H&A
GLOBAL INVESTMENT
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ASIA SPOTLIGHT

A German and Chinese Friendship

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Welcome to the second edition of "Asia Spotlight". Every single edition will discuss a different industry segment. H&A Global Investment Management, as the European Asset Management Hub within the Fosun Group, combines Direct Industry Insights by Fosun Industry Teams and Asia Financial Asset Management Expertise provided by Fosun Asset Management (FAM).

We will take a closer look on China's regulatory environment for the Chinese tech sector and point out although a strong recovery in the equity multiples remains uncertain for the time being, the industry is well positioned for a short-term recovery and we are optimistic about the sector's overall resilience.

A quick view on China's regulatory environment for the Chinese tech sector

Most recently, the focus in China has firmly shifted back to the challenges within real estate sector and potential knock-on effects on other sectors like the wealth management and pharmaceutical industry.

This has diverted attention away from the broader tech sector and its lackluster performance. The reason for this weak performance (see Chart 1) is basically that over the past two years, China's tech companies have been operating under a challenging regulatory environment with officials repeatedly criticizing companies for various violations such as data privacy violation and monopolistic behavior, among **many others.**

Nevertheless, since late 2022, we have observed that Beijing's approach starts to soften and gradually shifts to a more supportive tone. Since 2023, authority's priorities are increasingly emphasizing on revitalizing the online platform sector as one of the engines to support China's economic recovery[1].

» This might be a solid basis for recovery of the sector. «

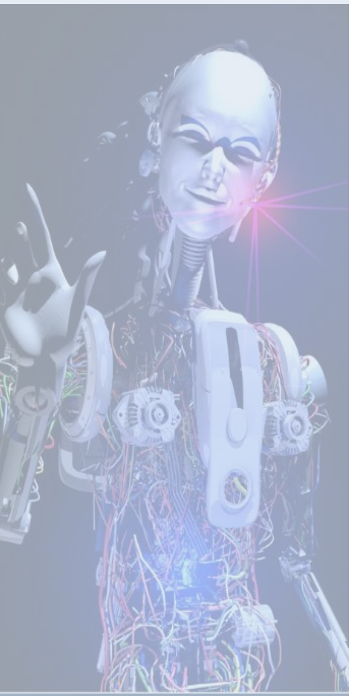
A difficult period for the Chinese techs

In late 2020, China initiated a regulatory storm against the Big Tech firms out of concerns that the major internet platforms like Alibaba, Meituan and Didi were becoming too powerful.

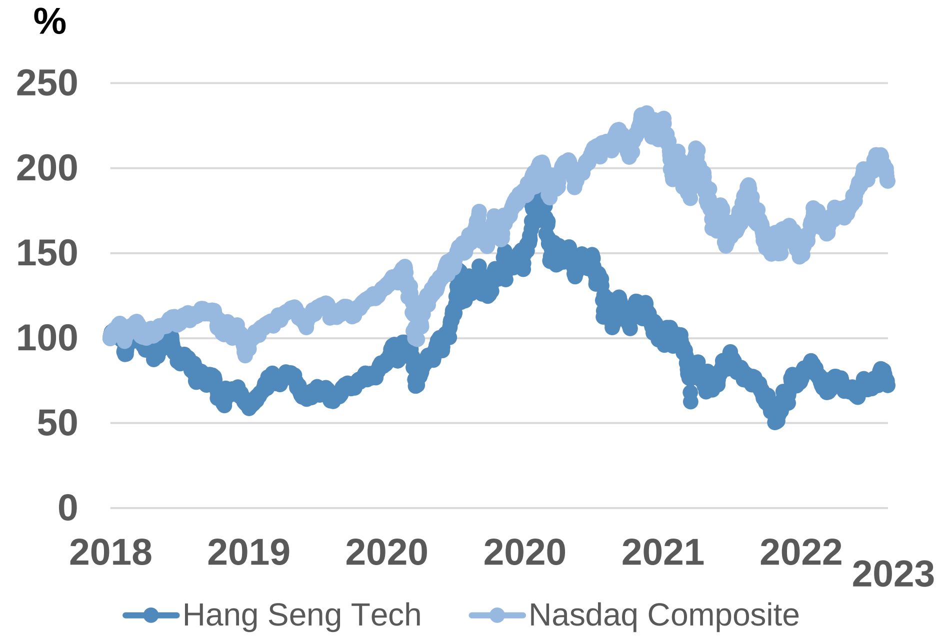
Since then, China has taken a number of steps to establish a more regulated operating environment for the internet sector. Between 2020 and early 2022, the regulatory authorities have pursued several landmark cases, amended the Anti-Monopoly Law, proposed updates to the Anti-Unfair Competition Law, and took a significant step in strengthening its data protection by adopting the Personal Information Protection Law (PIPL). Many of the initiatives have targeted antitrust, data and algorithm security, fintech regulation, and gig workers' rights, among other areas.

