Mithra Forensic Research

VIPS' Cash Flow is more like 'Cash No'

Update July 30, 2015

1 REASONS FOR THE DELAY IN THIS UPDATE

It has been a month since Mithra's last update on VIPS. The delay was certainly not because I had run out of potential manipulations to highlight at VIPS—quite the contrary. I believe that VIPS' most recent financial statements provided additional indications of potential financial statement manipulation as highlighted in the reports here and here.

While I was in process of writing another lengthy update on 1Q 2015 results, I was sidetracked. A few of VIPS' promoters thought that through intimidation and harassment they would silence me. They failed. In fact, Mithra Forensic Research, LLC is now operating as an independent investment research firm concentrating exclusively on accounting and fraud shorts.

While the events of the last few weeks have been both disheartening and entertaining, I would much rather spend my time seeking answers to the questions that I pose with respect to financial statement manipulation.

So with that in mind, I have but one question for VIPS and VIPS' promoters—what is up with your Cash Flow or, should I say, Cash No.

2 WHETHER IT IS MEASURED IN USD OR RMB, CASH IS STILL KING

Mithra's reports of May 12th and May 29th identified a number of issues which I believe point to large scale financial statement manipulation at Vipshop. I highlighted several instances where VIPS' management made statements that were inconsistent with or contradicted by VIPS' financial statement filings or management's comments on earnings calls. I identified several potential manipulations that combined would have resulted in VIPS overstate its revenues by a multiple of ten. I highlighted the potential use of Related-parties and circular transactions as a means to artificially inflate revenue. I questioned the values reported for certain assets, such as Inventory and Property, Plant & Equipment. Finally, I questioned whether the Cash and Held-to-Market Investments balances were real.

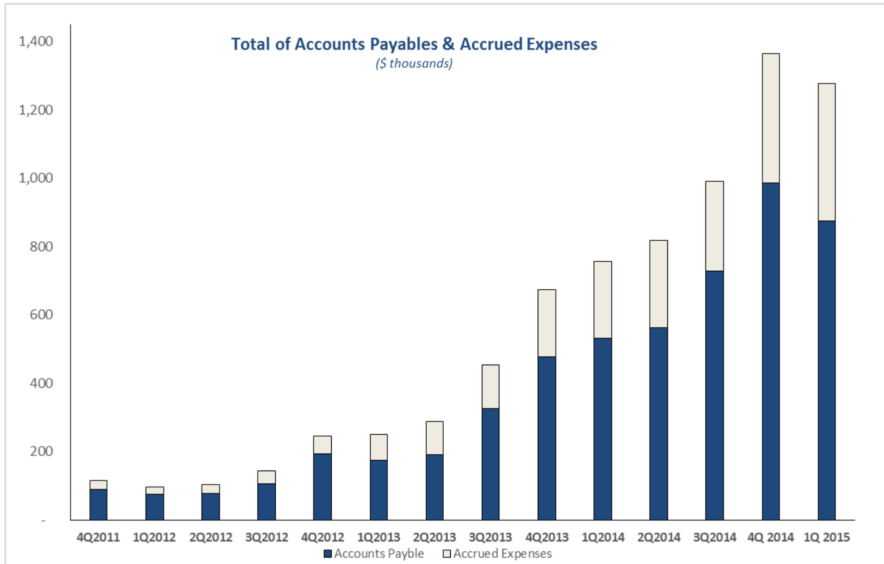
Of all of the issues that I raised, the topic that generated the most questions and comments was around VIPS Cash and Held-to-Market Investments. The key question on most people's minds was whether the growth in Cash and HTM was real. A few commentators stated that while they could not determine whether VIPS was engaging in manipulation, as long as VIPS generated positive and growing Cash Flows, they considered VIPS a buy. Based upon these comments and trends that I noted in VIPS' 1Q 2015[1] financial statements, I decided to dig deep into VIPS' reportedly strong Cash Flows.

Based upon my research, I believe that VIPS' cash flows are being prettied up. In fact, my analysis suggests that VIPS should be reporting about $594M less in Cash Flow from Operations than it is currently reporting. VIPS has push large amounts of its costs into the accounts payable and accrued expenses accounts. These balances are almost never paid down and accumulate to provide significant uplifts to VIPS' reported cash flows. In fact, the results of the analysis show that without the benefit of

[1] Vipshop Holdings, SEC Form 6-K, May 15, 2015.

ballooning payables and accrued expenses, VIPS would have reported negative cash flows from operations in 2014.

