

March 14, 2017
Company Update

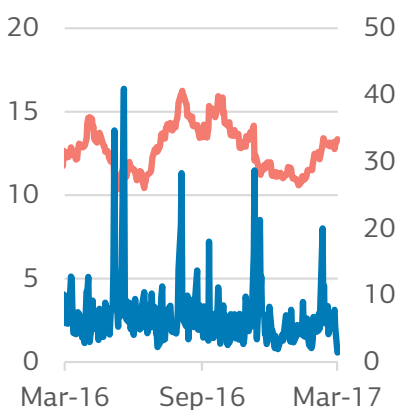
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Vipshop Holdings (VIPS US)

Price	USD 13.33
Market Cap	USD 7.871 bln
Rating	SELL
Price Target	USD 0.00
Difference	100.0%
Days to cover	2.4
Trailing P/E	26.71x

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



Source: Bloomberg March 13, 2017

Vipshop Holdings (VIPS US) The Put Potemkin

► Q4 Smoke and Mirrors

VIPS reported a strong Q4, up 36.5% in sales and with a 600% increase in free cash flow even as operating cash flows were cut in half year on year. The telltale held-to-maturity securities rose by 979% QoQ, as cash in the bank declined by about USD 55.5 mln. Did the company manipulate accounts to support its February 14 tender offer?

► March 15, 2017 Put Right

The company has offered a bond worth USD 632.5 mln to finance repayment of 1.5% senior convertible notes due in 2019. Owners have the right to put their notes to VIPShop March 15. Anecdotally, few have chosen that option.

► VIPS: An Also-Ran for Merchants

Our channel checks on sales indicate a continuing decline in market share for VIPShop.

► ABS Costs the Company 4.6%

VIPShop raised about USD 50 mln in an ABS now traded in Shanghai and plans to raise more. That provides some breathing room. But we think the company is funding its own sales growth, so, as cash resources decline, so will growth.

► Rating: SELL

We maintain our 0 price target on the stock.

Magic Numbers

VIPShop's Q4 2016 report pleased investors, but, given the company's intention to issue a note to repay upcoming puts on its convertible bond, we suspect some beautification.

Top-line sales growth was 36.5% year on year—somewhat lower than industry leader Alibaba reported but far better by at least 10x what any offline retailer is reporting these days. The company also touted a 600% improvement in free cash flow.

Table 1. VIPS Cash Flows YoY (in ,000 RMB)

	3 mos ended Dec 31, 2015	3 mos ended Dec 31, 2016	YoY
Net cash from operating activities	1,604,236	801,536	-50%
Impact from Internet financing activities	353,390	1,338,966	279%
Capital expenditures	(1,765,484)	(711,711)	-60%
Free cash flow in	192,142	1,428,791	644%

Source: Company 6K

Table 2. Revenue vs. Receivables Growth (in ,000 RMB)

	3 mos ended Dec 31, 2015	3 mos ended Sep 30, 2016	3 mos ended Dec 31, 2016	QoQ	YoY
Accounts receivable, net	351,423	1,602,909	2,333,918	46%	564%
Total net revenues	13,901,146	12,002,324	18,980,186	58%	37%

Source: Company reports

But the negatives abound. Operating cash flows declined from RMB 1.6 bln to RMB 800 mln. Held-to-maturity (HTM) securities ballooned as cash and cash equivalents declined by about USD 55.5 mln, supporting our suspicion that some of those HTM securities consist of notes receivable from off-balance-sheet companies. VIPS apparently did not collect for its higher sales. Accounts receivable rose by 564% QoQ.

Meanwhile, the FCF improvement came entirely thanks to RMB 1 bln less in capital spending. Despite this drop, the company still managed to complete its targeted 300,000 square meters of new warehouse space in the quarter. One wonders why VIPS can't chop capex every quarter.

We suspect that some of VIPS's HTM securities consist of notes receivable from off-balance-sheet companies.

Table 3. Balance Sheet Growth QoQ and YoY (in ,000 RMB)

	Q4 2015	Q3 2016	Q4 2016	QoQ	YoY
Cash and cash equivalents	3,324,384	4,876,764	4,109,577	-16%	24%
Held-to-maturity securities	1,807,403	62,234	671,776	979%	-63%
Property and equipment, net	2,949,604	4,109,117	4,467,451	9%	51%
Deposits for property and equipment	933,419	976,070	1,039,793	7%	11%
Land use rights, net	197,462	2,301,631	2,399,058	4%	1115%

Source: Company reports

In its delivery complex, VIPS continued to employ 20,000 full-time delivery staff in the quarter, flat against 2015 despite ~35% annual growth in deliveries. Fulfillment again decreased as a portion of revenue, from 8.8% in Q3 to 8.7% in Q4. The company reported earning about USD 25.5 mln from providing logistics services to third parties. The company also reported earning USD 19 mln from advertising services and USD 14.5 mln from its POP platform, where vendors sell directly to the public rather than to VIPShop.

VIPShop filed a tender offer on February 14 to finance the 2017 repurchase rights of its 2019 notes. Should VIPS draw down the loan facility, its costs for the 1.5% 2019 note will rise slightly.

In January, VIPS issues a RMB 300 mln asset-backed security for its internet finance unit. This unit extends 3- 6-month loans at 10-12% to suppliers and others. Internet financing contributed less than 10% of GMV, the company said.

Valuation

We believe that VIPShop reports distorted results via significant accounting manipulation. We think the company will ultimately be subject to sanctions, shareholder litigation, and reputational costs and that its equity will go to zero.

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Risks

- ▶ Timing
- ▶ VIPS may continue to access capital markets to replenish its cash balances
- ▶ VIPS may be acquired by a larger player.

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