

**E-COM
MONTHLY
UPDATE**



GLOBAL RETAIL RESEARCH



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GLOBAL RETAIL
RESEARCH & INTELLIGENCE
Fung Business Intelligence Centre

SEPT • 2014



FROM THE DESK OF DEBORAH WEINSWIG

Hello Everyone,

It has been an exciting month for e-commerce and innovation, as Alibaba went on tour to pitch the sale of its shares to potential investors eyeing the e-commerce market in China and beyond. The much-anticipated IPO could potentially raise \$24.3 billion or more, and is on track to become the world's largest IPO. The company's last filing released September 5 valued Alibaba at \$155 billion, just below Amazon.com, Inc.'s \$160 billion market capitalization. Since then, high demand has inspired the company to raise the range for its IPO price to \$66-\$68, which would value it around \$165 billion and make it the third largest Internet company listed in the U.S., after Google and Facebook. Alibaba's founder and Executive Chairman Jack Ma voiced his intent to expand aggressively in the U.S. and European markets after its NYSE listing.

A couple of other key events were also on our radar this reporting period, including Baidu's release of "Baidu Eye" (its version of Google Glass) and smart chopsticks, as well as the newly established omni-channel joint venture between Tencent, Baidu and China's biggest property developer, Wanda Group.

These developments are indicators of Chinese tech companies emerging as a force to be reckoned with, in terms of R&D capability, business model innovation, and execution prowess. This is the result of an overall focus on investment in infrastructure and human resources in the Chinese tech industry, the sheer size and potential of this market, as well as the quality of the current workforce and what we believe is a very strong new graduate pipeline.

In the U.S., Apple's latest product and payment innovations – the iPhone 6, the iWatch and Apple Pay – have kick-started a new round of disruptions in the intersection of mobile payment, wearables and m-commerce.

In this month's feature we will be discussing China's Internet giant Tencent, which operates the country's largest messaging apps and gaming platforms.

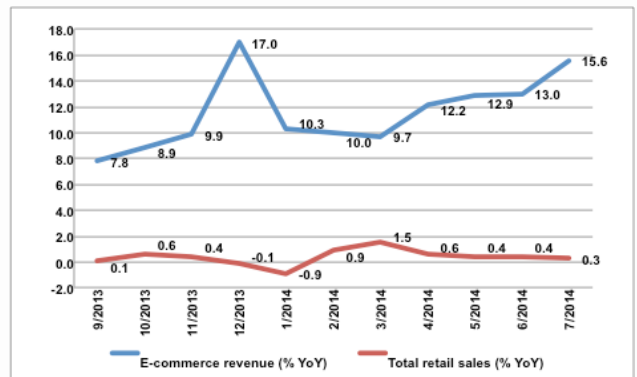
*Warmly,
Deborah*

U.S. E-COMMERCE UPDATE

Growth divergence between e-commerce and physical store sales intensified in July

E-commerce growth accelerated for the fourth consecutive month in July to 15.6% YoY, up from 13.0% YoY growth in June. At the same time, growth of total retail sales slowed four months in a row to reach 0.3% YoY in July, according to the latest Monthly Retail Trade and Food Services report of September 12 by the U.S. Census Bureau. As total retail sales have already included revenue from e-commerce, the figure suggests that the growth of physical store sales might be in the negative.

Exhibit 1: Monthly total retail sales and e-commerce sales – U.S.

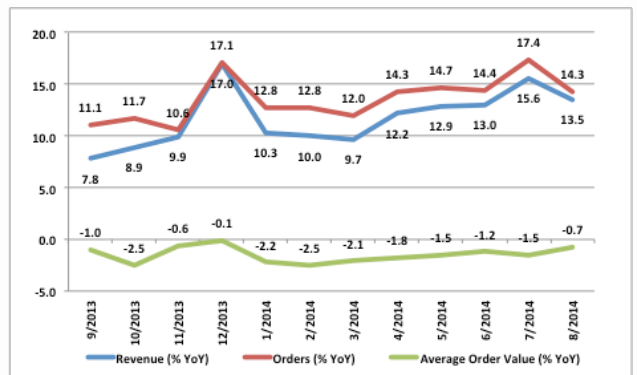


Source: The Custora E-Commerce Pulse, U.S. Census Bureau

E-commerce sales grew 13.5% YoY in August, following strong YoY growth throughout 2014

While the year-on-year growth of both revenue and the number of orders derived from e-commerce have grown steadily over the last 12 months, the growth of the average order value has remained negative due to competitive pricing with no definitive signs of improvement.