2.1 WHEN PAYING YOUR BILLS IS A HISTORICAL EVENT



In its SEC Form 6-K, filed on May 15, 2015, VIPS managed to do something that it had not done in 13 calendar quarters—it paid down the balance of the combined costs associated with Accounts Payable and Accrued Expenses. The decline was only about 6%, but it was a decline nonetheless.

In every quarter since 1Q 2012[2], VIPS has added more costs to its balance sheet through accounts payable and accrued expenses. These costs represent bills, currently or soon to be, invoiced that have yet to be paid. Companies try to strike a balance of not paying too soon and not paying too late; the company needs to both preserve its cash but also preserve relationship with its vendors.

Historically, VIPS had not seemed too concerned with upsetting or bankrupting its vendors as its bills on the balance sheet grew exponentially. VIPS often highlights the rapid growth in its revenues (a CAGR of 133% from 2012 to 2014), but another interesting fact that should be highlighted is that VIPS' combined balance of Accounts Payables ("AP")and Accrued Expenses ("AE") has grown at a whopping 135% CAGR from 2012 to 2014. Individually, AP has grown at a CAGR of 125% and AE has grown at a CAGR of 167% for the period.

Further evidence of VIPS' new-found payment religion is the fact that AP and AE as a percentage of Total Assets had been around 60% in 2012 and 2013, but by 2014, the figure was down to around 50%.

The fact that VIPS has started to pay down—even slightly--the balances on these two accounts could be due to a host of reasons, including:

- Vendors and employees having expressed that they are no longer willing to informally finance VIPS through a very extended payment plan;
- VIPS having decided that it is good business to pay your vendors and employees in a reasonable timeframe and in accordance to established agreements;

[2] Vipshop Holdings, SEC Forms 6-K March 2012 through May 2015.

- Peers decreasing time to pay vendors which requires that VIPS also adjust to remain competitive.

However, I will add another possibility for why VIPS:

- The vendors that are represented by the long outstanding AP and AE claims are Related Parties and they require cash for their operations or, possibly, for round trip transactions as described in the May 12th Mithra report.

Regardless, of the rationale, VIPS and other competitors are now shortening the time it takes to pay vendors. Given the large balance that VIPS holds in AP and AE, payment against these debts will severely negatively impact VIPS healthy and growing cash flows from operations ("CFFO") as well as Cash and HTM balances.

In fact, it could be argued that a significant amount of the reported Cash and Held-to-Maturity Investments were not available or accessible for the day-to-day operations of VIPS as they were already committed as payment for the bloated AP and AE balances. Cash and HTM as reported on the VIPS balance sheet was not sustainable and analysts should have netted the over-accrued amounts of AP and AE from the reported balances.

2.2 REPORTED CASH FLOWS DEPENDENT UPON SEVERELY DELAYED PAYMENTS

When trying to identify aggressive, manipulated or fraudulent accounting, many analysts will evaluate the trends in the Cash Flow statement to assess whether growth in earnings was accompanied by growth in cash. In the case of VIPS, one would have noticed that VIPS recorded impressive CFFO of $505M, against earnings of $123M[3].

The company also reported an increase of $437M in its Cash balance, primarily as a result of proceeds from a bond offering. But further analysis reveals two red-flags that point to aggressive accounting and possible manipulation.

Firstly, in the report dated May 12th, I explained my belief that VIPS had used CAPEX and a series of investments as a means of tunneling cash out of the company to RPTS who would then transact artificial sales. The accounting for these transactions would have required large cash outflows from investing which would then appear as equally large cash inflows from operations. Indications of round-trip transactions like this would be revealed in the fact that the amounts spent on Investing activities approximated the amounts received in Operating activities. The cash flow statement offers some support for this view as total cash outflows from CAPEX and Investments of $454M closely approximate the amount reported as net cash flows from operations of $505M.

[3] Vipshop Holdings, SEC Form 20-F, April 24, 2015.

Secondly, a scan of the Cash Flow Statement[4] reveals that the key drivers of growth in CFFO are large sources of cash from the increases in AP ($448M) and AE ($180M) which offset large uses of cash for Inventory ($337M) and Receivables ($99M).

