often offer schemes that enable crossing the border without incurring new taxes. To the extent customers are outside of Hengqin, though, such a scheme would constitute smuggling.

We have found irregularities in the Zhuhai company's accounts. On March 21, 2014, the government of Zhuhai posted a notice indicating that VIPShop had claimed deductible expenses but could not produce receipts for

5,000 of those expenses.[4] The State Administration of Taxation, on the national level, announced the breach and estimated that VIPShop had evaded RMB 70 mln in taxes on the island. This would be consistent with the notion that VIPShop is running revenue through a low-tax zone: it is more difficult to show evidence of costs if the zone is being used as simply a convenience.

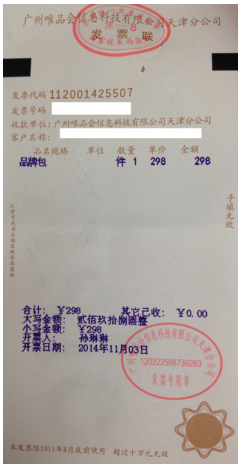
## Tax Haven?

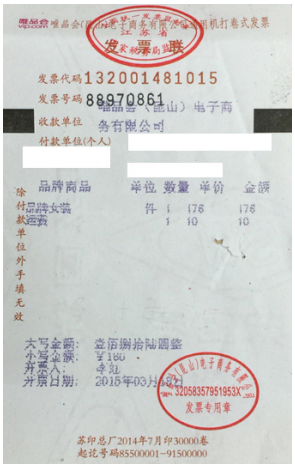
VIPShop will likely tell investors that the Zhuhai company is an easy way to save on taxes and that it is perfectly legal, but we remain puzzled as to the mechanics.

First of all, VIPShop tells us that it must operate through multiple corporate entities to comply with Chinese law: there is a VIE that collects revenue, a foreign-owned holding company, branch offices, and, we understand, both logistics and e-commerce companies in each locality where there is a warehouse. If revenue actually can all be centralized in a single, streamlined entity, why would VIPS set up such duplicative and tax-redundant structures?

The next problem is that whenever we have made purchases from VIPShop, we ask for a "legal receipt" indicating which corporate entity received the revenue. The receipts have come from the company's VIE or its disclosed logistic operations, not from Zhuhai. In China, the legal receipt is enormously important, and the entity that issues the legal receipt is the entity that records revenue.

Here are two of the receipts:




[4] See here.

Where, we wonder, does the income come from?

The entity that issued the left-hand receipt, for a purchase in Beijing, is Guangzhou Vipshop Information Technology Co. Ltd. Receipts issued to our Shanghai operation came from VIPShop (Kunshan) E-Commerce Co. Ltd.

We do know that the Zhuhai entity records costs. For example, brand partner Lancy, in its annual report to the Shanghai Stock Exchange, indicates that VIPShop Zhuhai is its fifth-largest customer. Costs are needed if there is to be income, but where, we wonder, does the income come from?

The Hengqin Zone is a well-known location for fast and loose money operations. Because China operates a closed capital account, many restrictions attach to the process of importing speculative capital from overseas and moving Renminbi outside of China. The most common method for enacting such transfers is to use a trade account to execute "imports," to carry money into China, and "exports," to move it out again. Free Trade Zones like the Pudong FTZ, Shenzhen's Qianhai Zone, and Hengqin Island are natural entrepots for this type of investment business.

We have no evidence whatsoever that VIPShop might be involved in such businesses, but we are puzzled about the structure. If VIPShop really needed to collect revenue in Zhuhai, it need only establish a branch of the VIE company. If it wanted to own warehouse and land, it might establish a new company. But we know that VIPShop does not have assets in Zhuhai or even an operating presence. The company's description is "e-commerce and logistics," while the Zhuhai company clearly has no e-commerce or logistics operations.

## The Logistics Mystery

VIPShop management says that the company now has 70% of its deliveries handled by companies in which VIPShop holds equity, and it will move that percentage to 80% by the end of this year. However, we have interviewed dozens of truckers at each of the logistics centers around China, and we have not found any who claimed to work for a company owned by VIPShop. One truck driver whom we interviewed at the Tianjin facility worked for the Hunan Pinjun Logistics Co. Ltd. That driver said that his company was in the process of being acquired by VIPShop but that the transaction had not been completed.

Truck drivers, of course, may not know the equity structure of their employers, but the names of the companies were generally fairly large and well-known logistics providers that are not owned by VIPShop, companies

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like Debang and Yunda. Most often, the truckers own their own vehicles and pay fees to a licensed company like Debang in a process called "gua kao" or "hanging off" a bigger company that meets all the regulatory requirements.

