

Small Talk – BAOZUN, Inc.



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Presented by  
**Betsy Wills, Director,**  
Rocky Mountain Chapter


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**BAO ZUN**

**What Does BAOZUN Do?**

- Leading brand e-commerce service partner in China
- In 2016, BZUN's platforms processed 25% of all branded e-commerce merchandise sold to customers in China
- E-commerce capabilities encompass all aspects of the e-commerce chain: IT solutions, store operations, digital marketing, customer services, warehousing and fulfillment
- Teaming up with BZUN enables "brand partners" to establish market presence and launch products quickly in online marketplaces, e.g., Tmall, JD.com and Amazon and O2O

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## Who are Brand Partners?

- Brand partners: Companies for which BZUN operates official brand stores or official marketplace stores under their brand names, or have entered into agreements to do so
  - Official brand stores: brands' official online stores
  - Official marketplace stores: brands' flagship stores and authorized stores on 3<sup>rd</sup> party online marketplaces

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## Online Marketplaces in China

- Tmall: owned by Alibaba; trade site based on Taobao's platform; operates on B2C system
  - Taobao: huge Asian online store, with millions of Chinese sellers and shops, operates on C2C system
- JD.com:
  - Aka Jingdong
  - Rapidly growing, market cap increased from \$37B to \$66B YTD
  - The 21<sup>st</sup> most visited website in the world
- O2O: "online-to-offline" and "offline to online"
  - Integration between e-commerce and physical retail shopping

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## What Does BAOZUN Do?

- 162 brand partners as of 6/30/18 – up from 140 as of 6/30/17
- Brand partners are diverse - includes apparel, appliances, electronics, home and furnishings, food and health products, cosmetics, fast moving consumer goods, insurance, automobiles, and mother and baby
- Top 3 categories: apparel, electronics and appliances
  - in 2019, BZUN expects that cosmetics could be the fourth largest category in the overall businesses

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## What Does BAOZUN Do?

- Partners include Philips, Nike and Microsoft, leaders in their respective industries
- Has set itself apart in China's e-commerce market by offering a broader range of services than its competitors
- Already integrated with all the big dogs in the field, including Alibaba's Tmall, Taobao and JD.com – so it's positioned well no matter who comes out on top (Alibaba is a 15% shareholder of BZUN)

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## Market Size

- China is world's most populous market
- China's roughly \$1.15 trillion in sales conducted through online platforms spending in 2017 accounted for about 50% of the world's online retail spending
- Chinese e-commerce spending increased 34% YoY in the first quarter of 2018 – impressive growth, especially considering that total spend in the category had already risen 32% in 2017
- Upper middle class and e-commerce in China growing rapidly – adoption of the Internet has occurred faster than the creation of brick-and-mortar retail infrastructure in many rural locations

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## Why Study BAOZUN?

- More global brands view e-commerce as a valuable part of their China expansion strategy
- BZUN has local knowledge and industry expertise to execute and integrate e-commerce strategies – Brands do not have to make the investment to establish and maintain local infrastructure and capabilities themselves
- Has been called the "Shopify of China" – both Shopify and BZUN connect retailers with suppliers and consumers, provide digital storefronts and fulfillment services. SHOP:
  - Provides online stores for over 600,000 businesses
  - 1+ MM customers
  - \$63+ B sold on SHOP
- SHOP 2018 YTD revenues = \$459MM (6/30/18)

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## BZUN Facts

- ▶ Founded in Shanghai, China in 2006 – incorporated in Cayman Islands in December 2013
- ▶ Branches all over China: Hangzhou, Beijing, Hongkong and Taiwan; overseas offices located in Japan, Korea and USA – employs over 700 IT engineers
- ▶ IPO: May 2015 @ \$10/ADS (American Depository Shares)
  - Each ADS = 3 Class A Ordinary Shares of BZUN
- ▶ Sector/Industry (M\*): Consumer Cyclical – Specialty Retail
- ▶ Foreign Private Issuer

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## What is a Foreign Private Issuer?

- ▶ Criteria to be a Foreign Private Issuer:
  - No more than 50% of outstanding voting securities may be held of record by U.S. residents; or
  - If more than 50% of voting securities are held by U.S. residents, and *none* of the following applies:
    - the majority of its executive officers or directors are U.S. citizens or residents;
    - more than 50% of the issuer's assets are located in the U.S.; or
    - the issuer's business is administered principally in the U.S.
- ▶ Determination is made annually, at the end of the company's second fiscal quarter


