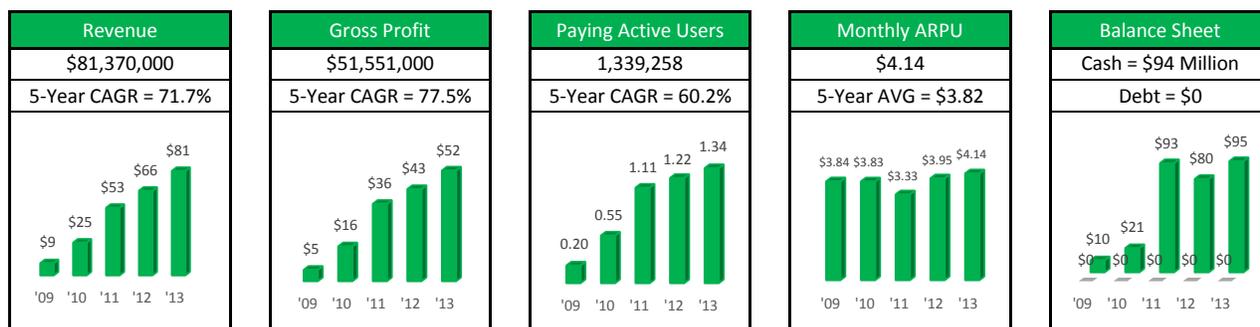




Jiayuan International
July 28, 2014

General Overview

Jiayuan International operates the largest online dating website in mainland China with more than 100 million registered users. The website is geared toward addressing the dating and marriage needs of China's rapidly growing urban singles population by providing trusted, effective platforms and superior user experiences. Jiayuan.com targets single adults that have the intention of forming long-term relationships with an end goal of marriage. The website ranks first in terms of the number of unique visitors and time spent among all online dating websites globally.



Purchase Logic

We acquired our stake in DATE at \$5.42 per ADS share for a total market capitalization of \$165 million. To calculate our effective purchase price we subtracted roughly \$80 million in surplus cash that was accumulated from operating earnings and the company's IPO in 2011. After subtracting this cash our effective purchase price was roughly \$85 million. In 2013 the company earned slightly more than \$10 million giving us an effective purchase price of 8.5x 2013 earnings. This purchase price was a substantial discount to the average 16x forward looking earnings of the average S&P 500 constituent. We believe that this discount was available due to two short-term headwinds: 1) The ARPU is on a temporary decline due to user migration from the PC to mobile platforms and 2) An unusually high marketing budget for television advertising in 2014 that will reduce earnings. We expect ARPU to increase in 2015 and 2016 when the mobile platform is fully developed and the company shifts its focus to monetizing active users. We have seen many companies successfully perform this shift in the last two years and believe Jiayuan will also be successful. The unusually high marketing budget was a discretionary expense that the CEO felt was necessary to continue to position the company as the nation's leader in online dating. This was the first time the company engaged in such an extensive advertising campaign and we believe the marketing budget will return to more normal levels moving forward.

Key Metrics

The key metrics for the business are Revenue, Gross Profit, Paying Active Users, ARPU, and Offline Revenue. Below is a brief description of these key metrics.

Revenue

Revenue is generated by charging the users fees for various services provided by the site. For example, the majority of revenues are derived by charging a 'digital stamp' when users send a message to connect with another member of the dating community. This digital stamp typically costs \$0.33 when the recipient accepts the message. All further communication is free. Users are also able to send digital gifts, such as flowers, for a small fee to demonstrate interest in a prospective partner.

Every user has a varying degree of online activity and generates a different volume of revenue for the business. To calculate the company's revenue the average revenue per user is multiplied by the number of active users plus the offline revenue. This metric is the ultimate gauge of Jiayuan's value proposition to the customer base and overall dominance in the online dating market.

Gross Profit

The gross profit is calculated by subtracting all expenses that are directly related to providing services to Jiayuan's online dating community. Expenses include salaries for software personnel to develop the site, IT costs associated with operating the data center, and payment processing expenses associated with collecting revenue from users. Gross profit excludes client acquisition costs and marketing. We believe this metric is more important than gross margins because as the user base grows Jiayuan is able to leverage the operating platform's fixed cost structure across more users allowing them to charge less per user (lower margins), but increase overall profits.

Paying Active Users

Paying Active Users are individuals that utilize Jiayuan's online services and have made some form of payment in the last 30 days.

ARPU (Average Revenue Per User)

The ARPU is defined as the average revenue generated by a single paying active users per month. The online revenue of the business can be calculated as follows:

$$\text{Online Revenue} = \text{ARPU} \times \text{Paying Active Users} \times 12$$

Offline Revenue

In recent years the company has launched a campaign to generate additional revenue through traditional match making services. In China it is not uncommon for wealthier individuals to pay roughly \$1,500 to hire a professional match maker; this is a multi-billion dollar industry. Jiayuan is uniquely placed with more than 10,000 registered users in over 100 Chinese cities. The company has been launching physical store locations in these key locations that specialize in offline personal match making services. Due to the massive online presence these new store locations have been extremely successful and could be an outstanding avenue for growth in the future.