Exhibit 2: Monthly e-commerce sales – U.S.



Source: The Custora E-Commerce Pulse, U.S. Census Bureau

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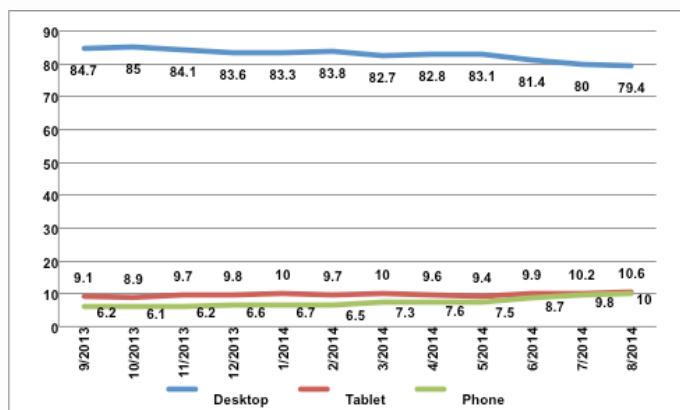
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Sales in the U.S. have increasingly become mobile-based in the past three months

The share of e-commerce orders made from smartphones jumped from 7.5% in May to 10.0% in August, while desktop e-commerce orders dropped from 83.1% to 79.4%. During the same period, the share of orders made from tablets remained largely the same. As tablet sales growth is slowing and smartphones are getting bigger and their functionality more e-commerce-friendly, we expect the bulk of m-commerce sales will be performed increasingly through smartphones. We anticipate that products and services like the iPhone 6 (with its larger screen) and digital payment with Apple Pay will only continue to boost m-commerce.

Exhibit 3: Orders share by device (% of total) – U.S.



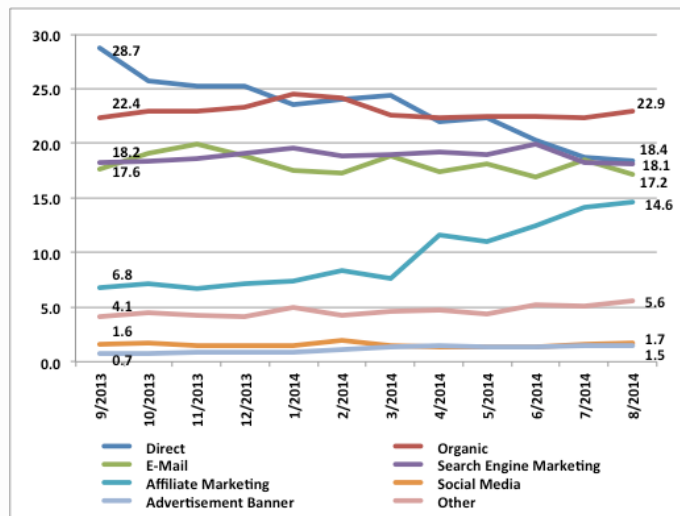
Source: The Custora E-Commerce Pulse

E-commerce traffic is increasingly driven by affiliate marketing

In the past 12 months, we have witnessed a stable trend with e-commerce order share by marketing channel, with the exception of unmediated direct traffic and affiliate marketing.

According to Custora, the share of e-commerce traffic via direct URL type-in fell drastically from 28.7% in September 2013 to 18.4% in August 2014. In the same period, the share of e-commerce traffic via affiliate marketing – a type of performance-based marketing in which a business rewards one or more affiliates for each visitor or customer brought by the affiliate's own marketing efforts – rose from 6.8% to 14.6%. It is also worth noting that despite the hype, the share of orders credited to social media has remained below 2% in the past 12 months. This suggests that the power of social media lies more in the promotion of brand awareness, rather than in facilitating the final purchase decision.