	Year ended December 31,		
	2012	2013	2014
	$	$	$
CASH FLOW FROM OPERATING ACTIVITIES:			
Net (loss) income	(9,472,074)	52,299,863	122,789,192
Adjustment to reconcile net (loss) income to net cash by operating activities:			
Allowance for doubtful debts	–	(31,090)	671,545
Prepaid expenses write-down	222,999	343,015	–
Inventory write-down	12,166,659	33,883,024	35,585,311
Depreciation of property and equipment	4,527,122	8,838,893	17,945,376
Amortization of intangible assets	4,801	229,456	40,328,316
Impairment loss on intangible assets	–	–	2,724,963
Loss on disposal of property and equipment	20,670	52,712	31,907
Share-based compensation expenses	7,596,949	12,456,263	36,790,447
Share of loss of affiliates	–	–	10,232,492
Impairment loss of other investment	–	–	1,006,083
Interest income on held-to-maturity securities	(1,026,325)	(4,256,810)	(19,278,368)
Amortization of debt issuance cost	–	–	4,303,481
Changes in operating assets and liabilities:			
Accounts receivable	(2,866,381)	3,791,431	(21,941,959)
Amounts due from related parties	1,924,616	177,237	(4,994,873)
Other receivables	(583,406)	(6,512,714)	(64,912,801)
Inventories	(86,388,390)	(160,045,398)	(337,003,681)
Advances to suppliers	2,859,976	(3,789,748)	8,606
Prepaid expenses	390,318	(1,697,925)	(850,747)
Prepayment of operating lease	–	–	(13,214,473)
Deposit related to acquisition of land use right	–	–	(7,168,459)
Deferred tax assets	–	(11,126,647)	(26,450,044)
Accounts payable	105,435,451	283,392,054	448,569,630
Advance from customers	40,567,356	75,833,038	97,553,687
Accrued expenses and other current liabilities	26,009,941	143,651,077	179,536,879
Amounts due to related parties(note a)	(168,989)	805,655	3,026,275
Deferred income	10,347,912	8,788,414	9,651,357
Deferred tax liability	–	–	(9,279,689)
Net cash from operating activities	111,569,205	437,081,800	505,660,453
Cash flows used in investing activities:			
Purchase of property and equipment	(12,379,386)	(22,248,981)	(256,027,300)
Purchase of other assets	(770)	(5,293,188)	(4,668,184)
Proceed from disposal of property and equipment	19,972	682,260	–
Decrease in restricted deposits	14,214,585	–	–
Purchase of held-to-maturity securities	(101,302,171)	(615,243,570)	(1,018,196,176)
Proceed from redemption of held-to-maturity securities upon maturities	16,231,306	321,208,517	809,201,909
Investment to affiliates and other investments	–	–	(74,773,712)
Acquisition of a subsidiary, net of cash acquired of nil, nil and $20,503 in 2012,2013 and 2014, respectively	–	–	(112,500,000)
Prepayment for investment to an affiliate	–	–	(6,527,910)
Increase in entrusted loan	–	–	(671,545)
Increase in restricted cash	–	–	(64,526)
Net cash used in investing activities	(83,216,464)	(320,894,962)	(664,227,444)
Cash flows from financing activities:			
Proceeds from bank borrowings	–	–	169,872,741
Repayment to bank borrowings	(12,710,720)	–	(169,872,741)
Capital contributions from non-controlling interests	–	–	1,214,769
Other capital contributions	–	–	689,294
Proceed from issuance of convertible notes	–	–	618,268,750
Issuance cost of convertible notes offering	–	–	(1,078,091)
Proceeds from issuance of ordinary shares in the offerings, net of issuance costs	62,689,835	90,348,312	–
Proceeds from issuance of ordinary shares upon exercise of stock options	191,533	2,049,326	1,786,728
Net cash provided by financing activities	50,170,648	92,397,638	620,881,450
Effect of exchange rate changes	994,462	1,657,914	(24,900,584)
Net increase in cash and cash equivalent	79,517,851	210,242,390	437,413,875
Cash and cash equivalents at beginning of the period	44,954,778	124,472,629	334,715,019
Cash and cash equivalent at end of the period	124,472,629	334,715,019	772,128,894

Note (a) Noncash financing activities: US$2,292,763 registered capital was contributed by shareholders of the VIE via offsetting the accumulated shareholder loan due from the Company to the shareholders on June 14, 2012.

[4] Vipshop Holdings, SEC Form 20-F, April 24, 2015.

