HEIJIN CAPITAL

HEIJIN CAPITAL BI-WEEKLY INVESTMENT COMMENTARY

June 28th – July 12th, 2020

HEIJIN CAPITAL

Commentary Overview

Market Snapshot

INDEX	CLOSE	2 WEEKS	YTD
Dow Jones Industrial Average	26,075	+1.9%	-9.7%
S&P 500 Index	3,185	+4.32%	-2.23%
NASDAQ	10.617	+7.53%	+16.78%
10-yr Treasury Yield (% yield)	0.65%	+0.01%	-1.23%
WTI Oil ($/bbl)	$40.55	+2.14%	-33.59%
Bonds	$118.49	+0.32%	+5.16%

*bonds are represented by the iShares Core U.S. Aggregate Bond ETF (NYSEARCA:AGG)

HEIJIN CAPITAL

Global Macro

China Rally - What's Next?

The past week has been the best week for Chinese equities in 5 years, ever since the Chinese stock market bubble in 2015. While in most western countries, stock indices are negative year-to-date, Chinese indices are positive; for instance, the Shanghai Composite Index is up almost 10% since the beginning of the year, despite the pandemic. China's strong stock market at the moment is quite an exception for the country in which historically equity markets performed modestly well. The question is now whether the bull market in China will last or not.

Who invests in Chinese equities is probably aware that the Chinese market is different from Western stock markets, in that the government's influence is substantial and reliable information is mostly distributed asymmetrically. Indeed, also this week's strong returns were fueled mainly by the government, and it's the endorsement of a "healthy bull market" in state-run media on Monday.

However, at the core of this year's rally are similar to the "Robinhood rally" retail investors. The pandemic led in China as most parts of the world to higher household savings rate. Since the yield of savings accounts and fixed income products are low, many Chinese people moved their money into stock markets and fueled an almost self-reinforcing rally. As the markets gained momentum, people began sharing stock analysis and trading gains on social media apps such as Weibo, leading to even more people buying stocks.

Another factor in the current rally in China is the People Bank of China's decision not to engage in significant monetary easing. When the pandemic broke out, many people expected the PBOC to lower rates and bought, therefore bonds to take part in a bond rally. However, as in recent weeks, it became increasingly evident that there won't be a significant monetary response; people moved their money out of bond markets, which suffered severe losses, and likely into stock markets.

Where markets are going from is uncertain. On Friday, Chinese state-owned funds announced they would pull out assets from stock markets, which can be interpreted as a signal that the government wants stock markets to cool down a bit to avoid the fate of the bubbles in 2007 and

2015. Consequently, in the short-term, we expect Chinese stocks to remain flat or decline. In the long-term, however, we think that the Chinese government will aim for a bull market, so companies under pressure from COVID can raise funds easier. Moreover, so far, most Chinese citizens invested their savings in the booming property markets; however, as this led to housing crises in China, the government is increasingly limiting investing in property markets for capital gains. Consequently, Chinese people will need another place to park their money, which could be equity markets.

Heijin's take on the situation is that while we are modestly bullish on Chinese equities in the long-term, we do not invest, and we do not recommend investing in Chinese equities unless someone is an expert of Chinese equity markets. For the normal market participant, investing in Chinese equities often resembles gambling, as markets depend substantially on asymmetrical (insider) information and the government.

HEIJIN CAPITAL

Sector Analysis
Wearable Medical Tech

As our lives become ever more entwined with technology, leaps and bounds have been made in all aspect from our phones, our cars and even the way we run our baths. One of the sectors that has obviously benefited from this expanse in technology is the medical industry. In the last decade alone, we have seen revolutionary new devices and procedures that have saved, improved and lengthened lives. As populations grow and budgets are slashed, we have seen increasing strain on the health care systems of many of the world's leading economy. The price of being admitted to hospital is startling, it cost roughly £300 for an ambulance to be called in the United Kingdom, and roughly £400 a day just to be in a hospital bed, let alone the cost of treatment which for some procedures for diseases such as cancer can be easily a 6-figure cost. This is why preventative medical care will play an ever-increasing role in society as we can begin to monitor and improve people's health before they need hospital care, reliving strain on the healthcare system and the taxpayer.

