



## VIPSHOP (VIPS US)

### Niche e-commerce platform in discount retailing; initiate with BUY

- A niche online e-commerce platform in China focusing on discount online retailing with strong reputation and loyal customer base in the niche segment.
- Strategic move to refocus on the core discount retailing market and operating improvement resulted in better margins
- Initiate **BUY** with TP of US\$ 25 on higher margin potential

**A niche player focusing on discounted online retailing.** VIPSHOP (VIPS) is a niche online e-commerce platform in China focusing on discount online retailing. Unlike its larger peers offering a wide range of merchandises to customers, VIPS focuses on flash sales of discounted branded products, resembling the outlet format in traditional offline retailing. The Company has earned a strong reputation in this niche segment with 69mn active customers at end-2019.

**Counter-cyclical nature.** In our view, the Company's business model offers some degree of counter cyclicity. During the economic downturn, brand owners typically choose to clear its inventories via heavy discounts to VIPS. This allows VIPS to lower purchase cost and offers a deeper discount to customers, which enhances the overall customer engagement and loyalty.

**Strategic reposition.** After multiple diversification attempts over the past few years, the Company has been refocusing on its core online flash sales business since 2018. Key strategies include shifting low-margin categories from direct sales (1P) to marketplace model (3P), refocusing on off-season branded apparel vs. in-season apparel, and outsourcing deliveries to external parties. These moves have improved core net margin from 3.2% in 2018 to 5.4% in 2019.

**Initiate with BUY.** We initiate **BUY** with a DCF-based TP of US\$ 25 to reflect its solid market position in the discounted online retailing market and ongoing margin improvement.

#### Results and Valuation

	2018A	2019A	2020E	2021E
Revenue (RMB mn)	84,524	92,994	96,186	104,486
Chg (% YoY)	15.9	10.0	3.4	8.6
Net profit (RMB mn)	2,129	4,017	5,509	6,416
Chg (% YoY)	9.2	88.7	37.2	16.5
Core net profit (RMB mn)	2,719	5,013	6,471	7,461
Chg (% YoY)	(6.9)	84.4	29.1	15.3
Earnings per ADS (RMB)	3.1	5.9	8.1	9.4
Chg (% YoY)	11.3	90.5	37.2	16.5
Core earnings per ADS (RMB)	3.9	7.4	9.5	11.0
Chg (% YoY)	(6.9)	89.8	29.1	15.3
Core P/E (x)	35.8	18.8	14.6	12.7
ROAE (%)	24.7	20.4	21.6	19.8
ROAA (%)	9.8	8.7	10.8	10.8

1 common shares = 5 ADS

Source(s): Bloomberg, ABCI Securities estimates

## Company Report

### Initiation

June 29, 2020

Rating: **BUY**

TP: US\$ 25

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ADS price (USD)	19.6
Est. share price return	27.4%
Est. dividend yield	NA
Est. total return	27.4%
Previous Rating & TP	NA
Previous Report Date	NA

Source(s): Bloomberg, ABCI Securities estimates

#### Key Data

52Wk H/L(USD)	54.6/6.1
Issued ADS (mn)	590
A share market cap (USD mn)	11,573
Avg daily turnover (USD mn)	127
Major shareholder(s)	
Eric Ya Shen	12.7%
Tencent	9.6%

Source(s): Bloomberg, HKEx, ABCI Securities

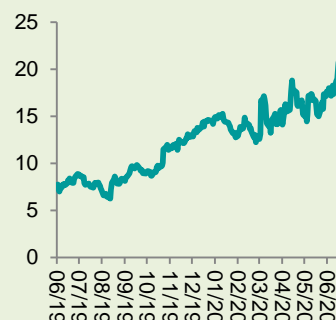
#### Share Performance (%)

	Absolute	Relative*
1-mth	13.1	4.6
3-mth	38.9	23.1
6-mth	35.1	33.2

\*Relative to MXCN

Source(s): Bloomberg, ABCI Securities

#### Share performance(USD)



Source(s): Bloomberg, ABCI Securities

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## Niche online discount e-commerce platform in China

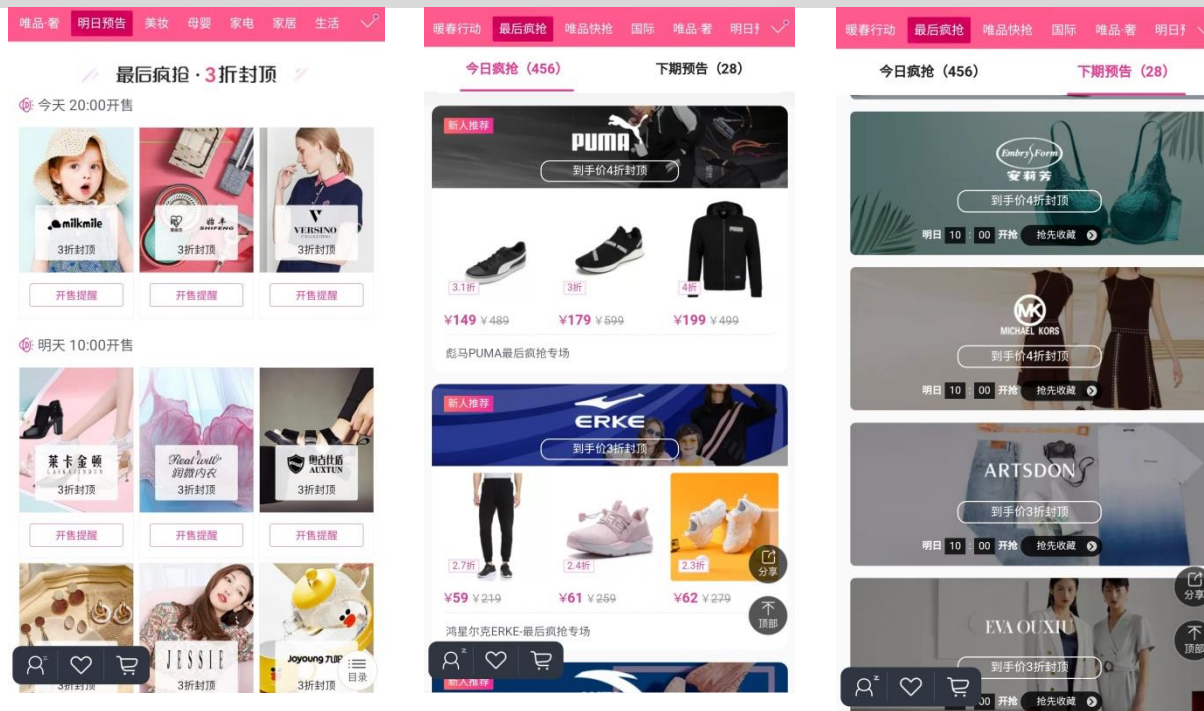
VIPSHOP (VIPS) is a niche online e-commerce platform in China focusing on discount retailing. Unlike its larger peers, including but not limited to Alibaba and Pinduoduo, which offers a wide range of product selections to customers, VIPS focuses on flash sales of discounted branded products, resembling the outlet format in traditional offline retailing.

