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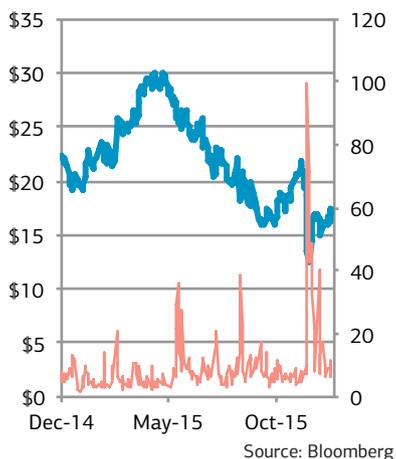
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VIPShop Holdings (VIPS US)

Price	USD 16.34
Rating	SELL
Price Target	0
Difference	100%
Market Cap	USD 9.35 bln
P/E	43x

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



VIPShop Holdings (VIPS US) Still Fraudulent

- ▶ **“Transaction Data” do not represent sales**
Many buyers of VIPShop have relied upon transaction data scraped from the VIPS web interface by an independent data provider. We created our own data scraper and have reviewed transactions that apparently occur on the site. We saw nowhere near 500,000 transactions a day, as VIPS reports. Moreover, perhaps around 33-50% of the database entries represent phantom inventory.
- ▶ **Hot enough for you?**
VIPS reported that “unseasonably warm weather” in China had caused customers to delay purchases of high-margin winter clothing and that it would miss its Q3 numbers. This nonsensical explanation caused the stock to tumble. We believe that the truth behind the miss is that VIPS lacks the cash to fund the related-party transactions that may be behind its high growth.
- ▶ **Cross border**
The company is reporting high growth in the sale of imported goods and has established (but not yet used) a bonded warehouse in Zhengzhou dedicated to cross-border e-commerce. But the company’s import records suggest low volumes of this kind of trade.
- ▶ **Reiterate Sell rating**
We continue to believe that VIPS should be forced to delist from NASDAQ.

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“Transaction” Data

It looks like Wall Street may have made sloppy assumptions regarding the relationship between “transaction data” scraped from the VIPShop website and the company’s actual sales results. We built our own web scraper and are underwhelmed by the transactions we saw on the VIPS website.

Up through about August 9, the public VIPS web interface contained “units sold” information for every SKU associated with each flash sale. This information remained available even after a flash sale ended. At least one independent market research company built a tool to collect this data, which it then packaged and sold in report form to interested parties. Around August 9, this data was removed from the VIPS web interface, and the market research reports were then discontinued.

Nevertheless, the prior reports continued to be used as evidence of the accuracy of the revenue numbers reported by VIPS. We set out to examine this claim more closely.

First, it is important to note that there is no technical requirement that unit sale numbers shown on the consumer site correspond to actual transactions. In fact, in the case of one of VIPS’ major competitors, the consumer-facing unit-sales data was so transparently fabricated that the market research company declined to produce reports for that site.

Our work has significant limitations that make it impossible for us to determine whether fraud was perpetrated on unknowing U.S. software and consulting firms, and through them, on the buy-side, or whether VIP.com actually saw a dramatic and unexplained falloff in transactions in early August. That is because our web scraper only went live in late August, after the reports sold to Wall Street ended. In October, VIPS again significantly revamped the web interface, possibly in preparation for Singles Day, and we are still in the process of bringing our scraper live again. As a result, we captured VIPS data for only about six weeks. Those weeks may have been anomalous.

But we doubt they could have been that anomalous. We think it safe to assume that VIPS did not see a 90% drop in sales overnight, and while we watched transactions on the site in August and September, we saw a very modest e-commerce business with far fewer than the 500,000 transactions currently reported per day. Counting transactions is imprecise because

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many items are placed in the shopping cart without being purchased, some are returned, and there are complicating factors such as coupons.

How It Works

We built a software tool to capture transaction data crossing the VIPShop servers, something the company makes possible by offering an open Application Program Interface (API). The API does not appear to have been made expressly to display transaction data but instead for the use of business partners. The API describes the meaning of codes in the database so that programmers can recognize which products sell in which region, for example, and whether they are part of an active sale and available in inventory.

