

Alibaba lottery, and more than lottery

Rating **Not Rated**
Current price **HK\$1.30**

- Utilizing Alibaba's offline POS and online merchant resources**
AGTech has entered into framework agreements with Alibaba Holding and Ant Financial in 1Q17, of which AGTech would act as the exclusive lottery platform of Alibaba and Alipay. AGTech has already pilot launched the physical distribution of Sports Lottery products through the "Rural Taobao" ("農村淘寶") network. We expect most Rural Taobao store owners would welcome these lottery products as they can earn extra commission income. As of end 2016, there were ~28,000 Rural Taobao POS nationwide, and Alibaba Group target to have 100,000 POS by 2020. AGTech could also cooperate with the merchants on Taobao and Tmall to utilize physical lottery products as a creative promotion tool.
- Partner with SF Express to offer lottery products through its couriers and services points nationwide**
AGTech has also established a 50:50 JV, "SF Lottery" ("順豐彩") with SF Holding. "SF-Themed Instant Scratch Lottery" designed by SF Lottery was approved by MOF as a national lottery product. This product has two major innovative elements: i) a redemption QR code linking with mobile payment systems; and ii) an additional lucky draw QR code which could be an advertisement platform for various companies. SF-Themed Instant Scratch Lottery was recently launched in Guangdong, Jiangsu, Hunan and Jiangxi through the channel resources of SF Express.
- Uncertain timeline but a potential re-open of internet lottery sales would be a substantial catalyst**
Since 1Q15, the PRC government has suspended online lottery sales, which represented ~20% of total lottery sales in 2014. While it is still unclear whether such online sales would re-open in the near future, if government gives the green light, we expect AGTech would be one of the key beneficiaries, given i) Alibaba Group's extensive active user base and its capability to provide one-stop solution from cloud computing technology and big data processing to online payment and personal credit system; ii) AGTech's well-proven experience in the development of new initiatives in Chinese lottery market under applicable regulations.
- Rolling out new games and entertainment initiatives**
AGTech was awarded the operation right for "Two-on-One Competition Poker" and "Guan Dan Competition Poker" in the PRC. These games are positioned as mind sport, of which skillful players would be rewarded by real money prize. AGTech has already deployed Two-on-One Competition Poker on Alipay channel. Moreover, AGTech launched a non-lottery social gaming platform, "Lucky Buy" on Taobao in 1Q17 as an additional promotion tools for Taobao merchants, and entered into JV agreement with PAYTM, the leading Indian mobile payment platform with 225 million users, to develop games and entertainment business in India.
- Synergy with Alibaba will gradually reflect in financial numbers**
While AGTech has incurred operating losses for >5 consecutive years before joint hand with Alibaba, we highly appreciate AGTech's capability to bring in new initiatives to PRC lottery market. AGTech is already participating in Taobao and Alipay, two of the most critical platforms of Alibaba Group, which demonstrated that Alibaba treat AGTech as a valuable business arm. We advise investors to keep an eye on the transformation of AGTech.

Company Report

4 August 2017

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Trading data

52-Week Range (HK\$)	1.21/1.96
3 Mth Avg Daily Vol (m)	2.9
No of Shares (m)	11,186
Market Cap (HK\$m)	14,542
Major Shareholders (%)	Alibaba Group (54.6%) Mr. Sun Ho (17.9%)
Auditors	PWC
Result Due	1H17: Aug

Company description

Alibaba Group became the controlling shareholder of AGTech in Aug 2016. Before joint hand with Alibaba, AGTech has already established a proven track record in R&D of lottery games and provision of lottery-related equipment in the PRC.

AGTech is now acting as the exclusive lottery platform of Alibaba Group and Ant Financial Group. The Company is also rolling out new non-lottery gaming businesses through the channels of Alibaba Group.

Price chart



Lottery expert joint hand with Alibaba Group

Became Alibaba's subsidiary in August 2016

After the completion of the subscription with Alibaba Holding and Ant Financial on 10 August 2016 (Ali Fortune, the subscriber, is 60%/40% owned by Alibaba Holding and Ant Financial), Alibaba Group became the controlling shareholder of AGTech with ~55% stake. Mr. Sun Ho, Chairman and CEO of AGTech, is now the second largest shareholder with ~18% stake.