Since its inception in 2008, the Company has earned a strong reputation in this niche segment with 69mn active customers as at end-2019. Overall, it enjoyed an early mover advantage in the flash sales area and has continuously solidified its market position throughout the past decade.

Its flash sales model offers daily sales events twice a day with a selection of popular branded products at deep discounts during the limited time period, providing a “bargain hunting” shopping experience for online consumers. E.g., the Company limits the purchase quantity for each item, and purchase decision would have to be made within 20 minutes before the items are removed automatically from the shopping cart.

Its flash sales offer various apparel products at a deep discount of up to 70% for major brands, as shown in the chart below.

Exhibit 1: Flash sales



Source(s): VIPSHOP app



**Quality brand partners:** The Company partners with various popular domestic and international brands to offer products ranging from apparel, cosmetics, baby products, consumer electronics, and more. The number of brand partners increased from 10.8K in 2016 to 18.4K in 2019. For brand owners, VIPS offers an effective online channel to clear off-season inventories.

**Counter-cyclical nature:** In our view, the business model offers a certain degree of counter cyclicity. During an economic downturn, the apparel brand owner may accumulate a large quantity of unsold inventories. After the season ends, the brand owners can clear its off-season inventories by selling it at heavy discounts to VIPS. For VIPS, the low purchase cost helps enhance margins and allows deep discounts to customers, which increases client engagement and loyalty.

### **Targeting a niche customer group**

The Company generated RMB148bn in GMV in 2019 and had 69mn active customers at end-2019. In our view, its smaller operating scale than major e-commerce platforms, including Alibaba and Pinduoduo, could be attributed to its niche market position as a discount online ecommerce platform targeting a niche group of customers.

On a positive note, its customer spending per year was RMB 2.1K in 2019, higher than RMB 1.7K for Pinduoduo. In our view, this could be attributed to its longer operating history (operating since 2008) than Pinduoduo (operating since 2015). In the ecommerce industry, per user spending would normally increase with the tenure of customers with the ecommerce platform.



## Strategic reposition to focus on core strength

Since its inception in 2008, the Company has overall gone through various stages of development.

**Development stage (2008-2013):** During this stage, the Company enjoyed rapid growth via its early mover advantage in the online flash sales market. Key milestones included its listing on NASDAQ in 2012.

**Diversification (2014-2017):** After establishing a foothold in online flash sales, the Company developed its ecosystem via expansion into online payment, consumer finance, logistics, and other areas. Key milestones included forming strategic partnerships with Tencent and another major online e-commerce platform in 2017.

**Strategic reposition (2018-current):** Since 2018, the Company has made a strategic decision to refocus on its core online flash sales business. Key moves included shifting low-margin categories from direct sales (1P) to marketplace model (3P), refocusing on off-season branded apparel vs. in-season apparel, and outsourcing deliveries to external parties. It also acquired ShanShan Outlet (杉杉奥特莱斯), a major outlet retail chain in China in 2019.

### Exhibit 2: Strategic development

	Key development
<b>Development stage (2008-2013)</b>	<ul style="list-style-type: none"> <li>● Operation since 2008</li> <li>● Listed in NASDAQ in 2013</li> <li>● Achieve break-even in late-2013</li> </ul>
<b>Diversification (2014-2017)</b>	<ul style="list-style-type: none"> <li>● Investing in Lefeng.com (乐蜂网) in 2014</li> <li>● Launching consumer finance business</li> <li>● Acquisition of Zhejiang Ebatong, a third-party payment service provider, in 2016</li> <li>● Acquisition of Feiyuan Logistics in 2015-16</li> <li>● Strategic partnership with Tencent and another major online platform in Dec 2017</li> </ul>
<b>Strategic reposition (2018-current)</b>	<ul style="list-style-type: none"> <li>● Refocusing on core online flash sales business</li> <li>● Outsource delivery to third-party logistic partners</li> <li>● Acquisition of ShanShan Outlet (杉杉奥特莱斯), a major outlet retail chain in China in 2019</li> <li>● Ceased operation of Lefeng.com (乐蜂网)</li> </ul>

Source(s): The Company

In our view, the Company's strategic reposition since 2018 is a sagacious move. First, the Company is able to take advantage of the ecosystem of other ecommerce platforms through its strategic partnership with Tencent and another major online platform, facilitating processes such as including payment and consumer finance in a cost-effective manner without investing heavily in building a similar system in-house. Outsourcing delivery to outside logistic partners also yields a similar cost benefit given the lower economies of scale of in-house delivery. Secondly, by repositioning its core apparel business to focus on off-season item instead of in-season items, the Company can avoid direct competition with Alibaba focusing mostly on in-season items. It also allows the Company to offer larger discounts to customers, strengthening its brand image of offering branded apparels at the lowest prices. Thirdly, shifting low-margin categories from direct sales (1P) to the marketplace model (3P) could also boost margins as the Company no longer bears the inventory cost of these categories.

