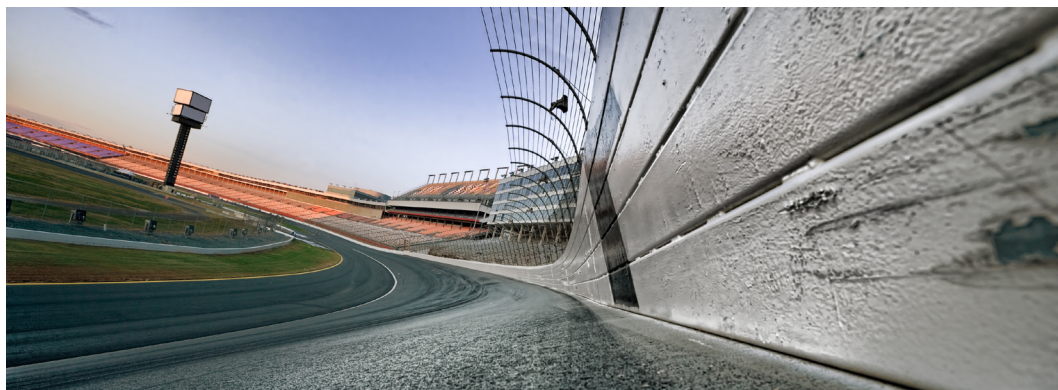


## TRENDS REINFORCED

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# SOUTHEAST ASIA'S INTERNET ECONOMY: ON A FAST TRACK

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COVID-19 has fast-tracked internet adoption in Southeast Asia, similar to how the SARS<sup>1</sup> outbreak catalyzed digitalization in China more than 10 years ago. Conditions have been ripe for Southeast Asia's e-transformation. Young and mobile-first populations, improving communication networks and affordable smartphones are among factors that have powered internet services in the region.

We see immense potential in Southeast Asia's internet economy. Amid rapid innovation across the board, three areas stand out to us for the secular growth opportunities they offer.

- **E-commerce:** The industry remains underpenetrated despite soaring sales. The proliferation of different business models has created scope for even traditional small businesses to participate in digitalization.
- **Financial technology (fintech):** Underbanked and cash-reliant populations have reeled in an array of fintech companies. Many offer e-wallets as a gateway to access a wider suite of financial products.
- **Gaming:** Successful games have found a global audience. Games are also evolving into social forums integrating chat functions and more modes of entertainment to boost user engagement and monetization potential.

Upcoming listings of fast-growing companies in these fields are likely to revitalize Southeast Asia's equity markets, whose old-economy focus has come under the shadow of North Asia's new-economy tilt. These listings could also offer diversification from widely held Chinese internet names. We believe that active investors like us, who can blend insights from North Asia's internet journey with perspectives from our Southeast Asian research teams to analyze distinct local trends, could gain an edge in identifying the best opportunities in the making.



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## A SHIFT INTO HIGHER GEAR

Southeast Asia's internet economy stands at an inflection point. Already massive, it accelerated in 2020 as COVID-19 pushed work, education and other essential activities online. The region's six largest economies—Indonesia, Malaysia, Philippines, Singapore, Thailand and Vietnam—saw 40 million new internet users in 2020 alone, taking the total number of users to 400 million, up 11% from 2019.<sup>2</sup> Of those who tried new digital services for the first time, 94% said they would continue with at least one of the services after the pandemic.<sup>3</sup>

Investors charting Southeast Asia's digitalization path have looked to China, where the 2003 SARS outbreak marked the dawn of e-commerce and other internet services in the country. China-based Alibaba Group launched its online shopping platform Taobao during the SARS epidemic. Last year, Taobao and other platforms under Alibaba generated sales of US\$74.1 billion in its annual "Singles' Day" shopping festival alone.<sup>4</sup>

Even before COVID-19 hit, Southeast Asia's internet adoption had been rising. Improving internet connectivity, increasingly affordable advanced smartphones, and swelling ranks of young mobile-first consumers have seeded a digital revolution unfurling beyond the bounds of desktops or laptops.