Pinjun Express ( 品骏快递 , see website here) is registered in Guangzhou as a subsidiary of Guangzhou VIPShop Information Technology, the VIPShop VIE; its chairman is Eric Shen. The VIE company is not owned by U.S. shareholders and thus neither is Pinjun. According to the website of Pinjun Express, the company is in the process of changing its name from Pinxin Investments to Pinjun Express. The company headquarters are in the VIPShop logistics center in Zhaoqing, as indicated on the website and on this job recruitment site. On its website, Pinjun says that it is owned and managed by Guangzhou VIPShop and that its clients include JD.com, Carrefour, Amazon, Suning, and Walmart.[5] Pinjun is advertising in many provinces for staff, and the company claims in its ads that it has a "steady and gently rising" guaranteed volume of deliveries from VIPShop.

**This photo from the Pinjun website identifies Eric Shen, here pictured addressing a Pinjun annual meeting, as "chairman."** | Photo source here

[5] The website is available in Google cache here.

According to the Pinjun website and related job ads, Pinjun Logistics employs more than 20,000 people.[6] Thus far, we have identified at least 12 Pinjun operating subsidiaries whose legal representative is Eric Shen (see Appendix B for the company list). Pinjun Holdings, for example, was registered on December 9, 2013 by Eric Shen in Guangzhou, according to a government website, and has been disclosed by VIPShop. Its registered capital is RMB 200 mln.

## Table 2. Pinjun Subsidiaries of the VIPShop VIE

| Guangzhou Pinxin Investment Holding Co Ltd (Later Changed to Pinjun Logistics) Subsidiaries | Disclosures |
|---|---|
| **Guangxi Pinjun Co Ltd** | Not Disclosed |
| **Guangzhou Pinjun Logistics Co Ltd** | Not Disclosed |
| **Ningxia Pinjun Express Delivery Co Ltd** | Not Disclosed |
| **VIPShop Guangzhou Information Technology Company Shenzhen Branch** | Not Disclosed |
| **Tianjin Pinjun Logistics Co Ltd** | Not Disclosed |
| **Yunan Pinjun Express Delivery Co Ltd** | Not Disclosed |
| **Anhui Pinjun Logistics Co Ltd** | Not Disclosed |
| **Guizhou Pinjun E-Commerce Co Ltd** | Not Disclosed |
| **Sichuan Pinjun Express Delivery Co Ltd** | Not Disclosed |
| **Xinjiang Pinxin Logistics Co Ltd** | Not Disclosed |

Source: AIC websites, J Capital

Pinjun appears to be seeking business from other companies but currently to derive the great majority of its business from VIPShop. If Pinjun really employs so many people, it is likely that the company is holding costs of VIPShop logistics without consolidating those costs up into the listed company. This was the tactic used by Longtop Financial, another favorite of U.S. investors, which delisted in 2011 after revealing that it had been lying about its cash. Longtop employed the majority of its staff in a separately owned company called Longtop Personnel and thus managed to make the listed company's margins appear higher than they were.

The revenue per logistics employee at VIPShop is about double what JD.com can report. It may be that the hidden nature of Pinjun is making that possible.

[6] The assertion is made on the "About Us" page of the Pinjun website.

### Table 3. Revenue Per Logistics Employee

| Category | JD | VIPS |
|---|---|---|
| **Delivery and warehouse employees** | 43,133 | 11,703 |
| **Revenue (mln USD)** | $7,612.00 | $3,773.66 |
| **Revenue per employee** | $176,477 | $322,452 |

Source: Company reports

## Multi-Headed Hydra

We have found dozens of undisclosed companies on the Mainland, some belonging to VIPS subsidiaries. The capital contributed to these companies amounts to at least USD 160 mln, according to public records. There are additionally 13 undisclosed companies registered in Hong Kong with names similar to VIPShop and of which Eric Shen is the sole director. Ownership is unknown. We believe that these shell companies are taking in capital, ostensibly to invest in logistics, but our interviews with truck drivers and brand partners to VIPShop have found scant evidence of owned logistics companies carrying VIPS products.

The list of companies we have discovered is attached. So far, in the registered capital in the subsidiaries that have NOT been disclosed by VIPShop, we count USD 160 mln. Given that we have not found all companies and that investment capital often enters China under other guises, we believe that the real number must be twice this amount.

If so, that would be an interesting result. In its SEC financial statements, VIPShop reports that it owned USD 309 mln in PPE as of December 21, 2014. The AIC reports that we aggregated list USD 7 mln in PPE, of which USD 4 mln was added in 2014. Alternative AIC reports, for which 2013 is the most complete year, indicate USD 16.5 mln in PPE in 2013 (the SEC number was USD 24 mln). Total registered capital in VIPS subsidiaries, disclosed and non-disclosed, amounts to USD 298 mln, from what we can count, of which USD 160 mln is in undisclosed subsidiaries.