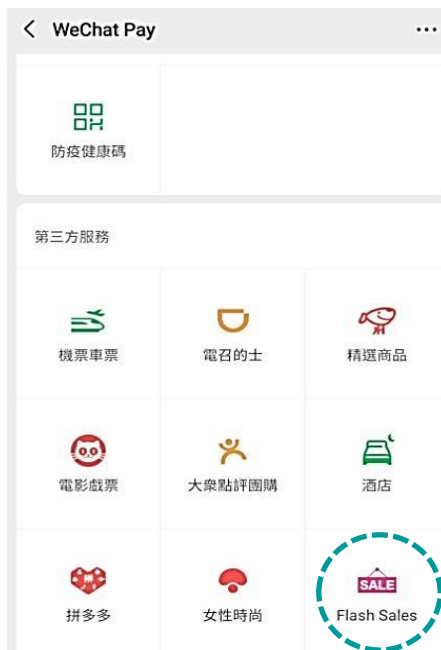


### Strategic partnerships

VIPS formed strategic partnerships with Tencent and another major online e-commerce platform in 2017. At end-2019, Tencent is VIPS's second largest shareholders with a 9.6% stake.

Under the strategic partnerships, the Company could leverage sizeable traffic of its strategic partners. E.g., it enjoys access points on WeChat Pay. Currently, about 22%-25% of new customers are acquired via strategic partners' traffic.

#### Exhibit 3: VIPS' entry point in WeChat Pay



Source(s): WeChat app



## Peer comparison

There are two major business models for online e-commerce platforms – in-house and co-op. In our view, each business model has its pros and cons. The decision to adopt which model is dependent on one's business strategies.

**Co-op business model:** Alibaba and Pinduoduo operate online marketplaces and charge commission on merchants' sales. They also rely mostly on third-party logistics companies for product delivery.

In theory, this model requires less fixed-asset investments and working capital. In addition, product and geographical expansion are also easier as platforms can leverage the product sourcing capabilities of merchants and network of its logistic partners. However, quality control can be challenging due to the multiple parties involved in the supply chain, which can affect customer loyalty.

**In-house business model:** In theory, this business model, with more control on product quality and supply chain, could potentially lead to better quality assurance and customer loyalty. Such model, however, usually requires hefty early-stage investments, which could suppress profitability in early years.

VIPS's online discounted platform operates both the direct sales (1P) and marketplace (3P) businesses. The core apparel business is mostly under the 1P model while low-margin categories are under the 3P model. For logistics, it once relied on in-house operation but has recently switched to outsourcing for better economies of scale.

**Exhibit 4: In-house vs. Co-op –theoretical pros and cons**

	In-house	Co-op
Business model	Direct sales	Marketplace
Inventories	Self-owned inventories	Inventories owned by merchants
Logistics network	Self-built logistics network	Third party logistics partners
Product expansion	Harder as platforms need to source new product by itself	Easier as platforms can leverage on merchants' product sourcing capabilities
Geographical expansion	Harder due to the need to establish logistic infrastructure	Generally easier, as platform can leverage on logistic partners' network
Quality assurance	Easier	More difficult due to more parties involved and less control on external parties
Margins	Potentially lower due to higher fixed cost and product cost	Potentially higher as platforms mainly charge sales commission with no inventory cost.
Working capital requirement	Higher	Lower

Source(s): ABCI Securities





Exhibit 5: Business comparison

	Alibaba	A major e-commerce platform	Pinduoduo	VIPSHOP
Direct sales	NA	Direct sales business sourced products from over 19K supplies at end-2018	NA	Core apparel products
Online marketplace	<p>Taobao and Tmall had over 2bn product and service listings at Mar, 2019.</p> <p>As of Mar 31, 2019, there were over 190,000 brands and merchants on Tmall, including 77% of the consumer brands ranked in the Forbes Top 100 World's Most Valuable Brands for 2019.</p>	Over 270,000 merchants at end-2019,	<p>3.6mn active merchants in 2018</p> <p>"team purchase" model to allow customers to purchase products at low prices</p>	Low-margin product categories
Omni-channel initiatives	<p>Freshippo –grocery retail chain</p> <p>Partnership with various offline retailers including SunArt, Starbuck, Suning, Intime, Lianhua Supermarket, Red Star Macalline, etc. on omni-channel initiatives</p>	<p>Online-to-offline supermarket platform</p> <p>7FRESH- 24/7 fresh food supermarket</p> <p>SEVEN FUN- lifestyle space in Beijing to provide meal and leisure options</p> <p>Partnership with Walmart</p>	Strategic partnership with Gome Retail	Acquired ShanShan Outlet (杉杉奥特莱斯), a major outlet retail chain in China in 2019.
Logistic network	<p>In FY3/19, Cainiao Network's 15 strategic logistic partners employed over 1.6 mn delivery personnel in more than 700 cities and 31 provinces in China.</p> <p>Collectively, these partners operate more than 190,000 hubs and sorting stations and delivered 25.1 bn packages in FY3/19.</p>	Self-owned logistics network	External logistic partners	External logistic partners
Fintech	Ant Financial (33% stake)	Potential conversion into 40% of FinTech business' equity interest in the future, subject to regulatory approval	NA	NA

Source(s): Companies, ABCI Securities





## DuPont analysis

We conduct a DuPont analysis to study the ROA composition among the major online ecommerce platforms, Alibaba, VIPSHOP, Pinduoduo, etc.

