

TYNDALL
INVESTMENT MANAGEMENT

FP Tyndall Global Fund Commentary – August 2018

“There are a few players who like to think about the game” – Sachin Tendulkar

Although the month of August is normally one of the quieter months of the year in terms of corporate news, the unrelenting Trump tweet account posts have caused significant wobbles in emerging market currencies. We outlined in previous commentaries the issue of a strengthening dollar, and the ramifications on emerging markets with dollar debts or liabilities, however President Erdogan has managed to amplify the impact on his country by trying to go toe-to-toe with the US President.

On the corporate side, Indra Noori stepped down as CEO of Pepsico, which we hold in the Fund, after 12 years at the helm, and as her final act announced the acquisition of Sodastream for \$3.2 billion in cash. Our holding in Blackrock wobbled as Fidelity announced the launch of a couple of zero-cost index trackers and Elon Musk drew the ire of investors and the SEC by tweeting about his intentions with Tesla (not held in the Fund). We may return to Pepsico and Blackrock in future commentaries.

The FP Tyndall Global Fund (B Inc) rose by 3.48% over the month, raising the year-to-date returns to 10.67%.

Although you might have questioned the reasoning behind the quote from the Little Master, we have decided this month to disclose a little more detail on one particular division of our investment in Tencent, which has underperformed in the last six months; albeit up 150% since we switched out of our holding in Naspers (which owns 31% of Tencent) into the company itself.

The debate over what constitutes a sport has been one going on for many years. The Council of Europe charter on sports defines it as “all forms of physical activity, which through casual or organised participation, aim at expressing or improving physical fitness and mental well-being, forming social relationships and obtaining results in competition at all levels”. Although opponents of this all-encompassing definition would likely take up positions such as ‘inclusion as an Olympic sport’ or ‘requires specialist equipment and/or footwear’ the decision by the 2022 Asian Games to include e-sports as a category may take some by surprise; the IOC is yet to decide whether it will become an Olympic Sport, but it is under discussion whether they will be included in Paris 2024.

e-sports is a rapidly growing phenomenon, especially amongst the 10-35 year-old age bracket (although not exclusively). In China 25% of this demographic is actively engaged in playing e-sports, while in the Rest of the World the percentage is 17% and growing; it has become a multi-million-dollar industry for not only the companies that make and distribute the games but also for the players themselves, with top players able to generate prize money in the region of \$4.5m per annum. The numbers are staggering; in China alone, it is estimated that 560 million people play these games, accounting in 7/10^{ths} of the online population, and 56% watch live streaming of others competing in e-sports competitions.

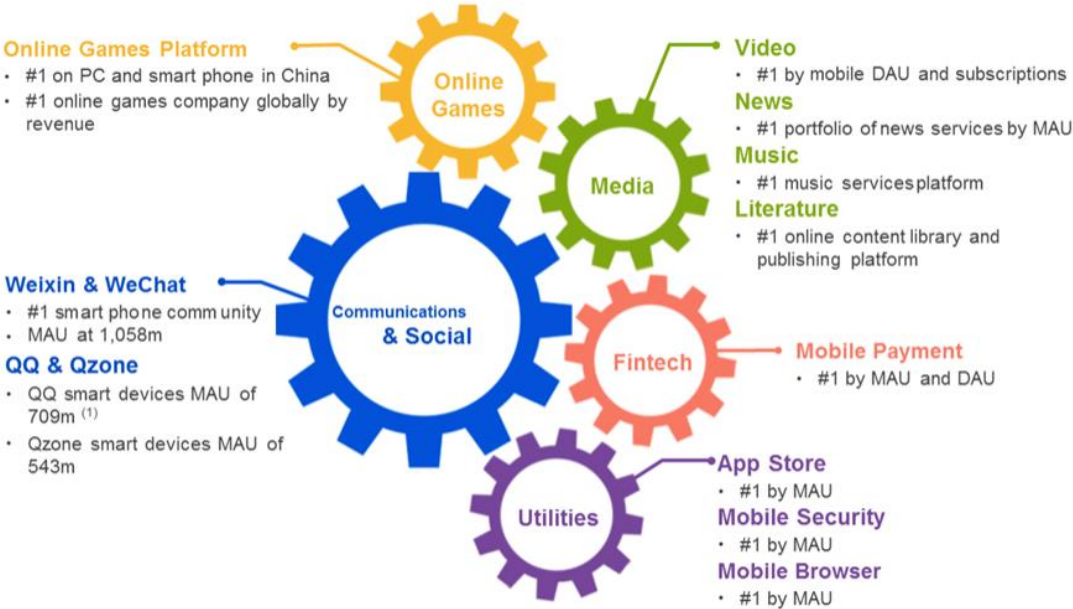
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At the 2017 final of League of Legends (LoL), held at the Bird's Nest stadium in Beijing, 40,000 people packed into the stadium to watch two South Korean teams battle for the top prize, while 43 million people logged in to watch the live streaming of the event. Such is the popularity of the event that LoL held a mid-season invitation event in May, which was won by a Chinese team. In 2016, there were 1,718 LoL tournaments worldwide, with total prize money of \$29.2 million.