We think Southeast Asia's digital economy offers immense opportunities. The region is a diverse collection of countries at various stages of development, representing a huge addressable market with an overall gross domestic product (GDP) of around US\$3 trillion—slightly bigger than India.<sup>5</sup> Some 585 million people reside in the region, and an expanding middle class is ready to spend.<sup>6</sup>

### SOUTHEAST ASIA REPRESENTS A LARGE ADDRESSABLE MARKET

Exhibit 1: Select Southeast Asian countries

|   | Indonesia | Malaysia | Philippines | Singapore | Thailand | Vietnam |
|---|-----------|----------|-------------|-----------|----------|---------|
| GDP (US\$bn)  | 1,060     | 338      | 362         | 340       | 502      | 341     |
| Population (mn)                                     | 270       | 33       | 109         | 6         | 70       | 97      |
| Internet penetration (%)                            | 48        | 84       | 43          | 89        | 67       | 69      |
| E-commerce market size (US\$bn)                     | 32        | 6        | 4           | 4         | 9        | 7       |
| E-commerce penetration (%)                          | 8         | 4        | 5           | 14        | 5        | 4       |
| E-commerce spend using digital or mobile wallet (%) | 29        | 14       | 20          | 20        | 19       | 21      |
| Gaming market size (US\$m)                          | 1,680     | 876      | 572         | 327       | 667      | 472     |

Sources: GDP and population from International Monetary Fund, World Economic Outlook database: April 2021, as of 2020. Internet penetration from World Bank, as of 2019. E-commerce market size from Google, Temasek, Bain & Company, e-Conomy SEA 2020, At full velocity: Resilient and racing ahead, 2020. E-commerce penetration from Bernstein, June 16, 2021. E-commerce spend using digital or mobile wallet from FIS, The 2021 Global Payments Report, as at 2020. Gaming market size from Allcorrect Games, April 22, 2021, as of 2020.

## THE INNOVATION PROMISE

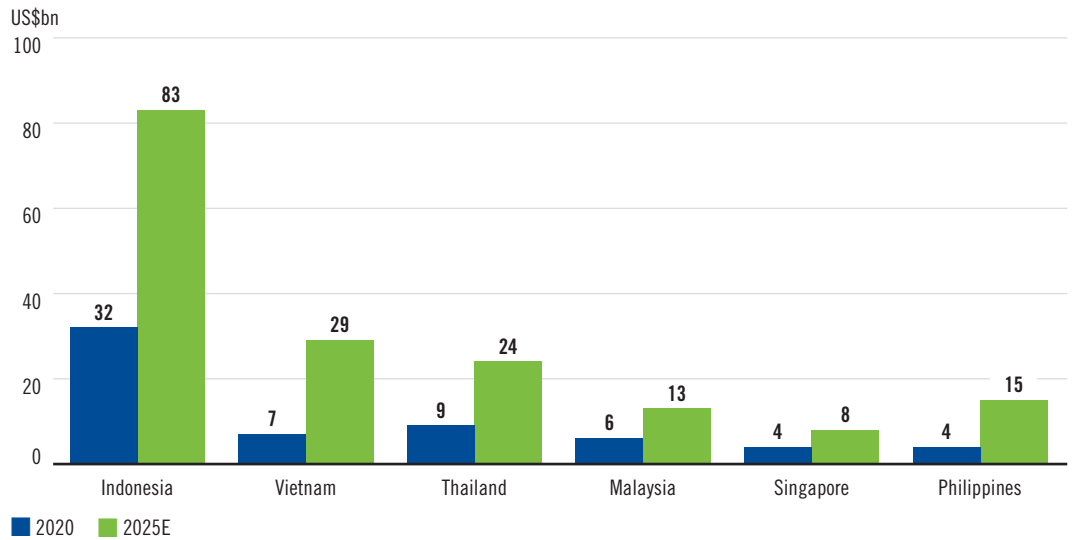
Internet-enabled businesses have made virtual inroads into previously untapped Southeast Asian markets, overcoming infrastructure gaps that beset parts of the region. We have seen rapid growth in e-commerce, fintech and gaming, and we expect their reach to widen further in the coming years. This heralds opportunities for pro-technology firms—and threats for the less savvy.