To recap, under the DuPont model:

*Return on average asset (ROA) = Core net margin (i.e. core net profit/revenue) x Asset turnover (i.e. revenue/Average total asset).*

Under VIPS's direct sales business model, direct-sale GMV is recognized as revenue, while Alibaba and Pinduoduo only recognize sales commission as revenue (which is only a small % of GMV) under the marketplace model. As a result, the conventional DuPont formula might not be entirely applicable in this case.

To account for their accounting treatment difference, we adjust the DuPont for formula by replacing revenue with GMV in the equation. Hence, the revised formula becomes:

*Return on average asset (ROA) = (Core net profit/GMV) x (GMV/average total asset)*

**Alibaba:** Alibaba's ROA is the highest among its major peers. In our view, this is mainly driven by its high core net profit/GMV ratio, which could be partly attributed to its co-op business model that bears neither the inventory nor the logistic cost. In addition, its GMV-to-average total asset ratio is also decent at 5x given its asset-light business model.

**VIPSHOP:** Its ROA is the second highest after Alibaba. This is driven by its high core profit/GMV ratio enabled by sales of apparel products. However, its GMV-to-average total asset ratio is the lowest among peers, which could be due to its direct sales business model.

**Pinduoduo:** Pinduoduo is still loss-making with a negative ROA. Its negative core net margin/GMV ratio is mainly due to its high marketing and selling expenses equivalent to 90% of revenue and 114% of gross profit in 2019. Such high expenses came from the support given to merchants' price promotion. In our view, this subsidy-driven price promotion strategy has led to superior GMV-to-average total asset ratio (16.9x in 2019) at the expense of overall profitability.

### Exhibit 6: ROA analysis (2019)\*

	Core net profit/GMV (A)	GMV/average total asset (B)	ROA (AxB)
Alibaba	2.3%	5.0	11.6%
A major e-commerce platform	0.5%	8.9	4.6%
Pinduoduo	(0.4%)	16.9	(7.2%)
VIPSHOP	3.4%	3.2	10.9%

\*FY3/20 for Alibaba

Source(s): Companies ABCI Securities



## Industry trends

China's retail sales dropped by 13.5% YoY in 5M20, according to National Bureau of Statistics (NBS). Among the product categories, jewelry, automobiles, furniture, apparel, construction materials, and consumer electronics were the hardest hits.

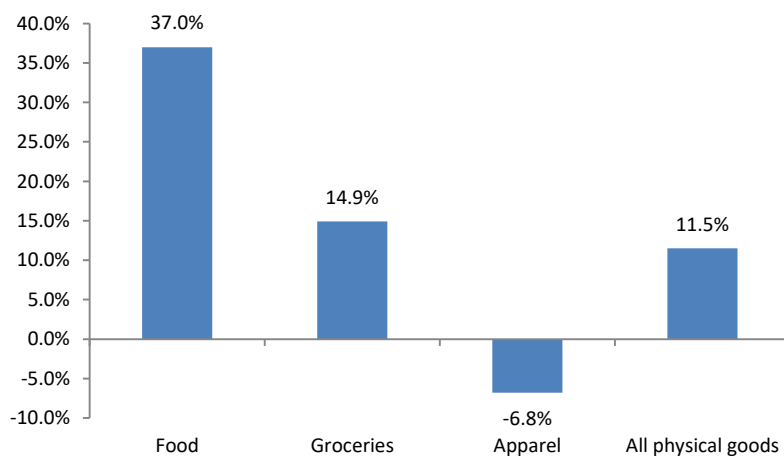
Under the weakening macro backdrop, online sales of physical goods grew by 11.5% in 5M20, down from 19.5% YoY in 2019. In our view, this would inevitably impact major online sales platforms. On a positive note, the 11.5% YoY growth in 5M20 implies sequential improvement in 2Q20 vs. the 5.9% growth in 1Q20.

The recent virus outbreak has prompted more consumers to utilize online shopping, especially for groceries and good products due to the closure of physical shops and cut-off in local transportation. In our view, such changes in consumer behavior could benefit the ecommerce industry as a whole in the long run.

In recent years, we have seen emerging trends in the ecommerce sector that are benefiting players with strengths in specific areas.

**Food products:** Overall, food products achieved an online sales growth of 30.9% YoY in 2019, higher than 15.4% and 19.8% YoY for apparel and grocery products, according to NBS. In 5M20, online sales of food grew by 37.0% YoY, outperforming other major categories. In our view, this is partly driven by ongoing improvement in logistic supply chain, especially the same-day delivery and cold-chain service.