Tencent is the global leader in the mobile and PC gaming market (and owner of Riot Games, the developer of LoL), deriving 34% of their revenue from online games. Companies such as Microsoft, Amazon, Alibaba, NetEase, Electronic Arts and Activision Blizzard are all investing heavily in the field and the current growth in the market suggests that there is room for all to be successful.

Tencent's Key Platform Capabilities



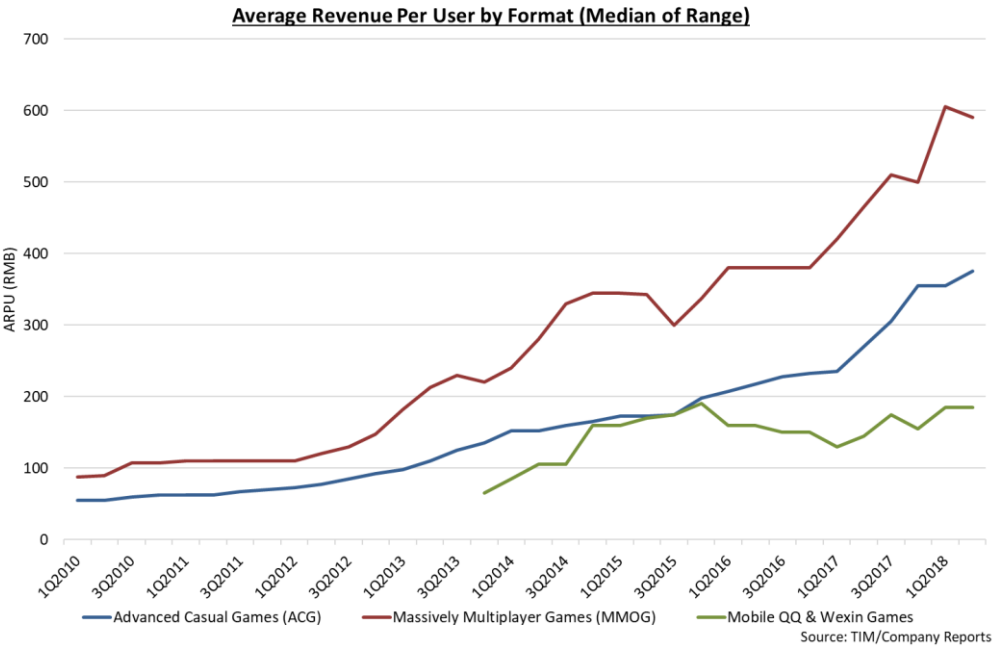
All above rankings refer to China market, unless otherwise stated. Company data as of 30 June 2018
 1. Includes users who logged in and sent a message or participated in certain activities such as QQ Moments, games, Interest Tribes, live broadcast, online music & literature

Source: Company Presentation

Honor of Kings (HoK) is another game developed and published by Tencent; is the highest grossing game on both the Apple iOS and Google Android platforms. Although Tencent, under pressure from the Chinese government had to limit play time for the under-12 category, it has 80 million daily active users (DAU). Furthermore, there are currently 14m DAUs outside China, who spent \$200m on the game in the last six months alone. While LoL is predominantly a PC game, HoK has been designed from the ground up as a mobile game so that players can invite friends, see who is online, and discuss in-game strategies making the user base more resilient.

Although the winds might seem favourable for Tencent, the latest results from their gaming division were seen as disappointing, causing the company to fall by 10% on the news, before recovering and ending the day down 3%. The stock had been under pressure after the release of the news that China had suspended sales of the game 'Monster Hunter'. On investigation it was discovered that the 3rd party developer had not completely adhered to the regulatory requirements, so once the appropriate adjustments have been made it can once again be tendered for approval.

Tencent releases most of its games as free-to-play, relying on in-game purchases to earn revenues. Surprisingly, a large percentage of players also voluntarily participate in monthly subscription services, with the incentive of VIP functionality. In-game purchases are the multi-billion-dollar part of the business, where players pay to adapt their characters or buy added capabilities and features in order to be able to compete against other players and make their own characters more identifiable.