Before Alibaba's subscription, AGTech has already established a proven track record in R&D of lottery games and provision of lottery-related equipment in the PRC. Given AGTech's expertise in lottery industry and Alibaba Group's extensive user base, their cooperation would bring enormous synergy, in our view.

The exclusive lottery platform of Alibaba Group and Ant Financial Group

In 1Q17, AGTech has entered into framework agreements with Alibaba Holding and Alipay respectively, of which AGTech shall i) sell and distribute lottery products in physical form through certain channels and networks of the Alibaba Group, including physical stores managed, co-managed or controlled by Alibaba Group; as well as retail POS registered with the platforms of Alibaba Group, ii) provide online activities and services including information subscription and other content on the Alipay Lottery Channel (which are not subject to the applicable PRC lottery laws and regulations), and iii) distribute and sell lottery products in online form on the Alipay Lottery Channel when it is allowed under applicable laws and regulations in the PRC (which is currently prohibited). Under such agreements, AGTech is now acting as the exclusive lottery platform of Alibaba Group and Ant Financial Group, and the profit generated from the above activities through Alibaba Holding or Alipay channels would be shared among AGTech and Alibaba / Alipay on 50:50 basis.

Exhibit 1: AGTech is now using the "Ali Lottery" logo on Company website



Source: Company website

Offering Sports Lottery products through Rural Taobao physical POS network

AGTech has already pilot launched the physical distribution of Sports Lottery products through the “Rural Taobao” (“農村淘寶”) network. Rural Taobao is physical POS in partnership with Alibaba platform, aiming to serve as the O2O and last-mile delivery centers in rural areas. As of end 2016, there were approximately 28,000 Rural Taobao POS nationwide, and Alibaba Group target to have 100,000 POS by 2020. With the technical support from AGTech, a number of Rural Taobao stores started to offer Sports Lottery products in 1Q17. As the store owners could share commission by selling the lottery products with negligible additional operating costs, most store owners would likely to welcome this new business line. Hence we believe there is huge room for this Rural Taobao lottery retail network to expand. Besides, AGTech could also cooperate with the merchants on Taobao and Tmall to utilize physical lottery products as a creative promotion tool, in our view.

Exhibit 2: AGTech started cooperating with “Rural Taobao” to distribute Sports Lottery products



Source: Internet

Set up JV with SF Express to develop new lottery products and channels

For physical lottery business, in addition to the synergy with Alibaba Group, AGTech has established a 50:50 JV, “SF Lottery” (“順豐彩”) with SF Holding, the leading express service provider in the PRC. SF Lottery helped National Sports Lottery Centre to design and develop a new product, “SF-Themed Instant Scratch Lottery”, which has been approved by the MOF as a national lottery product. Management stated that there are two major innovative elements in SF-Themed Instant Scratch Lottery: i) a self-service redemption QR code for customers to redeem award to their own mobile payment accounts; and ii) an additional lucky draw QR code, customers might earn extra reward after fulfilling certain criteria (such as download and register account for a particular mobile application), this function could act as an advertisement platform for various companies.

Launched SF-Themed Instant Scratch Lottery in four provinces recently

In April 2017, SF Lottery has entered into distribution agreements with four provincial Sports Lottery Administration Centre, namely Guangdong, Jiangsu, Hunan and Jiangxi, in which SF Lottery would distribute the SF-Themed Instant Scratch Lottery through the relevant channel resources of SF Holding (SF Express has ~300,000 couriers and ~13,000 services points nationwide). In early July, these four provinces have launched the SF-Themed Instant Scratch Lottery in some of their key cities. Management shared that this new products was well-received by the market, especially among young ladies, who are not major customers of lottery products traditionally. Hence we view that SF Lottery is a good complementary to the National Sports Lottery Centre's existing network, and would possibly carry into more cities and provinces gradually.