One such example of the marriage of preventative medicine and advances in technology is in the wearables market. The US consumer use of wearables increased from 9% to 33% in just four years. The market is expected to boom in the next decade with an expected growth over the next 5 years at a CAGR of Over 13% putting the expected value of the industry at $56.2 BN in 2024. Initially it was brands such as Fitbit and Garmin who's activity trackers allowed health conscious consumers to track their daily steps and average heat rate. However, the new generation of tracker is much more than a gimmicky accessory, but a valuable addition to both the wearer’s life and insurers bottom lines, who can track their health in real time, thus allowing them to be placed on the right plan and also notify wearers of a potential issue before it comes an real threat requiring medical attention. This is the future of medicine, where the focus is on the health and wellbeing of patients before they become patients. The ability to address potential problems before they become a serious issue later will massively improve patient wellbeing, reduce treatment costs and alleviate strain on the globe’s health care systems. So which companies are leading the charge on the future of wearable medical tech?

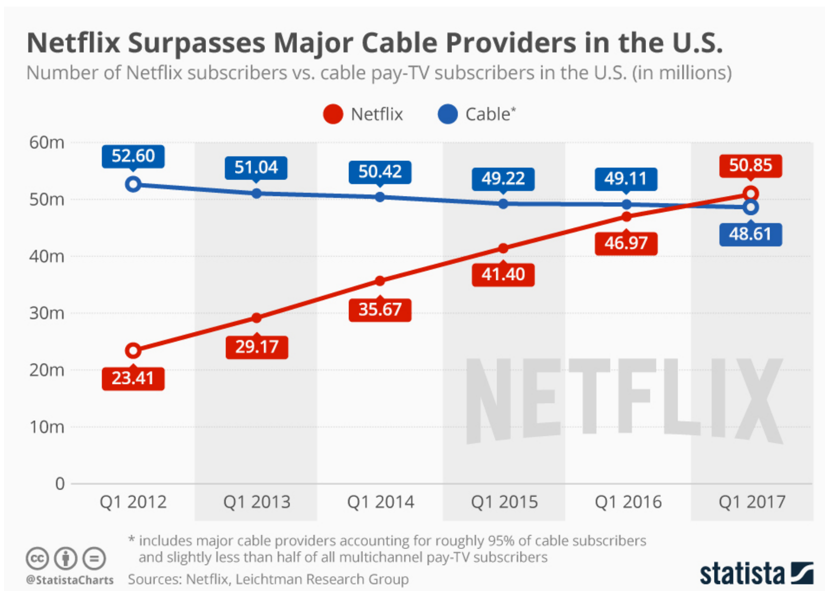
Masimo Corp. (NASDAQ:MASI) - Masimo is an American manufacturer of noninvasive patient monitoring technologies based in Irvine, California. The company sells more pulse oximetry to hospitals than any other company. Masimo is an industry renowned and widely trusted supplier of medical devices to improve patient outcomes. Their SET (Signal extraction technology) revolutionized pulse oximetry products due to its unparalleled accuracy even in challenging conditions such as external noise and cold extremities. Their wearable provides breakthrough measurements that are not available on other health or wellness devices. Wearers can accurately track lung function, pulse rate, perfusion rate, respiration and Pleth Variability index. This is then all displayed, tracked, displayed visually through their app. Moreover, Masimo have recently launched the SafetyNet-covid-19 remote patient solution which helps ensure the safety of patients, doctors and front-line workers through their cloud based remote monitoring systems, allowing doctors to remotely tend to their patients. The Masimo SafetyNet clinician portal allows providers to track patient compliance, helping them to identify when intervention may be required, as well as offer insight to help them prioritize patients. With advanced automation features, institutions can more easily deploy home care monitoring at scale while ensuring clinicians stay informed of important developments in a patient's condition. The company itself is financially robust and has a strong reliable earning profile, with the next five years forecast earnings growth rate to be over 10%. The company over the past 5 years has made brilliant advances in debt reduction, recently becoming debt free compared to 2015 when its debt to equity ratio was 38%. In Massimo we see a forward thinking, industry leader with solid financials and a stellar future ahead.

