

# China Youzan (8083 HK)

## The China Shopify, Expecting SaaS scale effect in no time

Hong Kong | TMT sector | Company Initiation

8 Jan 2021

### Investment Summary

#### Private traffic management is the main trend for offline merchants

Take Tencent as an example. Tencent itself focuses more on WeChat payment and advertisement business, while its e-commerce SaaS services mainly choose to cooperate with third-party SaaS platforms. Therefore, the rapid development of social e-commerce platforms has provided huge business opportunities for third-party SaaS platforms. We believe that for merchants who already have enough user traffic of repurchase, it is more appropriate to open an online store through a third-party SaaS platform for private traffic management. Effective private traffic management can increase customer repurchase rates and reduce Customer acquisition cost. At the same time, since the growth of traditional e-commerce users has obviously reached a bottleneck and the cost of public traffic is high, it is especially important for small and medium-sized businesses to have their own fixed customers and to manage them efficiently under private traffic management.

#### The company focuses on product development and strives to improve user experience and renewal rate

We believe that for SaaS product providers, their future growth potential is closely tied to product R&D capabilities. Strong R&D capabilities are one of the main moats for SaaS product providers. The company clearly understands the importance of having a strong R&D system, so its investment in R&D is extremely high. The company's R&D expenses in 2019 were RMB 404 million, and the R&D expense ratio was 34.6%. As the company has more and more SaaS products, the rapid increase in SaaS revenue can bring obvious marginal effects, and the R&D expense ratio is expected to gradually fall. Relying on a strong R&D system and investment, the company can continuously polish its products according to the merchants' feedback. Thereby, increasing the user experience and merchant's renewal rate. Further, the company's strategy of targeting mid-top tier merchants will also increase the company's future merchants' renewal rate. We believe that maintaining a high renewal rate is particularly important for SaaS product providers. The renewal rate has a critical impact on the company's revenue and profit ends. The continuous optimization of the renewal rate can effectively increase the company's SaaS business revenue and reduce the company's overall sales expense rate. The company's 2019 merchant renewal rate was 45%, with a huge upward potential in the future.

#### Valuation and investment thesis

Since the company is still in the early stages of development and has not yet recorded a profit, we use the PS ratio to value the company. We are giving the company a 2022 target PS of 25x. Taking into account that the company's listed entity currently holds 51.9% of the shares of Qima Technology (Youzan's operating body), we give the company a 10% control premium, and the **24-month** target price is HKD3.96, with respective 2020/2021/2022 PS (51.9% of revenue) at 63.7x/39.8x/27.5x. We initiate with a Buy rating. (Market closing price as of 6 Jan) (exchange rate: RMB 0.88/HKD)

#### Risks

1) The company is listed on HKEX GEM board, which may have higher risk and volatility comparing to stocks listed on HKEX main board 2) The expansion of SaaS customers is worse than expected 3) The increased industry competition 4) GMV increase less than expected 5) Merchants renewal rate less than expected

### Buy (Initiation)

CMP HKD 2.92

(Closing price as of 6 Jan)

DEC-22 TARGET HKD 3.96 (+36%)

#### COMPANY DATA

O/S SHARES (MN) :	17,249
MARKET CAP (HKD MN) :	50,367
52 - WK HI/LO (HKD):	3.16/0.49

#### SHARE HOLDING PATTERN, %

Whitecrow Investment Ltd.	11.66%
Tencent	6.70%

#### PRICE VS. HSI



Source: Wind, Phillip Securities

#### KEY FINANCIALS

CNY mn	FY19	FY20E	FY21E	FY22E
Net Sales	1171	1818	2908	4216
P/S, x (51.9% of NS)	63.0	47.0	29.4	20.3
Net income	-592	-332	-292	-179
EPS	-0.040	-0.019	-0.017	-0.010
P/E, x	N/A	N/A	N/A	N/A
ROE, Adj (%)	-15.2%	-8.0%	-8.0%	-5.4%
ROA, Adj (%)	-5.6%	-3.0%	-2.6%	-1.6%

Market closing price as of 6 Jan

Source: Company Data, Phillip Securities Est.

#### Research Analyst

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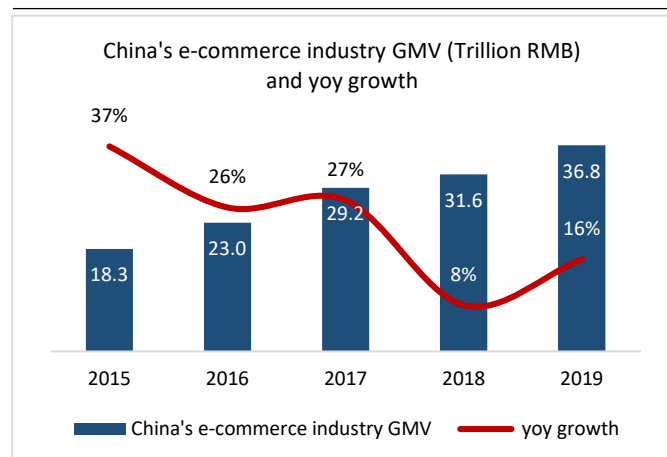
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## Industry Review and Forecast

### China's e-commerce industry

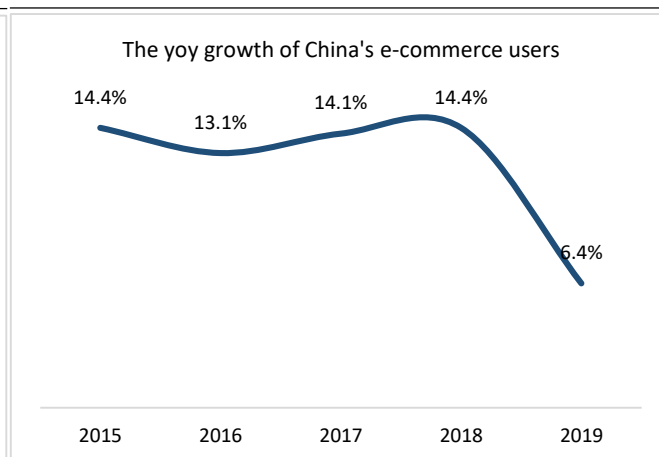
China's e-commerce industry is now mature and its growth is slower than before. The growth of traditional e-commerce users, led by Tmall, JD.com, and Vipshop, has significantly slowed down, which means that competition in the industry has become increasingly fierce and customer acquisition costs have become higher. According to data from the Qianzhan Industry Research Institute, China's e-commerce GMV and users increased by 13.1% and 6.4% yoy in 2019, respectively, and these growth rates were significantly slower than the 36.6% and 14.4% in 2015. The noticeable slowdown in user growth coupled with the gradual increase of merchants on traditional e-commerce platforms has led to intensified competition among merchants to a certain extent. The cost of user traffic for traditional e-commerce platform has risen sharply, putting a certain amount of pressure on small and medium-sized merchants and long-tail merchants.

Figure 1: China's e-commerce industry and yoy growth



Source: QianZhan, PSHK

Figure 2: The yoy growth of China's e-commerce users

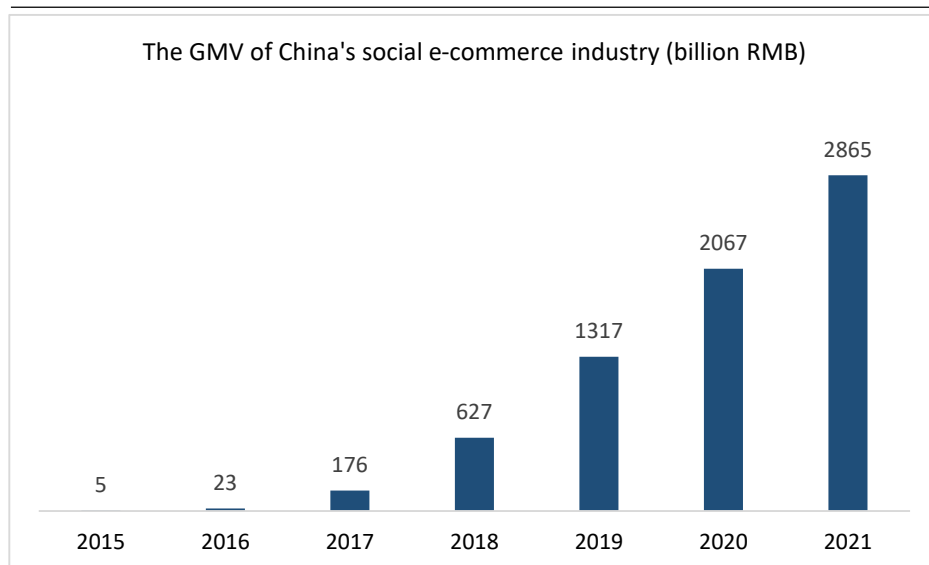


Source: QianZhan, PSHK

### China's social e-commerce industry

In today's mobile Internet era, social platforms Apps represented by WeChat have huge user traffic and occupy most of the user's online time. Take WeChat as an example. As of 2019, WeChat has 1.165 billion monthly active users, and the huge user traffic of WeChat has greatly reduced the cost of customer acquisition for its social e-commerce. On the other hand, other functions in the WeChat ecosystem such as WeChat Payment etc. also provide good technical support for its social e-commerce platform. At present, WeChat has created its unique social e-commerce ecosystem through decentralized innovation and breaking the traditional e-commerce model, allowing small and medium-sized enterprises to quickly expand their business and user base, while directly controlling and managing their customer data and customer relationships. According to the Zhiyan Consulting Report, the GMV of China's social e-commerce industry has increased from RMB 4.69 billion in 2015 to RMB 1.32 trillion in 2019, and is expected to reach RMB 2.86 trillion in 2021.

