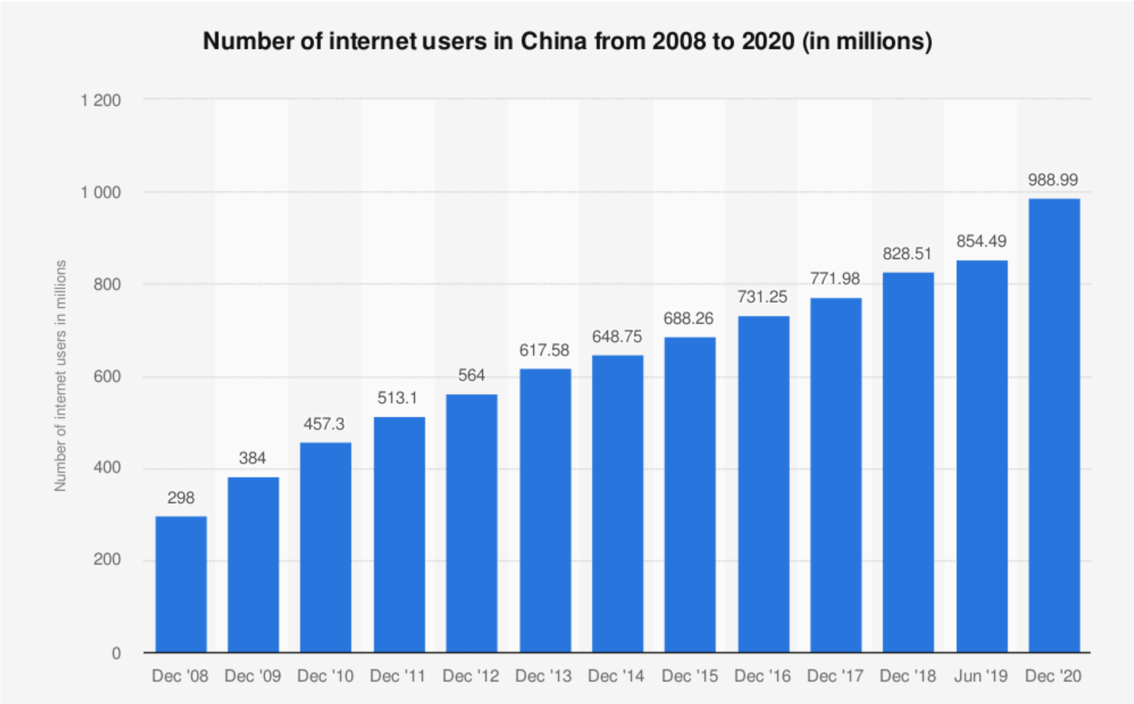
Thesis: Vipshop

Everyone agrees on the basic story about the Chinese internet and the e-commerce revolution: China's online consumption potential is massive, there is still a long and sustainable growth trajectory ahead and the country is home to some of the planet's most promising and innovative companies in this space. However, one of its dominant companies in this sector does not get the global attention and respect it deserves.



Source: CNNIC, Statista

While Alibaba's Tmall and Taobao websites have a clear leadership in the Chinese e-commerce space thanks to the fantastic vision of Jack Ma and its management team; JD.com has its proprietary last mile delivery model, more closely resembling western companies like Amazon; and more recent "social commerce" apps like Pinduoduo are making headways; Vipshop has, in this house's opinion, clearly been able to stablish and defend its own unique niche in this space.

Vipshop was founded back in 2008 by Eric Shen and Arthur Hong, two entrepreneurs from Guangdong province and is basically a flash discount website, a sort of crossover between Groupon and TJ Maxx but with unique Chinese characteristics that made its business model flourish while nothing quite similar has found success in western markets.

Source: Vipshop's August 2021 Investors' Presentation

While its competitors offer every kind of product and merchandise, Vipshop basically focuses on apparel and 70% of its audience is comprised of female shoppers.

With the leadership in its niche and a special focus on second and third tier cities, Vipshop was able to be the main discount channel for thousands of local Chinese stores in such cities, companies that wouldn't have much of a leadership or impact in Tmall but are the top priority inside Vipshop's system.

This way, when one goes to a mall in any second or third tier Chinese city, although one will occasionally encounter items selling for, say, a 10% discount, when one goes to Vipshop he will find the same items selling for a discount at least twice as large.