3 OVER-RELIANCE ON ACCRUALS IS RELATIVE

For comparison purposes, I re-configured the Cash Flow statements of VIPS and 4 of its peers in the flash sales sector to present cash flows using the Direct method. This approach provides ease of comparison and a clearer identification of the extent to which each company is reliant upon various sources and uses of cash flows. The model I used is the Uniform Credit Analysis ("UCA")[5] model. The UCA model is presented in the form similar to that of an income statement. For purposes of this analysis I am only computing up to the level of Core Cash Flows from Operations (excluding impact of other income, interest and taxes); the full UCA model computes Cash Flows from Investing and Financing in a similar manner.

($millions)	Uniform Credit Analysis for FYE 2014				
	VIPS	DANG	JMEI	JD.COM	ZU
Revenue	3,774	1,282	633	18,535	1,200
Δ Operating Receivables	(99)	2	(4)	(312)	(3)
Δ Deferred Revenue & Advances	107	34	7	(14)	21
Cash from Revenue	**3,782**	**1,318**	**635**	**18,209**	**1,218**
Cost of Sales (ex Depreciation & Amort)	(2,777)	(1,037)	(380)	(16,114)	(862)
Δ Inventory	(308)	(64)	(69)	(936)	(4)
Δ Operating Payables	510	74	57	862	54
Cash Cost of Revenue	(2,575)	(1,027)	(392)	(16,188)	(813)
Cash GM	**1,206**	**291**	**243**	**2,021**	**405**
Cash Operating Expense	(827)	(245)	(191)	(3,088)	(309)
Δ Accrued Exp. & Other Current Liabs	181	6	10	490	9
Core Operating Cash Flow	**560**	**52**	**63**	**(577)**	**105**
Cash GM as % Cash Revenue	31.9%	22.1%	38.3%	11.1%	33.3%
Core Operating Cash Flow as % of Cash Revenue	14.8%	3.9%	9.9%	-3.2%	8.6%
Working Capital Sources of Cash	798	114	74	1,339	83
Working Capital Uses of Cash	(407)	(62)	(73)	(1,248)	(8)
Net Working Capital Cash impact	**390**	**51**	**1**	**91**	**76**

Source: 2014 Financial Statements for VIPS, Dangdang, Jumei, JD.com and Zulily.

The UCA model reveals that while VIPS is third in highest Cash Gross Margin as a percentage of Cash Revenue, VIPS generates considerably more Core Operating Cash Flow as a percentage of Cash Revenue. Impressive as those figures are, the absolute values reveal that VIPS owes much of its reported Cash Flow simply to the net impact of changes in working capital sources (AP, AE, Deferred) and uses (AR, Inventory).

[5] Uniform Credit Analysis is a registered trademark of the Risk Management Association, Philadelphia, PA.

In fact, without the aid of these working capital changes, VIPS would have reported only 4.5% in Core Operating Cash Flow as a percentage of Cash Revenue—less than half of the 9.9% achieved by JMEI which gets minimal benefit from working capital changes in support of its reported cash flows.

Now that we know the importance of AP and AE, we can conduct comparative analysis on these accounts to assess the extent to which VIPS' balances are out of sync with its peers. I analyzed each of these accounts against two key sets of performance indicators:

- percentage of Total Assets; and
- the Cash Conversion Cycle.

3.1 WHETHER BY BALANCE SHEET...

The analysis of AP and AE balances as a percentage of Total Assets revealed that VIPS and DANG lead the sector by a wide margin.

	Accounts Payable and Accrued Expenses as a % of Total Assets					
	VIPS	DANG	JMEI	JD	ZU	Average of JMEI, JD & ZU
AP	*986.6*	*399.6*	*145.4*	*2,637.3*	*109.3*	***964.0***
Accrued Expenses (ex. taxes payble)	*377.0*	*113.5*	*20.2*	*856.1*	*39.5*	***305.3***
Total AP + AE	*1,363.6*	*513.1*	*165.6*	*3,493.4*	*148.8*	***1,269.3***
AP as % of TA	*36.1%*	*54.9%*	*19.6%*	*24.6%*	*22.2%*	***22.1%***
Accrueds as % of TA	*13.8%*	*15.6%*	*2.7%*	*8.0%*	*8.0%*	***6.2%***
AP and Accrueds as % of TA	*49.9%*	*70.5%*	*22.3%*	*32.6%*	*30.2%*	***28.4%***

Source: 2014 Financial Statements for VIPS, Dangdang, Jumei, JD.com and Zulily.