### E-commerce: More ways to spend

E-commerce has been one of the first and fiercest battlegrounds in Southeast Asia's internet space. Gross merchandise value in the region ballooned to US\$62 billion in 2020 and is expected to multiply to US\$172 billion by 2025.<sup>7</sup> For now, Southeast Asia's e-commerce penetration rate still looks low. It was around 6% in 2020, whereas China's had already crossed 20%.<sup>8</sup>

#### ONLINE SHOPPING SEES LONG RUNWAYS OF GROWTH

Exhibit 2: E-commerce markets by gross merchandise value (US\$bn)



Source: Google, Temasek, Bain & Company, "e-Economy SEA 2020, At full velocity: Resilient and racing ahead, 2020." E=estimated. There is no assurance any estimate, forecast or projection will be realized.

The e-commerce wave has altered the retail landscape, leaving many incumbents on the back foot. Physical department stores have lost market share. Multinational brands leveraging traditional distribution channels to dominate consumer spending have seen increasing competition from small and nimble local brands capturing demand online.

Change is equally present within e-commerce as different business models emerge. Besides conventional shopping platforms such as Lazada and Shopee (under Alibaba and Sea Limited respectively), livestreams and other social media channels have become new tools to win sales. Then there is the online-to-offline model, which melds digital conveniences with brick-and-mortar offerings, essential for less urbanized areas and less digitally savvy demographic cohorts. As an example, e-commerce players in Indonesia have collaborated with mom-and-pop shops known as "warungs" to offer digital services such as mobile credit top-ups and bill payments.

### Fintech: Nascent disruption

Fintech has secured a foothold in Southeast Asia, where universal access to banking services remains a challenge in its less developed countries, often due to deficient infrastructure. The number of "unbanked" people across the region is estimated to be 290 million—larger than Indonesia's population.<sup>9</sup> Many economies remain highly cash-based, out of necessity or habit. Given the lack of existing infrastructure and the profoundly underserved markets, fintech entrants have significant scope to leapfrog traditional financial players.

Gaps in financial inclusion have attracted an array of fintech providers, ranging from internet start-ups to established telecom firms. Banks have also entered the fray to defend their turf and reap potential efficiencies. For one thing, fintech could reduce their need for physical branches, leading to lower costs and higher profits. Technology-powered data collection and analysis could also strengthen credit assessments and other risk management processes. Banks' modernization, along with the spread of new fintech companies, has the potential to raise the efficiency of financial systems in Southeast Asia.

E-wallets have proliferated in recent years, riding on the boom in smartphones and e-commerce. COVID-19 has fueled e-wallet usage further. Digital payment gross transaction values in Southeast Asia amounted to US\$620 billion in 2020 and could double to US\$1.2 trillion by 2025.<sup>10</sup>

Ambitious fintech players view e-wallets as a launchpad for more—and often disruptive—services. Digital loans, robo-advice and bite-sized insurance are among novel offerings that have emerged. Expectations for digital lending are especially high given low credit penetration rates in Southeast Asia. The region's digital loan book, at US\$23 billion in 2020, is estimated to quadruple to US\$92 billion in 2025.<sup>11</sup>

### **Gaming: An evolving play**

Southeast Asia's gaming industry has thrived with the rise of sophisticated mobile games and competitive esports. COVID-19 lockdowns drew even more users to gaming, a pastime that could stick beyond the pandemic. The gaming market was worth around US\$5 billion in 2020 and is projected to reach US\$13 billion by 2025.<sup>12</sup>

Some regionally developed games have built an international following. Sea's digital entertainment arm Garena launched Free Fire in 2017, which has since gained users across Asia, Latin America, North America and the Middle East. Available in more than 130 markets, it was the most downloaded mobile game globally in 2019 and 2020.<sup>13</sup>

Gaming companies have relentlessly sought to raise user engagement, which is key to boosting product longevity and in-game purchases. Many games have evolved into broader social platforms where users can interact and discover music and other forms of entertainment. Illustrating this trend, Free Fire partnered with world renowned music producer DJ Alok to feature his live concert and create a game character modeled after him.