Figure 3: The GMV of China's social e-commerce industry



Source: QianZhan, PSHK

#### The differences between social and traditional e-commerce

We believe that e-commerce shopping can be divided into two major stages, the demand stage and the purchase stage. In the demand stage, traditional e-commerce is dominated by search shopping, so user consumption is typically planned consumption. On the contrary, part of social e-commerce shopping are unplanned consumptions, such as product sharing in Wechat's Moments to stimulate users' desire to consume. In the shopping phase, the consumption conversion rate of traditional e-commerce is lower than that of social e-commerce. The main reason is that the trust mechanism of social e-commerce (recommendation by friends) is more credible than traditional e-commerce user reviews, so that consumption can be quickly promoted on social e-commerce platforms.

In addition, in the case of abundant supply of goods, the ranking of items will have an extremely important impact on traditional e-commerce consumers. Consumers generally choose items with higher rankings, so the centralized characteristics of traditional e-commerce (traffic flow in from one entrance, the platform) makes the user traffic continuously converge to the high ranking items. In this case, product marketing and advertisements become especially important. On the other hand, social e-commerce (decentralized), doesn't has the characteristic of user traffic asymmetric, because in the case of friend recommendation, consumers' trust in friends will reduce their dependence on ranking and brand, causing products more likely to get their user traffic equivalent to its price-performance ratio. Therefore, we believe that social e-commerce is more friendly to long-tail products and small and medium-sized businesses, while traditional e-commerce is more focused on top products. We believe that the application scenarios of the two e-commerce models in the future will be different.

### Private traffic management is the main trend for offline merchants

Take Tencent as an example. Tencent itself focuses more on WeChat payment and advertisement business, while its e-commerce SaaS services mainly choose to cooperate with third-party SaaS platforms. Therefore, the rapid development of social e-commerce platforms has provided huge business opportunities for third-party SaaS platforms. The third-party e-commerce SaaS platforms help offline merchants to build their online stores on social platforms (such as WeChat) and provides services such as online products transactions, order management, online payment, and user management. For offline merchants, compared to opening a store on traditional e-commerce, the third-party SaaS platform provides store opening services with two major advantages.

1) The private traffic management of social e-commerce is more effective. Through third-party SaaS platform to open a store in the social e-commerce (such as opening a store on WeChat), the offline merchant can directly manage and interact with their consumers. On the other hand, if a merchant opens a store in a traditional e-commerce platform, it cannot directly manage its consumers. Since the traditional e-commerce platforms control the user traffic, hence the buyers can only reach the merchants' good through the search engine. Therefore, it is more effective for businesses to manage private traffic in social e-commerce platforms.

2) Since third-party SaaS platforms do not need to provide merchants with strong user traffic like the traditional e-commerce platforms do, the fees charged by third-party SaaS platforms for opening stores and selling products on social e-commerce platforms will also be less than the traditional e-commerce platform. Take Tmall as an example. Tmall merchants need to pay an annual fee of RMB 30,000-60,000 and a sales commission of 2%-5%, while China Youzan (the leading third-party SaaS platform in the industry) only charges a minimum of RMB 6,800 annual SaaS service fee.

Based on the above reasons, we believe that for merchants who already have enough user traffic of repurchase, it is more appropriate to open an online store through a third-party SaaS platform for private traffic management. Effective private traffic management can increase customer repurchase rates and reduce Customer acquisition cost. At the same time, since the growth of traditional e-commerce users has obviously reached a bottleneck and the cost of public traffic is high, it is especially important for small and medium-sized businesses to have their own fixed customers and to manage them efficiently under private traffic management.

### The top tier third party SaaS providers are likely to be the beneficial from the launch of "Wechat small stores"

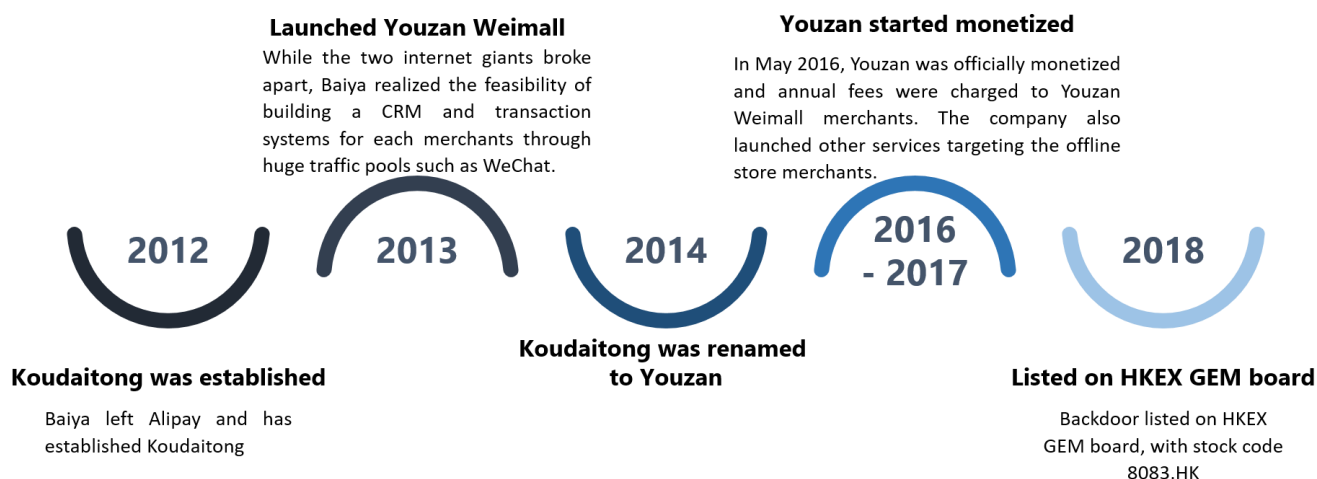
In June 2020, Tencent launched "small WeChat store", a small program designed to help small businesses open online stores for free. But since it only offers basic SaaS services for free, hence its main customers are the relatively small SMEs. On the contrary, the main customers of leading third-party SaaS providers in the industry (such as Weimob and Youzan) are the relatively large SMEs. The free function "small WeChat stores" offers are incompatible with the needs of the large SMEs. We believe the "small Wechat stores" will gradually eliminate the low tier third-party SaaS providers, making the industry gradually concentrated, which is beneficial to the industry's leading third-party SaaS providers. In addition, the free SaaS services provided by "WeChat small stores" can encourage small SMEs to adapt to the current digital trend and grow rapidly from it. When these small SMEs take shapes, the free SaaS services no longer fulfill their requirements, they are expected to become potential new customers of the top tier third-party SaaS providers in the industry.