However, despite differences in sales volumes, assets and product focus, JMEI, JD and ZU all tend to maintain AP and AE levels of no more than 33% of Total Assets.

DANG which is more similar to ZU and JMEI in terms of assets and revenues, reported AP and AE which exceeded 70% of Total Assets. DANG recently missed its EPS target for 1Q 2015 by a wide margin. DANG posted positive earnings in 2014, but had recorded earnings losses for 2013, 2012, and 2011. DANG has also revealed net decreases in Cash for 3 of the last 4 years. In our opinion, DANG is holding large amounts of AP and AE because it is preserving and closely monitoring its cash balances.

VIPS however has been profitable for several years; reports blockbuster growth in revenue and cash flows quarter-on-quarter and year-on-year. Why then does VIPS look more like DANG (carefully preserving scarce cash) than JMEI (managing grow) when it comes to its AP and AE metrics?

In my opinion, VIPS should be reporting AP and AE totals approximating 28% of Total Assets, in line with JMEI, JD and ZU. VIPS has recently had AP and AE totals of over 60% of total assets.

VIPS' current level of AP and AE at 50% of Total Assets suggests a company struggling, not thriving as its reports suggest.

3.2 OR BY DAYS OUTSTANDING...VIPS DOES NOT PAY

Another way of evaluating the reasonableness of VIPS' AE and AP balances is to evaluate the company's Cash Conversion Cycle (CCC) which is a measure of how long it takes to convert sales into cash. Typically, the CCC is computed by taking the values for Days Sales Outstanding adding to it the value for Days Inventory Outstanding and subtracting the values for Days Payables Outstanding.

Most firms have relatively small, if any, balances for Deferred Sales and Accrued Expenses and these figures are not usually used in the CCC formula. However, given the level of importance Deferred Revenues and Accrueds serve in this industry sector, I have modified the CCC calculation as follows:

Adjusted CCC =

+ Days Sales Outstanding (DSO) + Days Inventory Outstanding (DIO)

– Days Payable Outstanding (DPO) – Days Accrued Expenses Outstanding (DAEO)

– Days Deferred and Advance Revenue Outstanding (DDRO) – Days Due Related Parties Outstanding (DRPTO)

Also, because I am attempting to assess the adequacy of the ending balances of each account, I am using ending balance sheet account figures for each of the formulas, **not** the averages. For example DAEO is computed as: [Ending Balance of Accrued Expenses / Operating Expenses] * 365 days. Each of the key competitors in this space records negative Cash Conversion Cycles owing to the fact that they

Accounts Payable and Accrued Expenses as a % of Total Assets

	VIPS	DANG	JMEI	JD	ZU
Revenue (millions)	$3,773.7	$1,282.5	$632.9	$18,535.0	$1,200.0
COGS	2,835.3	1,045.5	382.7	16,380.0	875.6
OPEX	827.4	245.5	190.8	3,088.0	308.7
Accounts Receivable	118.6	4.6	6.9	392.7	8.3
Inventory	578.3	354.8	101.6	1,964.8	17.4
Accounts Payable	986.6	399.6	145.4	2,637.3	109.3
Accrued Expenses (ex. taxes payble)	377.0	113.5	20.2	856.1	39.5
Deferred Revenue and Advances	260.6	101.1	11.1	63.3	44.2
Owed to Related Parties	12.2	0.4	-	52.4	-
Total Assets	2,732.0	728.0	743.3	10,717.0	492.4
DSO -Days Sales Outstanding	*11.5*	*1.3*	*4.0*	*7.7*	*2.5*
DDRO - Days Deferred Revenue Outstanding	*25.2*	*28.8*	*6.4*	*1.2*	*13.4*
DIO - Days Inventory Outstanding	*74.4*	*123.9*	*96.9*	*43.8*	*7.3*
DPO - Days Payble Outstanding	*127.0*	*139.5*	*138.7*	*58.8*	*45.6*
DAEO - Days Accrued Expenses Outstanding	*166.3*	*168.7*	*38.6*	*101.2*	*46.7*
DRPTO -Days Related Parties Owed Outstanding	*5.4*	*0.6*	*-*	*6.2*	*-*
Adjusted CCC in days	*(238.0)*	*(212.4)*	*(82.8)*	*(115.9)*	*(95.9)*
Adjusted CCC in months	*(7.9)*	*(7.1)*	*(2.8)*	*(3.9)*	*(3.2)*

Source: 2014 Financial Statements for VIPS, Dangdang, Jumei, JD.com and Zulily.

tend to have a large number of cash sales and they are not obligated to pay vendors until 45 to 60 days after sales are completed.