If these undisclosed companies are acquiring assets, those acquisitions could account for the PPE number.

### Tianjin, Ezhou, and Zhaoqing

We reiterate that we are skeptical of the company's PPE claim if that PPE is attributed to the disclosed operating subsidiaries. We are perfectly aware that the logistics facilities exist but have yet to see evidence that their value resides on the VIPS balance sheet.

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In its 20-F, the company makes the following disclosure:

> "As of December 31, 2014, we . . . own close to 500,000 square meters of logistics centers and office space in Tianjin, Ezhou and Zhaoqing."

Note that our previous report contained a transcription error and referred only to Tianjin.

- Regarding Tianjin, we were clearly told by our sources that Goodman had built not only the Phase 1 but the Phase 2 facility to VIP spec and leases both to VIPShop for a 10-year term. Sources may have been mistaken, but we are not able to find independent confirmation of ownership, and the AIC reports we have on VIPShop's Tianjin company do not contain PPE assets that would account for ownership of a warehouse. The Phase 3 facility has not started construction, although VIPShop has made a down-payment on land for the facility.
- Regarding Ezhou, the city government announced in 2013 that VIPShop would invest RMB 1.6 bln in e-commerce facilities in the city. We believe that the reason the physical assets are missing from the books of VIPShop's disclosed subsidiary in Hubei Province (where Ezhou is located) is that the investment came from an undisclosed subsidiary called VIPShop Hubei Logistics Co. Ltd. This company was established in January 2014 and appears to be one of the many affiliates of investment companies with Eric Shen as the director in Hong Kong. VIPShop Hubei Investment Ltd. was registered in Hong Kong in September 2013 by Eric Shen under the registration number 1968015. News reports indicate that the Hubei investment company is the investor in the facilities.
- In Zhaoqing, the VIPShop investment company registered in Hong Kong called VIPShop Guangdong Investments Ltd. is the parent company owning the land for the warehouse. Another investment company called Guangzhou Pinxin Investment is hiring logistics employees and will soon change its name to Pinjun, the name of the logistics company owned by VIPShop.

We believe that the AIC reports we have accessed are accurate in reflecting very few assets owned by disclosed companies.

In other words, we believe that the AIC reports we have accessed are accurate in reflecting very few assets owned by disclosed companies. We think it likely that the assets belong to undisclosed companies privately owned by management. If this is indeed the case and if VIPShop investment capital has been used to establish these facilities, the contracts under which the benefits of the facilities are conveyed to shareholders need to be disclosed in SEC documents.

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Going by VIPShop's own disclosures, we believe that the physical assets would be worth approximately USD 200 mln including construction in progress. In China, on the high end, a warehouse costs RMB 2,500 per square meter to build. We know from public records that VIPS has spent RMB 60.9 mln on land. If the company does indeed own nearly 500,000 sq m of warehouses, in whatever entity, then the total value of the land and logistics assets would be about USD 210 mln.

## Two-Pronged Structures?

Investors say that VIPShop has told them that each branch operates through two types of structures, a logistics company and an e-commerce company, and that the logistics companies own the warehouse assets.

If this is the case, then we wonder why VIPShop revenue would sit in companies disclosed to investors while its costs would reside in undisclosed companies. Additionally, if those logistics companies hold assets, do they also have liabilities belonging to VIPShop? Typically in China, physical assets are desirable because they can be leveraged for debt.

## Table 4. Pinjun Subsidiaries of the VIPShop VIE

| Logistics Companies Owned By Offshore Entities | Disclosure |
|---|---|
| **Vipshop (Sichuan) Logistics Co Ltd** | Not Disclosed |
| **Vipshop Tianjin Logistics Co Ltd** | Not Disclosed |
| **Vipshop Zhaoqing Logistics Co Ltd** | Not Disclosed |
| **Vipshop Henan Logisitcs Co Ltd** | Not Disclosed |
| **VIPShop Hubei Logistics Co. Ltd** | Not Disclosed |

Source: J Capital, AIC and Hong Kong Company Registry

On the top of the next page is a simplified org chart showing the company structure for the logistics operation at Zhaoqing.

This structure is a nightmare from an operational and taxation point of view. There are two reasons we can think of for creating such a crabbed corporate structure: deviousness and incompetence. Neither is desirable in a listed company.