Exhibit 7: China's online sales growth by category (5M20)

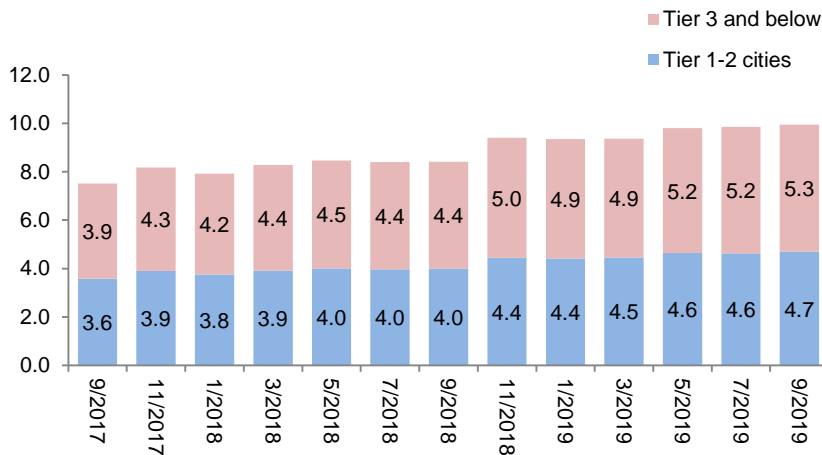


Source(s): NBS, ABCI Securities

**Lower tier cities:** Overall, major ecommerce platforms have been focusing on lower tier cities in recent years. About 70% of new customers of Alibaba are from lower tier cities. There were about 1bn mobile shopping users in Sep 2019, according to Questmobile, of which about 53% of users were from lower-tier cities (tier 3 and below).



Exhibit 8: Number of mobile shoppers by city tier (100m)



Source(s): Questmobile, ABCI Securities

**Social ecommerce:** Social ecommerce, which leverages social network such as WeChat to allow users to share product information with friends, has become increasingly popular. Consumers could enjoy steep discounts when they share an item to their friends, or by joining the ongoing group-buying deals on the app.

Also, more online brands/online platforms partners with celebrities or internet KOLs (Key Opinion Leader) to offer live videos or short videos to introduce products. E.g., Austin Li (李佳琦), a male KOL famous for selling lipsticks and other cosmetic products in his live program, has over 50mn fans. Another ecommerce KOL, Viya (薇娅), had over 30mn customer views for her live programs in the recent "Nov 11 festival" (雙十一). She has also once achieved a record over RMB 300mn daily sales during the Nov 11 festival in 2018.



## Financial analysis

For 2019-2021E, we expect GMV to grow by 6% CAGR to RMB 166bn by 2021E, driven by the growing number of active users.

**Annual active customer:** the Company had 69mn annual active customers at end-2019, with a growth rate of 14% YoY in 2019. Looking forward, we expect it to reach 75mn by 2021E.

**Annual spending per active customer:** Annual spending per active customer has been largely stable at about RMB 2.1K in recent years. We overall expect this trend to continue going forward.

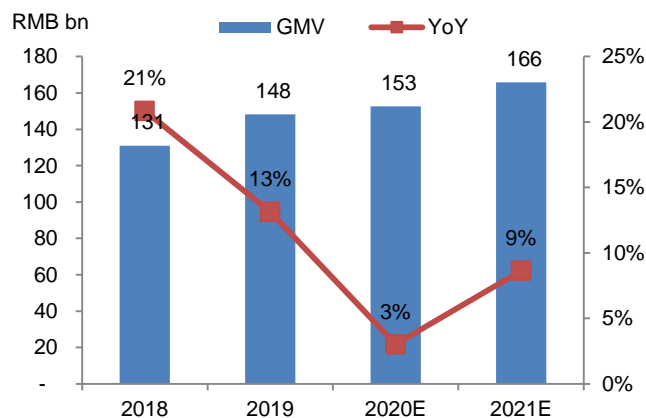
Based on the above assumptions, we expect revenue to post 3% and 9% YoY growth in 2020E and 2021E respectively.

### Exhibit 9: Major assumptions

	2018	2019	2020E	2021E
Active customer (mn)	61	69	70	75
GMV (RMB bn)	131	148	153	166
Annual spending per active customer (RMB)	2,165	2,148	2,169	2,213

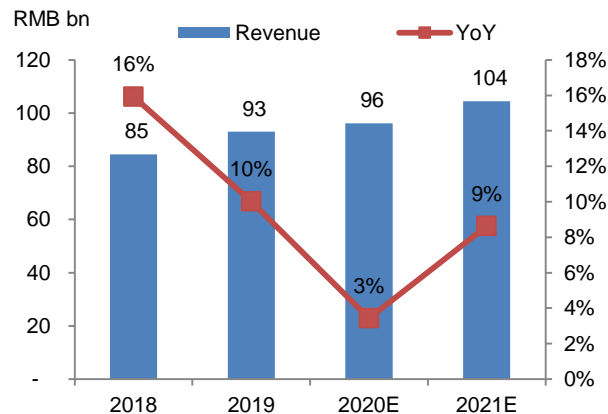
Source(s): the Company, ABCI Securities estimates

### Exhibit 10: GMV outlook



Source(s): The Company, ABCI Securities estimates

### Exhibit 11: Revenue outlook



Source(s): The Company, ABCI Securities estimates

In terms of revenue mix, product revenue accounted for 95% of revenue in 2019, followed by other revenue (5%). Looking forward, we expect the ratio to remain largely stable given the Company's focus on direct sales business.

### Exhibit 12: Revenue forecasts (RMB mn)

	2018	2019	2020E	2021E
Product revenue	81,510	88,721	91,766	99,685
Other revenue	3,014	4,273	4,420	4,801
<b>Total revenue</b>	<b>84,524</b>	<b>92,994</b>	<b>96,186</b>	<b>104,486</b>

Source(s): The Company, ABCI Securities estimates



**Gross margin:** Gross margin improved from 20.2% in 2018 to 22.2% in 2019, driven by improving product mix. Looking forward, we expect gross margin to remain largely stable in 2020-21E to reflect our more conservative stance amid the current downturn in the economy.

**Fulfillment expenses:** Non-GAAP fulfillment expenses/sales ratio has improved from 8.8% in 2018 to 7.7% in 2019 driven by improving operational efficiency. Looking forward, we expect it to improve further to 7.1% by 2021E.

