

# GLOBAL INNOVATION PROVIDES INVESTMENT OPPORTUNITIES



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Whether analysing large brands or global companies benefiting from technological change and innovation, Perpetual's equity investment approach is underpinned by the same disciplined, active, value-based methodology. We constantly assess the world's best investment ideas to find companies that have the potential to deliver strong investment returns over the long term. We do not attempt to predict where markets are heading – we concentrate on the best quality investments at prices that represent good value, based on their potential risks and returns.

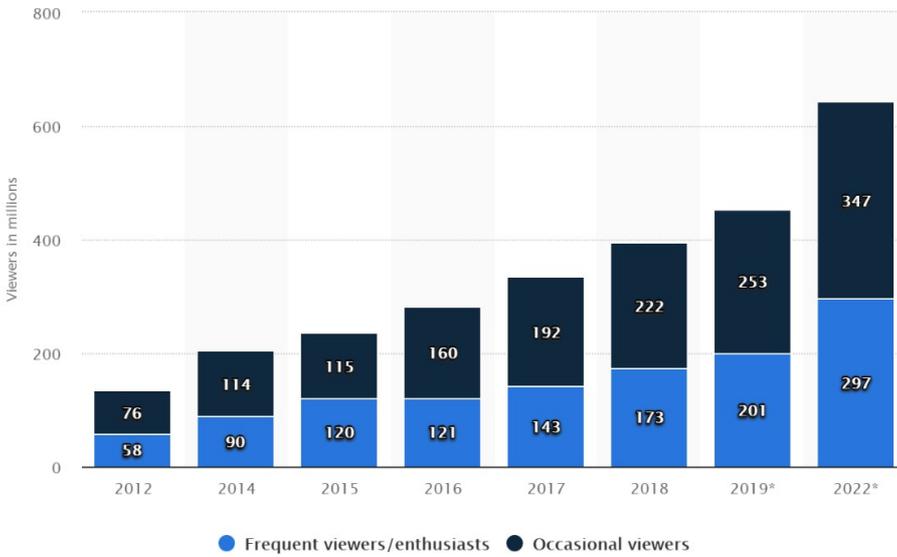
The Perpetual Global Innovation Share Fund seeks to invest in high quality companies with strong balance sheets, consistent earnings growth and strong free cash flow. The following stocks are two exciting opportunities that meet that brief.

## **Gaming – a new frontier**

If you've noticed that gamers seem to be spending more time watching games than ever before, you aren't alone. Young gamers (aged 18-25) are spending, on average, three hours and 58 minutes each week doing just that according to a recent survey by Limelight Networks<sup>1</sup>, an increase of 33 minutes from last year.

To put that in perspective, if we add up those hours, that would total more than eight full days of watching eGames per year.

Figure one



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Figure one: esports audience size worldwide from 2012 to 2022, by type of viewers (in millions)

\* Forecast Figures for periods other than 2017, 2018, 2019 and 2022 come from previous reporting

Figure one shows the global esports audience size from 2012 to 2022, broken down by type of viewers. In 2018, the number of frequent esports viewers and enthusiasts amounted to 173 million. This number is projected to reach 201 million in 2019. The entire esports market is projected to generate over a billion US dollars in 2019 – and esports is just one (albeit significant) segment of Gaming.

Many might ponder the attraction of video game live streaming – after all, why would you watch someone else play a game when you could play it yourself? However, playing video games and watching video games being played are two distinct but complementary forms of entertainment – one is active while the other is passive. In fact, it’s arguably no different than playing sport versus watching sport. Given the huge increase in the number of people playing video games, it’s no surprise that the number of people watching gamers in action has also grown.

A key beneficiary of this growth has been the video game streaming platforms themselves. Twitch, the leading platform in the US, is locked away within Amazon, which acquired the business in 2014 for US\$970m.

Huya, the leading platform in China, started life as a subsidiary of YY (a live streaming company we’ve owned since the Fund’s inception) but became public with an IPO in May 2018. We bought a position in Huya shortly after the IPO. As illustrated in figure two, its quarterly revenue has experienced exponential growth.



Figure two: Huya quarterly revenues

We believe these businesses are natural monopolies, or at least duopolies, due to the strong network effects associated with the platforms. Streamers will most likely only stream on a single platform and will gravitate towards the platform with the greatest number of users. Viewers will go to the platform with the greatest variety of streamers. We've seen this play out already in the US where Twitch retains its dominant position despite efforts by YouTube Gaming and others trying to gain a foothold.