HEIJIN CAPITAL

Investment Analysis
Netflix And Its Growing Competition

Netflix has become a household name in most countries across the globe and has played a major part in the digitalization of the entertainment world. But the major players in the movie production/entertainment space that lagged in the digitization of their business are gaining subscribers at breakneck speed.

Netflix in our view is almost like the Tesla of the entertainment and movie production industry. Once upon a time an underdog and today it is at the forefront and a market leader in some ways. A few years ago, Netflix was simply a streaming platform that gave subscribers access to an enormous selection of movies, TV shows, and documentaries. At the time their service began to destroy other platforms such as the iTunes store (for movies) that charged a user per movie (sometimes in excess of $15-20) or to rent them. In comparison to Netflix that today charges from $9 to $16 with no limit on the number of hours/movies watched/TV shows watched etc. For most consumers Netflix rapidly became a no-brainer especially for those that payed for cable only for movies on occasions, which tends to cost >$100 in the US per month. In a way Netflix was also detrimental to the "grey area" world of free streaming platforms online (e.g. 123movies, Putlocker(s), Popcorn Time etc). From the chart below by Statista we can see that it was in Q1 2017 that Netflix turned the tables.



COVID-19 & Netflix

Many investors that did not think through Netflix's business model may have initially thought that millions of people confined in their homes would have significantly pushed up revenues because of more hours watched. But the only way Netflix significantly improves their top-line is with more eyeballs, I.e. more subscribers.

For Q1 2020, Netflix forecasted that they would add 7m subscribers in Q1 alone (at the time when very few had anticipated the state of the world months after 01/01/2020), but as rightly expected by some they knocked it out of the park with over 15m added subscribers. This is what majorly drove up their top-line growth.

As expected, subscriber growth in UCAN remained in-line with previous years, however in other regions subscriber growth for Q1 2020 was incredibly strong as shown below.