Exhibit 3: SF-Themed Instant Scratch Lottery



Source: Internet

Uncertain timeline for the re-open of internet lottery sales in the PRC, but there would be immense impact to AGTech if government gives the green light

The PRC government has suspended online lottery sales since 1Q15. Before the pause, it was estimated that online lottery sales reached RMB85bn in 2014, representing ~20% of total lottery sales in the PRC. After over 2 years of suspension, it is still unclear whether such online sales would re-open in the near future. However, if government gives the green light for private companies to participate in online lottery business (which may involve channels, new games or backend controlling system), we expect AGTech would be one of the key beneficiaries, given i) Alibaba Group's extensive active user base and its capability to provide one-stop solution from cloud computing technology and big data processing to online payment and personal credit system; ii) AGTech's well-proven experience in the development of new initiatives in Chinese lottery market under applicable regulations, which included two virtual sports lottery products ("Lucky Racing" ("幸運賽車"), a motor racing themed virtual game launched in Hunan during 2011 and "e-Ball Lottery" ("e 球彩"), a football themed virtual game launched in Jiangsu during 2013) as well as the SF-Themed Instant Scratch Lottery introduced recently.

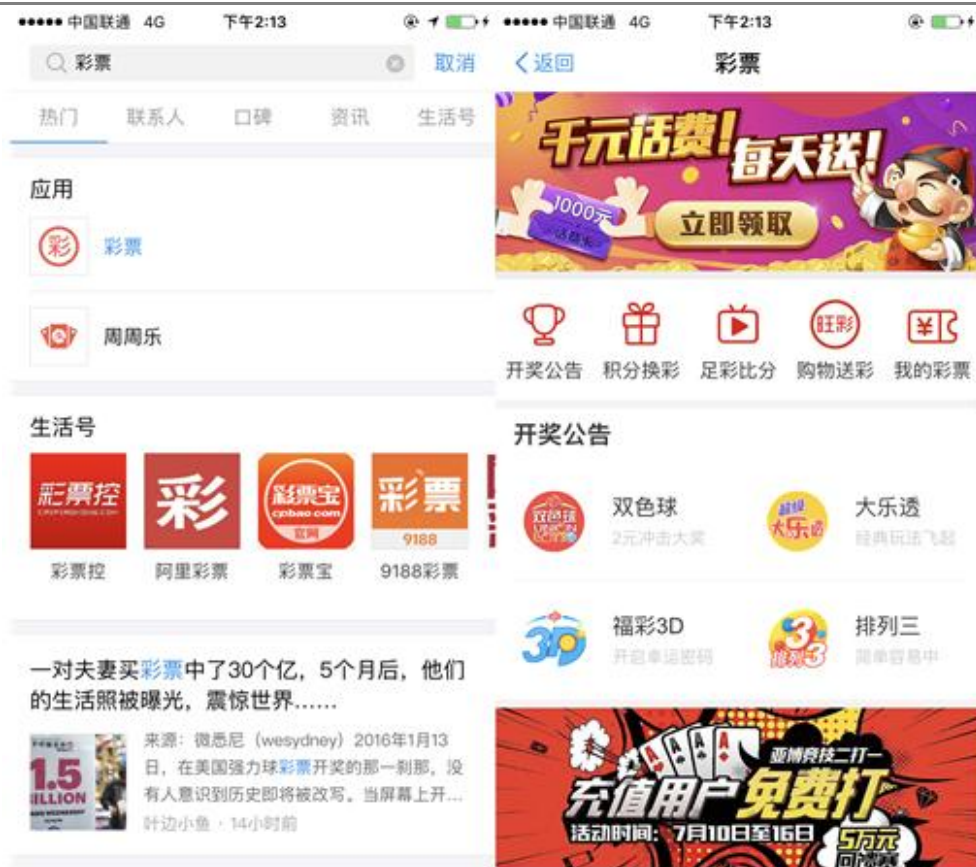
Rolling out new games and entertainment businesses

Ventured into competition poker game market

In January 2017, AGTech announced that the Company was awarded the operation right by the Chess and Poker Centre under the General Administration of Sport of China for “Two-on-One Competition Poker” (“競技二打一”) and “Guan Dan Competition Poker” (“競技擲蛋”) in the PRC. These competition poker games are newly introduced by the Chess and Poker Centre in 2016. Such games are positioned as mind sport, of which players might need to pay fees (in real money or virtual currency) to participate in the game, and skillful players would be rewarded by real money prize. We believe such mechanism gives competition poker games significant advantage over those existing internet/mobile card and board games.

AGTech was awarded an exclusive 5-year priority operation right for Guan Dan Competition Poker, and acted as one of the authorized operators for Two-on-One Competition Poker. AGTech has already deployed Two-on-One Competition Poker in Alipay channel, while Guan Dan Competition Poker is scheduled to roll out in 2H17. It is expected that Chess and Poker Centre would launch more competition poker games through open tenders in coming years. We view that Alibaba Group could take competition poker games as an entry point to build up its position in the mobile game market. Hence we expect AGTech would continue to expand its competition poker game portfolio going forward.