## Company Overview and its Competitive Advantages

### The leading social e-commerce store SaaS service provider in China

Baiya (formerly known as Zhu Ning) established Koudaitong (Previous name of Youzan) in November 2012. Prior to the establishment of Koudaitong, Bai Ya worked for Alipay under Alibaba as the chief product designer and other positions, and he has extensive experience in the internet community, e-commerce, online payment and other sectors. In the initial stage of its establishment, Koudaitong mainly helped Taobao merchants to initiate business in the WeChat ecosystem. On 22th November, 2013, in order to take control of all the traffic entrances, Taobao has blocked the access from WeChat. At the same time, WeChat users could not directly access Taobao through WeChat. While the two internet giants broke apart, Baiya realized the feasibility of building a CRM and transaction system for each merchant on platforms with huge user traffic such as WeChat. In December 2013, Koudaitong launched Youzan Weimall, and Koudaitong was renamed to Youzan in November 2014. In May 2016, Youzan officially monetized and annual fees were charged to Youzan Weimall merchants. In the early days of the monetization, Youzan was questioned by many merchants, but soon the merchants realized that the GMV increase brought by Youzan Weimall far exceeded the annual service fee charged by Youzan. In 2017, the company released Youzan Retail, Youzan Beauty, Youzan Catering and other services for offline store merchants. In 2018, the company was backdoor listed on the Growth Enterprise Market of the Hong Kong Stock Exchange with the stock code 8083.HK. In the same year, the company teamed up with Kuaishou to launch the "short video e-commerce shopping guide" solution. At present, the company provides powerful SaaS systems with omni-channel operations and integrated new retail solutions, applying PaaS cloud service to create business customization options, while providing extended services such as Youzan Guarantee, Youzan Distribution, Youzan Promotion, etc. As of September 30, 2020, the company has 97,875 paying merchants.

Figure 4: The company's milestone



Source: Company, PSHK

### The company's diversified SaaS products

The company's core products mainly serve the business clients, including Youzan Weimall, Youzan Retail, Youzan Beauty, Youzan Education and etc. Below are the descriptions of these products.

Figure 5: The company's core SaaS products

Products	Description
<b>Youzan Weimall</b>	Positioned as a full-scenario e-commerce solution, divided into single-store version and chain version. Helped merchants to open stores on multiple channels and to achieve massive exposure. It also provides nearly a hundred kinds of marketing services to help increase the GMV. It also provides private traffic management platform for merchants.
<b>Youzan Retail</b>	The omni-channel integrated management tool of the retail business scene and runs through the entire business of the merchant, including store opening, marketing, operation, data decision-making etc. It improves the operating efficiency of the store. It provides invoicing systems, multiple payment methods, multiple marketing methods, management of private domain traffic, customer data analysis and other services.
<b>Youzan Beauty</b>	The solution for the integrated operation of the Beauty chain merchants. It provides a set of software to solve all business needs (including recharge cards and sub-cards, appointment management, billing and cashier services, capital assets, store and online store management, etc.). It provides a wealth of marketing tools specifically designed for the beauty industry to enhance the customer expansion and transaction rate. It also provides a comprehensive membership management system and data analysis, focus on business decision-making in beauty industry scenarios
<b>Youzan Education</b>	Focus on solutions for enrollment and teaching. It services cover the core businesses of the sector such as recruitment, teaching and services. It provides online omni-channel promotion, multi-form online teaching services, efficient educational administration system, and supervisory interaction basis, etc.
<b>Youzan Chain</b>	Positioned as a chain brand multi-store management, multi-channel growth digital operation system. It helps the digitalization of chain brand merchants' stores, shopping guide, marketing, and membership. It provides a central office for headquarters operations, which allows effective controls of the operations of various stores to enhance performance growth. It also provides services that allow authorized franchisees and directly-operated branches to become partners of the chain.
<b>PaaS platform</b>	For large-scale merchants, it provides a series of personalized services beyond the basis of SaaS products, including self-use, tool-based and platform-based products, by gathering third-party development resources.

Source: Company, PSHK

Youzan Weimall is the flagship product among the company's all SaaS products. It is divided into single store version and chain version. The single-store version includes basic version, professional version and flagship version, with annual fee of RMB 6800, 12800 (14800 from 2021 onward), and 26800 (28800 from 2021 onward) respectively. As for the customized version for large merchants, the annual fee ranges from hundreds of thousands. Merchants can subscribe to the appropriate version according to their own scale and needs. The basic version is more suitable for individuals or operation teams with less than three people, the professional version is more suitable for growing e-commerce or store merchants, while the flagship version is more suitable for businesses with a certain scale and operate in multiple business scenarios. In addition, the higher grade the version is, the more the functions it provides. The following are the differences in function of each of the single store version.

Figure 6: The differences in function of each of the single store version

Function	Basic	Professional	Flagship
Annual Fee	RMB 6800/year	RMB 12800/year (RMB 14800 /year from 2021 onward)	RMB26800/year (RMB 28800 /year from 2021 onward)
<b>New Store launching services (新店上線服務)</b>	×	✓	✓
<b>Marketing - Channel</b>			
WeChat Official Account, WeChat Mini Program, Baidu Mini Program, Weibo, Alipay Life Account, Youzan Sogou Input Method, Kuaishou, Wechat Livestream	✓	✓	✓
Seller (銷售員)	×	✓	✓
Community group buying(社區團購)	×	×	✓
<b>Marketing – Marketing Method</b>			
多人拼團、秒殺、限時折扣、優惠碼、優惠券、團購返現、訂單返現、贈品、滿減/送、降價拍、找人代付、我要送禮、心願單	✓	✓	✓
好友瓜分券、砍價 0 元購、打包一口價、優惠套餐、支付有禮、0 元抽獎	×	✓	✓
定金膨脹、週期購	×	×	✓
<b>Marketing – Customer Maintain</b>			
Sign in (簽到), coupon issuance (發券寶), customer service robot (客服機器人)	✓	✓	✓
Reward points (積分商城), Stored value card (會員儲值), fan interactive marketing (互動粉絲行銷)	×	✓	✓
User Portrait (人群畫像)	×	×	✓
<b>Marketing – Operating Analysis</b>			
Data Screen (數據大屏)	×	✓	✓
Heat map (熱力圖)	×	×	✓
Promotion Analysis (推廣分析)	×	×	✓
Single Product Analysis (單品分析)	×	×	✓
Market Insight (市場洞察)	×	×	✓
<b>Marketing - Infrastructure</b>			
Scan code payment(掃碼收款, verification tool(驗證工具), poll survey(投票調查, free shipping tool(包郵工具), electronic statement (電子面單)	✓	✓	✓
Electronic Invoice (電子發票), customer service sales performance report (客服銷售業績報表)	×	✓	✓
<b>Addition function</b>			
The latest marketing/data tools in 2020	×	×	✓
<b>Others</b>			
Account Permission (帳號權限)	3	10	30
Cloud service fee	Free for the first 10k orders	Free for the first 20k orders	Free for the first 40k orders

Source: Company, PSHK



### The company's diverse extended services and transaction services

The company currently holds an internet payment license, so it is capable to provide customers with payment, loan, guarantee and other financial services. Youzan Guarantee is one of the most popular services among merchants. Youzan Guarantee provides endorsement services for customers and help merchants to increase their conversion rates. Due to the weak credibility on social ecosystem, the conversion rate of unfamiliar purchases is low. Generally, the conversion rate of non-fans is less than 1%. Many buyers refuse to trade because of concerns about the quality of goods and after-sales services. Youzan Guarantee can increase the creditworthiness of the social ecosystem and increase the purchase conversion rate for merchants. Youzan Guarantee charges 0.5% of the merchant's GMV as a service fee. If the merchant does not generate any transactions during the business period, Youzan Guarantee does not charge any fees. The followings are the descriptions of Youzan Guarantee functions.

Figure 7: The descriptions of Youzan Guarantee's functions

Function	Description
Youzan Guarantee Logo	When consumers make purchases, the product page and payment settlement page display the Youzan Guarantee logo, so that buyers can shop at ease and have a higher conversion rate
Escrow service	Declare to consumers that the store has paid performance bond for breach of contract
After-sales Mediation	When an after-sales rights protection dispute occurs between a store and a consumer, consumers can apply for Youzan customer service to intervene in mediation, Youzan wholeheartedly assists merchants and consumers in solving after-sales problems, and protects the interests of both buyers and sellers
Insurance compensation	Youzan cooperates with China Life Insurance Company to provide compensation in accordance with "Youzan Guarantee and Compensation Rules" to provide double protection for merchants and consumers
Other rights of Youzan Guarantee	Enjoy the free transfer services for Youzan and 5% off the service fee for return shipping fee subsidy

Source: Company, PSHK

Figure 8: Youzan Guarantee Logo



Source: Company, PSHK



In addition to Youzan Guarantee, Youzan also provides financial services such as 1) fast payment collection, 2) Youzan transfers, and 3) installment payments. Fast payment collection improves liquidity for merchants. After the order is shipped, the factoring company provides financing services for the merchant (a certain percentage of the transaction amount) before the consumer confirms the receipt. After the buyer receives the goods and the seller receives the payment, the merchant will return the financing amount. Through the time differences, the merchants can recover the payment in advance and accelerate their capital turnover. The charge from Youzan for fast payment collection is generally 0.5% of GMV. 2) Youzan transfers allow merchants to transfer payment to meet the need of merchants to transfer funds to other merchants and pay wages to employees. The handling fee charged for Youzan transfer is RMB 1 per transfer. 3) Installment payment can reduce the financial pressure of buyers to purchase high-priced goods and increase the purchase conversion rate. The company charges 0.5%-1.3%/month as an installment fee.