Historical Performance of Key Metrics

Year	'09	'10	'11	'12	'13
Total Revenue	\$9,359,000	\$25,432,000	\$52,628,000	\$65,936,000	\$81,370,000
<i>Gross Profit</i>	\$5,192,000	\$16,168,000	\$35,975,000	\$42,874,000	\$51,551,000
Active Users	203,317	552,930	1,111,060	1,224,890	1,339,258
Monthly ARPU	\$3.84	\$3.83	\$3.33	\$3.95	\$4.14
Offline Revenue	\$0	\$0	\$8,256,708	\$7,846,817	\$14,771,378
Cash	\$10,169,000	\$20,545,000	\$93,079,000	\$79,576,000	\$94,839,000
Debt	\$0	\$0	\$0	\$0	\$0

Revenue

In the last 5 years Jiayuan has compounded revenue at a rate exceeding 70%. This rapid growth was attributed to the success of their online dating platform. As the number of active users has grown revenue has compounded accordingly. Jiayuan is now the largest online dating site in China and holds a 60% market share. Due

to this dominant market position and a relatively saturated market we do not anticipate meaningful revenue growth from the online platform in the upcoming years.

The company has recently launched a new business initiative focusing on an online-to-offline model to drive additional revenue growth. This revenue growth comes from personalized match making services at physical store locations. The runway for growth in this area is very long and has a strong potential to greatly increase the company's bottom line. It is our expectation that in 3 years the company will double revenues through this offline channel by opening physical store locations.

Gross Profit

Gross profit has increased in-line with revenues at a rate of more than 70% over the last 5 years. Historically revenue and gross profits have moved in tandem due to the relatively stable gross profit margins (63-68%). We anticipate that the gross margins will decline in the upcoming years as Jiayuan lowers pricing and derives more revenue from the offline model. This will decouple the link between revenue and gross profit causing gross profit to grow less quickly than revenues. It is our expectation that gross profit will continue to rise despite lower margins at a rate between 10-15% for the next 5 years as the offline model gains traction.

Paying Active Users

The number of paying active users has grown from 203,000 in 2009 to more than 1,300,000 today. When Jiayuan was founded the online dating market in China was relatively untapped and new users flocked to Jiayuan's platform. Now that the market has matured we anticipate very little growth in paying active users over the next 5 years.

ARPU (Average Revenue Per User)

The ARPU has been relatively stable for the last 5 years, but in 2014 has seen a moderate decline. This decline is due to the migration of the user base from the PC to mobile devices. The ARPU on mobile devices is less than the ARPU for users on the PC. In the last two years Jiayuan allocated considerable resources building out an attractive mobile platform for users to engage their dating community. This investment has paid off considerably as engagement on the mobile platform now accounts for more than 50% of all activity to the site. With this process largely complete the company will begin to revamp monetization efforts on the mobile platform to increase ARPU on the mobile platform. We believe these efforts will bring APRU from mobile in-line with the PC. The ARPU should return to historical averages as these efforts begin to bear fruit. Over the next 10 years we anticipate relatively stable ARPU with fluctuations between -20% to +20%.

Offline Revenue

Historically the offline revenue has been a small contributor to Jiayuan's top line. The company has recently launched a campaign to attract some online users to physical store locations for personalized match making. The company currently operates 59 store locations and is increasing this number to more than 80 locations in 2014. The same-store-sales at existing locations was up more than 34% year-over-year demonstrating that the model is building momentum. It is our expectation that in 2014 and 2015 the company will compound offline revenue at a triple digit rate and it will contribute roughly 50% of all revenue by 2018.

Summary of Key Metrics

Metric	Expectation
Revenue	Growth of approximately 20% per year
Gross Profit	Growth between 10-15% per year
Active Users	Relatively flat
ARPU	Decrease in 2014 Return to historical average by 2016
Offline Revenue	Near term triple digit growth More than 50% of revenue by 2018

The Moat Around The Metrics

Jiayuan benefits from several positive dynamics that help create an economic moat around the business. The company has a network effect among users, slight pricing power, strong operating leverage, user stickiness, and a trusted brand name.

Network Effect

The industry for online dating tends to lend itself to a few key players winning the entire market. The reason for this dynamic is related to the network effect among users. An individual interested in dating benefits from having more user profiles to select from in their local area. The more users the better the service, the better the service the more users. This provides some stability in the market share of the major online dating players in developed countries. It is difficult for new sites with no users to gain traction against larger incumbents.

