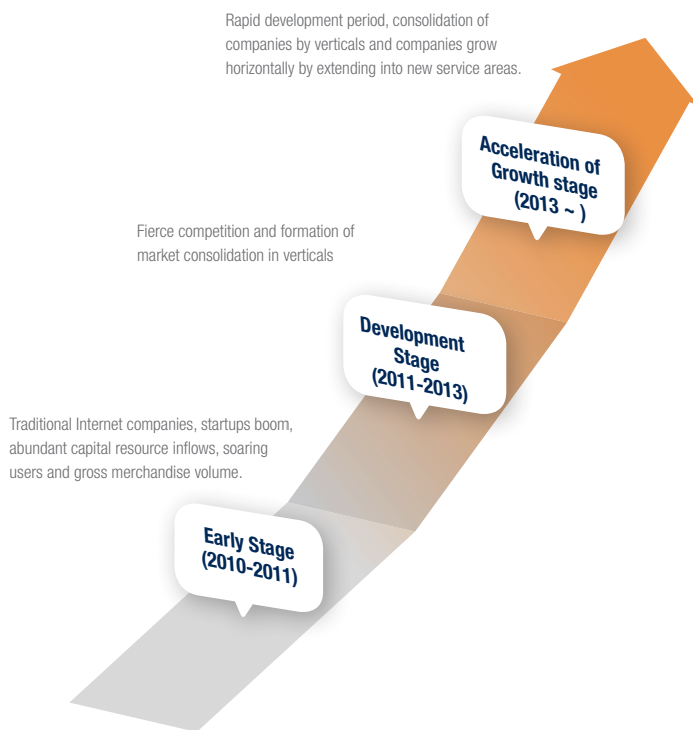




It is fair to say that China's Internet industry is no longer at an early phase. However, what is new and underpenetrated is online to offline ("O2O") service commerce. With the Chinese Internet space moving beyond the simple connecting of disparate information (through portals, search engines, etc.), entertainment offerings, and purchases of physical goods to veritably connecting services to users.

Evolution of the China O2O Economic Cycle

Source: Mirae Asset Global Investments (2015)



From infancy to maturity, the O2O space is growing up.

Local Lifestyle O2O Market: Too Big to Ignore

In 2014 the local lifestyle O2O market was valued at RMB 235 billion (USD 38 billion), growing over 36% for the year³. Amidst this promising market, conventional O2O models can be found in online travel agent companies like Ctrip and Qunar, Chinese versions of Priceline and Kayak that offer the added value proposition of connecting people with airline and hotel booking services. Then there are real estate website companies like Soufun and Leju, connecting online users to offline real estate developers and agents. In effect, O2O development is occurring within the innovation segment that generally consists of verticals that have not yet been subject to the forces of disruption brought on by the Internet, as manufacturing and traditional retail sectors have already experienced. Food and beverages, healthcare goods and medical services, general beauty & household services, along with local transportation are examples of key innovation segments that occupy meaningful market sizes, as listed below.

Retail Sales Mix in China (2014)

Source: Euromonitor International, NBS, Credit Suisse

Market	Retail Sales (USD bn)	(RMB bn)
Food and non-alcoholic beverages (mix)	11,028	68,485
Housing (services)	7,099	44,082
Clothing and footwear (goods)	3,591	22,303
Transport (services)	3,127	19,417
Health goods and medical services (mix)	2,789	17,318
Household goods and medical services (services)	1,859	11,545
Electronics and home appliances (goods)	1,563	9,709
Hotels and catering (services)	1,563	9,709
Jewelry and accessories (goods)	1,521	9,446
Education (services)	887	5,510

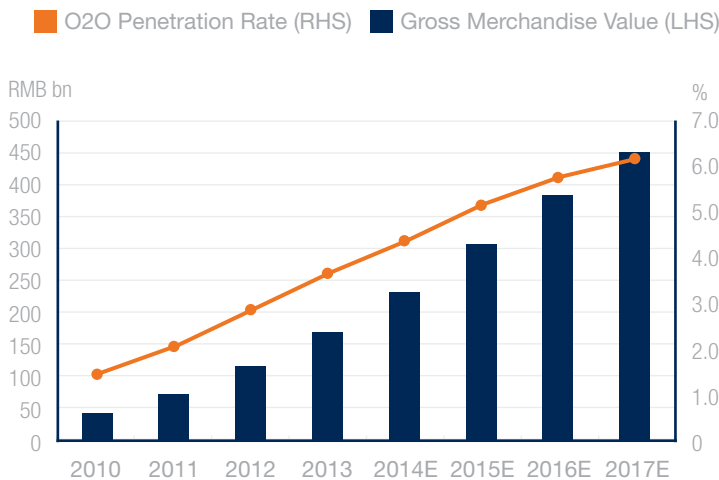
A colossal market across segments.