On the other hand, the company also provides a variety of non-financial/insurance extension services, such as 1) Youzanke and 2) Youzan distribution. 1) Youzanke is a product promotion platform launched this year. Currently, it has access to multiple traffic platforms such as WeChat and Kuaishou. Through Youzanke, merchants' products can be connected to different influencers (KOL), and KOLs can also select products that match their fan characteristics through the platform and carried out live streaming e-commerce business (直播帶貨) in exchange for part of the GMV as a commission share. The company, who acts as the technical platform of Youzanke, charges 10% of the commission as revenue. The GMV of Youzanke is growing rapidly every month. The GMV in September is about 8 times that of January. 2) Youzan Distribution provides a distribution market that allows merchants with inventory but lack traffic to connect with merchants that lack inventory but with sufficient traffic. Thereby driving the overall GMV of the merchants. The company generally charges 1%-5% of GMV as a service fee.

#### **Youzan Weimall is connected to multiple traffic platforms, hence merchants can open stores online on multiple channels**

The company's Weimall has the advantage of multiple platforms. Currently, it has cooperated with multiple traffic platforms such as WeChat, Kuaishou, Baidu, Weibo, Momo, Alipay, QQ, Douyu, Xiaohongshu and etc. In addition, merchants can access live streaming platforms such as Kuaishou Live Broadcast and Momo Live Broadcast to stimulate the store's GMV, through Youzan Selling Assistant (有贊賣貨助手). We believe that in the current era of the rise of private traffic management, due to the different user profiles and characteristics of each traffic platform, the company's multi-platform layout can more easily meet the strong demand of merchants for multi-platform store opening and diversified marketing. For example, for merchants selling cosmetics, their female cosmetics can be marketed on platforms that are female oriented (such as Xiaohongshu). At the same time, for the male cosmetics, the merchant can choose to cooperate with a well-known KOL with mainly male fans for live streaming e-commerce (直播帶貨) on Kuaishou. In this way, merchants can enjoy a higher advertising conversion rate, which drives the increase of GMV. On the other hand, for Youzan, diversified traffic platform cooperation can reduce the company's excessive dependence on a single platform.

Figure 9: The company's diversified traffic platform cooperation

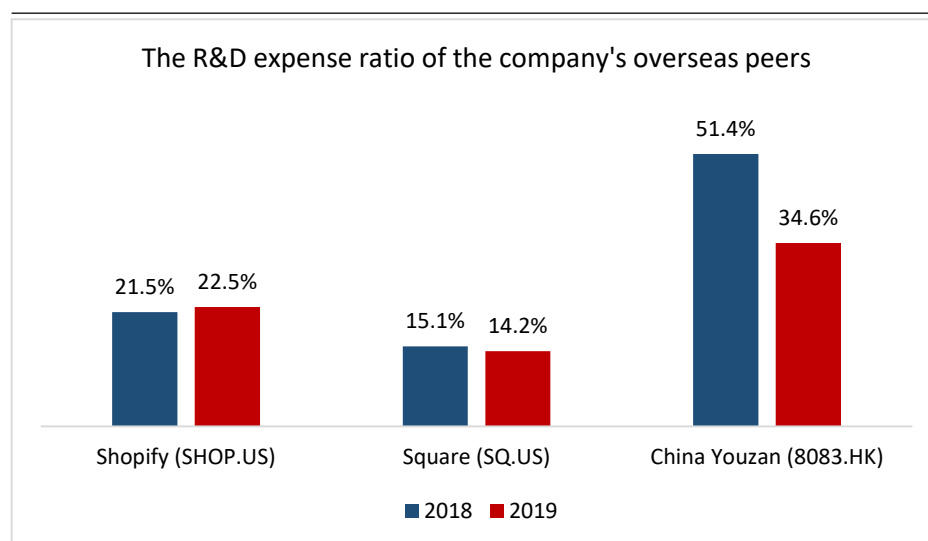


Source: Company, PSHK

### The company focuses on product development and strives to improve user experience and renewal rate

We believe that for SaaS product providers, their future growth potential is closely tied to their product R&D capabilities. Strong R&D capabilities is one of the main moats for SaaS product providers. The company clearly understands the importance of having a strong R&D system, so its investment in R&D is extremely high. As of the end of 2019, the company has more than 1,000 technical personnel, accounting for 36% of the total number of employees. On the other hand, the company's R&D expenses in 2019 were RMB 404 million, and the R&D expense ratio was 34.6%. As the company has more and more SaaS products, the rapid increase in SaaS revenue can bring obvious marginal effects, and the R&D expense ratio is expected to gradually fall. Comparing with its overseas peer Shopify (SHOP.US), as Shopify's SaaS business is relatively mature, although its R&D investment has continued to grow in recent years, the R&D expense ratio can still remain stable at about 20%.

Figure 10: The R&D expense ratio of the company's overseas peers

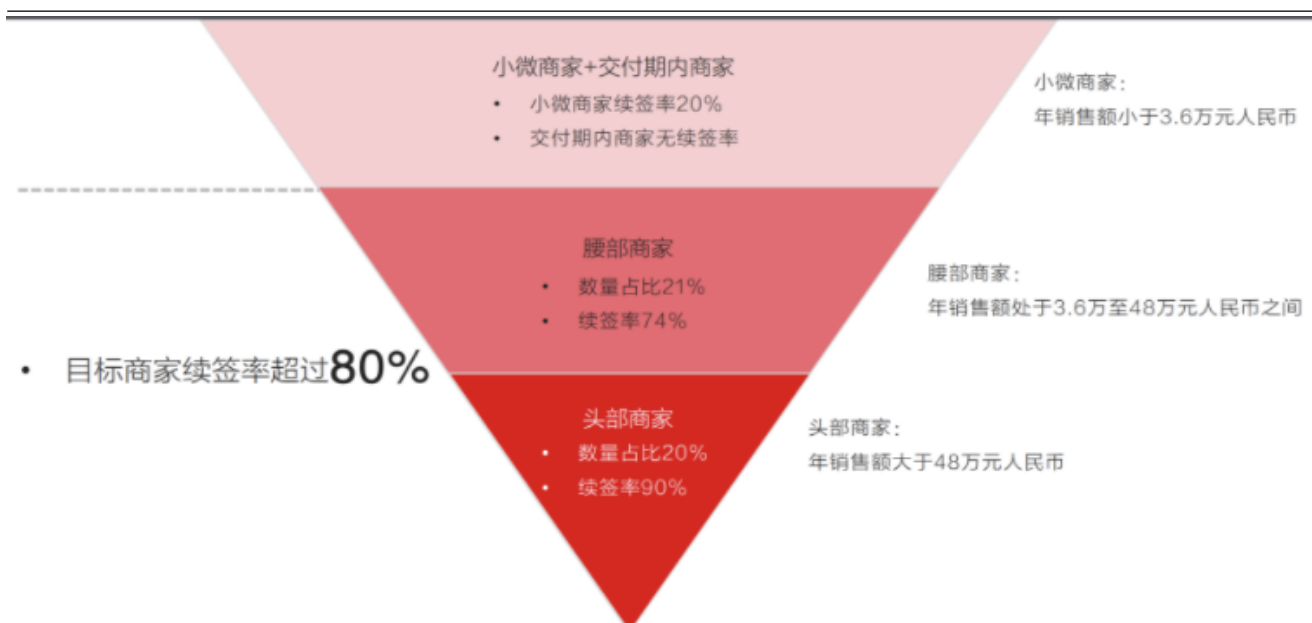


Source: bloomberg, PSHK

Relying on a strong R&D system and investment, the company can continuously polish its products according to the merchants' feedback. At present, the company conducts dozens of functional iterations on its products every month according to the needs of the merchants, and regularly publishes feedback of merchants for the products, as well as the current development progress of the functions built to target the needs of merchants. The company's active interaction with merchants and the ability to meet their needs in real time can effectively allow it to establish long-term partnerships with merchants, thereby increasing merchant renewal rates. As of the end of 2019, the renewal rate of the company's top-tier merchants (annual GMV exceeding RMB 480,000) was as high as 90%. But the renewal rate of small merchants (annual GMV less than RMB 36,000), due to their poor payment ability, was only 20%. Hence the company's overall merchants' renewal rate was only 45% in 2019. However, we believe that the company intends to mainly focus on expanding its proportion of top-tier and mid-tier merchants (annual GMV higher than 36,000). Although the cost of acquiring top and mid-tier merchants is relatively high. Nonetheless, due to the longer life cycle, higher willingness to pay and higher renewal rate of these merchants, the company's SaaS business is expected to become more stable afterward. We believe that in the future, with the gradual effectiveness of the high-mid tier merchants expansion strategy, the renewal rate is expected to reach a higher level.