Exhibit 4: Orders share by channel (% of total) – U.S.



Source: The Custora E-Commerce Pulse

CHINA E-COMMERCE UPDATE

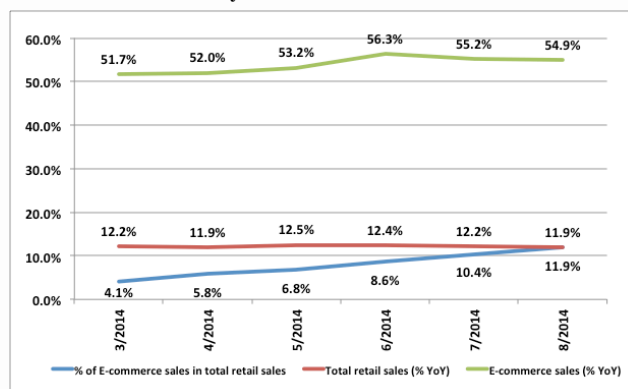
E-commerce sales grew 54.9% YoY in August, continuing a trend of strong YoY growth throughout 2014

Growth of both total retail sales and e-commerce sales has been decelerating in the past two to three months, reflecting the weakened Chinese economic outlook in the period.

E-commerce share still growing at the pace of more than one percentage point per month

E-commerce's share of total retail sales rose to 11.9% in August, an increase of 1.5 percentage point from July.

Exhibit 5: Monthly retail and e-commerce sales – China



Source: National Bureau of Statistics, China.



JD.com's traffic flow surpassed Tmall.com's for the third consecutive month in August

For the third month in a row, JD.com was at the top of the traffic flow ranking released by Huihui Shopping Assistant in August. This could suggest that JD.com's heavy investment in logistics to offer a better "last mile" experience to the customer may be paying off. At the same time, Vip.com replaced Amazon.com's local subsidiary Amazon.cn as number three, but its current ranking is vulnerable to challenge not only from Amazon.cn but also Suning.com. While JD.com and Tmall.com together made up two thirds of e-commerce traffic flow in August and led other e-commerce players in China by a large margin, their dominance has been significantly weakened in the past 12 months as other competitors upped their games.

Ranking	E-commerce sites	Description	Share of flows	Ranking Change
1		JD.com or Jingdong Mall is an e-commerce company headquartered in Beijing. It is one of the largest B2C online retailers in China by transaction volume	33.4%	No Change
2		Tmall.com is the B2C online retail platform operated by the Alibaba Group	32.3%	No Change
3		Vip.com offers a flash sales model that provides a unique online shopping experience for customers	5.0%	+1
4		Amazon.cn is an e-commerce platform mostly for books and electronics that is owned by Amazon.com	4.9%	+1
5		Suning.com is the B2C e-commerce platform operated by Suning Appliance Company Limited, one of the largest retailers in China	4.9%	No Change
6		Yihaodian is an online grocery business (B2C) owned by Walmart.	3.7%	-1
7		Dangdang.com started as an online bookstore. Its product offerings now extend to include household merchandise, cosmetics, digital, home appliances, books, clothing and maternity and kids products	2.1%	No Change
8		Gome.com.cn is the B2C e-commerce platform operated by GOME Electrical Appliances Holding Limited, one of the largest electrical appliance retailers in Mainland China and Hong Kong	1.7%	+1
9		Yixun.com (or 51buy.com) is the e-commerce arm of Tencent	1.1%	-1
10		Jumei.com is an online cosmetics retailer	0.9%	No Change



INDUSTRY UPDATE

WHAT IS ALIBABA?

Alibaba is China's biggest online commerce company, and one of the largest in the world. It is the most popular destination for online shopping in China, the world's fastest growing e-commerce market. Transactions on its online sites totaled \$248 billion last year, more than those of eBay and Amazon.com combined.