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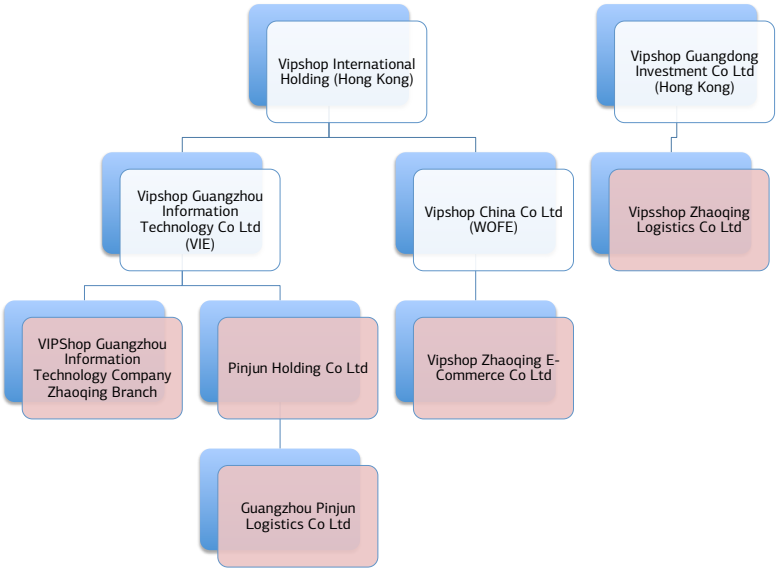
### Vipshop Entities for Operations in Zhaoqing (Pink)




Source: J Capital

## Mystery Shareholders

VIPShop has an odd habit of opening and closing major subsidiaries and of changing its shareholdings.

- VIPShop (Beijing) E-Commerce Co. Ltd., which rented a large logistics facility in Beijing from Global Logistic Properties, was formed in March 2012 and dissolved in May 2013 and yet was responsible for the logistics operations of the northern part of the country.
- VIPShop (Foshan) E-Commerce Co. Ltd. is in the process of being closed down after operating for only one year. The company's logistic operations for Guangdong Province have moved to the new facility in Zhaoqing. The Zhaoqing operating entities were established in 2013 and 2014 but have not yet been disclosed other than to say that there is a branch in Zhaoqing.
- Likewise, the original Kunshan warehouse operations have been moved a few kilometers away to a second rented facility. The original facility remains in operation, but we estimate that no more than 100 people work there, based on the number of people coming to work on company buses; staff say that VIPShop employees are all transported by bus and not permitted to access the facility by foot or motorbike. All this moving occurs in spite of the company's statement to the SEC that it incurs significant loss of inventory in a move. Given that the original facilities are under-utilized, we believe this could have to do with the financing arrangements for the logistics facilities.
- In the registration documents for the principal operating subsidiary

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in China, VIPShop (China) Co. Ltd., VIPShop International Holdings is the 83% shareholder, while the owner of 17% of the company's equity is undisclosed. Given that the company was formed prior to IPO, the additional shareholding might have represented the interests of a private equity investor. The shareholding structure was changed in December of 2012, but public documents do not identify the minority shareholder who exited.

| 投资人及出资简明信息 | | | | | | | |
|---|---|---|---|---|---|---|---|
| 投资人名称 | 国别(国家) | 出资方式 | 余额缴付期限 | 币种 | 出资比例 | 认缴出资额(万元) | 实缴出资额(万元) |
| VIPSHOP INTERNATIONAL HOLDINGS LIMITED | 香港 | | | 美元 | 0.833300 | 15,000.00 | 15,000.00 |

**Screenshot from the record of VIPShop (China) Co. Ltd.'s record of equity.**

- After acquiring Lefeng.com, on February 28, 2014, VIPShop changed its ownership, moving it to a new Hong Kong holding company. Yet VIPS reported in its 20-F for 2014 that Lefeng was owned by a company in the British Virgin Islands called Lefeng.[7] Ownership was moved to a Hong Kong company in March 2014.

The company has registered a series of offshore holding companies whose ownership details are not disclosed.

The company additionally has registered a series of offshore holding companies whose ownership details are not disclosed. Those we have found so far are as follows:

## Table 5. VIPShop Offshore Entities

| Vipshop Offshore Entities | Disclosure |
|---|---|
| **Vipshop International Holdings Limited** | Disclosed |
| **Vipshop Dongbei Investment Limited** | Not Disclosed |
| **Vips Henan Investment Limited** | Not Disclosed |
| **Vipshop Jiangsu Investment Limited** | Not Disclosed |
| **Vipshop Pazhou Investment Limited** | Not Disclosed |
| **Vipshop Shaanxi Investment Limited** | Not Disclosed |
| **Vipshop Xinjiang Investment Limited** | Not Disclosed |
| **Vipshop (Hong Kong) Limited** | Not Disclosed |
| **Vipshop Guangdong Investment Limited** | Not Disclosed |
| **Vipshop Hubei Investment Limited** | Not Disclosed |
| **Vipshop International Limited** | Not Disclosed |