We believe that maintaining a high renewal rate is particularly important for SaaS product providers. The renewal rate will directly affect the ability of SaaS product providers to achieve profitability. SaaS product providers generally sell products through agents, and for products sold by agents, agents can get part of the sales as sales commissions. Youzan is no different, with most of its SaaS products' sales conducted through agents. The commission share given to agents are accounted in the selling expenses. With that being said, compared with new merchants, the commission share ratio for renewing merchants is lower. According to management, the commission points for new customers are currently 40%-60%, while the commission share for renewing customers is generally 10-15ppts lower than that of new customers. Therefore, the renewal rate has a critical impact on the company's revenue and profit ends. The continuous optimization of the renewal rate can effectively increase the company's SaaS business revenue and reduce the company's overall selling expense rate.

Figure 11: The merchants' renewal rate of the company



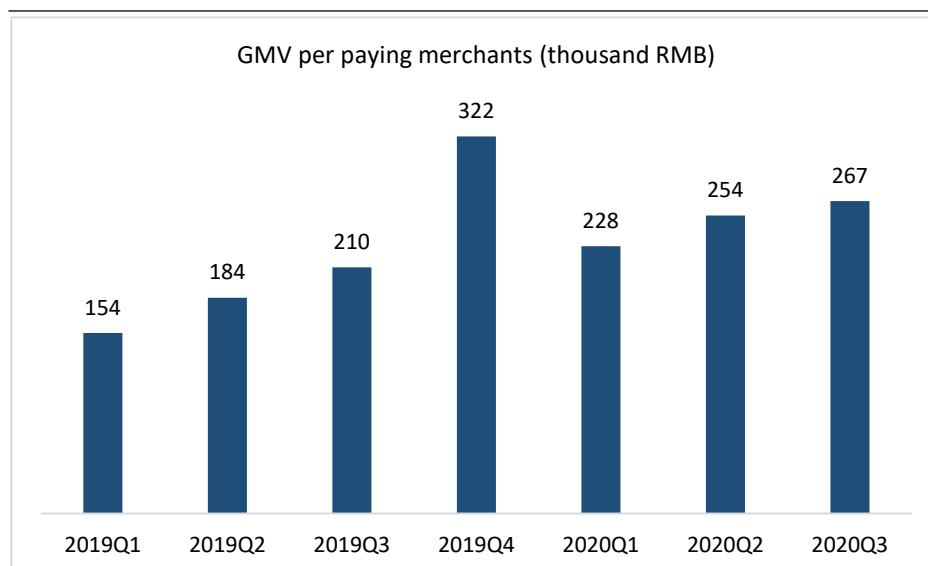
Source: Company, PSHK

### The monetization efficiency on existing merchants is expected to increase

Improving monetization efficiency has always been one of the biggest problems for e-commerce SaaS service providers. Compared with traditional e-commerce platforms, the traditional e-commerce platform's centralized characteristic can continue to bring traffic to merchants, hence traditional e-commerce platforms can enjoy higher bargaining power in the current Internet age where "traffic is king" and also enjoy higher monetization effectiveness. On the contrary, private traffic e-commerce SaaS providers will not actively divert traffic for merchants. Therefore, e-commerce SaaS tool providers lack the ability to monetize traffic, which affects their monetization efficiency and bargaining power to a certain extent. Nevertheless, even without considering new merchants, we believe that the company's monetization efficiency is expected to be further enhanced (for existing merchants). The main reasons are:

1) A tool itself cannot create value for the tool provider. Only when the user of the tool can continuously and effectively generate value by using the tool, can the tool create value. We believe that the average GMV of merchants is one of the more effective indicators to measure merchants' performance improvement. The average GMV per paying merchants (quarterly GMV generated by Youzan SaaS products/paying users as of the end of the quarter) has gradually increased in recent years, from RMB 154,000 in 2019Q1 to RMB 267,000 in 2020Q3. Ignoring the data deviation caused by the churn of low-tier merchants with low average GMV and the increase of top-tier merchants with high GMV, the average GMV of the company's paying merchants has grown hugely, with a CAGR of 44% during the period. As long as merchants realize that the company's SaaS products can effectively increase their GMV, the company will have higher bargaining power, and its SaaS products will have a certain room for price increase. We believe the company can increase its monetization efficiency on existing merchants by increasing the price of SaaS products in the future. Although the company has already announced to increase RMB 2000 in price for Youzan Weimall's professional and flagship version, nonetheless, in a mid-long term perspective, we believe the company's SaaS product still have certain room for price increase.

Figure 12: GMV per paying merchants



Source: Company, PSHK

2) Even if the company's products do not increase in price in the future, the company can still enhance its monetization effectiveness on existing merchants by increasing the ARPU. The overall ARPU (total revenue / paying merchants) of 2019 and 2020Q3 were RMB 14,217/4,924, respectively. We believe that there is still sufficient room for improvement in ARPU in the future. The main reasons are ① As the company's extended services and payment service system further improved in the future, the penetration rate of extended services and payment services is expected to increase, driving the overall ARPU to increase. ② We believe that when a business has a certain degree of trust and recognition for the company's SaaS products, and when the business's scale has grown to a certain extent, they will upgrade to higher-level SaaS products, thereby increasing the company's overall ARPU.

As a whole, we believe that even without considering new paying merchants, the company still has the ability to enhance its monetization efficiency, laying a certain foundation for the company to start generating profit and to achieve SaaS scale effect.

#### **Launched overseas product allvalue, allowing merchants to enter overseas' market**

During the 8th Anniversary Ecological Conference of Youzan on November 27, 2020, Baiya announced that Youzan will launch allvalue, an overseas product, to meet the strong demand for cross-border e-commerce sales from Chinese merchants. The allvalue brand means "All you need to grow is what we value", and once again emphasizes the company's consistent idea to create value for the growth of merchants. Allvalue provides a variety of functions for merchants. The followings are descriptions to some of the functions.

1) Help merchants quickly build online stores, the entire shop opening process is simple to operate, and provides multi-industry and multi-category store templates for merchants to choose. The templates are all designed by international first-class designers to improve buyers' shopping and browsing experience.

2) Access the world's leading social platforms for product sales, including Facebook, Line, Instagram, etc., and provide mobile social communication channels to facilitate buyers to contact merchants and customer service for shopping consultation. Youzan also developed an application for merchants, which is convenient for merchants to effectively grasp store orders and other operating data.

3) Help merchants to carried out social marketing and operate private traffic management in overseas markets. It helps merchants to connect with overseas advertising platforms such as Google, Facebook, etc., and provide merchants with rich marketing tools. In addition, allvalue also provides a socialized customer management (SCRM) system, where merchants can interact with buyers, including the establishment of member discounts, points systems, etc., to stimulate repurchase rates and increase customer loyalty.

The company is expected to effectively assist merchants in entering overseas markets by relying on years of experience in providing online store opening and private traffic management services in China. At the same time, the company has established different operation teams in overseas regions to provide overseas localized services for Chinese merchants to increase the success rate of them going abroad. At present, the overseas e-commerce markets have great growth potential, with the high going-aboard demand from Chinese merchants, we believe that allvalue will become the company's future key growth driver.

Figure 13: GMV per paying merchants

The logo for allvalue, featuring the word "allvalue" in a blue, lowercase, sans-serif font. The dot on the "e" is a small orange circle.