**Marketing expenses:** Non-GAAP fulfillment expenses/sales ratio has improved from 3.8% in 2018 to 3.5% in 2019 driven by improving economy of scales. Looking forward, we expect it to improve further to 3.0% by 2021E.

**R&D expenses:** Non-GAAP R&D expenses /sales ratio was 1.5% in 2019. We expect this ratio to improve in 2020-2021E, reaching 1.2% in 2021E.

**General & admin expenses:** We expect non-GAAP G&A expense/sales ratio to improve to 3.0% in 2021E vs. 4.0% in 2019, driven by improving operational efficiency.

Exhibit 13: Non-GAAP cost trend (RMB mn)

	2018	2019	2020E	2021E
Fulfillment	(7,416)	(7,205)	(6,925)	(7,419)
Marketing	(3,200)	(3,289)	(2,982)	(3,135)
Technology and content	(1,798)	(1,388)	(1,154)	(1,254)
General and admin	(2,321)	(3,704)	(3,366)	(3,135)
<b>Total</b>	<b>(14,734)</b>	<b>(15,586)</b>	<b>(14,428)</b>	<b>(14,942)</b>
<b>% of revenue</b>				
Fulfillment	-8.8%	-7.7%	-7.2%	-7.1%
Marketing	-3.8%	-3.5%	-3.1%	-3.0%
Technology and content	-2.1%	-1.5%	-1.2%	-1.2%
General and admin	-2.7%	-4.0%	-3.5%	-3.0%
<b>Total</b>	<b>-17.4%</b>	<b>-16.8%</b>	<b>-15.0%</b>	<b>-14.3%</b>

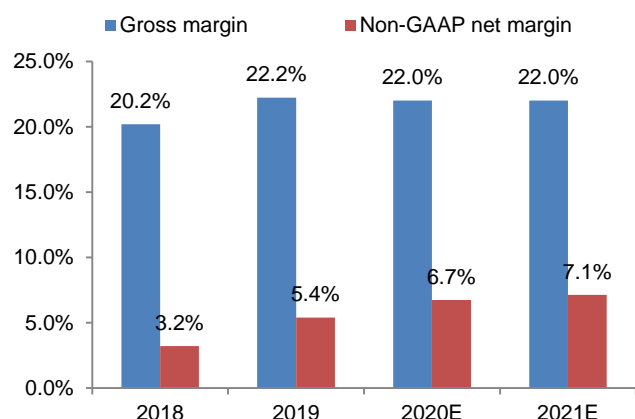
Note: Excl. impacts of share-based compensation and other non-operating items

Source(s): The Company , ABCI Securities estimates

Based on improving gross margins and cost trends, we expect core net profit to reach RMB7.5bn by 2021E vs. RMB5.0bn in 2019.

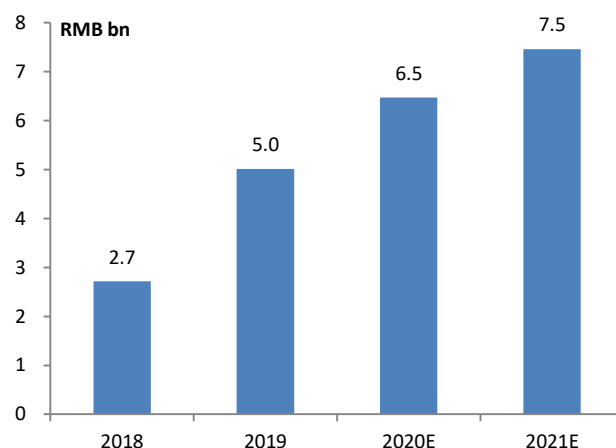


Exhibit 14: Margin outlook



Source(s): The Company, ABCI Securities estimates

Exhibit 15: Core net profit outlook



Source(s): The Company, ABCI Securities estimates

## Earnings sensitivity

In terms of earning sensitivity, we estimate that a 50bp improvement in core net margin will increase its 2020E core net profit by 6%.

Exhibit 16: Earnings sensitivity analysis

Changes in core net margin (bps)	Changes in 2020E core net profit
50	6.0%
40	4.0%
30	3.0%
20	1.0%
10	0.0%
(10)	(3.0%)
(20)	(4.0%)
(30)	(6.0%)
(40)	(7.0%)
(50)	(9.0%)

Source(s): ABCI Securities estimates



Exhibit 17: Quarterly financials (RMB mn)