[7] The record is here.

| | |
|---|---|
| **Vipshop Sichuan Investment Limited** | Not Disclosed |
| **Vipshop Tianjin Investment Limited** | Not Disclosed |
| **Lefeng.com E-Commerce Co. Ltd.** | Not Disclosed |
| **Pinwei Real Estate Co.** | Not Disclosed |
| **Lefeng.com Limited (Cayman)** | Disclosed |
| **Vipshop Holding Limited** | Disclosed |

Source: J Capital, AIC and Hong Kong Company Registry

As if that were not enough, the China holding company, VIPShop (China) Co. Ltd., has a series of undisclosed subsidiaries as well.

### Table 6. Subsidiaries of VIPShop (China) Co. Ltd.

| Company Name | Disclosure |
|---|---|
| **Chongqing Vipshop E-Commerce Co. Ltd.** | Disclosed |
| **Vipshop (Foshan) E-Commerce Co. Ltd.** | Disclosed |
| **Guangzhou Pinwei Software Co. Ltd.** | Disclosed |
| **Guangzhou Vipshop Small Loan Co. Ltd.** | Not Disclosed |
| **VIPShop Hubei Ecommerce Co. Ltd.** | Disclosed |
| **Vipshop Kunshan E-Commerce Co. Ltd.** | Disclosed |
| **Pinheng (Shanghai) E-Ecommerce Co. Ltd.** | Disclosed |
| **Vipshop Jianyang E-Commerce Co. Ltd.** | Disclosed |
| **Vipshop Tianjin E-Commerce Co. Ltd.** | Disclosed |
| **Vipshop Zhaoqing E-Commerce Co. Ltd.** | Not Disclosed |
| **Vipshop Zhuhai E-Commerce Co. Ltd.** | Disclosed |
| **Shanghai Vipshop Small Loan Co. Ltd.** | Not Disclosed |

Source: Source: J Capital, AIC, Company Reports

# Disclosed and Undisclosed

## Guangzhou NEM and SEP

The trading company that Eric Shen still discloses owning, Guangzhou NEM, was closed in 2012. Its registered address continues to be used by VIPShop as a destination for returns, and when we visited, we were told by local people that VIPShop had operated form the premises. This is a company, according to the 20-F (page 101) "primarily engaging in the sales of

consumer electronic and telecommunications products," but we can find no trace of its activity. Perhaps, though, the Guangzhou-based company is not the "Guangzhou NEM" referred to in the 20-F. Eric Shen is also listed as the director of a Hong Kong company called Guangzhou NEM Import and Export Co Ltd. that closed in 2013. The company's website, nem.cn, now defunct, shows that NEM was exporting accessories for mobile phones.

Meanwhile, company COO Arthur Hong discloses that he chairs a French company called Société Europe Pacifique Distribution (SEP Distribution) that distributes accessories for mobile phones. We accessed the public financial records for this company and learned that Arthur Hong and two other people with Chinese names are the sole owners. In 2014, the company exported Euro 428,733 worth of products and sold another Euro 2 mln within France, making a profit of Euro 80,000. Co-located[8] with SEP Distribution is a company called Colorfone, which, according to Arthur Hong's bio from 2011, was founded by him. Colorfone makes fashionable cases for cell phones, and its products are sold by a Guangzhou-based company called Suncia.[9] We do not know of related-party transactions among these companies but marvel that Arthur Hong has the time to manage this quite substantial business while also acting as COO of VIPS.


**VIPShop sells handsets and mobile phone components, like this Konka handset, as does SEP Distribution, Arthur Hong's company.**

[8] A Google street image of Colorfone and SEP is at this URL: https://goo.gl/maps/0x3Do

[9] The products are advertised on the Global Sources website: http://www.globalsources.com.hk/gsol/I/Flip-mobile/p/sm/1095512586.htm#1095512586

## The VIPShop Charity

We find it odd that VIPShop would raise money on the Mainland to benefit a Hong Kong institution.

As we have reported in the past, VIPShop owns a charity operating in several provinces, called the "365 Love Foundation" (365 Aixin), which supports schooling for poor rural children. VIPShop last fall sponsored a charity bazaar and performance event attended by numerous Hong Kong pop stars and benefitting a school for children with special needs in Hong Kong.[10] The event is apparently one in a series. The company claims that 2 million members are supporting the foundation with donations. The fund's registered location is the same as that for the undisclosed investment company owned by VIPShop called Pingxin Investment Holdings.