Alibaba's second quarter ending June 30 was highlighted by revenue of \$2.54 billion, a 46% increase from last year based on current RMB exchange rates.

On September 8 at New York City's Waldorf-Astoria Hotel, Alibaba kicked off a two-week multi-city U.S. roadshow sharing 100 investor presentations.



The company's last filing, released September 5 revealed that Alibaba is planning to sell 320.1 million shares with an expected range of \$66-\$68 per share. If these estimates are solid, Alibaba could raise between \$19.2 billion and \$21.1 billion. Including the extra shares set aside for underwriters, the amount raised could jump to \$24.3 billion. Since that filing, Alibaba has indicated that both the price and number of shares offered to the market could change before the final IPO.

The same filing values Alibaba at \$155 billion, just below Amazon.com Inc.'s \$160 billion market capitalization.

The IPO will be on the NYSE September 19.

Alibaba has appointed Barclays as the designated market-maker for the company's IPO. Separately, it was reported that Goldman Sachs will serve as "stabilization agent" to manage the deal's early floor trading.



On August 29, China's biggest property developer, Wanda Group, and Internet companies Baidu and Tencent unveiled a new e-commerce joint venture. The three companies said they will integrate online and offline selling to provide e-commerce services in Wanda's 107 shopping malls, as well as its hotels and resorts. They plan to invest 5 billion yuan (\$814 million).



On September 9, Apple revealed two new iPhones — the iPhone 6 and the iPhone 6 Plus — and a long-rumored smart watch, the iWatch. The faces of the iPhone 6 and iPhone 6 Plus are 4.7 inches and 5.5 inches respectively, significantly bigger than the previous 4-inch model. All three items have mobile payment capabilities, and are an integral part of Apple's newest payment solution initiative, Apple Pay.

amazon

On August 25, Amazon announced its acquisition of Twitch, a live-streaming gaming network that Google had reportedly expressed an interest in buying, for \$970 million.

Amazon started talking up its new Amazon Sponsored Links platform with potential partners and is anticipating a launch later this year, *The Wall Street Journal* reported on August 25. Ads from the new platform would replace those by Google currently found on Amazon's webpages. They also would be sold outside the Amazon universe. The platform would make it easier for marketers to reach Amazon's 250 million active users.



A team of engineers at Google X, the technology company's long-range research lab, safely carried out more than 30 test flights of deliveries by drones this month, Google announced on August 28. The deliveries, consisting of items ranging from a chocolate bar to first aid, took place in Queensland, Australia to avoid the Federal Aviation Administration's strict U.S. restrictions on drones.



Uber has begun testing UberFRESH, a service that provides lunch between 11:30am and 2:30pm to customers in the Santa Monica, California trial area, with a prix fixe menu that offers a new selection each day and a weekly menu change, for \$12 per meal.

In late August, Uber opened its premium UberBlack tier for business in Hangzhou and Chengdu in China. The launches mark Uber's first foray beyond China's first-tier cities of Shanghai, Beijing, Guangzhou, and Shenzhen.

In mid-August, Uber opened its software platform to almost a dozen partner companies with mobile apps, including Starbucks, United Airlines, and Hyatt Hotels. Using this platform you can book a table for two on OpenTable while reserving a car to the restaurant.



Xiaomi had its first flash sale in Indonesia on September 4, selling 5,000 Redmi 1S phones. As expected, all the phones sold out in under one hour — or seven minutes according to Lazada Indonesia and Xiaomi. This would seem slow compared to the India sale on September 2, which sold 40,000 phones in 4 seconds.

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In August, McDonald's Corp posted a job opening for a product director of loyalty as part of its global digital team, a move that sheds light on the fast-food giant's rumored plans to launch a loyalty program and mobile e-commerce service. According to the job listing, the brand plans to evolve the customer experience by developing and executing digital initiatives across every facet of its interactions with customers, including a multi-channel loyalty reward program.