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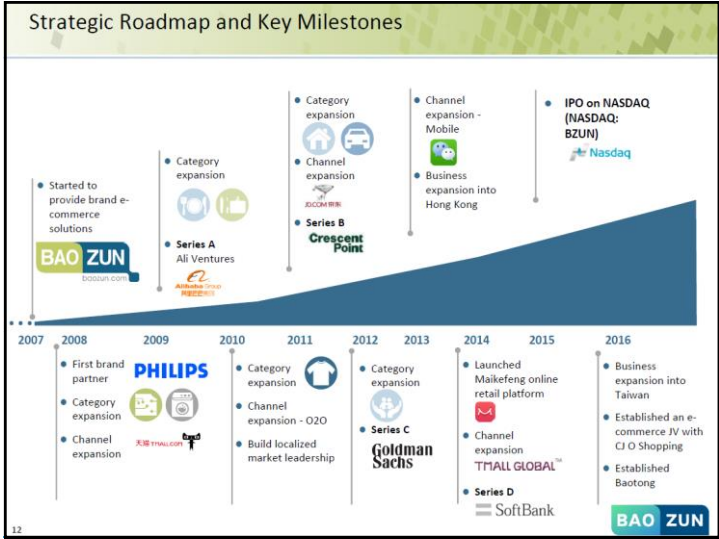
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### SEC Reporting by Foreign Private Issuers


- SEC has adopted special forms for foreign private issuers:
  - Form 20-F = Annual Report (similar to Form 10-K for domestic companies)
  - Form 6-K = Current Report (similar to Form 8-K for domestic companies)
- Financial Statements: may be presented pursuant to U.S. GAAP, International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB"), or home country accounting standards with a reconciliation to U.S. GAAP
- Exempt from SEC's proxy, beneficial ownership reporting and short swing profit trading rules

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### Sources of Revenue

- BZUN generates revenues from two revenue streams:
  - (1) product sales (increasing popular products, BZUN's marketing and promotional campaigns)
  - (2) services (consignments, service fees and growth in sales from existing brand partners)
- Business model transitioning from distribution to software services, which is significantly boosting profitability
  - Q218 non-distribution business revenues increased 89% YoY

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### Annual and Quarterly Financial Summary (Renminbi (RMB) in Millions) (Source: Morningstar)

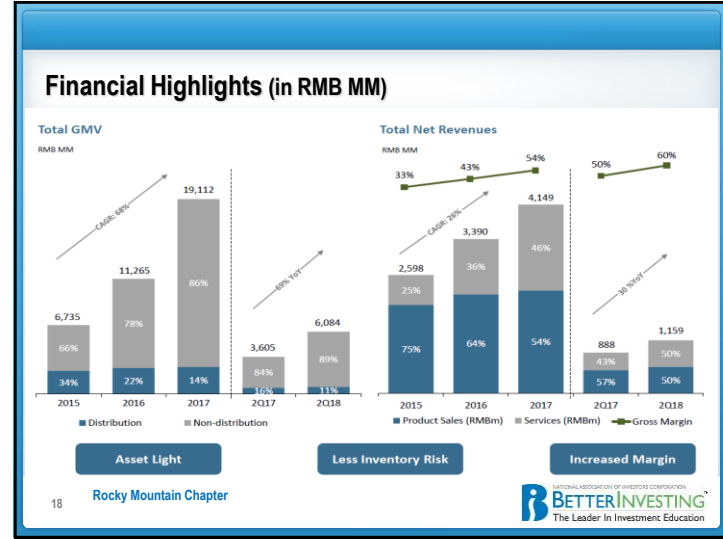
Financials BZUN	2017-12		2016-12		2015-12		2018-06		2017-06	
	Annual	Quarterly	Annual	Quarterly	Annual	Quarterly	Annual	Quarterly	Annual	Quarterly
Revenue	4,149	1,159	3,390	1,159	2,598	1,159	1,159	1,159	888	888
Operating Income	256	58	85	58	0	58	58	58	33	33
Net Income	209	37	87	37	23	37	37	37	30	30
Earnings Per Share	3.57	0.63	1.59	0.63	-0.09	0.63	0.63	0.63	0.51	0.51
Diluted Average Shares	59	60	55	60	34	60	60	60	59	59

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### Annual and Quarterly Financial Summary in US\$ (in thousands, except per share/ADS data)

Income Statement	Annual (US\$)		Quarterly (US\$)	
	12/31/17	12/31/16	6/2018	6/2017
Revenue	\$637,660	\$488,302	\$175,200 (30.5%)	\$131,000
Product Sales	346,992	313,474	87,200 (14.4%)	74,400
Services	290,668	174,828	88,000 (88.6%)	56,600
Operating Income	39,397	12,303	8,800	5,500
Net Income	32,143	12,477	5,600 (23.5% YoY)	4,400
EPS/ADS*	.55	.23	.10	.08

\* Each ADS = 3 ordinary shares



### Morningstar – BZUN: Sector: Consumer Cyclical Industry: Specialty Retail

**Key Stats BZUN**

	Stock	Ind Avg	Relative to Industry
Price/Earnings TTM	106.8	77.1	High
Price/Book	11.6	12.7	Low
Price/Sales TTM	5.4	3.0	High
Rev Growth (3 Yr Avg)	37.8	12.5	High