We find it odd that VIPShop would raise money on the Mainland to benefit a Hong Kong institution. VIPShop has no operations in Hong Kong that we know of, and donations in Hong Kong would likely be made in hard currency, leading to many logistical and regulatory problems. Or is the purpose not really charitable?

# The Volume Metrics

### How Many Trucks?

Our observation of logistics centers generally supports our view that VIPShop is much smaller than the company claims in its reports to U.S. investors, but our count cannot be exact. We offer the following metrics.

- The 7,110 active brand partners are highly fragmented, with the top 10 accounting for only 7% of volume, according to the company. If each brand owner averages six sales a year, it is reasonable to think that there are at least 3,500 brands delivering goods to the warehouses in a given month (7,110 divided by 12 months times 6 events, or half 7,110).
- Look at it a different way: the company reported 48,000 sales events for 2014, more than doubling in a year. That means there are 4,000 events per month.
- The brands both deliver product and haul away the unsold product.
- VIPShop says that most brand partners deliver to each of the five major logistics centers for each flash sale.
- Each delivery would require a minimum of one truck, since the brand owners are responsible for their own product and do not, according to

[10] See here.

our interviews, bundle with other brand owners.

- Assuming there are 30 operating days per month, each facility must be visited by 233 trucks per day delivering and retrieving the branded products.
- VIPShop delivered 107 million orders in 2014 to end-users. This computes to about 65,000 orders per day per facility. Based on speaking with drivers who say they carry 3,000-4,000 items, this would require a minimum of 20 trucks per facility.
- Returns are delivered to the logistics centers as well in separate trucks. Assume five trucks per day handling returns.
- The company says that 30% of products are now delivered on a "just in time" basis, meaning that brand owners deliver to warehouses only after receiving an order. However, with a 20% return rate, those brands would still need to take back returns.
- Under the most efficient of circumstances, then, and assuming delivery to central substations, we estimate that each facility would need to see truck traffic of at about 300 trucks per day in normal times. We have never observed a facility with that volume of traffic, and for some facilities, such as Kunshan, we can confirm that traffic is drastically lower.

## Sales Events

- Given the way revenue for VIPS ticks up quarter after quarter as dependably as a metronome, we find the volatile metrics of the sales events hard to believe. The company's revenue per sales event tripled between 2012 and 2013 then declined in 2014, but the number of sales events doubled, ensuring the revenue growth. To accomplish this feat, business development and marketing staff did grow but more slowly than head count for the business as a whole. Everything else stayed more or less the same: the average spend per order (about USD 35), revenues per active customer (about USD 160), and the number of orders per sales event (about 2,500, up from 750 in 2012). The number of orders per brand rose significantly, from 11,467 in 2013 to 15,091 in 2014. We are simple businesspeople at J Cap and have never worked with a listed company as successful as VIPS, but we strain to understand how a business in China can double its brand partners, sales events, and revenues without affecting margins.

## Packaging

- We have interviewed companies that make packaging for VIPShop. Although the companies could not disclose their sales specifically to VIPShop, all were experiencing low growth rates and say that VIPShop demand was typical of demand from other customers.

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## Warehouses

Even as VIPS commits to build vastly more warehousing, the level of warehousing the company had in 2014 made it the least efficient in the space in terms of dollar earned per square meter of warehousing, except for Dangdang. But VIPShop only outshines DANG because of the astonishing revenue growth over the last two years; in 2012, DANG outperformed.

## IT

There is one issue on which all observers of VIPShop are agreed, and that is that the company's logistics operations are very low-tech. This is not surprising given the low spend on IT. VIPShop lumps telecom, IT, R&D, and content expenses into one category, which is consistently 2-3% of gross revenue. The disclosure is as follows:

### Table 7. Revenue in USD per sqm of Warehouses

| Company | 2012 | 2013 | 2014 |
|---|---|---|---|
| **VIPS** | $2,936.98 | $5,266.81 | $5,862.18 |
| **AMZN** | | | $10,524.91 |
| **JD** | | | $7,612.15 |
| **DANG** | | | $3,141.84 |

Source: Company reports

> "Technology and content expenses primarily consist of the compensation and benefits of our IT staff, telecommunications expenses, and expenses incurred in creating content for our sales events on our websites, including model fees and professional photography expenses. As we continue to expand our IT capabilities to support our anticipated growth, we expect our technology and content expenses to continue to increase in the foreseeable future."

Amazon, by contrast, spent more than 10% of net sales on technology and content in 2014, up from 9.5% in 2013.