While I expected relatively sizeable and negative CCC days for all firms, the figures for the market leader, VIPS, and DANG are massive and, again, out of sync with other key competitors.

The CCC reveals that VIPS and DANG are holding onto their cash from sales for 7 to 8 months before having to pay for inventory and other operating costs. The key contributors to these massive figures are indeed AP and AE. Vendors and employees are essentially financing VIPS' and DANG's businesses.

Again, with respect to paying bills, VIPS is behaving more like cash-challenged DANG than a company flush with cash. VIPS might argue that good cash management is a positive , however, in my view, taking 8 months to pay your vendors and employees is rarely a sustainable business model. Moreover, VIPS management has mentioned previously that it has an excellent cash management template:

- Customers mostly pay cash on delivery[6];
- VIPS holds Inventory in its warehouse for no more than 12 days[7];
- VIPS' arrangements with vendors allows it to pay for goods usually 1 to 1.5 months after the sale[8].

If all of the above are true, then

- Why does VIPS show 11.5 days sales outstanding;
- Why is Inventory on hand for nearly 74 days;
- Why is Days Payable in excess of 127 days and Days Accrued at 166 days;
- Where do you find employees willing to wait 4 months for salary payment?

And critically, how will VIPS' reported Cash and HTM be impacted now that VIPS and several of its competitors seem to be shortening days outstanding for AP and AE. For these reasons, I have serious concerns about the sustainability of a model that relies upon ever-growing vendor financing. Based upon previous reports, I have additional concerns that AP and AE may well be accounts used to funnel cash to RPTs as part of a faked sales scheme.

[6] BNP Paribas Research, "Vipshop Holdings: Compelling Growth Story", June 25, 2014.
[7] BNP Paribas Research, "Vipshop Holdings: Compelling Growth Story", June 25, 2014.
[8] BNP Paribas Research, "Vipshop Holdings: Compelling Growth Story", June 25, 2014.

4 SO WHAT'S THE IMPACT OF DELAYING PAYMENT

Given the fact that metrics at VIPS and DANG are outside the bounds of several other established flash sales companies, I decided to use figures reported at JMEI, JD, and ZU to compute an industry average target. The computations for each metric determined that VIPS' average AP and AE balances should:

- approximate 28.4% of VIPS' Total Assets or
- average 81 days in Accounts Payable and 62 days in Accrued Expenses

I computed values for the ending balances of AP and AE for VIPS using these estimates.

If VIPS had reported Accounts Payables and Accrued Expenses balances at a percentage of Total Assets or at CCC levels averages of those at Jumei, JD.com and Zulily, **VIPS would have recorded between $589 and $594M LESS in Cash Flow from Operations than reported for 2014.**

Total Assets Approach

	Average JMEI, JD and ZU	2014 Total Assets	VIPS' Reported 2014 balance	VIPS' Revised 2014 using avg.	Extended Payment Impact on CFFO
Accounts Payable	22.1%	2,732.0	987	605	382
Accrued Expenses	6.2%	2,732.0	377	171	207
Total AP + AE	28.4%		1,364	775	589

Source: 2014 Financial Statements for VIPS, Dangdang, Jumei, JD.com and Zulily.

Days Outstanding Ratio Approach

	Average JMEI, JD and ZU	2014 COGS and OPEX balances	VIPS' Reported 2014 balance	VIPS' Revised 2014 using avg.	Extended Payment Impact on CFFO
Accounts Payable	81.0	2,835.3	987	629	357
Accrued Expenses	62.0	827.4	377	141	236
Total AP + AE	143.0		1,364	770	594

Source: 2014 Financial Statements for VIPS, Dangdang, Jumei, JD.com and Zulily.