During this period of regulatory tightening, the Chinese tech names experienced a sharp de-rating of their valuations due to destruction in investor confidence and uncertainties associated with the long-term stability in the operating environment of China[1].

> *Since 2022 regulatory pressure started to ease*



Hang Seng Tech Index posted negative return over the past 5 years and underperformed Nasdaq



Rolling Performance

	Hang Seng	Nasdaq
08.18-08.19	-33,3%	15,9%
08.19-08.20	100,6%	42,0%
08.20-08.21	-13,5%	29,6%
08.21-08.22	-32,7%	-10,7%
08.22-08.23	-4,4%	2,5%

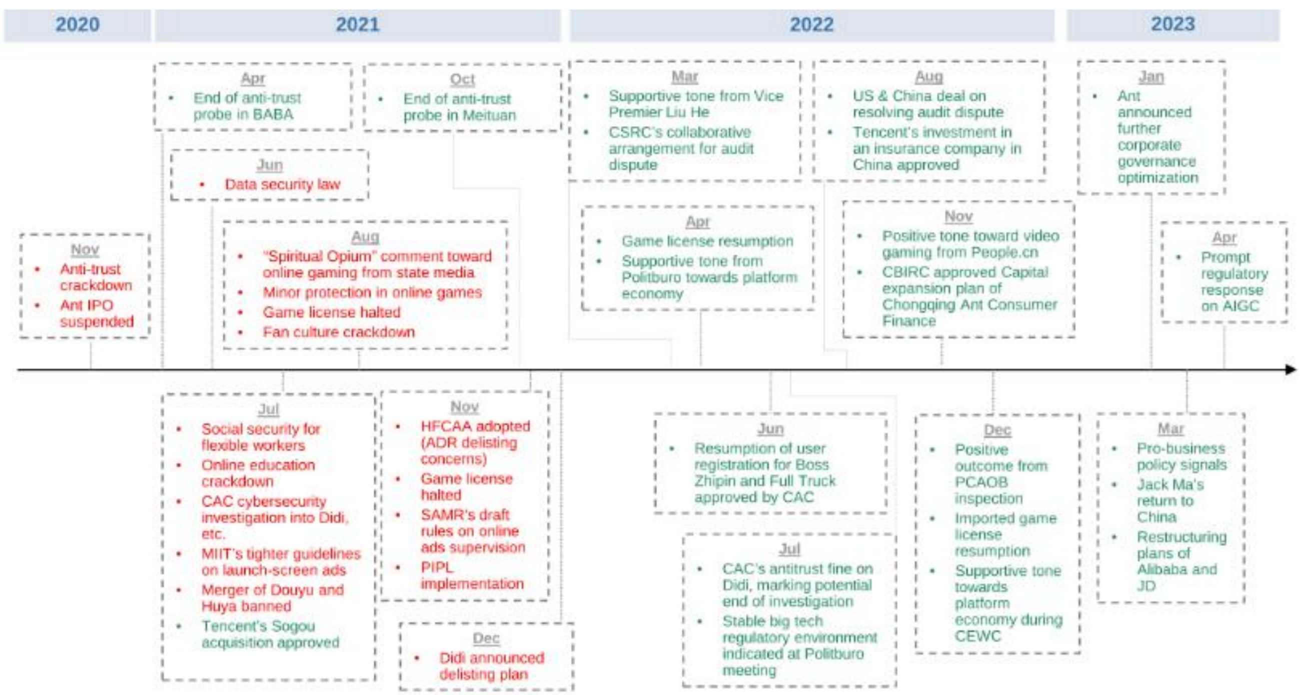
Relative Performance (Hang Seng Tech Index vs. Nasdaq Composite); Source: Bloomberg, observation period: 01.01.2018 – 18.08.2023 I FAM research

Early signs of easing

Since 2022, regulatory pressure started to ease. The tech sector moved into a more normalized regulatory environment, as showcased by a series of early signs including supportive tone from Vice Premier Liu He in March 2022, followed by game license resumption in April, resumption of user registration for Boss Zhipin – an online recruitment platform – in June and Cyberspace Administration of China (CAC)'s antitrust fine on Didi (mobile transportation operator) in July.

Moving in to the second half of 2022, the market gained further confidence toward the video gaming industry and platform economy. This, combined with China reopening its economy in late 2022 restored some of the previously lost confidence[1].

In this following chart we show how major regulatory initiatives have moved from tightening (red) to supporting (green)[2].



Source: Bloomberg, FAM research, Morgan Stanley research

Regulatory inflection

Moving into 2023, China's Internet industry continued to improve on the back of an easing regulatory tone.

In July 2023, the People's Bank of China imposed fines on Ant Group and Tencent, marking an end to regulatory probes. On 12th July, China's National Development and Reform Commission (NDRC) praised Alibaba, Tencent and Meituan for their investments in key technology areas. Later on, Premier Li Qiang presided over a symposium with platform enterprises to listen to opinions and suggestions for promoting the standardized and healthy development of the platform economy.