Exhibit 4: Recent promotion of “Two-on-One Competition Poker” on Alipay



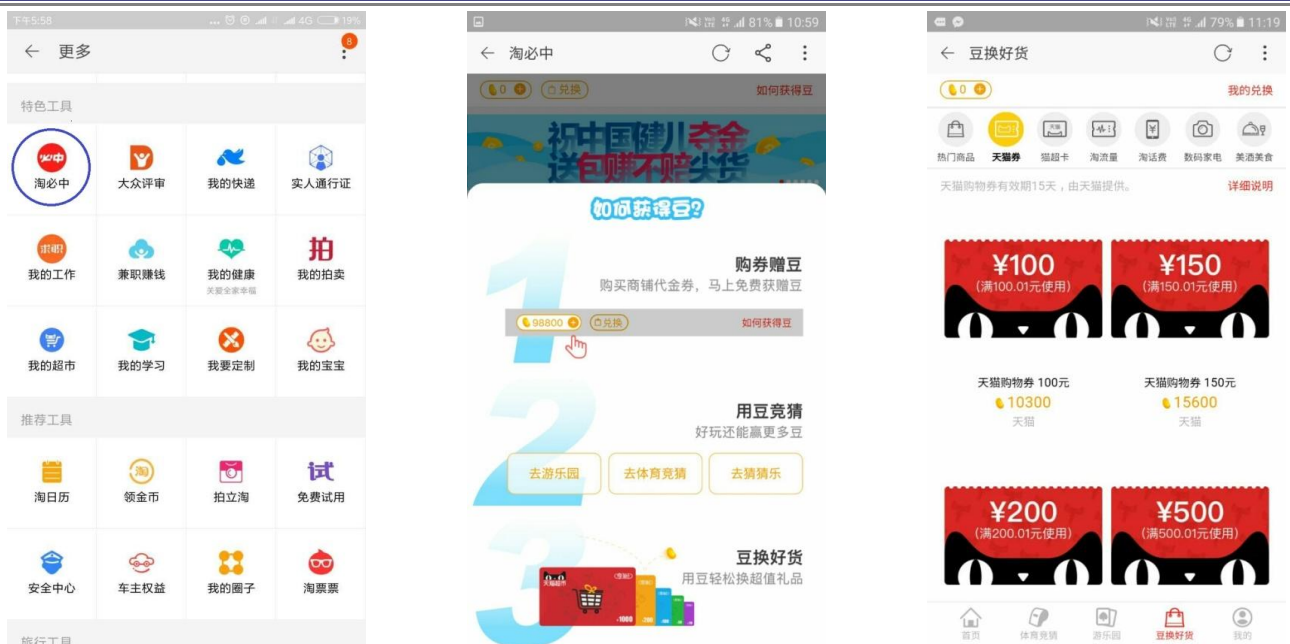
Source: Internet

Exhibit 5: Interface of AGTech's "Two-on-One Competition Poker"