TECHNOLOGY UPDATE

Wearables

On September 3 Sony announced that the Smartwatch 3 would be running Google's new platform specifically for wearables. Smartwatch 3 comes with a 1.2GHz quad-core processor, a 1.6-inch screen and Sony's now trademark IP68 waterproofing. Other key features include 4GB of storage, 512MB of memory NFC support, GPS and a 420mAh battery.

Smart clothing such as Ralph Lauren's shirt for athletes features fabric embedded with sensors and circuitry. Engineers from the Hong Kong Polytechnic University are working on similar designs, testing the fabric's durability and ability to withstand something as extreme as bullets.



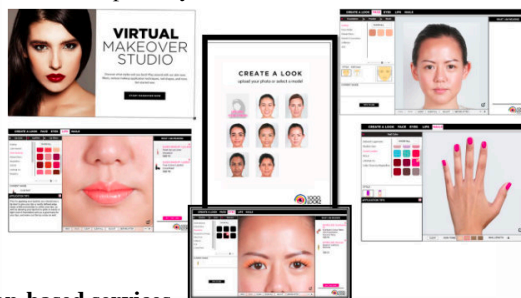
In September Baidu unveiled the Baidu Eye, its answer to Google Glass. Unlike Mountain View's creation, it doesn't actually come with a display but instead wraps behind the user's head. It recognizes voice and gesture commands, and responds by manipulating a connected smartphone in the absence of a display.

During the same event Baidu also debuted its new smart chopsticks, which can be used not only to eat, but also to detect the quality of oil used in your food –its light indicator glows red if it's unsafe for consumption, and glows blue if it's safe. The product has a special appeal to the Chinese consumer, as food safety is a major concern in China. Baidu has not yet announced any price or release date for either device, but has promised that the chopsticks will also be able to detect PH levels and for the fitness conscious, calories in food.

Augmented Reality

Apple filed two new patent applications on September 4 that boost the iPhone's navigation abilities with Augmented Reality features. The patent describes a way that the iPhone could use its camera in combination with on-device software to generate virtual maps of the user's surroundings, which are overlaid on a real feed, and which can do things like provide a look inside surrounding buildings.

In August, Singapore-based beauty e-commerce site Luxola lifted the veil over its new app, LX Studio. This nifty application allows users to virtually try out beauty products from different brands before they decide what makeup to buy.



Location-based services

Estimote has launched its new Estimote Stickers, iterations on their original Beacon gadgets, which give apps hyper local awareness. Stickers continues that mission, paring down the size of the beacon hardware to an impossibly thin 3mm, with a smaller, more easily hidden footprint and battery life up to a year. Each carries an adhesive backing, just like the first-generation devices, and includes accelerometer and temperature sensors in addition to Bluetooth radios.

REGULATORY UPDATE

India banned foreign direct investment in B2C e-commerce

On August 22, India's Commerce Minister Nirmala Sitharaman was reported as saying that foreign direct investment (FDI) is not allowed in B2C e-commerce companies, according to *The Economic Times*. Currently, 100% FDI is permitted for operating a B2B e-commerce business in India.

In August California Governor Jerry Brown signed Bill SB 962 into law, making "kill switches" mandatory on all new smartphones. Starting next summer, all phones sold in the state must have a built-in feature that enables the owner to remotely render the device inoperable to strangers or thieves, and it must be activated by default. The idea is to discourage smartphone theft, a problem plaguing law enforcement across the country. However, if some states adopt this law, but others don't, maintaining compliance whenever devices cross state lines could be a nightmare of complication and a bigger expense for tech companies and carriers.

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FEATURE:

Tencent 腾讯
智慧沟通 灵感无限



Founded in November 1998, Tencent has grown into one of China's most popular Internet service ecosystems. It provides value-added Internet, mobile and telecom services and online advertising under the strategic goal of providing users with a "one-stop shop" for online lifestyle services. Tencent's leading Internet platforms have created the largest Internet community in China that meets Chinese Internet users' needs in the areas of communication, information, entertainment and e-commerce

Core strength

Instant messenger – QQ (829 million MAU) and WeChat/Weixin (438 million MAU)

Gaming – accounted for 56% of Tencent's revenue

Social media – Qzone (645.1 million MAU)

Note: Q2 2014 figures, MAU: monthly active user

Strategy

Through an ecosystem of service-oriented (as opposed to merchandise e-commerce-oriented) online platforms, Tencent controls a large volume of Internet

traffic flow and user information, and utilizes them to create value.