All you need to grow is what we Value

倾 注 全 力 为 你 的 增 长 创 造 价 值

Source: Company, PSHK

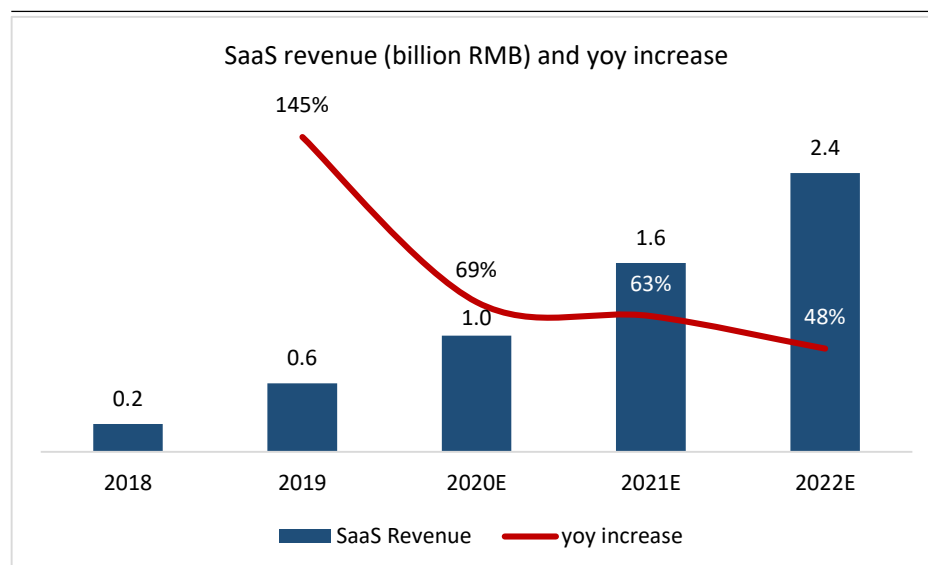
## Financial Analysis and Forecast

### Revenue

The company's revenue is composed of three business segments, SaaS and extended services, transaction services and other businesses. The company's total revenue rose from RMB 586 million in 2018 to RMB 1.171 billion in 2019, an increase of 99.7%. The company's SaaS and extended services/transaction services/other business revenues accounted for 53.4%/40.2%/6.3% and 63.6%/28.5%/7.9% of revenue in 2018 and 2019, respectively.

In terms of breakdown, the company's SaaS business revenue in 2018/2019 was RMB 242 million/RMB 593 million, an increase of 145%. This huge growth was mainly driven by the simultaneous growth of the number of paying merchants and the ARPU of merchant SaaS services. The number of paying merchants in 2019 was 82,300 (+39.6% yoy) and the ARPU of the SaaS business in 2019 was RMB 7,200 (+75% yoy). We believe that the number of paying merchants and the ARPU of the company's SaaS business still has huge potential for growth in the future. Considering 1) The renewal rate will gradually increase due to the continuous expansion of top and mid-tier merchants in the future. 2) The popularity of the private traffic management e-commerce model will further increase in the future. 3) The digital transformation trend of offline merchants will continue in the future. We expect the company's paying merchants to reach 169,000 in 2022 with 2019-2022 CAGR of 27.0%. On the other hand, we believe that the ARPU of the SaaS business can rise steadily in the future because 1) the continuous increase in proportion of top and mid-tier merchants will drive ARPU upward 2) the upgrade of higher level SaaS products by merchants as a result of increasing degree of trust on the company's SaaS products from merchants, will also drive ARPU upward 3) the future increase in price of SaaS products (including the recent rise of price in 2021) will also likely to increase the company's future SaaS ARPU. Based these assumptions, we predict that the SaaS business ARPU in 2022 will reach RMB 14,300, and the CAGR will be 26% in 2019-2022. In conclusion, we estimate that the company's SaaS business revenue in 2020/2021/2022 to be RMB 1.00/1.63/2.41 billion, representing a yoy increase of 69%/63%/48% respectively.

Figure 14: SaaS revenue and yoy increase

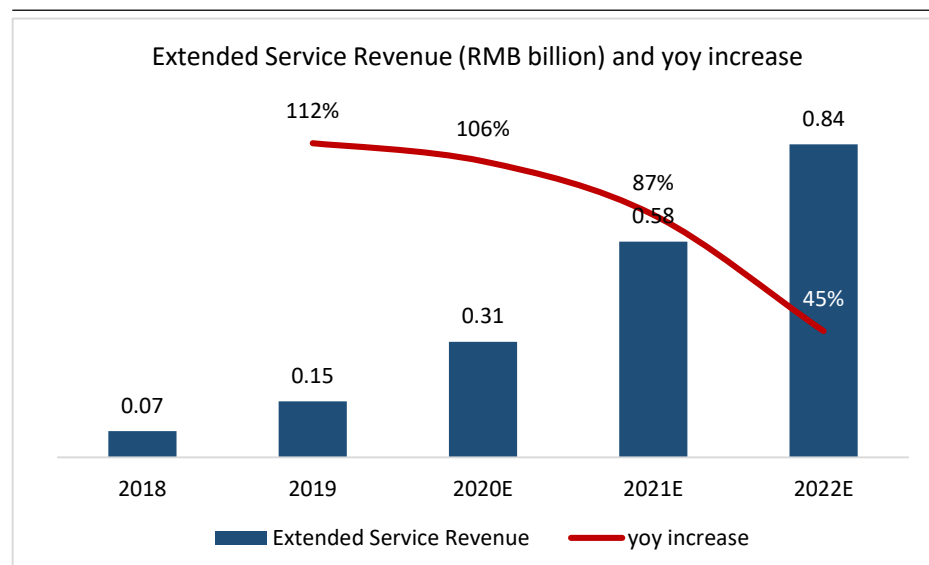


Source: Company, PSHK



As for the company's extended services, it rose from RMB 70 million in 2018 to RMB 150 million in 2019, an increase of 112%. This increase is mainly due to the increase in merchant GMV (the charging method for extended services is generally linked with the GMV) and the increase in the penetration rate of company extended services. The overall GMV of the company's merchants in 2018/2019 was RMB 33.0 billion / RMB 64.5 billion, and it increased by 65.5% in 2019. On the other hand, the take rate of extended services (extended service revenue/GMV, this ratio can be used to measure the company's extended service penetration rate) in 2018/2019 were 0.21%/0.23% respectively. Looking ahead, we believe that the further popularization of private traffic e-commerce system in the future will drive the increase in total GMV of the company's merchants. It is estimated that GMV will reach RMB 195 billion in 2022, with CAGR in 2019-2022 at 44.6%. Meanwhile, we believe as the company's extended services system continue to further improve, the extended service penetration rate/take rate will gradually increase. We predict the take rate of extended services to be 0.43% in 2022. To sum up, we estimate that the company's extended service revenue for 2020/2021/2022 to be RMB 309/578/839 million, representing a yoy increase of 106%/57%/45% respectively.

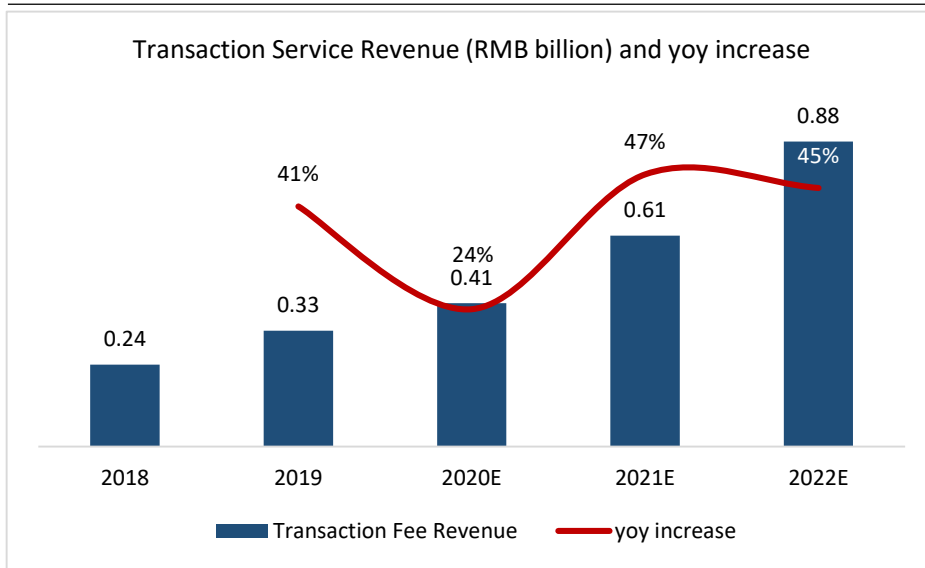
Figure 15: Extended service revenue and yoy increase



Source: Company, PSHK

For the company's transaction services business, revenue rose from RMB 240 million in 2018 to RMB 330 million in 2019, an increase of 41%. This increase was mainly due to the increase in merchant GMV (transaction fee income is linked to GMV), but at the same time it was offset by the shrinking of the company's original payment business. The transaction service take rate (transaction fee income/GMV) also dropped from 0.715% in 2018 to 0.517% in 2019. We believe that the company will continue to shrink its original payment business in the future, and the company's future payment business will mainly serve SaaS merchants in order to complete and enhance the closed loop of the e-commerce transaction ecosystem. Therefore, we predict that the company's future transaction service take rate will continue to remain at low level, estimated to be about 0.4%-0.45%. Based on this assumption, we estimate that the company's transaction fee income for 2020/2021/2022 to be RMB 413/607/877 million, representing a yoy increase of 24%/47%/45% respectively.