	1Q19	2Q19	3Q19	4Q19	1Q20
Product revenue	20,460	21,722	18,477	28,062	17,964
Other revenue	859	1,021	1,136	1,257	829
<b>Net revenues</b>	<b>21,319</b>	<b>22,743</b>	<b>19,613</b>	<b>29,319</b>	<b>18,793</b>
Cost of revenue	(16,962)	(17,654)	(15,379)	(22,318)	(15,176)
<b>Gross profit</b>	<b>4,357</b>	<b>5,089</b>	<b>4,234</b>	<b>7,001</b>	<b>3,617</b>
Fulfillment	(1,762)	(2,199)	(1,580)	(2,053)	(1,394)
Marketing	(781)	(878)	(721)	(944)	(412)
Technology and content	(383)	(422)	(401)	(362)	(339)
General and admin	(669)	(706)	(682)	(1,732)	(839)
Impairment				(278)	
Other operating income	101	81	319	144	149
<b>Profit from operations</b>	<b>863</b>	<b>965</b>	<b>1,169</b>	<b>1,775</b>	<b>782</b>
Investment gain	214	15	(32)	(31)	43
Impairment losses on investment		(12)	(84)	(44)	(5)
Interest expenses	(32)	42	(27)	(15)	(35)
Interest income	71	31	34	70	81
Fx gain	(42)		45	(35)	49
Share of results of investee	47	(10)	(12)	2	(61)
<b>PBT</b>	<b>1,121</b>	<b>1,031</b>	<b>1,093</b>	<b>1,724</b>	<b>854</b>
Income tax expenses	(244)	(213)	(212)	(314)	(173)
<b>PAT</b>	<b>877</b>	<b>818</b>	<b>881</b>	<b>1,410</b>	<b>681</b>
Minority interest	(5)	(4)	(6)	46	4
<b>Net profit</b>	<b>872</b>	<b>814</b>	<b>875</b>	<b>1,456</b>	<b>685</b>
<b>Core net profit</b>	<b>816</b>	<b>1,063</b>	<b>1,202</b>	<b>1,931</b>	<b>986</b>
<b>YoY</b>					
Group revenue growth (%)	7%	10%	10%	12%	-12%
EBIT growth (%)	30%	141%	230%	77%	-9%
Net profit growth (%)	65%	19%	283%	111%	-21%
Core profit growth (%)	12%	84%	141%	111%	21%
<b>Margin</b>					
Gross profit margin (%)	20.4%	22.4%	21.6%	23.9%	19.2%
EBIT margin (%)	4.0%	4.2%	6.0%	6.1%	4.2%
Net margin (%)	4.1%	3.6%	4.5%	5.0%	3.6%
Core net margin (%)	3.8%	4.7%	6.1%	6.6%	5.2%

Source(s): The Company, ABCI Securities





## Initiate with BUY

We initiate **BUY** on the counter with a DCF-based TP of USD 25.

Our DCF-based valuation range is USD 22.2- USD 28.7 per ADS, based on 1-5% terminal growth rate and 12% WACC. We set our TP to USD25, around the mid-point of this range. Our TP implies 16.1x 2021E core PE.

The following table shows the sensitivity analysis.

Exhibit 18: DCF sensitivity

	WACC					
		10.0%	11.0%	12.0%	13.0%	14.0%
Terminal growth	1.0%	28.1	24.8	22.2	20.0	18.1
	2.0%	30.2	26.3	23.3	20.8	18.8
	3.0%	32.8	28.2	24.7	21.9	19.6
	4.0%	36.3	30.7	26.4	23.2	20.6
	5.0%	41.3	33.9	28.7	24.8	21.8

Source: ABCI Securities estimates

## Peer valuation analysis

VIPS's comparable peers are major online e-commerce platforms, including Alibaba and Pinduoduo. Overall, it is trading at a valuation discount to its peers on a core P/E basis. In our view, this is due to its smaller size of operation and narrower product selection than peers. Its undemanding valuation could imply potential re-rating potential in the medium term given the Company's ongoing margin expansion.

Exhibit 19: Peer valuation

		Market cap (Lcy)	Price (Lcy)	P/sales			Core P/E		
				2019	2020E	2021E	2019	2020E	2021E
China e-commerce platforms									
BABA US Equity	ALIBABA	578,690	215.7	8.1	6.4	5.0	29.2	25.5	20.1
PDD US Equity	PINDUODUO	101,990	85.2	22.9	15.0	9.2	NA	NA	118.1
VIPS US Equity	VIPSHOP	13,193	19.6	1.0	1.0	0.9	18.8	14.6	12.7
Average of four major e-commerce platforms in China				8.3	5.8	4.0	33.5	28.5	45.1

Source(s): Bloomberg, ABCI Securities estimates



## Risk factors

### Market competition

The Company competes with other online ecommerce platforms including Alibaba and Pinduoduo. The competition will be on commission rate, promotion discount, brand advertising, technological investment, and more.

### Slowing ecommerce consumption

As the Company is exposed to consumer spending on services, any significant slowdown of consumption in China would impact financial performance. In the long term, we believe domestic market growth would converge with income growth, which is usually in line with GDP growth.

### No dividend record to ordinary shareholders

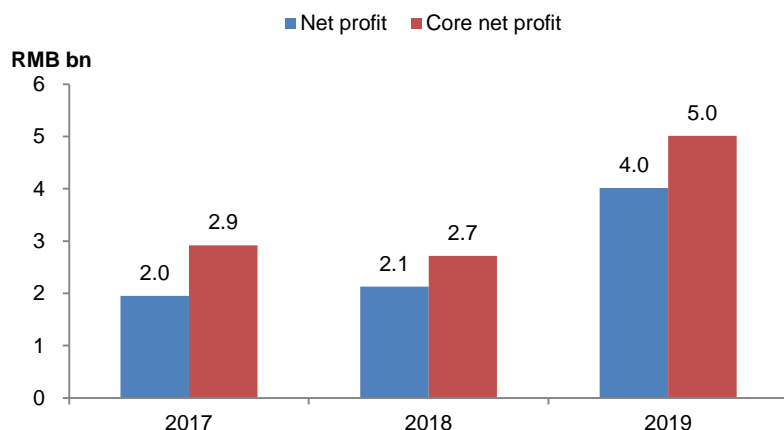
The Company has omitted dividends to ordinary shareholders since listing, which could be due to its weak profitability over the past few years. The situation may change in the medium term if its profitability improves over the next few years.

### Non-GAAP financials

The Company has disclosed the non-GAAP financial metrics, such as the non-GAAP net profit, to supplement its GAAP financial measures. Historically, there were differences between its GAAP net profit and non-GAAP net profit due to inclusion of items such as share-based compensation and other non-core items in the former.

Among these items, share-based compensation expense is related to various factors, including price movement of ordinary shares, expected volatility, risk-free interest rate, etc. While investors tend to exclude these items when performing analysis given their non-cash nature, we believe these non-GAAP financial measures should only serve as reference.