There was an explosion of new video game streaming companies formed in China during 2014-2015, around the time of Amazon's acquisition of Twitch. This led to a fiercely competitive environment until last year when Tencent invested in the two leading platforms, Huya and Douyu, on the same day. Since then, these two platforms have grown while others have struggled. The third largest competitor in the space, PandaTV, filed for bankruptcy last month.

Industry consolidation and a more benign competitive environment will allow Huya to capture a greater share of the economics of this growing industry. We believe the market is underestimating the company's long-term earnings potential from its core Chinese business.

We're also optimistic about Huya's growth potential outside of China through its subsidiary NimoTV, which is focused on becoming the leading game streaming platform in Southeast Asia and Latin America. It is able to do this by adopting a localisation strategy where it supports local broadcasters and titles. This strategy seems to be working – in Indonesia, Vietnam, Thailand, and Brazil, four markets that represent 638 million people, NimoTV is the leading video game streaming app and ahead of Twitch. Given the network effects naturally at play, we believe these early leads could become permanent, creating a valuable business over time not just in China, but internationally as well.

### **Paper...scissors...electronics?**

We believe paper shelf labels are a dying breed. Over time they'll be replaced by electronic shelf labels (ESLs) which provide several advantages:

- ESLs save time and resources – a store with 10,000 shelf labels can spend hours each night physically printing and replacing labels to implement price changes, just to have to do it all over again...and again
- ESLs allow retailers to implement dynamic, real-time pricing
- ESLs allow retailers to implement a global price change, so the physical stores match your website or can swiftly react to a competitor's price
- ESLs enable the implementation of surge pricing during busy times – it's controversial, but easily done.

Perpetual first noticed ESLs in Alibaba's 'New Retail' Hema store, but it's not just internet companies adopting this technology. Best Buy started by deploying ESLs in 60 of its 1000 stores in early 2018 and has now deployed them in over 150 stores. Walmart is currently testing ESLs and is expected to roll them out over the next few years.



This is a small but exciting trend...but how do you translate this thematic into a stock call? After reviewing a number of stocks, the team identified E Ink Holdings as a sound investment opportunity.

E Ink Holdings is a Taiwanese company that has a virtual monopoly on electronic paper (ePaper), a display made up of millions of microcapsules that each contain black and white particles suspended in a clear fluid (see figure three). Applying a positive or negative charge to the display changes which particles rise to the surface and become visible, which is how the display gets updated.

The key advantage of these displays is that they're easy to read (no light is shining into your eyes) and they're low power (because they only consume power when you update the image). This is why they're used in every Kindle and almost every other eBook reader in the world.

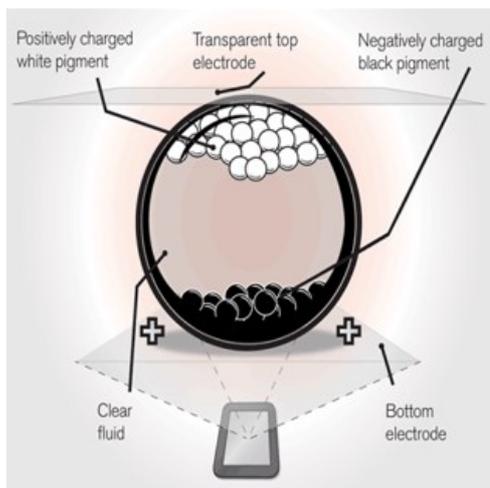


Figure three: ePaper

For E Ink Holdings, eBook readers account for around 80% of their revenue<sup>2</sup>, while the remainder is largely made up of displays for ESLs. Interestingly, those electronic shelf labels at Hema, Best Buy and Walmart use ePaper from E Ink. On top of that, ESLs sold by SES-imagotag, the leader in ESLs, also uses ePaper from E Ink.

We believe this acceleration in ESL-related growth will drive double digit earnings growth for E Ink for the foreseeable future, a factor that isn't currently being reflected in the stock price; this provided the ideal opportunity to buy a new position in an innovative, quality business at a good price.

[1] Based on Limelight Network's "The State of Online Gaming – 2019" research, available at <https://www.limelight.com/resources/white-paper/state-of-online-gaming-2019/>

[2] Ebook readers are now a fairly stable market, although we expect this will accelerate in 2022 or so when colour ePaper from E Ink becomes suitable and allows Amazon to sell a colour ePaper Kindle.

investor's capital.