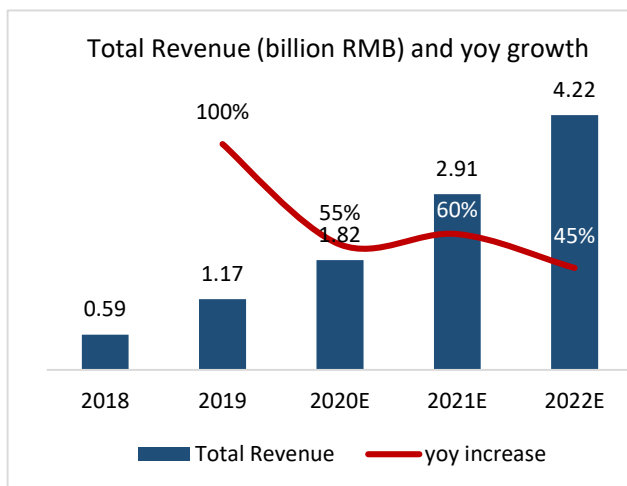
Figure 16: Transaction service revenue and yoy increase



Source: Company, PSHK

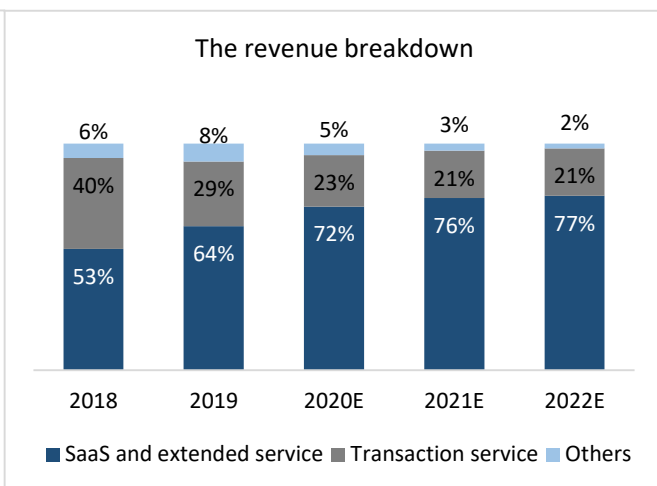
Because the company's other revenue business segment is not one of the company's core business, it includes advertising business and some leftover businesses. Therefore, we do not make future revenue forecasts for the segment. The revenue remains the same for 2020/2021/2022. Overall, we predict that the company's total revenue for 2020/2021/2022 will be RMB 1.82/2.91/4.22 billion, representing a yoy increase of 55%/60%/45% respectively.

Figure 17: Total revenue and yoy growth



Source: Company, PSHK

Figure 18: The revenue breakdown

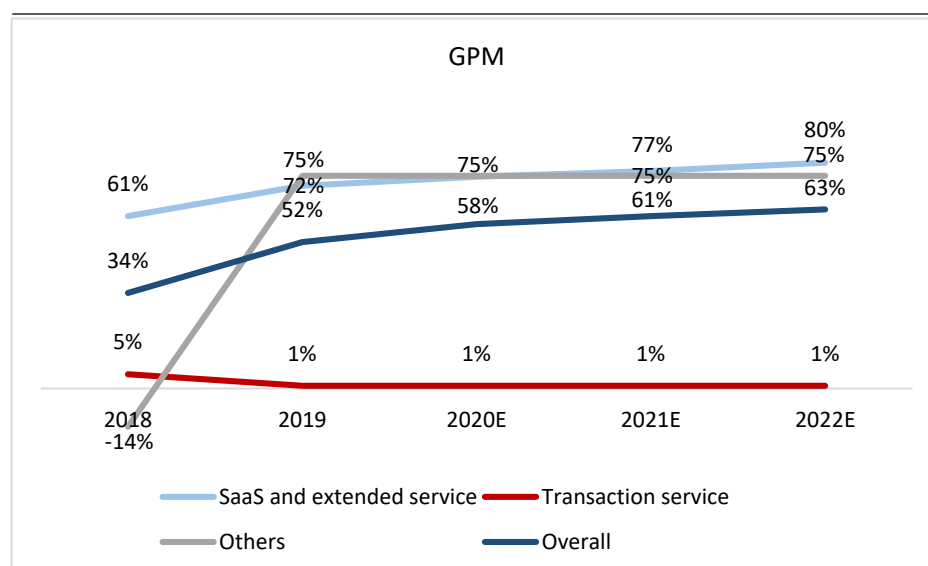


Source: Company, PSHK

## Gross Profit Margin

The company's gross profit margins in 2018/2019 were 33.8%/51.9%, an yoy increase of 18.1 pts in 2019. This increase was mainly due to 1) the increase in the proportion of revenue from SaaS and extended services (higher gross profit margin). 2) At the same time, the gross profit margin of SaaS and extended services increased by approximately 10ppts due to the large increase in the number of merchants. In terms of segments, we believe that the company's GPM of SaaS and extended service business will continue to rise in the future, mainly due to 1) SaaS scale efficiency 2) the expected increase in extended service penetration rate. We forecast it to be 75%/77%/80% in 2020/2021/2022. As for the payment service business, since the company's payment platform is mainly positioned as the infrastructure of the SaaS business, the fees it collects from the merchants are basically the same as those charged by the third-party payment platforms (such as WeChat Pay and Alipay) that it connects to, hence we predict the GPM for this segment to be below 1% in the future. Overall, we forecast the company's gross profit margin for 2020/2021/2022 to be 58%/61%/63%.

Figure 19: GPM

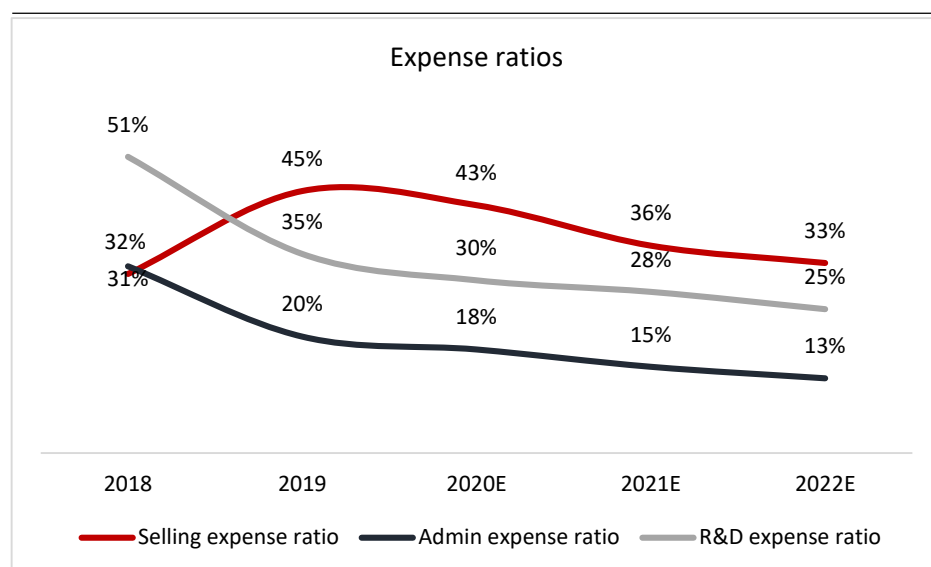


Source: Company, PSHK

## Expense ratio

We believe that with the increase in the merchant renewal rate and the increase in the proportion of extended service revenue in the future, the company's selling expense ratio is expected to gradually decline. We forecast the selling expense ratio of the company in 2020/2021/2022 to be 43%/36%/33%. At the same time, the admin expense ratio and R&D expense ratio (included in other operating expenses and equity-settled share-based payments) are also expected to decline correspondingly with the high growth of income (scale effect). We forecast the company's admin expenses ratio for 2020/2021/2022 to be 18%/15%/13%, and the R&D expense ratios for 2020/2021/2022 to be 30%/28%/25%.