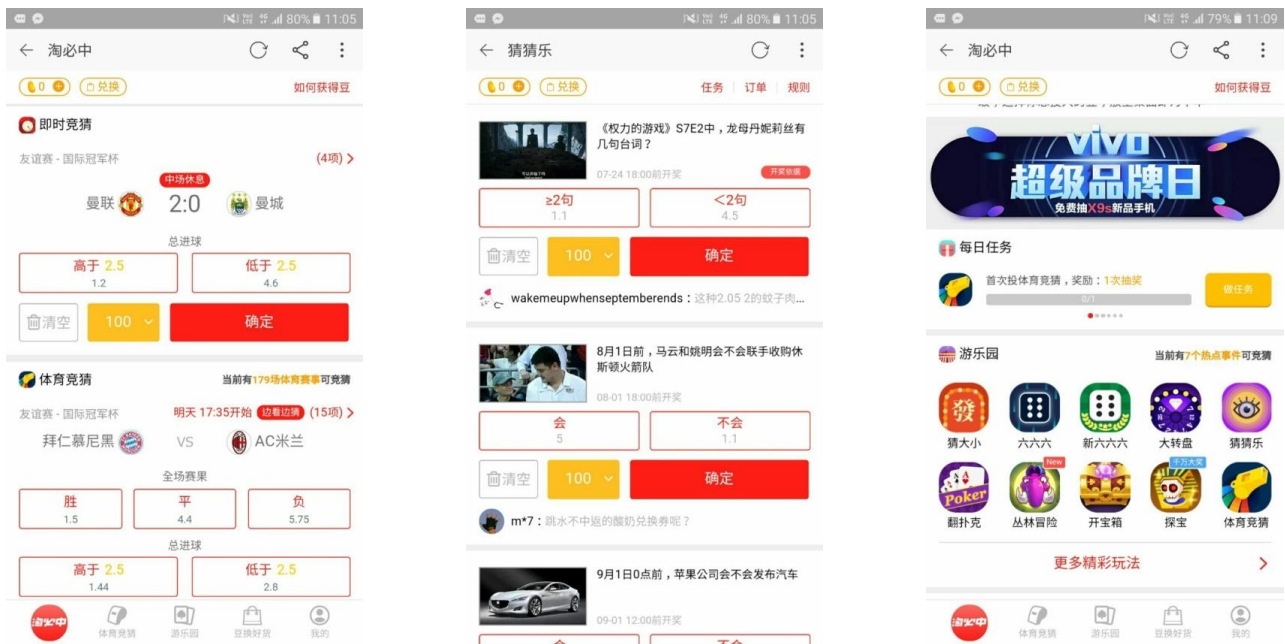

Source: Internet

A new non-lottery social gaming platform in Taobao

Furthermore, AGTech's non-lottery social gaming platform, "Lucky Buy" ("淘必中"), has commenced operation on Alibaba Group's Taobao channel since 1Q17. Lucky Buy is one of the tools on Taobao. Users can earn bonus points by purchasing shopping coupons of specific Taobao merchants, these bonus points can then be used to play various games, such as guessing the results of sport matches, predicting the outcomes of various social events as well as other different mini-games. Users can convert their bonus points to physical gifts or cash coupons. We believe Lucky Buy can act as additional promotion tools for Taobao merchants. Besides, the variety of games offered can help increase customer stickiness to Taobao platform.

Exhibit 6: User guide of "Lucky Buy" ("淘必中")


Source: CIRL

Exhibit 7: Various games in “Lucky Buy” (“淘必中”) platform


Source: CIRL

Forming JV with PAYTM to tap into games and entertainment market in India

AGTech also started expanding its business platform to international market. On 24 July, AGTech and PAYTM Holding, entered into agreement to form a 45:55 JV, for the purpose of developing and operating platforms for users to play various innovative mobile games and participate in different user engagement activities. PAYTM Holding is the leading mobile payment platform in India with 225 million users and an associate of Ant Financial.

The cooperation is expected to help PAYTM Group to drive deeper consumer engagement as Indian customers can earn exclusive rewards and discounts on the platform. The huge user base made PAYTM the ideal local partner for AGTech to venture into Indian market, and the establishment of this JV is a significant breakthrough which lays the foundation for further international expansion of AGTech in the future.

Synergy with Alibaba will gradually reflect in financial numbers

Incurred operating losses in the past mainly because heavy R&D costs and difficulties in expanding new games due to regulatory constraints

Before joint hand with Alibaba, AGTech has incurred operating losses for >5 consecutive years, primarily because AGTech put a lot of effort and resources in the R&D of new lottery game types constantly. However, roll out and expansion timelines of these new games were slower than expected due to regulatory constraints. For instance, “Lucky Racing”, a virtual sports lottery product, is still available in only one province after launching for >5 years. That said, we still highly appreciate AGTech’s capability to bring in new initiatives to PRC lottery market, which is challenging for any private companies. Besides, the lottery-related equipment market in the PRC is highly competitive with heavy price pressure, which also hurt AGTech’s profitability.

We expect cooperative synergy with Alibaba Group and SF Express would gradually reflect in upcoming financial numbers

However, we view that AGTech is now entering a new era with the support from Alibaba Group. The extensive channels of Alibaba Group as well as the newly established JV with SF Express would create massive offline and O2O business opportunities for AGTech’s physical lottery segment, which help the Company to scale up rapidly. If PRC government re-open online lottery sales and allow private companies to participate, it will be another substantial catalyst to AGTech. Moreover, the new venture in games and entertainment segment indicates that AGTech is now going beyond a pure lottery company, this new business line could be another potential growth driver going forward.