**Exhibit 20: Net profit vs. Non-GAAP core net profit**



Source(s): The Company, ABCI Securities



## Financial forecast

### Consolidated income statement (2018A-2021E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E
<b>Total revenue</b>	<b>84,524</b>	<b>92,994</b>	<b>96,186</b>	<b>104,486</b>
Cost of sales	(67,455)	(72,314)	(75,025)	(81,499)
<b>Gross profit</b>	<b>17,069</b>	<b>20,680</b>	<b>21,161</b>	<b>22,987</b>
Fulfillment	(7,489)	(7,318)	(7,083)	(7,590)
Marketing	(3,241)	(3,324)	(3,031)	(3,188)
R&D	(2,001)	(1,568)	(1,407)	(1,528)
General and admin	(2,674)	(4,064)	(3,870)	(3,681)
Others, net	757	367	667	724
<b>Operating Profits</b>	<b>2,421</b>	<b>4,773</b>	<b>6,438</b>	<b>7,725</b>
Interest income	243	217	220	230
Interest expenses	(160)	(86)	(70)	(75)
Investment and FX gain	243	38	50	50
Share of results of investee	(47)	27	30	30
<b>PBT</b>	<b>2,700</b>	<b>4,970</b>	<b>6,668</b>	<b>7,960</b>
Tax	(566)	(984)	(1,200)	(1,592)
<b>PAT</b>	<b>2,133</b>	<b>3,986</b>	<b>5,468</b>	<b>6,368</b>
Minority interests	(5)	30	42	49
<b>Net income</b>	<b>2,129</b>	<b>4,017</b>	<b>5,509</b>	<b>6,416</b>
Share-based compensation	671	688	962	1,045
Other non-core items	(81)	308	0	0
<b>Core net income</b>	<b>2,719</b>	<b>5,013</b>	<b>6,471</b>	<b>7,461</b>
<b>Growth</b>				
Total revenue (%)	15.9	10.0	3.4	8.6
Gross Profits (%)	4.8	21.2	2.3	8.6
Operating Profits (%)	(10.0)	97.1	34.9	20.0
Net profit (%)	9.2	88.7	37.2	16.5
Core net profit (%)	(6.9)	84.4	29.1	15.3
<b>Operating performance</b>				
Operating margin (%)	2.9	5.1	6.7	7.4
Net margin (%)	2.5	4.3	5.7	6.1
Core net margin (%)	3.2	5.4	6.7	7.1
ROAE (%)	24.7	20.4	21.6	19.8
ROAA (%)	9.8	8.7	10.8	10.8

Note: Individual items may not sum to total due to rounding

Source(s): The Company, ABCI Securities estimates



Consolidated balance sheet (2018A-2021E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E
Fixed assets	12,593	16,899	20,999	25,099
Investments	2,139	5,116	5,116	5,116
Other non-current assets	1,505	3,539	3,539	3,539
<b>Total non-current assets</b>	<b>16,237</b>	<b>25,554</b>	<b>29,654</b>	<b>33,754</b>
Cash & equivalents	9,540	6,574	9,496	13,404
Restricted cash	498	1,146	1,146	1,146
Short-term investments	2,321	3,053	3,053	3,053
Account receivables	5,675	1,296	1,296	1,296
Inventories	5,368	7,708	5,763	8,871
Other current assets	3,923	3,252	3,252	3,252
<b>Total current assets</b>	<b>27,325</b>	<b>23,029</b>	<b>24,006</b>	<b>31,022</b>
<b>Total assets</b>	<b>43,562</b>	<b>48,583</b>	<b>53,660</b>	<b>64,776</b>
Advance from customer	1,473	1,233	1,233	1,233
Account payables	11,630	13,792	12,398	16,052
Borrowings and notes	6,639	1,094	1,094	1,094
Other current liabilities	6,203	7,807	7,807	7,807
<b>Total current liabilities</b>	<b>25,945</b>	<b>23,926</b>	<b>22,532</b>	<b>26,186</b>
Long term debt	-	65	65	65
Other non-current liabilities	406	2,343	2,343	2,343
<b>Total non-current liabilities</b>	<b>406</b>	<b>2,407</b>	<b>2,407</b>	<b>2,407</b>
<b>Total liabilities</b>	<b>26,351</b>	<b>26,333</b>	<b>24,939</b>	<b>28,593</b>
Equity attributable to shareholders	17,262	21,827	28,257	35,669
Non-controlling interests	(51)	423	464	513
<b>Total equity</b>	<b>17,211</b>	<b>22,250</b>	<b>28,721</b>	<b>36,182</b>

Notes: Individual items may not sum to total due to rounding

Individual items may vary from reported figures due to rounding /definition differences

Source(s): The Company, ABCI Securities estimates



**Consolidated cash flow statement (2018A-2021E)**

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E
<b>Operating cash flow</b>	<b>5,746</b>	<b>12,290</b>	<b>7,922</b>	<b>8,908</b>
<b>Investing cash flow</b>	<b>(6,694)</b>	<b>(8,240)</b>	<b>(5,000)</b>	<b>(5,000)</b>
<b>Financing cash flow</b>	<b>587</b>	<b>(6,257)</b>	<b>-</b>	<b>-</b>
FX effect	178	(112)	-	-
<b>Net cash flows</b>	<b>(184)</b>	<b>(2,319)</b>	<b>2,922</b>	<b>3,908</b>

Notes: Individual items may not sum to total due to rounding

Individual items may vary from reported figures due to rounding /definition differences

Source(s): The Company, ABCI Securities estimates



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Rating	Definition
Buy	Stock return rate $\geq$ Market return rate (10%)
Hold	- Market return rate (-10%) $\leq$ Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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