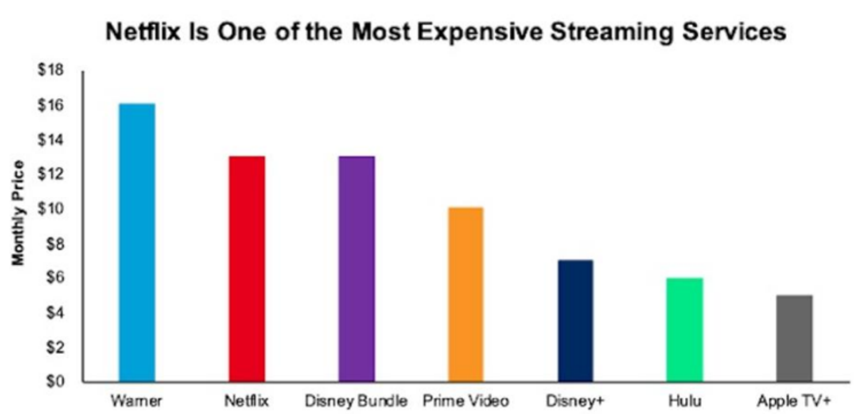
(in millions)	Q1'19	Q2'19	Q3'19	Q4'19	Q1'20
UCAN Streaming:					
Revenue	$ 2,257	$ 2,501	$ 2,621	$ 2,672	$ 2,703
Paid Memberships	66.63	66.50	67.11	67.66	69.97
Paid Net Additions	1.88	-0.13	0.61	0.55	2.31
ARPU	$ 11.45	$ 12.52	$ 13.08	$ 13.22	$ 13.09
Y/Y % Growth	4%	12%	17%	17%	14%
F/X Neutral Y/Y % ARPU Growth	4%	13%	17%	17%	14%
EMEA:					
Revenue	$ 1,233	$ 1,319	$ 1,428	$ 1,563	$ 1,723
Paid Memberships	42.54	44.23	47.36	51.78	58.73
Paid Net Additions	4.72	1.69	3.13	4.42	6.96
ARPU	$ 10.23	$ 10.13	$ 10.40	$ 10.51	$ 10.40
Y/Y % Growth	-4%	-6%	1%	3%	2%
F/X Neutral Y/Y % ARPU Growth	2%	3%	6%	7%	4%
LATAM:					
Revenue	$ 630	$ 677	$ 741	$ 746	$ 793
Paid Memberships	27.55	27.89	29.38	31.42	34.32
Paid Net Additions	1.47	0.34	1.49	2.04	2.90
ARPU	$ 7.84	$ 8.14	$ 8.63	$ 8.18	$ 8.05
Y/Y % Growth	-11%	-5%	8%	9%	3%
F/X Neutral Y/Y % ARPU Growth	7%	12%	17%	18%	12%
APAC:					
Revenue	$ 320	$ 349	$ 382	$ 418	$ 484
Paid Memberships	12.14	12.94	14.49	16.23	19.84
Paid Net Additions	1.53	0.80	1.54	1.75	3.60
ARPU	$ 9.37	$ 9.29	$ 9.29	$ 9.07	$ 8.94
Y/Y % Growth	-2%	-1%	0%	-1%	-5%
F/X Neutral Y/Y % ARPU Growth	3%	5%	3%	0%	-3%

Over the past five years Netflix has added many subscribers thanks to its in-house productions (referred to as Netflix Originals). Many of these movies or TV shows have gained immense popularity across the globe and today are a significant driver of Netflix's growth. In fact, executives at market leaders such as Warner Bros and Disney are getting increasingly worried as their productions typically take significantly longer to roll-out and have higher budgets.

Netflix is able to be nimbler and finances all these productions by issuing debt as their >182m subscriber base provides a consistent cash flow stream. This why their FCF profile is not as healthy as Disney's for example that stood at $2.2bn in Q1 2020 alone (although Disney holds multiple lines of business and is not directly comparable to Netflix in some cases).

At the end of Q1 2020, Netflix reported FCF of $162m in comparison to $(480) m in Q1 of last year. Many investors that again don't look at financials looked at this positively, but these are misleading if we only glance at the figures in the earnings announcement. As previously outlined, Netflix has significant OpEx for their production activities. However, due to COVID-19 most of their productions were stopped apart from productions in Iceland & Korea, which translates into a sharp reduction in costs/cash used for these productions across the globe. These reductions will make Netflix seem more attractive on an FCF basis as it is forecasted to be $(1)bn for 2020 in comparison to the $(2.5)bn loss they expected. But these costs are only being passed over to the following year where more productions will begin and delayed ones will resume, which should have a drastic impact on their FCF profile.

Heijin views Netflix as a strong player in the entertainment space, but uncertain credit markets may make it more expensive for them to finance new productions despite the lower RFR. In the end, Netflix has a BB- credit rating, which means they issue junk bonds, and in today's markets not many have the appetite for riskier assets. The primary way we and other firms on the street see Netflix significantly improving their bottom-line is by adding Ads. There was a time when Facebook, Spotify, and so many others did not have Ads as they waited for mass market adoption before doing so. But Netflix is in a prime position as they have a 182m subscriber base and simply adding Ads in the 5 second transition period between episodes could be a big plus. If Netflix's future productions generate less subscriber growth and simply increase underlying operating costs, they may deviate into a territory of an ever-growing debt burden and lacklustre FCF compared to its competition. Netflix is considered as a luxury now compared to other similar streaming platforms that are much cheaper for consumers in less-developed economies. The main reason behind this is that these competitors are offered by Apple, Amazon, Google (Youtube), Disney and more that generate FCF from other operations and can actually afford a loss-making service for an extended period of time to gain market share. After all, today, both Amazon and Apple



HEIJIN CAPITAL

also have in-house studios to make productions with much larger budgets. These competitors are Heijin's biggest concern and should make investors dampen their growth expectations and consequently lowering its valuation, that even today is becoming less justifiable by some measures.