Consequently, if VIPS had recorded the figures these metrics indicate, VIPS would have reported negative CFFO of ($88M). VIPS' negative CFFO of ($88), combined with VIPS' reported negative Cash Flows from Investing of ($664) and proceeds from Cash Flows from Financing of $620M would have **resulted in a decrease in the cash balance of ($156M).**

($ millions)	VIPS' Reported 2014 balance	CFFO less $594M
Cash Flow from Operations	505.7	(88.2)
Cash Flow from Investing	(664.2)	(664.2)
Cash Flow from Financing	620.9	620.9
Effect of Exchange rate	(24.9)	(24.9)
Net Change in Cash	**437.5**	**(156.4)**
Beg. Cash Balance	334.7	334.7
Ending Cash Balance	772.2	**178.3**

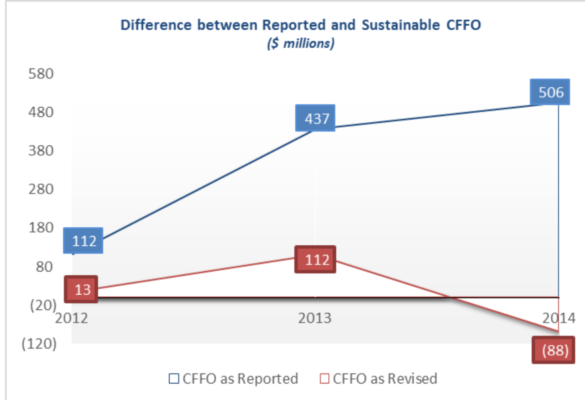
It is my belief that VIPS has held significant AP and AE balances in an effort to exhibit strong Cash Flow and Cash balance positions to the market.

However, VIPS and its competitors are now being forced to shorten payment cycles. If this continues, VIPS is clearly one of the most vulnerable companies in the space and would be forced to pay off significant AP and AE balances. I suspect that a sizeable amount of the reported Cash and HTM balances have already been set aside to pay these bills which is why Cash and HTM have risen over the last several years as well. Whether the counterparties are actual vendors or related parties, an unwinding of these AP and AE balances will negatively impact reported cash flow and cash balances. A significant amount of cash reported in Cash and HTM is likely to be unavailable or inaccessible as it is being held to satisfy AP and AE claims.

It should also be noted that the above analysis assumes that all of the outstanding AP and AE are reflected on VIPS statements. However, as I mentioned in the May 29th update, I suspected that the rapid and growing losses at investee companies is indicative of VIPS pushing expenses off-balance sheet. If VIPS is indeed pushing these costs on to Lefeng, Ovation and others, the true total balance of AP and AE is even higher than what VIPS is recording in its financials. It is unclear whether investee companies are also being forced to shorten payment schedules and to what extent these companies have cash on hand to pay the balances. A key question is whether the investee companies would look to VIPS for cash in the event that the investee companies were cash strapped.

Extrapolating this analysis for 2012 and 2013, we see that while VIPS has reported healthy and growing CFFO, adjusting those figures to account for inflated AE and AP would have resulted in CFFO of between $100M and $594M less than reported. In addition, given the rapid growth in AP and AE, the divergence between what was reported CFFO and revised Sustainable CFFO was expanding considerable by 2014.

<u>The chart to the right explains how VIPS' healthy Cash Flow is in fact, a disappointing Cash No.</u>



5 LESS CASH VALIDATES SOME EARLIER CONCERNS ABOUT CASH AND HTM

Nearly $600M less in Cash and HTM is accessible and available to VIPS due to it being set aside for payment of AP and AE. This lack of available cash also explains and confirms several suspected manipulations I raised previously:

- A lack of cash would explain why VIPS needed to borrow funds to invest in Ovation and Lefeng, despite showing large Cash and HTM balances at the time;
- Lower amounts of Cash and HTM might explain why reported interest was low in comparison to prevailing market rates for bank term deposits;
- Dwindling cash reserves would explain why a company with such a stellar record of revenue, earnings and cash flow growth has needed to access capital markets every year since its IPO in 2011.

I predict that VIPS will seek financing from the capital markets in 2015. In my opinion, if the company is using cash to pay off bloating AP and AE balances as well as pay for continued investment in CAPEX and logistics companies, it is burning through cash quickly.

Indeed, like its potentially manipulated Revenue and Gross Margin, VIPS' reported stellar results are far less impressive when examined against company and industry norms.

<u>For these reasons and those outlined in my reports of May 11th and May 29th, I continue to have grave concerns about VIPS' Cash, H-T-M and other accounts. I am maintaining a view of STRONG SELL / SELL SHORT with a target price of $0</u>.