The company might not be destined to become the global leader in e-commerce, but it certainly has found a very profitable and sustainable niche, where it is able to survive and thrive while not directly competing with the likes of Tmall, JD or Pinduoduo.

And everything had been going well for Vipshop. Over the past five years, the company has more than doubled its sales and increased its earnings fourfold. While exact and consistent numbers are hard to come by, our best guess is that the Ali ecosystem has a market share of around 50% of the Chinese e-commerce market, with its three next largest players, JD, Pinduoduo and Vipshop each having around a 10% share.

(in millions of CNY)	2016	2017	2018	2019	2020	2021 (YTD)
Revenue	56.591,30	72.912,30	84.523,90	92.994,40	101.858,50	116.961,20
Net Income	2.079,30	1.956,00	2.016,20	4.701,60	5.315,70	6.400,30

So all in all, hardly a dying and suffering company.

That is when the external problems started.

In March 2021, the world spectacularly learned the story of Bill Hwang, a maverick trader who had stablished an investment company called Archegos Capital Management. Archegos had for years run an extremely levered portfolio, sometimes using as much as 20:1 leverage in its positions.

Turns out, one of Bill Hwangs' favorite stocks was Vipshop.

Starting in January, Vipshop shares started a dramatic rise, and the reason, we now know, was in part because of Archegos' leveraged bets in the stock. When the shares approached US$45 we began to consider decreasing slightly our position despite still believing in the company.

However, we didn't have time to do much selling: over the next few weeks, Archegos was caught in the wrong side of the market and thanks to its insane levels of leverage, it completely blew up. And since all its trades had to be unwind, it eventually took Vipshop as one of its casualties[1].

As a consequence, in the space of a month, Vipshop's stock went back from US$ 45 to around US$25.

Throughout this ordeal, it should be noted, the company continued to prosper operationally and had no involvement with Bill Hwang an Archegos whatsoever. It was dragged to the eye of the hurricane by no fault of its own.

And the external problems kept on coming.

When it seemed that the stock would at least stabilize at around US$25 a share, the famous "common prosperity" and technology regulation campaigns in China got in full swing.

Around the planet, global investors started to panic, thinking that this would mean the end of capitalism in the country and even started to wonder whether Chinese companies had become "uninvestable".

It's important to note that one of the main features of the new Chinese regulatory framework for the industry was the prohibition of "closed garden" apps, since they allowed bigger companies to have monopoly-like behavior by refusing to list their competitors in their ecosystems. Vipshop's management was quick to point out that

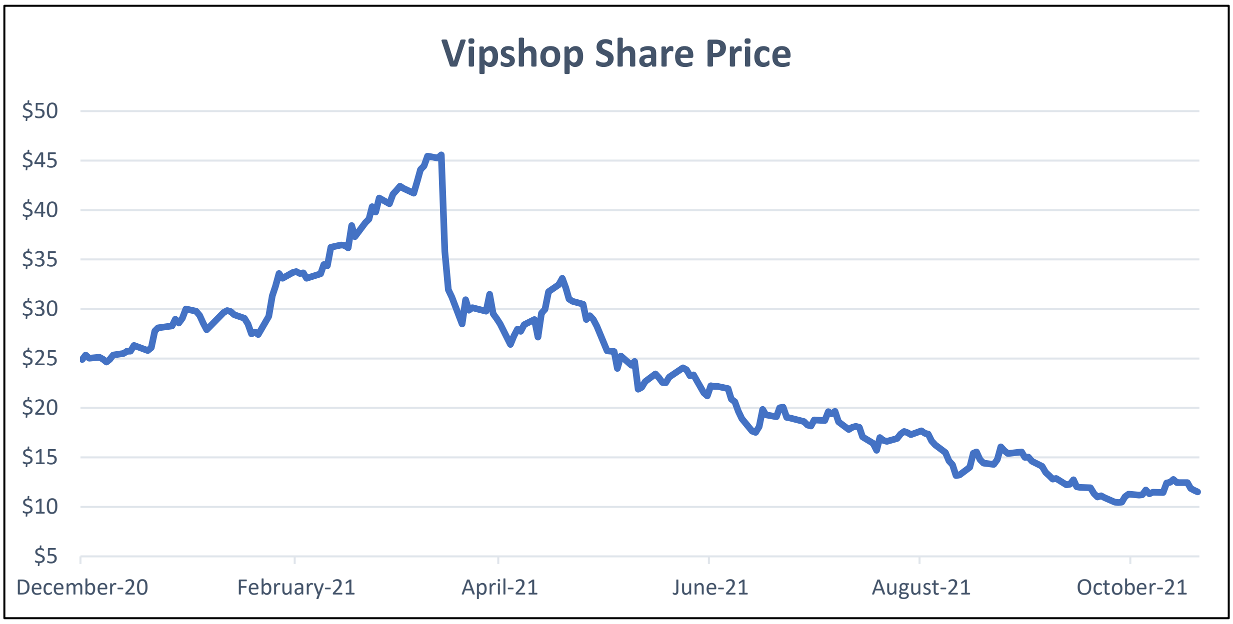
[1]https://www.bloomberg.com/news/articles/2021-03-30/vipshop-plans-500-million-buyback-after-archegos-selloff