Figure 20: Expense ratios



Source: Company, PSHK

## Valuation

Since the company is still in the early stages of development and has not yet recorded a profit, we use the PS ratio to value the company. We believe that the core businesses of the US-listed Shopify (SHOP.US) is similar to the company, both of which provide merchants with shop opening services, value-added services and payment services. As of January 6, 2021, Shopify's 2022 forecast market-sales ratio is 27.2x, but considering that Shopify's business development is relatively mature and future growth stability is relatively high, we will give the company a certain amount of valuation discount to Youzan. We are giving the company a 2022 target PS of 25x. Taking into account that the company's listed entity currently holds 51.9% of the shares of Qima Technology (Youzan's operating body), we give the company a 10% control premium, and the **24-month** target price is HKD3.96, with respective 2020/2021/2022 PS at 63.7x/39.8x/27.5x. We initiate with a Buy rating. (Market closing price as of 6 Jan) (exchange rate: RMB 0.88/HKD)

Figure 21: Comps Table

Company	Stock code	Closing Price	Market Cap	PE				PS			
				TTM	2020E	2021E	2022E	TTM	2020E	2021E	2022E
(listed currency)			(RMB mn)								
e-commerce SaaS companies											
China Youzan	8083 hk equity	2.92	41,970	-	-	-	-	25.6x	22.3x	14.9x	10.2x
Weimob	2013 hk equity	17.32	32,533	96.2x	-	163.9x	82.4x	20.6x	14.6x	9.9x	7.4x
Shopify	SHOP US equity	1092.40	882,680	-	301.2x	299.3x	238.2x	-	48.2x	36.7x	27.2x
Square	SQ US equity	221.16	669,077	-	312.2x	205.5x	121.0x	13.2x	11.0x	8.2x	7.1x

Source: Bloomberg, PSHK

Market closing price as of 6 Jan, US stocks closing price as of 5 Jan

## Risk

1) The company is listed on HKEX GEM board, which may have higher risk and volatility comparing to stocks on HKEX main board 2) The expansion of SaaS customers is worse than expected 3) The increased industry competition 4) GMV increase less than expected 5) Merchants renewal rate less than expected

## Financial Statements

### Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	FY18	FY19	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>586</b>	<b>1171</b>	<b>1818</b>	<b>2908</b>	<b>4216</b>
SaaS and extended services	313	744	1313	2209	3246
Transaction fee	236	334	413	607	878
Others	37	93	93	93	93
<b>Gross Profit</b>	<b>198</b>	<b>608</b>	<b>1059</b>	<b>1776</b>	<b>2675</b>
S&M expense	-182	-532	-782	-1047	-1391
Admin expense	-190	-237	-327	-436	-548
R&D expense	-301	-405	-546	-814	-1054
Other expense	-275	-266	0	0	0
Other operating gain/(loss)	-36	-174	0	0	0
<b>Operating Profit</b>	<b>-787</b>	<b>-1006</b>	<b>-596</b>	<b>-521</b>	<b>-319</b>
Net finance income	15	-12	-3	-6	-5
Other non-operating gain/(loss)	0	5	0	0	0
<b>Profit before tax</b>	<b>-772</b>	<b>-1012</b>	<b>-599</b>	<b>-527</b>	<b>-324</b>
Tax	46	97	47	41	25
NCI	294	324	221	194	119
<b>Profit for the year</b>	<b>-431</b>	<b>-592</b>	<b>-332</b>	<b>-292</b>	<b>-179</b>
<b>EPS (RMB)</b>	<b>-0.039</b>	<b>-0.040</b>	<b>-0.019</b>	<b>-0.017</b>	<b>-0.010</b>

### Key Financial Data

Dec Y/E	FY18	FY19	FY20E	FY21E	FY22E
<b>Valuation Ratio</b>					
P/E ratio, x	N/A	N/A	N/A	N/A	N/A
P/S ratio, x	94.5	63.0	47.0	29.4	20.3

### Per share data (RMB)

EPS	-0.04	-0.04	-0.02	-0.02	-0.01
Revenue per Share (51.9%)	0.03	0.04	0.05	0.09	0.13

### Growth & Margin

Revenue Growth	N/A	99.7%	55.3%	59.9%	45.0%
Operating income growth	N/A	N/A	N/A	N/A	N/A
Net income Growth	N/A	N/A	N/A	N/A	N/A
Gross Profit Margin	33.8%	51.9%	58.2%	61.1%	63.4%
Operating profit Margin	-134.2%	-85.9%	-32.8%	-17.9%	-7.6%
Net Profit Margin	-73.6%	-50.6%	-18.2%	-10.0%	-4.2%

### Key Ratios

ROE, Adj	-11.1%	-15.2%	-8.0%	-8.0%	-5.4%
ROA, Adj	-6.5%	-5.6%	-3.0%	-2.6%	-1.6%

Source: Company, PSHK Estimate

Market closing price as of 6 Jan

### Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY18	FY19	FY20E	FY21E	FY22E
<b>Non Current Asset</b>					
PPE	38	61	90	132	194
ROU assets	0	205	202	200	197
Intangible assets	1825	1632	1450	1288	1144
Capitalised contract costs	21	10	35	25	55
Others	2394	2253	2253	2253	2253
<b>Total Non Current Assets</b>	<b>4278</b>	<b>4161</b>	<b>4031</b>	<b>3898</b>	<b>3844</b>
<b>Current Asset</b>					
Capitalised contract costs	70	119	159	213	281
Inventories	2	2	2	2	2
Prepayments	408	924	1062	1221	1405
Cash and cash equivalents	400	746	1380	1290	1392
Others	1525	4547	4547	4548	4547
<b>Total Current Assets</b>	<b>2406</b>	<b>6337</b>	<b>7150</b>	<b>7274</b>	<b>7626</b>
<b>Total Assets</b>	<b>6684</b>	<b>10499</b>	<b>11181</b>	<b>11172</b>	<b>11471</b>
<b>Non Current Liabilities</b>					
Contract liabilities	56	48	135	172	279
Lease liabilities	0	184	182	179	176
Others	287	261	261	261	261
<b>Total Non Current Liabilities</b>	<b>343</b>	<b>493</b>	<b>578</b>	<b>612</b>	<b>717</b>
<b>Current Liabilities</b>					
Trade payables	6	4	10	11	17
Settlement obligations	1757	5070	5070	5070	5070
Contract liabilities	259	407	768	1208	1696
Others	434	627	627	627	627
<b>Total Current Liabilities</b>	<b>2456</b>	<b>6107</b>	<b>6474</b>	<b>6915</b>	<b>7409</b>
<b>Equity</b>					
Share capital	111	129	129	129	129
Reserve	3217	3530	3982	3690	3511
Non controlling interest	556	241	19	-175	-294
<b>Total Equity</b>	<b>3884</b>	<b>3899</b>	<b>4130</b>	<b>3644</b>	<b>3345</b>
<b>Total Liabilities and Equity</b>	<b>6684</b>	<b>10499</b>	<b>11181</b>	<b>11172</b>	<b>11471</b>

### Cashflow Statement

Dec Y/E, RMB mn	FY18	FY19	FY20E	FY21E	FY22E
<b>Profit (loss) before tax</b>	<b>-772</b>	<b>-1012</b>	<b>-599</b>	<b>-527</b>	<b>-324</b>
Depreciation and amortization	210	419	249	238	234
change in working capital	-759	-354	250	275	319
Others	307	331	50	47	30
<b>CFO</b>	<b>-1014</b>	<b>-616</b>	<b>-50</b>	<b>33</b>	<b>259</b>
Capex	-27	-43	-53	-78	-115
Others	966	-9	4	5	8
<b>CFI</b>	<b>939</b>	<b>-52</b>	<b>-50</b>	<b>-73</b>	<b>-107</b>
<b>CCF</b>	<b>224</b>	<b>954</b>	<b>735</b>	<b>-51</b>	<b>-50</b>
<b>Net Change in Cash</b>	<b>149</b>	<b>285</b>	<b>635</b>	<b>-91</b>	<b>102</b>
Foreign exchange	19	31	0	0	0
Recognised in FVTPL	-31	0	0	0	0
<b>Cash and CE at Y/E</b>	<b>400</b>	<b>746</b>	<b>1380</b>	<b>1290</b>	<b>1392</b>

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm 5\%$ from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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