After less than one year after the completion of Alibaba’s subscription, AGTech is already participating in Taobao and Alipay, two of the most critical platforms of Alibaba Group, which demonstrated that Alibaba treat AGTech as a valuable business arm. We believe the lottery and social gaming business of AGTech would help Alibaba in monetizing, as well as encouraging users to spend a longer time on Alibaba’s platforms. We advise investors to keep an eye on the transformation of AGTech.

Exhibit 8: Income Statement

Year to Dec (HKD mn)	FY12A	FY13A	FY14A	FY15A	FY16A
Revenue	229.3	208.4	211.1	301.6	251.5
COGS	364.2	421.2	518.9	677.7	847.1
Gross profit	101.6	91.3	69.6	69.2	73.3
SG&A	(102.5)	(108.5)	(124.1)	(162.8)	(246.1)
Share-based payments	(10.0)	(60.1)	(136.3)	(35.2)	(86.6)
Share of profits of JVs and associates	(0.0)	(0.0)	(0.0)	(0.0)	(0.0)
Others	(17.2)	1.6	4.1	2.1	(8.2)
Operating profit	(28.1)	(75.7)	(186.8)	(126.7)	(267.6)
Non-operating gains or losses	(0.1)	(0.1)	0.0	(191.0)	607.1
Net finance costs	(2.2)	(0.5)	0.0	2.1	(1.6)
Income tax expenses	(0.9)	(7.6)	(0.6)	(3.1)	(5.2)
Non controlling interests	(1.5)	1.0	(1.8)	3.2	0.3
Net profit	(32.9)	(82.9)	(189.2)	(315.4)	333.0

Source: The Company

Exhibit 9: Balance Sheet

Year to Dec (HKD mn)	FY12A	FY13A	FY14A	FY15A	FY16A
Cash & equiv	156.1	286.5	315.6	246.7	2,769.2
Inventories	24.5	46.5	25.3	56.3	18.8
Trade receivables	77.1	37.3	31.1	29.6	25.6
Other receivables, deposits and prepayments	42.3	55.4	68.8	75.9	80.6
Other current assets	0.0	0.0	0.0	0.0	0.0
Fixed assets	54.2	53.1	69.5	64.4	56.5
Goodwill	772.5	796.9	793.6	1,119.3	1,067.4
Other non current assets	25.5	38.6	31.6	21.8	16.3
Total assets	1,152.2	1,314.4	1,335.6	1,613.9	4,034.4
Short-term borrowings	17.6	0.0	0.0	22.0	45.0
Trade payables	4.7	9.8	26.1	36.7	18.4
Accruals and other payables	33.5	31.2	39.3	48.0	100.2
Contingent consideration payables - current	0.0	0.0	0.0	63.5	62.5
Other current liabilities	3.3	3.1	1.1	2.9	2.7
Long-term borrowings	0.0	0.0	0.0	0.0	0.0
Convertible bonds	0.0	0.0	0.0	0.0	1,329.9
Contingent consideration payables	0.0	0.0	0.0	326.8	113.8
Other non current liabilities	27.8	34.9	47.2	55.6	58.2
Total liabilities	86.8	79.0	113.6	555.4	1,730.6
Shareholders' equity	1,063.2	1,234.1	1,218.8	1,059.2	2,267.9
Minorities	2.1	1.3	3.1	(0.7)	35.9
Total equity	1,065.4	1,235.4	1,221.9	1,058.5	2,303.7
Net cash (debt)	138.6	286.5	315.6	224.7	1,394.3

Source: The Company

Rating Policy

	Rating	Definition
Stock Rating	Buy	Outperform HSI by 15%
	Neutral	Between -15% ~ 15% of the HSI
	Sell	Underperform HSI by -15%
Sector Rating	Accumulate	Outperform HSI by 10%
	Neutral	Between -10% ~ 10% of the HSI
	Reduce	Underperform HSI by -10%

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Analyst Certification

I, Lewis Pang hereby certify that all of the views expressed in this report accurately reflect my personal views about the subject company or companies and its or their securities. I also certify that no part of my compensation was / were, is / are or will be directly or indirectly, related to the specific recommendations or views expressed in this report / note.

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