## **NEW-ECONOMY DYNAMISM**

A flood of capital into Southeast Asia's internet economy has minted unicorns across the private and public markets. More than 10 companies in the region were each valued at more than US\$1 billion in 2020, including Singapore-based "superapp" operator Grab Holdings, Indonesian e-commerce company Bukalapak and Indonesian ride-hailing and e-commerce group GoTo.<sup>14</sup>

Several private companies have initial public offerings in sight. We expect a string of internet company listings to rejuvenate Southeast Asia's equity universe, whose old-economy heavyweights have been overshadowed by North Asia's technology giants.

## **LOCAL AND GLOBAL INSIGHTS**

Navigating Southeast Asia's internet economy will require skills and agility. Internet companies must be prepared to take a highly localized approach, tackling different languages, cultures, geographies and regulations with specialized solutions.

Likewise, investors evaluating these companies will need discernment. Our experience investing in North Asia's internet space offers an instructive guide for how we can view Southeast Asia's digitalization path. Yet, context remains crucial. Given the idiosyncrasies in each Southeast Asian market, we consider it vital to integrate insights from our local research teams with our global perspectives as we assess each investment opportunity from the bottom up.

In our view, recent regulatory scrutiny in China's internet industry has enhanced the relative attractiveness of Southeast Asia's internet space, with the potential to boost flows as investors seek to diversify. While we retain a positive fundamental view on China's internet giants, policy risk has driven increased risk premia and reduced valuations. By contrast, in Southeast Asia, internet companies are mostly at an earlier stage of development and market concentrations are generally slimmer. And compared with China, Southeast Asian governments have different priorities that make severe regulatory action in the internet space less likely, at least in the short to medium term.

This policy backdrop, coupled with COVID-19 revving up digitalization, has strengthened our case for Southeast Asia's internet economy. As its e-commerce, fintech and gaming industries potentially gain even more ground ahead, now could be the time for investors to examine these areas for long-term opportunities.

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#### Endnotes

1. Severe acute respiratory syndrome.
2. Source: Google, Temasek, Bain & Company, "e-Conomy SEA 2020, At full velocity: Resilient and racing ahead, 2020." There is no assurance any estimate, forecast or projection will be realized.
3. Ibid.
4. Source: Alibaba Group, November 12, 2020.
5. Source: World Economic Outlook database: April 2021, International Monetary Fund. Representative Southeast Asian countries: Indonesia, Malaysia, Philippines, Singapore, Thailand, Vietnam.
6. Ibid.
7. Source: Google, Temasek, Bain & Company, "e-Conomy SEA 2020, At full velocity: Resilient and racing ahead, 2020." There is no assurance any estimate, forecast or projection will be realized.
8. Source: Bernstein, June 16, 2021.
9. Source: Fitch Ratings, Digital Banks in South-East Asia, August 19, 2020.
10. Source: Google, Temasek, Bain & Company, "e-Conomy SEA 2020, At full velocity: Resilient and racing ahead, 2020." There is no assurance any estimate, forecast or projection will be realized.
11. Ibid. There is no assurance any estimate, forecast or projection will be realized.
12. Source: BofA Global Research, June 30, 2021. There is no assurance any estimate, forecast or projection will be realized.
13. Source: Sea Limited
14. Source: Google, Temasek, Bain & Company, "e-Conomy SEA 2020, At full velocity: Resilient and racing ahead, 2020." There is no assurance any estimate, forecast or projection will be realized. GoTo was formed from the merger of Gojek and Tokopedia—each considered a unicorn—in 2021.

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