Contact Details

Gregory Laurent Josi
Founder, Managing Director & CIO
gregory.laurentjosi@heijincapital.com

Pasha Tinkov
Executive Director & COO
pasha.tinkov@heijincapital.com

Moriz Martiner
Research Analyst
moriz.martiner@heijincapital.com

James Schofield
Director
james.schofield@heijincapital.com

HEIJIN CAPITAL

DISCLAIMER

Persons who access the information made available on the Heijin Capital S.A. and its affiliates (collectively, “Heijin”) website (the “website”) agree to the following:

While the material on this website is often about investments, none of it is offered as investment advice. For members of the public, this means that neither the receipt nor the distribution of information through this website constitutes the formation of an investment advisory relationship or any similar client relationship. The materials on this website are for informational purposes only and may not be relied on by any person for any purpose and are not, and should not be construed as investment, financial, legal, tax or other advice, recommendation or research.

The information contained herein does not constitute a distribution, an offer to sell or the solicitation of an offer to buy any securities in any jurisdiction in which such distribution or offer is not authorized.

This website may contain forward-looking statements on our current expectations and projections about future events. Statements that are predictive in nature, that depend upon or refer to future events or conditions or that include words such as “expects,” “anticipates,” “intends,” “plans,” “believes,” “estimates,” “thinks,” “seeks,” “targets,” “forecasts,” “could” or the negative of such terms or other variations on such terms or comparable terminology. Similarly, statements that describe Heijin's objectives, plans or goals are forward-looking. Any forward-looking statements are based on Heijin's current intent, belief, expectations, estimates and projections. These statements are not guarantees of future performance and involve risks, uncertainties, assumptions and other factors that are difficult to predict and that could cause actual results to differ materially.

These factors include, among other things, (1) general economic and business conditions; (2) new governmental regulations and changes in, or the failure to comply with existing governmental regulation, (3) legislative proposals that impact our industry or the way we do business, (4) competition, and (5) our ability to attract and retain qualified personnel. Accordingly, you should not rely upon forward-looking statements as a prediction of actual results and actual results may vary materially from what is expressed in or indicated by the forward-looking statements.

No representation or warranty is given in respect of the correctness of the information contained herein as at any future date. Certain information included in this communication is based on information obtained from third-party sources considered to be reliable. Any projections or analysis provided to assist the recipient of this communication in evaluating the matters described herein may be based on subjective assessments and assumptions and may use one among alternative methodologies that produce different results. Accordingly, any projections or analysis should not be viewed as factual and should not be relied upon as an accurate prediction of future results. In addition, this website may contain performance and other data. Past performance is not indicative of future performance.

This website contains hyperlinks to websites operated by Heijin and other parties. Heijin does not control the content or accuracy of information on third-party websites and does not otherwise endorse the material placed on such sites.

All information and content on this website is furnished “AS IS,” without warranty of any kind, express or implied. Heijin will not assume any liability for any loss or damage of any kind arising, whether direct or indirect, caused by the use of any part of the information provided. Heijin and its licensors do not warrant that the content is accurate, reliable or correct; that the website will be available at any particular time or location; that any defects or errors will be corrected; that unauthorized access to or misappropriation of the content will not occur; or that the content is free of viruses or other harmful components. Your use of the website is solely at your risk.

Thank you for your understanding,
Heijin Capital Management

*Past performance does not guarantee future results, which may vary. The value of investments and the income derived from investments will fluctuate and can go down as well as up. A loss of principal may occur.