Bloomberg, Company Report, as of 01.06.2023

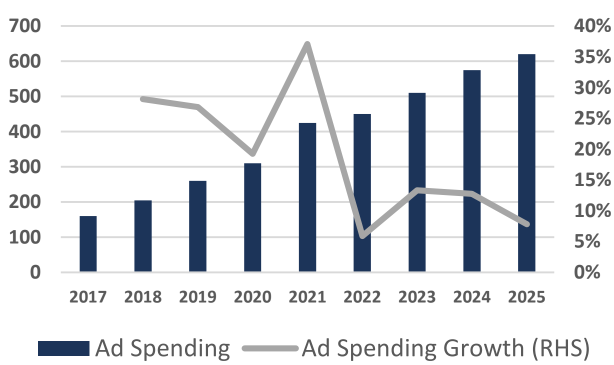
Representatives from companies such as Meituan, Xiaohongshu (social media and e-commerce platform), Alibaba Cloud, and Douyin (TikToks Chinese Version) delivered speeches, while representatives from PDD, JD.com and others submitted written statements. Overall, this marks the regulatory inflection point and is widely viewed as an indication of a more easing regulatory cycle ahead.

The tech sector well positioned for a near term recovery

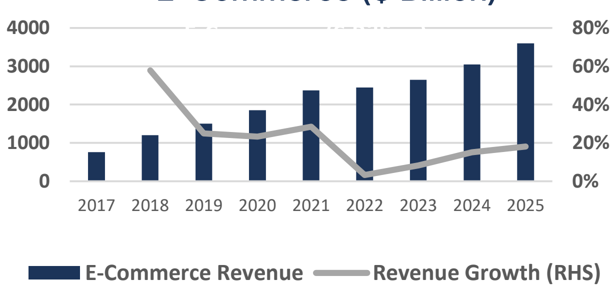
Going forward, we expect a continuation in the positive regulatory environment for the big tech companies in China.

Since early 2023, the market has already witnessed encouraging recoveries across the tech sector. For example, with the resumption in gaming license, leading gaming companies (both Tencent and Netease) have posted healthy recovery in gaming revenue in Q1 and are expected to deliver growth acceleration for the rest of the year driven by a wave of new launches.

Online Advertising ($ Billion)

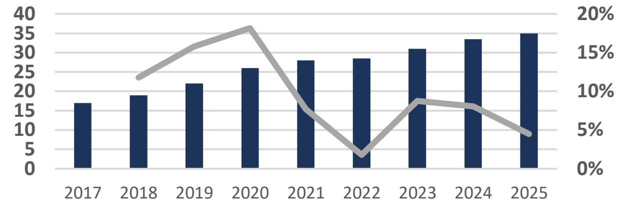


E-Commerce ($ Billion)



The digital ads sector, having thrived through a period of dampened demand due to both macro headwind and regulatory tightening on specific sectors such as Education and Financial Services, is gradually returning to an upward trending on the back of robust e-commerce demand. In the financial service sector, Tencent, in early 2023, launched Fenfu – an installment loan product – for selected WeChat Pay, a mobile payment and digital wallet service by WeChat based in China, that allows users to make mobile payments and online transactions) users, indicating that as the Fintech regulatory headwinds come to an end, companies are gathering up momentum to pursue growth.

Online Gaming ($ Billion)



Source: Statista, as of August-2023
https://www.statista.com/outlook/dmo/digital-advertising/china#ad-spending
https://www.statista.com/outlook/dmo/ecommerce/china

In Summary: We believe the increasingly supportive regulatory tone is largely driven by 1) big tech's important role in supporting China's economic recovery as Premier Li Qiang urged the big techs to do more to support the economy amidst a weaker than expected post-covid recovery; and 2) official's prompt support for the development of generative AI in the country. Regulators are increasingly recognizing platforms' roles in driving technological innovation, transforming traditional industries, and enhancing China's global competitive-ness.

From a valuation perspective, investor confidence on the Chinese tech names has been severely hit over the past few years, primarily due to the lack of longer-term visibility on the operating environment. Hence, we do not envision a strong recovery in the equity multiples of the sector for now and expect future share price upside be driven, to a greater extent, by earnings expansion. We believe the tech names are well positioned for a recovery in the near term and are optimistic towards the sector's general recovery.

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Sources I Calculation basis

1) *FAM assessment, based on Bloomberg data and Morgen Stanley Research.*
2) *Market sizes are determined by a combined top-down and bottom-up approach, based on a specific rationale for each market segment. As a basis for evaluating markets, we use annual financial reports of the market-leading companies and industry associations, third-party studies and reports, survey results from our primary research (e.g., Statista Global Consumer Survey), data on shopping behavior (e.g., Google Trends, Alibaba Trends), and performance factors (e.g., user penetration, price/product). Furthermore, we use relevant key market indicators and data from country-specific associations such as GDP, consumer spending, internet penetration, and population. This data helps us estimate the market size for each country individually.*