
Bin Yuan Capital All China Strategy – Aug 2016

Market Update

The markets of Hong Kong and China A were boosted by the news of Shenzhen-Hong Kong Stock Connect, which was expected to be launched by the end of the year. Related A-H arbitrage, brokerage, insurance companies, high yield stocks plus Tencent powered the HSI index to calendar year high.

During the month, Information technology, financials and utilities were the top 3 contributors while some of our small cap holdings were out of favor in Hong Kong Market. There are no fundamental changes to these companies and the businesses are on track. We have confidence in our holdings and expect the performance to recover in the next few quarters.

Local Observation and Portfolio Positioning

We have discussed the trend of structural changes towards service in China in the past. The golden era of investment opportunities in consumption/service space comes to the stage. Firstly, the user base of service and upgraded consumption is set to grow fast. Secondly, the capability of monetization is at sweet spot with scalability. Based on our data and grassroots diligences, a group of people ‘Town Youth’ play increasingly significant role in service consumption. The group is defined as young people living in lower tier cities.

Bigger user base

The participation of ‘Town Youth’ enlarged user base of service space, especially in entertainment, social networking and tourism...etc.

The factors that drive the rise of service consumption include increasing disposable income, lower property burden and connectivity between tier one and lower tier cities. Wage growth kept double digit growth annualized in the past 5 years cross regions in China. Specifically to ‘Town Youth’, relatively lower cost of living in township and lower tier cities enables them to have more money spent on upgraded consumption items. Data from National Bureau of Statistics in China shows 41.98% of expenditure in upgraded consumption in Hebei Province, which is 4% higher than that of Beijing.

Internet and social network narrows the distance between ‘Town Youth’ and metropolitans. Five years ago, one of our current holdings Weibo was simply regarded as the Chinese equivalent to Twitter that enables users in large cities to share short 140-character messages through website. Now, Weibo is the most influential social media platform in use by well over 282 million of daily active users and still fast growing. According to Weibo’s annual report, over 80% of users are below 35 years of age. Weibo provides a platform for companies, public figures, celebrities and

government organizations to speak out their voices and discuss personal and social topics with a level of freedom. It is not only an online social platform but also a place to participate in public conversations. Users from either 'Metropolitan Youth' or 'Town Youth' enjoy the equal dignity in Weibo to share their interests, joys, opinions and others. 'Town Youth' even shows more enthusiasm in the fashions of celebrities, music and TV shows. The regional convergence in Weibo shows more evidences of that the urban-rural gap between internet users is reducing.

Easier monetization

It is arguably that the aesthetic preference of 'Town Youth' has fundamentally shaped the paradigm of China's consumption pattern. The economic magnitude that comes with it can also be considerable. We have witnessed the 'The Herd Effect' among 'Town Youth'. Since 'Town Youth' share the similar aesthetic pursuit, what is in fashion (or what they recognized as fashion) can easily be spread and accepted. This effect is traceable from the movies, online games and live shows. Since a few 'leading sheep' start to pay for those services, more will follow. The convergence of interests enhances the scalability and bodes well for monetization and investment efficiency. With the help of 'Town Youth', the box office of single movie 'Mermaid' reached 3.3 billion RMB and the games 'Crossfire' and 'Dungeon and Fighter' of our holding Tencent recorded revenue of 1.11 billion USD and 1.05 billion USD respectively.

The bigger user base and more active interaction will enhance the value of advertisement. It is proven that Weibo has become a powerful digital communications and marketing channels for companies to market their products and services. It has successfully developed rich media functions like text, images, links, videos, music, emoticons, short video and even live video to diversify advertisement as much as possible. Weibo covers a broad range of China's internet population, including entertainment stars, domestic and international celebrities, CEOs, professionals, media personalities and youth. We believe companies or merchants would like to make very good use of this platform to reach more people and increase audience engagement, which differs from traditional marketing and communications strategies. Moreover, thousands of Weibo celebrities and Key Opinion Leaders turn into successful entrepreneurs after they attract large number of followers.

Effective cross-selling on platform will further improve profitability. After the success of games 'Crossfire' and 'Dungeon and Fighter', we continue to see significant opportunity for Tencent to monetize its vast social network user base. Tencent has well over 853 million monthly active users in 300 cities. By leveraging Tencent's large entertainment ecosystem, it is capable to crosssell online games, music, dramas, movie and advertisement to its large users across QQ, mobile QQ and Wechat. More than 400millions of 'Town Youth' will make greater contribution to support a higher ARPU of Tencent in the future.

In our portfolio, we select the best consumption/service names with fast growing loyal users and scalable business model of monetization.

Sincerely,



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