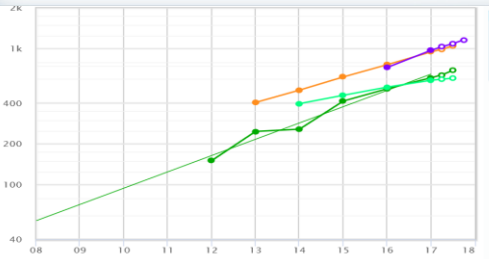
### BZUN Competitors

- ▶ Morningstar:
  - Amazon
  - JD.com
  - Alibaba Group Holding
  - eBay
  - O'Reilly Automotive
- ▶ Online SSG:
  - Sleep Country (ZZZ.TO)
  - At Home Group (HOME)
  - Stitch Fix (SFIX)

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### BZUN Competitors (BI)



Historical Sales	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Growth(%)
Baozun (BZUN)	---	---	---	---	151	247	257	414	509	614	31.7%
Sleep Country C (CS) (ZZZ.TO)	---	---	---	---	---	---	396	456	524	588	14.2%
At Home Group (HOME)	---	---	---	---	---	404	498	622	766	951	23.9%
Stitch Fix (SFIX)	---	---	---	---	---	---	---	---	730	977	33.8%

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### SWOT Analysis

**S**trengths – **Internal** factors that may positively influence company performance


**W**eaknesses – **Internal** factors that may negatively influence company performance

**O**pportunities – **External** factors that may positively influence company performance

**T**hreats – **External** factors that may negatively influence company performance



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### Strengths

- ▶ Moving from distributing merchandise to more profitable services model
- ▶ Depth and breadth of offerings go beyond rivals
- ▶ Software is scalable, customizable and adaptable
- ▶ Alibaba is a shareholder
- ▶ Position in Chinese e-marketplace

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### Weaknesses

- ▶ BZUN's success is dependent on the success of its brand partners
- ▶ Substantial majority of BZUN's revenues is derived from merchandise sold or services rendered on Tmall.
- ▶ Sales are tied to the earning consumer – if consumer sentiment decelerates, could adversely impact sales of brand partners' merchandise and BZUN revenues
- ▶ BZUN relies on third-party delivery service providers to deliver products to consumers - any major interruptions to or failures in these third parties' delivery services could prevent the timely or successful delivery of products



### Opportunities

- ▶ Attract new brand partners
- ▶ China is a huge potential market
- ▶ Chinese consumer spending continues to migrate online
- ▶ Purchasing power of Chinese middle-class continues to increase

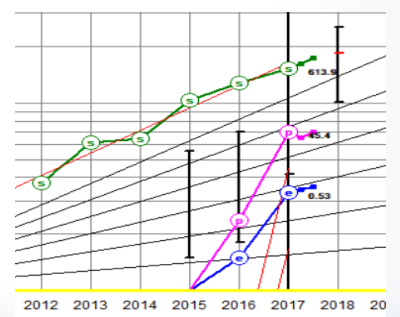


### Threats

- ▶ Competition: Alibaba and JD.com may choose to bring their brand and e-commerce capabilities in-house
  - But Alibaba has no reason to undercut its investment in BZUN
- ▶ Business is subject to supervision and regulation by many relevant PRC government authorities – required licenses and permits
- ▶ A decrease in the use of channels like Tmall would reduce demands for BZUN's services, which would adversely affect its business and results of operations
- ▶ PRC is unpredictable - Long term viability and prospects of online retail business in China is unknown
- ▶ Potential trade war between USA and China




### SSG: Is BZUN a Quality Company?




**Adding Judgment – Sales (%)**

- ▶ 29% - Toolkit ACE est. (2 year)
- ▶ 30% - Yahoo 2018
- ▶ 35% - Yahoo 2019
- ▶ 37% - Five years historical
- ▶ 40% - Q217 to Q218

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**Adding Judgment – EPS (%)**

- ▶ 18% - Zacks 2019 Industry (Computers - IT Services)
- ▶ 34% - Latest Quarter
- ▶ 59% - Yahoo 2018
- ▶ 66% - Yahoo 2019
- ▶ 68% - Zacks 2019 est.

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**Adding Judgment - High P/E**

- ▶ 30 - Better Investing High P/E
- ▶ 49 - Average P/E
- ▶ 118 - 52 week High P/E
- ▶ 80 - Current P/E

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**Adding Judgment – Low P/E**

- ▶ 20 - Better Investing Low P/E
- ▶ 21 - Average Low P/E
- ▶ 47 - 52 week Low P/E

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### Adding Judgment – Low Price (\$)

- ▶ \$\_\_\_ - Forecasted Low Price
- ▶ \$ 6.60 - Average Low Price for last 5 years
- ▶ \$36.78 - 80% of current price

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### After this Study, What Are Your Thoughts?

- ▶ I'm considering adding BZUN to my portfolio
- ▶ BZUN is too young/speculative
- ▶ Chinese ADS has too much risk for me
- ▶ BZUN doesn't fit my portfolio
- ▶ Will put on my watch list

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### Next Small Talk

October 23, 2018

7 PM (MDT)

Register at [rmchapter.org](http://rmchapter.org)

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