And yet the VIPShop task in some ways is even greater than Amazon's. VIPShop now delivers its own product to the end-user instead of using third-party services like the postal system, on which Amazon relies heavily. VIPShop permits brand partners to sell any number of SKUs and any volume of each SKU, sometimes only one example of each item, requiring a massive IT capability. VIPShop now says that nearly one-third of products are delivered "just in time," meaning that the sales occur first then the

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brand partners deliver to VIPShop warehouses, the products are delivered to the customers, and this all occurs within 48 hours. VIPShop has the highest product return rate we have heard of for a major direct seller, and yet it manages to take back all these orders, execute refunds, and make the returns to brand partners all with a manual pick-and-pack operation.

As operational people ourselves at J Cap, we believe that these achievements are flatly impossible.

## Other Issues That Leave Us Confused

- We are puzzled as to why VIPShop should establish and close logistics centers in the space of only 15 months. It has taken us 15 months just to get moved into a new house, much less run a billion-dollar operation. And why should entities bulge in revenue and then disappear?
- We have a tough time understanding the "just in time" inventory system. For one thing, given Chinese logistics, how is it that a company can deliver to VIPShop and VIPShop deliver to a customer all in 24-48 hours?
- Why is the return rate so high? Even TV shopping networks generally don't go above 10%.
- Why is VIPShop importing products and selling imported goods? As we understand it, VIPShop does not need to pay suppliers until 30-45 days after receiving goods. Why undermine this model by paying outright for the same goods on an imported basis?
- How can a company receive 107 million orders with no search tool on its website?
- If VIP.com is such a powerful sales location, why don't brand owners on the home page have to pay more?
- Is VIPShop planning to use Eric Shen's company, Pinwei Real Estate, to own land? If not, why is a real estate company needed?
- Among the financial entities that VIPShop operates is a company that factors receivables. For its first year as a business, this company was solely owned by Eric Shen. On May 19, 2014, the equity was moved to VIPS (China) Co. Ltd. ownership. It would be good to know whether Eric Shen was paid for his equity.
- Although it may be reasonable to offer factoring services to suppliers, the company is specifically licensed to provide these services to exporters. An interesting detail about this company is that an online comment from a borrower makes it clear that the Zhuhai entity is owner of some of the receivables.

## J'Accuse

We believe that VIPShop has diverted investor capital and failed to disclose material investments. We think that equity owners have a right to know which assets they actually own and to which cash flows they are entitled. VIPShop has failed to provide this information.

We challenge VIPShop to disclose to its U.S. shareholders its full financial statements filed in China.

VIPShop should make clear the basis of consolidation for the company and its subsidiaries.

VIPShop should tell investors what is happening in Zhuhai.

We believe that VIPShop has diverted investor capital and failed to disclose material investments.

VIPShop should disclose the nature of its relationship with Pinjun. Given the VIPS disclosure that companies in which it owns equity carry 70% of VIPShop deliveries, the company should specify whether that refers to Pinjun. VIPShop should also give an indication of its future intention regarding Pinjun—a separate IPO? An acquisition?

We suspect that VIPShop may be hiding costs. We ask that the company describe its contracts with Pinjun and inform investors whether Pinjun or other companies hold staff or loans for which VIPShop has responsibility.

# Valuation

We reiterate our target price of zero based on our view that whatever profit may be derived from VIPShop is not moving into the listed company owned by U.S investors. We continue to believe that the business is far smaller than reported. We think the Zhuhai subsidiary revenue is likely to represent investment capital carried into China and that the gross revenue for the China company could be as little as one-tenth what has been reported. We do not have confidence that VIPS shareholders own the assets of the company or its cash flows.

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# Risks

- We may misunderstand consolidation issues or have access to erroneous reports, and we may be wrong about the size of VIPShop operations.
- The company may have a reasonable explanation, or an explanation acceptable to shareholders, for its unusual ownership structure.
- Because the company operations are highly fragmented with little concentration of customers or service providers, VIPShop may credibly represent high growth well into the future, and no third party will be successful at making a definitive determination.

# Appendix A: The AIC and Statutory Financials

Following extensive public commentary on our May 13 report, we retrieved other sets of AIC financials via other agents, and we received figures that differ in every regard from our own. Those reports were very incomplete. We mostly were able to obtain numbers only through 2013 and for only for the VIE, the WFOE holding company, the Jianyang company, the Kunshan company, and the factoring subsidiary. We did obtain high-level numbers for the Jianyang, Hubei, and the factoring companies for 2014.

The reports for each company differ in data format. The new figures indicate higher revenue but still do not support the SEC financials.

The AIC records are fraught with difficulties. The one at the top of the next page, for example, from the VIPS Hubei company, reports RMB 5 trn in assets. Clearly the note that the unit is 10,000 RMB is incorrect and the unit should be single RMB.