³ iResearch (2014)

In China, the new wave of services offered are within labor-intensive verticals, such as transportation (Kuaidi and Didi Dache are the Chinese versions of Uber-like car hailing companies), home services (58Home), entertainment ticketing, food delivery, catering, and much more. The industry GMV (gross merchandise value) of local lifestyle services – commingling online and offline – is an estimated total RMB 4.7 trillion (USD 760 billion) in 2013, rising 13.3% year over year⁴, while the China O2O market size has been gaining share on the back of a structural step-change in users' mindshare toward online services. The China O2O market size recorded RMB 170 billion (USD 27 billion) in 2013, up 45% year-over-year, and is expected to reach RMB 455 billion (USD 73 billion) in 2017, growing at a robust four-year +27.6% CAGR⁵. Despite this brisk pace of growth, the penetration in the whole local lifestyle service market is still in the single digits as displayed in the graph underneath.

China O2O Market Size

Source: iResearch 2014



Low penetration and on the way up.

“ The fragmentation of the services market, availability of labor, and growth potential driven by per capita income growth in China altogether pave a bright outlook for the industry. ”

Big O2O: Taxi Apps

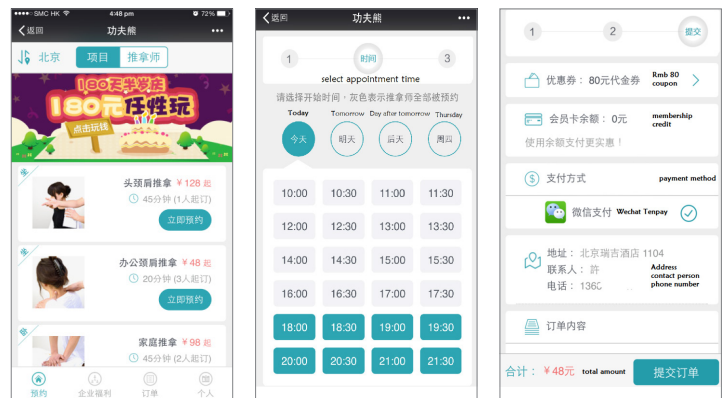
Kuaidi Taxi, a private company partially invested by Alibaba Group Holdings, is a taxi-hailing smartphone app which shows the real-time locations of taxis and allows users to hire cabs via their application. The company covered over 261 cities in China by March 2014. The number of daily transactions topped 6.23 million, 20.7 times of a year ago⁶.

Small O2O: Massage Therapist to your home

KungFu Bear (功夫熊 in Chinese) is a typical example of a startup O2O company in Beijing. The company offers massage and physical therapy services at your designated location. The entire order flow happens through their app, starting from showing a list of massage therapists with basic information such as location, years of experience of the therapist, historical reviews, and service price. Users then are able to secure a booking and complete their payment using Tenpay (by Tencent Holdings) in just a few clicks.

KungFu Bear Platform (Masseur Marketplace for Massages at Home)

Source : Mirae Asset Global Investments, KungFu Bear



The comforts of home with the services of outside.

⁴ iResearch (2014) ⁵ iResearch (2014)

⁶ <http://www.chinainternetwatch.com/7038/kuaidi-taxi-app-released-q1-financial-performance/>



China Internet Giants Join the Fray: Positioning Aggressively for O2O

After a decade of rapid progress and development, China's leading Internet companies are hungry for new levers of growth, which is an evident consequence of investments and spending. As such, during the past few years we have seen intensive strategic investments by Alibaba, Tencent and Baidu. Just to name several examples:

- Alibaba invested USD 1.3 billion in Autonavi, a leading provider of digital map content and navigation solutions in China⁷;
- Tencent placed USD 736 million of strategic investments in 58.com, a leading online classified service provider in China⁸;
- Baidu invested USD 111 million in Nuomi, one of the leading group buy sites in China, and have announced in their second quarter 2015 conference call their plans to invest a further RMB 20 billion (USD 3.2 billion) in the O2O segment over the next three years⁹;
- Meituan is a strong contender in this segment, and is backed by Alibaba and global private equity firms. The company's GMV in the first half of 2015 exceeded RMB 47 billion (USD 7.57 billion), up +190% from last year wherein mobile applications contribute to 95% of total transactions¹⁰.

As an extension of natural consumer behavior, O2O is a clear catalyst for the increasing usage of mobile payments; which is expected to become a frequently used payment instrument in China. With that in mind, and while developing the O2O market, the Internet giants are also closely eyeing the mobile payment market as such consumption habits continue to expand their share within the Internet economy.

The Road Ahead for O2O

As we have seen, Chinese consumers are no longer solely using the internet to search for information, but are now seeking to connect online through mobile to offline products and services, marking the advent of the O2O market. O2O is now making its way into segments that have previously been untouched by innovation, such as food and beverages, housing, transport, and general beauty & household services. Looking ahead, it is this migration of internet giants into the O2O market combined with the opportunities presented by key innovation segments, driven by the fragmentation of the services market and China's per capital income growth, which makes O2O a justifiable investment theme to play in the years ahead.

“ Chinese consumers are now seeking to connect online through mobile to offline products and services. ”

⁷ <http://www.bloomberg.com/news/articles/2014-04-11/alibaba-agrees-to-buy-autonavi-in-1-5-billion-mapping-deal>

⁸ <http://www.wsj.com/articles/tencent-buys-nearly-20-stake-in-58-com-1403880379>

⁹ Company Disclosures

¹⁰ Company Disclosures



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