VIPShop generates a unique URL for every sale. Our tool captured that URL, the start and end dates for the sale, the total price and discounted price, the different SKUs for products being sold within the sales event, the number of items available, and the number on “hold,” meaning that they have been placed in a shopping cart but not yet purchased. We also saw the regions in which each item is available for sale. The data table looks like this:

Table 1. VIPS Sales Database

580719	10020717	伊思君凯esback女装专场	http://list.vip.com/580719.html?ff=611012796754	2015-11-22 10:00:00	2015-11-25 09:59:00	VIP_HZ
580720	10016789	衣恋旗下Roem女装专场	http://list.vip.com/580720.html?ff=61101279724	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_BJ, VIP_HZ, VIP_SH, VIP_CD, VIP_NH
580727	10000285	百家好BASIC HOUSE&Mind Bridge女装混合专场	http://list.vip.com/580727.html?ff=6110127967113	2015-11-22 10:00:00	2015-11-25 09:59:00	VIP_BJ, VIP_NH, VIP_SH, VIP_CD, VIP_HZ
580919	10007796	感恩节精选葡萄酒回馈专场	http://list.vip.com/580919.html?ff=6110127972178	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_NH
580920	10007796	感恩节精选葡萄酒回馈专场	http://list.vip.com/580920.html?ff=6110127972177	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_SH
580921	10007796	感恩节精选葡萄酒回馈专场	http://list.vip.com/580921.html?ff=6110127972178	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_CD
580922	10007796	感恩节精选葡萄酒回馈专场	http://list.vip.com/580922.html?ff=6110127972178	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_BJ
580923	10007796	感恩节精选葡萄酒回馈专场	http://list.vip.com/580923.html?ff=6110127972177	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_HZ
580965	10015042	香阁儿XANGIRL女鞋专场	http://list.vip.com/580965.html?ff=6110127972118	2015-11-21 10:00:00	2015-11-24 09:59:00	VIP_BJ, VIP_HZ, VIP_SH, VIP_CD, VIP_NH

From left to right, the fields represent the VIPShop SKU, the vendor SKU, a description of the product, the sale URL, the start and end dates of the sale, and regional codes indicating where the products are available. “NH” represents Macau, Fujian, Guangdong, Guangxi, Hainan, Taiwan, Hong Kong, and Yunnan. | Source: J Capital Research

When we choose an SKU from the table, it leads us to the page representing that item’s sales event. “Stock” indicates the number of items available. “Saled” means the number sold, and “hold” represents items currently in shopping carts. The min and max indicate the minimum and maximum number of items available per customer.

We found the following problems with the data:

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Table 2. Sales Table for a Particular Sales Event

ID	Name	Link	Sale Price	Market Price	Stock									
					id	name	stock	saled	hold	sn	min	max	type	ptype
75947325	卡其色复古气质长袖长款外套	http://www.vip.com/detail-568956-75947325.html?serial=reco-A/C-180001-user.list.rank-21/200-	439	1939	195477288	L (165/88A)	0	0	0	N3DWC1288H404	1	1	1	0
					195477289	M (160/84A)	0	0	0	N3DWC1288H403	1	1	1	0
					195477290	S (155/80A)	3	0	0	N3DWC1288H402	1	2	0	0
					195477291	XL (170/92A)	0	0	0	N3DWC1288H405	1	1	1	0

Source: J Capital Research

▶ **Many items displayed are Potemkins**—there is no actual inventory on sale:

- ▶ In 7 of 17 transactions on November 18, we were not able to purchase items displayed as on sale. The items could not be added to a shopping cart.
- ▶ In 7 of 22 transactions on November 9, we were not able to add actively sold items to our shopping cart even though the database and the website showed that items were available.



A photo from the VIPShop website of the item represented in the table above.

- ▶ On November 11, 12 of 36 transactions did not result in a reduction of inventory.
- ▶ In 40 of 76 purchase transactions we made on November 12, 16, and 18, when we put items in our shopping cart, the number of items recorded in the database as available did not change. In the other 36 transactions, our purchase of an item caused the number of available items to tick down by one.

▶ **Very few sales are being made.** When we watched particular SKUs from day to day, the number of available items seldom ticks down.

- ▶ On any particular day, there are around 1,100 active sales events. Each sales event might have around 400 SKUs and up to 11 examples of each SKU. It would make sense for perhaps 1,000 SKUs from the top 20 or so brands to generate at least a few hundred transactions each in a day. Yet, for the brief period of time when we watched, the inventory ticked down in those popular sales slowly or not at all.

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- ▶ **Several of the top-selling brands for 2014 display active sales but do not have available inventory.**

This indicates that VIPS places a lot of emphasis on displaying a large number of products in active sales but not so much emphasis on selling them.