We have summarized and translated the financial reports we have at hand and made them available here.

### Difficult AIC Records

唯品会（湖北）电子商务有限公司　注册号：420710000010395

基本信息　股东及出资信息　资产状况信息　对外担保信息　预览并公示

正在填报：企业资产状况信息

| | | |
|---|---|---|
| 资产总额 | 584003062.84 | 万元 |
| 所有者权益合计 | 654499235.61 | 万元 |
| 营业总收入 | 3057382913.98 | 万元 |
| 其中：主营业务收入 | 3057382913.98 | 万元 |

# Appendix B: Subsidiaries

We have compiled the attached list of VIPS subsidiaries and related parties from public sources. The list is of necessity incomplete, as each territory and each nominee owner must be searched independently. We will add to the list as we discover more subsidiaries. The list is available for download here.

# Appendix C: The SAIC System

In March 2014, while no one seems to have been watching, Chinese regulators changed the way companies report their financial results and with one blow removed a sturdy tool of Chinese financial research, the "annual report" made to the Administration of Industry and Commerce.

In years past, companies got their financials audited some time in the first quarter of the year and submitted the documents to the city AIC. The AIC then would upload the data to its own database. After that was done, a group of agents would be able to access the reports and sell them to commercial users.

On March 1, 2014, all this changed. Since then, companies have no longer been required to submit audited reports or detailed financials. They now upload to the AIC their basic data: gross revenue, profit, total assets, and total liabilities. But the key change is that companies may report whatever results they decide best represent the company; there is no penalty for dissembling. Furthermore, companies can change their submissions by accessing the AIC database system.

Presumably more accurate financial data now is kept only by the Tax Administration, which may not divulge data other than the income taxes paid by a given company.

In the past, accessing the statutory financial reports has been one component in deep-dive research into company operations—not necessarily a big part of the work but useful in several ways. The "annual inspection" report formerly required of all companies and submitted to the local Administration of Industry and Commerce (AIC) became much more problematic since a regulatory change March 1, 2014. That change essentially made the AIC a registrar rather than part of the regulatory process. It eliminated the requirement that companies submit audited financials, and companies are now to enter whatever financial data they deem appropriate.

Companies in the past sometimes changed their AIC filings, but this was a dubious and fraught process. It involved stiff fees to "public relations" intermediaries and special pleading. Now companies may change their own filings.

Different agencies of the Chinese government collect different data, and they share at different levels of abstraction. For example, each city's Bureau of Finance at the district level collects a very detailed set of financials that include each staff member's salary. At the other end of the spectrum, the new AIC rules require only that companies submit their best estimate of assets, liabilities, revenue, and taxes.

Agencies may share portions of the filings for purposes such as establishing credit databases (shared by banks, the police, the Tax Administration, and several other agencies) or for statistical purposes. Because the legal

regime around sharing or transferring data is unclear in the extreme, sometimes, agencies will publish data openly, sometimes they will sell it to commercial buyers, and sometimes they will prosecute and jail people who access or publish the same data.

Access to AIC financial data is regulated by province. Some provinces provide detailed financial data and company director lists freely to the public. Others provide very little. The data even when available from publicly accessible databases is restricted for transfer, especially to "foreigners," an act which is proscribed by the draconian Archives Law.

## Data Accuracy

Before the change in 2014, the AIC annual financial reports, called the "annual inspection," tended to be useful for some things and not others. Generally speaking, Chinese auditors care a lot about assets and less about profit, and the files reflect this: the value of land and plant tends to be meticulously recorded, as does the value of loans. Revenue is often understated as a way to avoid taxes. The issuance of a legal receipt is what makes revenue traceable by tax authorities, and so companies selling to consumers understate their revenue the most, since consumers are usually willing to skip the receipt in return for a lower price.

The biggest problem with trying to analyze a Chinese company based on its annual inspection report is consolidation rules. The companies seldom account for revenue from subsidiaries unless the revenue has actually been paid and cash recorded. They may not accurately account for equity investees. They generally will not account for inter-company transfers as, for example, a pork company selling frozen meat to its subsidiary in order to make sausage. Revenue to an operating subsidiary may be counted twice, locally and in the holding company.

For these reasons, examining the annual inspection reports for subsidiaries of large companies, like Alibaba for example, would be completely useless. When companies are fairly compact, however, the reports, before 2014, were often useful.

Due to unclear laws and practices around transferring AIC data, we have compiled the AIC reports we received into a report about the data and elected to make that report available here. It should contain enough detail to assist investors in evaluating the company.

# Disclaimer



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