Pricing Power

Most online dating sites compete against free versions of their online dating service. However, one advantage to online sites that target individuals interested in serious relationships is that users would *prefer* to pay. The majority of free online dating sites are littered with incomplete user profiles, inactive users, and young adults that are interested in ‘hooking up’. By requiring users to pay and complete robust user profiles it filters out individuals that are not interested in a serious relationship. This provides a slight form of pricing power for the most dominant online dating sites that serve users interested serious relationships.

Operating Leverage

While individuals looking for serious relationships would prefer to pay something they still are price conscious. The relatively fixed costs associated with operating an online site allow Jiayuan to charge less and maintain gross profits as additional users join the company’s platform. The large market share positions the company well to be price competitive while still investing into substantial advertising campaigns that protect and cultivate the brand image.

Stickiness

Completing an online profile for a serious dating site can take anywhere from 1 to 2 hours. The more complete the profile the better odds an individual has of attracting an appropriate spouse. For this reason many individuals spend a meaningful amount of time completing these user profiles. The time required to complete a profile makes individuals slightly resistant to switching to a new platform. In the last 5 years more than 100 million users in China have registered with Jiayuan.

Brand Name

Online dating sites must position themselves as a trusted and reputable business to attract user engagement. Jiayuan is by far the most trusted and respected online dating site in China. The phrase “Jiayuan” was searched 50 times more often than the common term “dating website” on Baidu.com. This is a huge competitive advantage for Jiayuan when it comes to attracting new users. The operating leverage inherent in the business model allows them to continue to invest additional resources into branding efforts while remaining price competitive.

Risks

Jiayuan possessed unique investment characteristics at our time of purchase. When we acquired our stake in Jiayuan the business had more than 50% of its market capitalization held as cash on hand. This large cash position greatly limited the downside risk. Due to the limited downside risk we acquired a position size of approximately 10% of portfolio assets. Below are the primary risks we’ve assumed as owners of Jiayuan.

Short-Term Risks

- **Cyber Attacks.** As an online company there is always the potential of a cyber-attack removing the site from service. This would decrease revenues during the downtime, hurt the brand name, and could possibly compromise user information leading to a law suit. In the event of a cyber-attack we believe the short-term performance of the business would be impacted, but the long-term prospects of the business remain intact.
- **Material Deficiencies on Internal Controls.** During 2010 and 2011 the company had deficiencies in internal controls over financial reporting measures. This deficiency was corrected starting in 2012. Should the company fail to maintain internal controls over financial measures for reporting purposes on the US stock exchanges it could materially impact the short-term performance of the stock.
- **Fraud.** Owning companies domiciled in China comes with the risk of investment fraud. However, we believe the probability of Jiayuan overstating earnings, market share, or financial performance is remote. The online dominance of Jiayuan is easy to verify through third party research that monitors web traffic to the website. Additionally, the company has mailed dividends totaling more than \$30 million to shareholders since going public in 2011. Substantial dividend payments of this magnitude are evidence of real cash flows and legitimate financial performance.

Long-Term Risks

- **Rising Client Acquisition Costs.** Online dating businesses are defined by high user churn. As users churn off the platform it is important that new users replace those exiting. This process typically involves paid search advertising to acquire new clients. If the client acquisition costs rise due to increased competition for new users it would materially impact the business. We view this risk as remote due to the strong brand name, competitive position, and leveraged operating costs of Jiayuan. These factors allow Jiayuan to pay more to acquire customers than the competition due to a higher customer life time value.
- **New Entrants.** It is relatively cheap to establish new online dating businesses. The low barriers of entry make it easy for new entrants to attempt to penetrate the market. We view this risk as remote due to difficulty in reaching a ‘critical mass’ of users when competing against incumbent sites. The network effect of online dating makes it difficult for new sites to gain traction.
- **Declining ARPU.** It is possible that the ARPU will not recover due to difficulties monetizing the mobile platform. In the event that ARPU does not recover, or continues to decline, it would materially impact the business.

- **Offline Model Fails.** In the event that the offline model fails and does not generate additional income for the business the growth prospects would be materially impacted. In 2013 Jiayuan generated \$10 million in income strictly from the online platform. Our purchase price of \$85 million is attractive even in the event that the offline business is not successful.

Conclusion

Jiayuan.com is the leading online dating site in China. We purchased the company for \$165 million, but more than 50% of this purchase price was covered by the \$95 million in cash held by the business. Our effective purchase price of 8.5x forward earnings was roughly half the price of an average S&P 500 constituent. We received this discount due to temporary headwinds as the business transitions users to the mobile platform and spends heavily on advertising in 2014. The key metrics for the business are revenue, gross profit, paying active users, ARPU, and offline revenue. We view all of these metrics trending positively in the upcoming years due the company's strong competitive position. The economics of the business are protected by a strong network effect, slight pricing power, operating leverage, stickiness in the user base, and a powerful brand name. We anticipate receiving substantial dividend payments from the company's large cash position or to sell the business if the price rises to approximately 12x forward earnings.

Works Cited

- 1) *DATE Annual Report - SEC Filing 20-F*. EDGAR, 2013.

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