The company requires brand partners as to provide as many SKUs as possible and requires at least 250 per sale. This is odd for a flash sales business. Flash sales operate on the principle of scarcity: they need to have a few attractive products offering deep discounts for a limited amount of time. A wide variety of choice works in opposition to impulse buying. But the brand partners fill in long data tables describing the SKUs in the data format VIPShop needs for its database. Brand partners also supply photos of the items they plan to sell, though VIPShop consistently reports that it photographs incoming items for sale and that its studio photography attracts brand partners.

Brands are also required to supply much more inventory than can be sold. This makes sense if VIPS wants to establish an audit trail.

Major Brands

It seems plausible that some sales on VIPShop may have been spurred by capital transactions.

- ▶ In 2014, L'Oreal was reportedly one of the biggest-selling brands. This year, the site offers news and product introductions for that company but no product sales that we have been able to find. In February 2014, VIPShop paid USD 112 mln for a controlling stake in the online cosmetics store Lefeng, also called Lafaso. L'Oreal was among the brands sold on that site, and Lefeng may well have held inventory that was written off in the sale.
- ▶ In 2014, Estee Lauder was reportedly a major brand for VIPShop. But Estee Lauder only announced the launch of its Tmall store in May 2014 and said, according to [news reports](#), that Tmall was its only authorized e-commerce platform other than its own official website.
- ▶ Many of what were reportedly the fastest-growing brands, such as Inman, Camel, and Kao, were all seeking IPOs in 2014 and had incentive to show high growth.
- ▶ The Chinese brands To Youth and Semir have been named as [top selling brands](#) on the site in 2014. To Youth offers links on its site to Tmall, JD, WeChat, Dangdang, Yihaodian, and its own stores but has no mention of VIPShop. In 2014, Semir reported modest sales growth

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No one at Taobao/Tmall or JD seems to have noticed the warm weather.

- of 11.7% and did not disclose sales online or sales through VIPShop.
- ▶ Disney [was reported](#) to be worth about 1.7% of sales for VIPShop in 2012, so about USD 12 mln. Disney does not disclose its China revenue, but the clothing business is tiny, with just one store, compared with 47 in Japan. Parks in Hong Kong, Japan, and Singapore would generate most of the revenue.

The Recent Quarter

The stock declined in November because of the company's nonsensical explanation for missing its revenue and profit targets for Q3. Management blamed unseasonably warm weather, saying that customers delayed purchases of expensive winter coats. But no one at Taobao/Tmall or JD seems to have noticed the warm weather, nor do meteorological records in fall 2015 show any marked difference from the previous two years. China's warmest July was in 2010, its warmest August in 2007, and warmest September in 2005, according to the National Centers for Environmental Information. An analyst on the call suggested that low confidence in VIPShop management was responsible for the 40% decline in the stock and asked what management intended to do, but the answer was vague. "We're in this for the long term." The company did say it would repurchase shares and authorized a USD 300 mln repurchase program over the next two years. But if our view is correct and VIPShop actually has far less cash available than its statements would suggest, then the repurchase will be token only.

Land Purchase

On the call, VIPS informed investors that it had spent USD 132 mln to buy land in a new "Pazhou Internet Innovation Zone" in Guangzhou. This new zone, which has already captured tributary land purchases by Alibaba, Tencent, Fosun, Xiaomi, Gome, and YY, according to the local press, represents Guangzhou's attempt to make its annual trade fair relevant again. The city has built a huge new exhibition complex, but unfortunately, the trade fair has significantly dwindled in volume as well as in importance. This new "Internet Innovation Zone" presumably will focus on cross-border e-commerce. But VIPShop hardly needs new office space, and by its own count has 1.6 mln square meters of warehouses, up 33% since Q1 and 140% since the end of 2014. The revenue per square meter is about USD 3,000, as opposed to more than USD 9,000 for Amazon.

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Cross Border

“Cross border” e-commerce is all the rage in China now, and VIPShop has purchased a bonded warehouse in Zhengzhou to facilitate sale of imported goods—although an agency that manages bonded goods told us that VIPS was not using the Zhengzhou space. In the last quarter, VIPS reported 164% QoQ growth in cross-border e-commerce and said that 5% of GMV is cross border, but the company would not disclose how much business this represents. The “5% of GMV” disclosure seems disingenuous since VIPS does not disclose GMV.

But let’s assume that GMV is equivalent to transactions. The company reported 45 million sales transactions in the quarter with an average value of about USD 30. That would mean 2.3 mln cross-border orders and about USD 68 mln in revenue.

We downloaded import records for VIPShop from Panjiva, which obtains Chinese Customs records. In the nearly three years since January 1, 2013, VIPShop has imported USD 20,322,403 worth of goods. Even if the goods have an 80% gross margin, the volume seems insufficient to represent 5% of GMV in Q3 2015.