Why is it relevant?

At a market cap of HK \$1.16 trillion (\$150 billion) at the end of the trading session on September 15, Tencent is China's largest Internet company (before Alibaba is listed) and one of the largest in the world. Together with Alibaba and Baidu, they represent the most successful Internet companies in China. While Tencent may be no match for Alibaba in terms of merchandise e-commerce, it has the potential to win out in the omni-channel front building on its experience in the field of service e-commerce.

Tencent has also been aggressive in its international expansion, with notable success in emerging markets such as India and Russia.

Substantial shareholders

MIH Holdings Limited – 33.66%

Ma Huateng, founder and chairman of Tencent – 10.14%

Year	Major Events
Nov 1998	Tencent was founded
Feb 1999	Launched instant messaging service – QQ
Aug 2000	Launched mobile & telecommunication value-added services
Jun 2001	Launched Internet value-added services
Aug 2003	Entered online games market
Nov 2003	Launched web portal – www.QQ.com
Jun 2004	Listed on the main board of Hong Kong Stock Exchange
May 2005	Launched multi-media social networking service Qzone
Mar 2006	Launched C2C platform paipai.com and online payment platform Tenpay
Jul 2006	QQ.com became the most popular web portal in China by page views and united visitors
Mar 2010	QQ IM peak simultaneous online user accounts exceeded 100 million
Jan 2011	Launched mobile social communication service – Weixin (the international version is known as WeChat)
Feb 2011	Invested in Riot Games in the United States
Mar 2011	Launched video portal v.qq.com
Dec 2011	Launched e-commerce open platform buy.qq.com
Jan 2013	Weixin & WeChat registered user accounts exceeded 300 million
Aug 2013	Launched game centers on Mobile QQ and Weixin
Sep 2013	Invested and formed strategic cooperation with Sogou, a subsidiary of Sohu.com, Inc. and the owner and developer of Sogou search engine, Sougou Input and Sogou browser.
Feb 2014	Strategic partnership with Dianping, which operates a popular Yelp-like website in China
Mar 2014	Strategic partnership with JD.com, one of the largest B2C online retailers in China by transaction volume
Mar 2014	Strategic partnership with CJ Games, a Korean game developer
Apr 2014	QQ IM peak simultaneous online user accounts exceeded 200 million
Jun 2014	Strategic partnership with 58.com, China's Craigslist



The ecosystem

Tencent offers various free services to attract new users, generate interaction within the community, and promote its value-added paid services .