China has a formal procedure to both allow the release of games and to approve their monetisation. Recently, however, the officiating body has been undergoing restructuring, so although Tencent has over 15 games approved for normal monetisation, they have a backlog of 45 games in the pipeline. In order to try and ease the process the Chinese government has allowed a green channel that grants a one-month monetisation testing period, however once proof of concept is over, the game still needs to go through the formal monetisation approval process. Tencent’s latest blockbuster, Player’s Unknown Battlegrounds (PUBG), is now in this limbo window, having reached what the company calls a ‘very significant size’; until it gets formal approval the company is unable to draw revenues from it. We believe that the introduction of the Green Channel is a positive sign that the government recognises the issue but wishes to develop further guidelines before issuing further approvals.

Although HoK and LoL have approval for monetisation as tactical tournament games the company believes that it can better capture the revenue potential from the events; PUBG Mobile and Fortnite (released by EPIC Games, of which Tencent owns 40%) remain unmonetized tournament games and retain revenue optionality once approval is achieved; Fortnite accumulated over 10 million pre-registrations prior to its roll-out. We believe that Tencent will be able to continue to grow its revenues from the gaming sector as they increase the percentage of higher Average Revenue Per User (ARPU) categories, roll-out more games, increase the international distribution of their titles and in due course see the Chinese authorities work through the backlog of products awaiting approval. In the meantime, we also expect Tencent to continue developing its own games and taking equity stakes in 3rd party companies that are developing and introducing popular games.

Tencent’s Dominance of Chinese Mobile Gaming

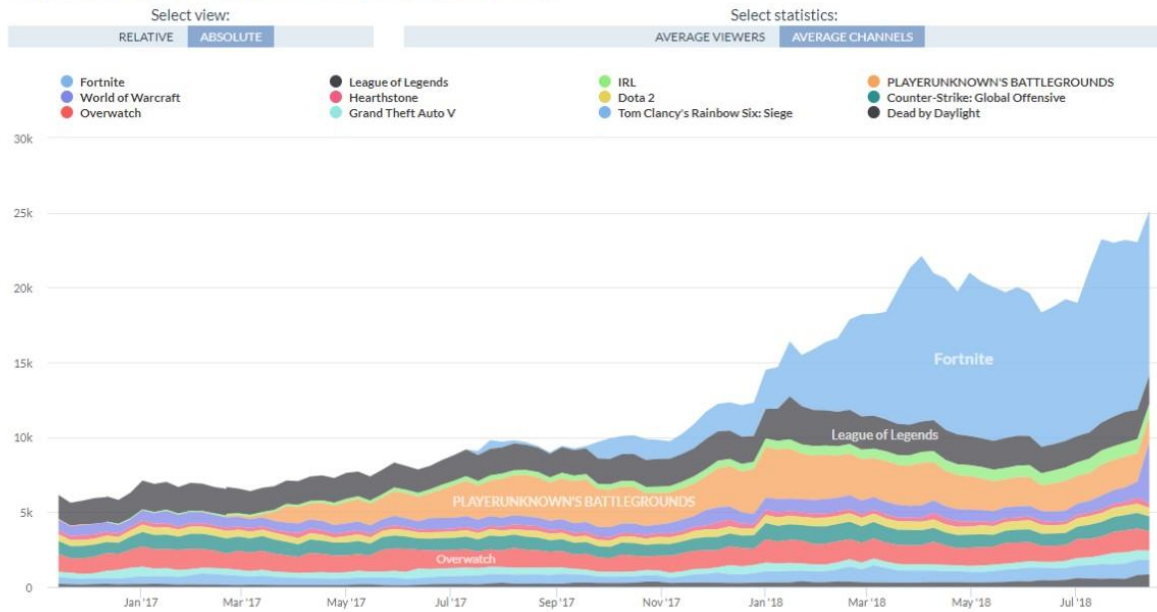
Top-Selling Games Week of August 20 th 2018		
Rank	Name	Publisher
1	Honour of Kings	Tencent
2	MT4	Tencent
3	Fantasy Westward	NetEase
4	Saint Seiya	Tencent
5	Langrisser	Zilong
6	King of Chaos	Tencent
7	Onmyoji	NetEase
8	QQ Speed	Tencent
9	Free Fantasy	Tencent
10	Westward Journey	NetEase

Most Downloaded Games Week of August 20 th 2018		
Rank	Name	Publisher
1	King of Kings 3D	Tencent
2	PUGB Mobile	Tencent
3	Meteor Butterfly Sword	NetEase
4	Zootopia	Tencent
5	Bleach	DeNa China
6	Talking Tom Candy Run	Outfit 7 Ltd
7	Bumper.io	Voodoo
8	Honour of Kings	Tencent
9	Hole.io	Voodoo
10	Mini World Block Art	Miniwan Tech

Source: SensorTower

An example of how there is room for other companies to take advantage of this adoption of e-gaming is Twitch, which almost went unnoticed when Amazon bought it for \$1 Billion in 2014. Twitch is the leading platform in the US for e-sports, which is the fastest growing category in live broadcast. Twitch is growing over 50% year-on-year. Noticeably the top two most watched, and fastest growing, games are both owned by Tencent.