New Math on Customer Numbers

VIPShop reports that there were 5 mln new customers in Q3 and that these customers contributed 7.5% of the orders, or 3.4 mln orders. There were 15 mln total customers and 11 mln repeat customers, so 1 mln of the new customers must also have been “repeat customers,” meaning they purchased more than once in the quarter. That leaves 4 mln new, non-repeat customers. But there were 3.4 mln orders by new customers. How can 4 mln people make 3.4 mln orders?

Other revenue declined, and the company explained that this was because of a decline in the third-party market place revenue. One-third of VIPShop sales are now taking place on its “marketplace,” meaning that brands fulfill the orders themselves. There is nothing to differentiate these sales from sales on JD or TMall, and we question why VIPS’ take rate has not declined as vendors have moved off the platform.

Non-Intuitive

We find the VIPS platform difficult to use and an unlikely place for flash sales. Sales sit far down in the site, and it can take 10 clicks to add an item to a shopping cart. Compare this to Zulily, a U.S. flash sales site, which never requires more than three clicks. Flash sales work when they play to impulse purchasing and create a sense of scarcity.

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It also doesn't make sense to us that bigger sites with more traffic could have had such little success with the flash sales model. Taobao offered the same flash model as VIPShop, taking inventory on consignment and providing all the logistics, but the company discontinued the model in calendar Q3 2015 because of low traction. JD.com began offering flash sales on the same model after Spring Festival in 2014 but, marketing companies say, has extremely low volumes.

Pinjun

Fulfillment expenses declined by 8% compared with Q2 2015 and rose by 53% YoY, compared with revenue growth of 63%. That could be because of the "just in time" or marketplace model, under which VIPShop does not provide fulfillment services.

VIPShop disclosed that 80% of deliveries are now being made by its owned companies. Pinjun Express, the logistics company owned by VIPShop's main operating entity in China, claims to handle over 70% of deliveries in most regions, including Shanghai, and indeed, the last deliveries to our Shanghai office were made by Pinjun. But Pinjun discloses only two sub-stations in Shanghai, in Yangpu and Putuo. We visited both on November 12, the day after Singles Day, when package volumes should be close to their annual peak. We were told that messengers pick up packages from the stations twice per day. At each station, a company manager came out to ask us to leave the premises and we were not able to ask how many messengers were attached to the stations, but based on the size of the stations and the number of packages inside, we estimate that each might handle 1,000 deliveries per day. A messenger at the Yangpu station said that station was responsible for all VIPShop deliveries in the district.



Left: Pinjun delivery station serving the Yangpu District of Shanghai. Right: the Putuo station at Zhennan Lu. | Photos by J Capital on November 12, 2015.

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Even if there are other, undisclosed stations each of roughly the same size, one for each of Shanghai's 15 districts, then, at 1,000 deliveries per day each, Shanghai would be responsible for only about 15,000 deliveries per day. But the Kunshan logistics center, serving the Shanghai region, currently reports about 100,000 orders per day.

Media

VIPShop has been advertising heavily on television. We question whether all those expenditures are really for branding. For example, the company Tibet Shannan Lingyun Media, or Yunmedia, is a digital agency for which VIPS is among the largest customers, paying RMB 52.8 mln in 2014. Yunmedia operates an online fashion magazine and has a significant business in factoring receivables. The complementarity in media is not clear.

Just before VIPS acquired Lefeng, it was advertising on Lefeng's "cloud video platform," according to Lefeng Internet Information (300104). That is another expenditure that would not seem to contribute much to VIPS brand awareness.

A CSRC announcement shows that the Keda Group, which provides media placement services to VIPs and owns a company that builds e-commerce logistics parks, is a proxy holder of shares for others and also acquired an ecommerce platform.

VIPS also seems to be investing in health insurance. According to an October announcement by the listed company Jiangsu Sanyou, VIPShop's VIE company, Guangzhou VIPShop Information Technology, is its co-investor in a health insurance company with RMB 1 bln in registered capital that will sell insurance online.

Valuation

We continue to believe that VIPShop has fraudulently inflated its sales results and should delist.

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Risks

- ▶ Our technical analysis of VIPS transactions may miss significant sales and has viewed only a relatively brief period of sales that may not represent the whole.
- ▶ Given low tariffs that apply to e-commerce players, the cross-border business could take off and make VIPShop very attractive.
- ▶ At the current valuation, VIPShop might be more highly valued by A share investors and could become a take-private target.

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