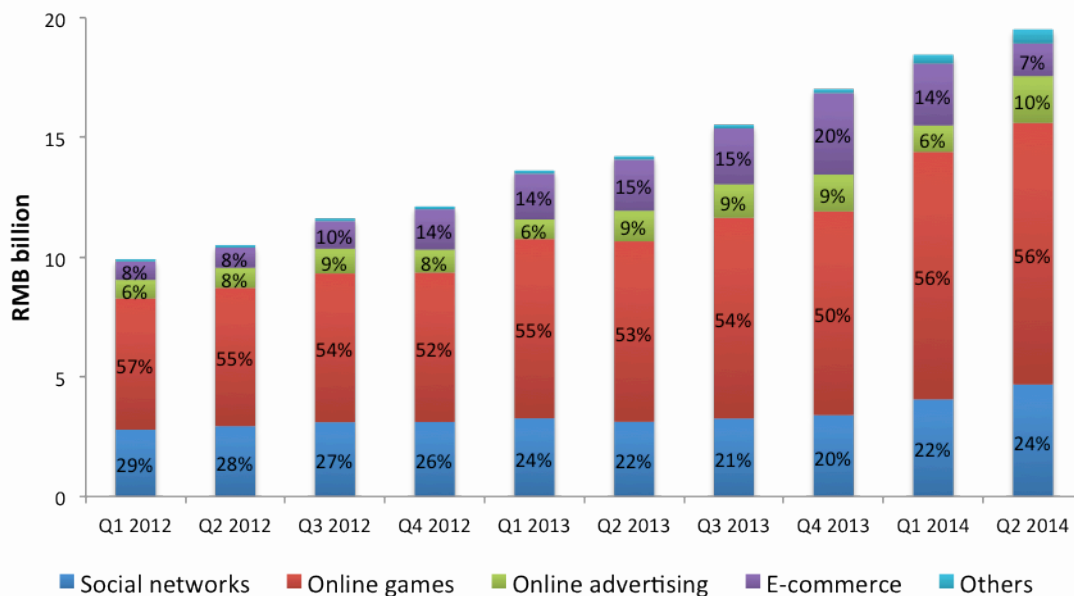
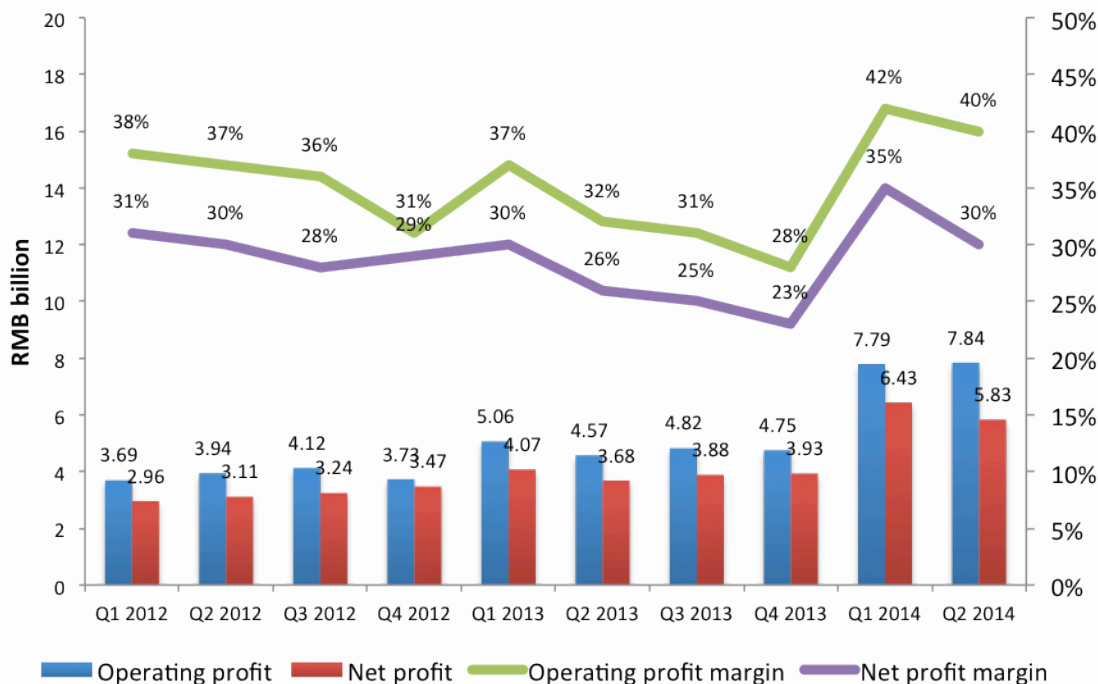


Business Model

Value-added services (80% of Q2 2014 revenue)	Advertising (10% of Q2 2014 revenue)	E-commerce (7% of Q2 2014 revenue)
• Fee-based revenue	• Traffic-based revenue	• Gross merchandise volume
		• Fee / commission
		• Traffic-based revenue
Social Networks (24% of Q2 2014 revenue)	Brand display	Principal
Online Games (56% of Q2 2014 revenue)	Performance display	Agent



Key Financial & Operational Metrics



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