because of its relatively small size and the fact that it is a niche player in the market, such anti-monopoly tech regulations could even be considered favorable for the company.

But when in doubt, investors, always China skeptics to begin with, have completely dumped the stock, selling first and asking questions later.

As if all of that wasn't enough, eventually the SEC started its own campaign against US-listed Chinese companies, threatening to delist any company unable to provide its financial books to American auditors.

Throughout this perfect storm for Vipshop, its stock declined close to 75%, trading recently at around US$11 a share.



Source: Bloomberg, FCL Capital

Just to give a perspective of how insanely cheap this valuation has become, here are some metrics according to Bloomberg's consensus for the company: (and remember, this is a growing and operationally thriving company, not in any kind of operational problem or financial distress!)

2021 Consensus	Vipshop	Alibaba	Ebay	Amazon
Price-to-Sales	0,4x	3x	4,5x	4x
Price-to-Earnings	8x	18x	17x	44x
Free Cash Flow Yield	12%	4,50%	6%	1,50%

In any metric we might look, we are witnessing one of the cheapest companies in the world and not only that, but one that is operationally healthy and thriving. This is not even a turnaround story, it is just a story where if one stays calm, one can see the underlying numbers behind the panic.

So, what are the risks?

Overall, after listening to the company’s management and chatting with some competitors, investors and Chinese tech players, this house is not too worried about the so called “common prosperity” campaign and even agrees with the management in that it might be a long-term positive development for the business.

We think the only real concern is the SEC: if it goes ahead with its threat to delist all Chinese companies that can’t present its financial books to American authorities (the Chinese regulations forbid Chinese companies of doing that) then hundreds of Chinese companies listed in New York, including Alibaba, Didi, Vipshop and so many others, will have to delist by 2024.

First, it should be noted, Vipshop is hardly alone: there are many more prominent companies that will face the same fate. Second, this house disagrees that this course of action is in the investors best interest. But here is the main point: an order to eventually delist (and presumably a subsequent listing in Hong Kong or a going private situation) is hardly the end of the world. In fact this is traditionally even seen as a short-term trigger.

Granted, it is a virtual certainty that an eventual Vipshop delisting would be a pity: this would mean that as investors we would never be able to realize the company’s full potential, which, this house suspects, is even above the US$45 a share the company touched back in February. But any attempt of such a move would presumably command a premium to Vipshop’s currently depressed share prices resulting in a short-term spike in the shares.

Again, we don’t cheer for such an outcome. We think the best course of action would be for the market to resume its proper functioning and rationality and to realize that Vipshop shares (and indeed the shares of many other Chinese companies listed in the US) are worth multiples of what they are trading for now.

Overall, Vipshop is an amazing and promising company that his house intends to hold for many years to come. We are confident in its niche position, its future growth, its management´s ability to deliver and think that its current price is the market’s fault and no blame belongs to Vipshop itself.

Over time, not only Chinese tech has faced discounts in valuation when compared to US tech, but Chinese companies listed in New York have faced discounts when compared to its peers listed closer to home, since the duality of having operations in one place and investors in another has brought them an extra layer of doubt and skepticism. On top of that, thanks to the Archegos debacle and the fact that it is a smaller company, Vipshop has faced an even more intense selloff than most comparable companies.

We think the Chinese tech sector might be one of the champions of the decade and currently, even considering extreme negative scenarios, we don’t see any other company we are more confident and with such an undeserved discount than Vipshop.