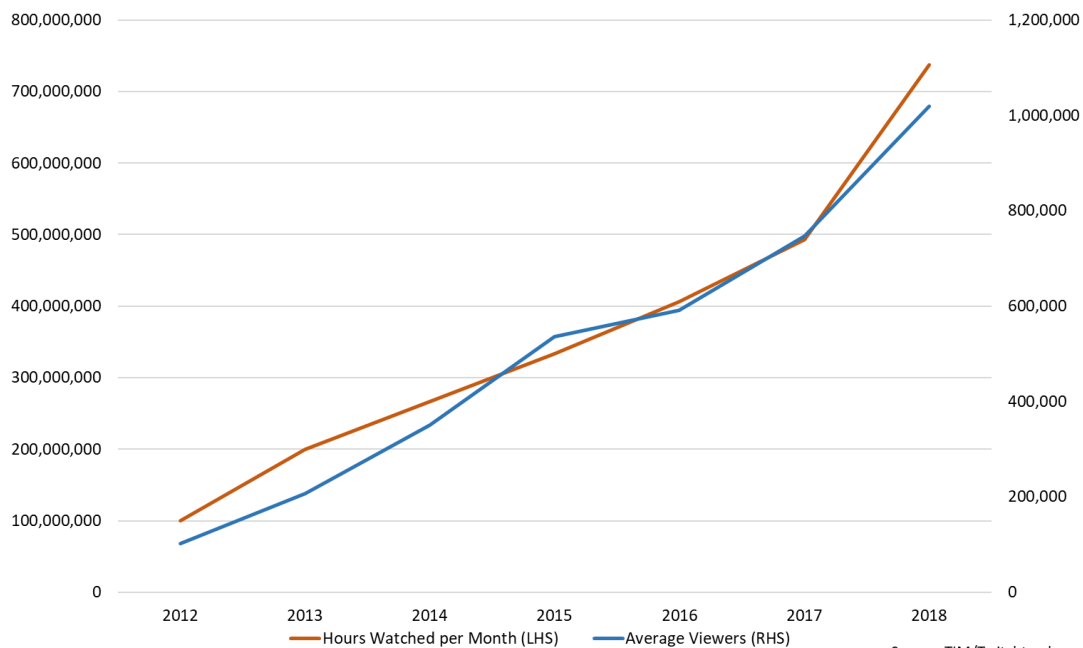
TOP GAMES BY VIEWERS AND CHANNELS SHARE



Source: Twitchtracker.com

In comparison NFL is viewed for 6 billion hours annually and the latest broadcast rights (in 2013) were sold for \$47.5 billion. Twitch is already registering almost 800 million hours per month (9 billion on an annualised basis). Viewers pay subscriptions from which Twitch extracts a platform fee and allows streamers to interact with viewers. Although Tencent is the clear leader in Asia, Facebook and YouTube are trying to compete with Amazon in the Rest of the World; Amazon, however, has a clear head-start with the traction Twitch has already achieved. We expect that Jeff Bezos will start to draw more attention towards the increasing popularity and profitability of Twitch in the coming quarters as the revenues from other operations become more meaningful.

Twitch Key Performance Indicators



We hold Tencent, Microsoft and Amazon in the Fund, all of which can benefit from the rise of e-gaming. With Tencent's dominance in Asia and its increasing number of acquisitions of game producers, we believe that once the regulatory issues are ironed out in China the share price weakness seen this year will be judged to be unwarranted and thus we continue to hold our position in the Fund.

Postnote: On 31st August the Chinese authorities released new regulations to reduce the play time amongst children in a move to tackle the increasing incidence of myopia. Tencent has already enforced restricted game time for younger players on its Honor of Kings product, and therefore can adapt these restrictions across its platform more easily than peers. Although the adolescent population accounts for 10-15% of the total online game market and the average time spent playing games is below the current time limit imposed by the regulatory bodies the news will likely cause investors to worry that the regulators reduce play time even more.

The authorities also plan to restrict the number of new online games; this may actually turn out to be beneficial to the leading developers such as Tencent and NetEase, as those with portfolios of longer duration and popular games are likely to gain market share. We expect that the approval process will continue to be slow but the higher quality games that Tencent produces are likely to be looked upon more favourably by the regulators.

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