

Sanqi Interactive (002555 CH)

From MMORPGs to More

Sanqi Interactive (“**Sanqi**”) excelled itself with chuanqi-themed games and effective marketing. We keep positive on Sanqi’s healthy topline growth, backed by its solid game pipeline, category diversification and overseas expansion. We forecast Sanqi to deliver 29%/40% revenue/earnings CAGR during FY18-21E. Initiate with BUY with DCF-based TP RMB30.

- A leading MMORPG player with chuanqi-themed types and effective marketing.** As a leading game developer and operator with chuanqi-themed MMORPGs, Sanqi successfully transformed from web games to mobile games operator, with high quality hot titles. Backed by its reputable R&D team and highly effective marketing, we forecast Sanqi to deliver 29%/40% revenue/earnings CAGR during FY18-21E, thanks to its strong pipeline, category diversification and overseas expansion.
- Category diversification to deliver ongoing pipeline.** Backed by its successful record of chuanqi-themed MMORPGs, Sanqi will continue strengthen its position in chuanqi-themed types development, in our view. Meanwhile, Sanqi also expanded its game category into diversified types, including SLG, ARPG, casual games, etc, backed by self-development and IP investment. We expect its ongoing category expansion to help it gain shares and tap into younger generations, especially supported by recent hot titles of The Soul Land (斗罗大陆), Yi Dao Chuan Shi (一刀传世) and Jing Ling Sheng Dian (精灵盛典). Further catalyst will come from its rich game reserve, including Fantasy of Tomorrow, Glory Adventure, etc.
- Stepping-up overseas expansion to tap into broader market.** Apart from strengthening its leading position in domestic market, Sanqi steps up its overseas expansion path by leveraging its advantage in traffic operation and precise marketing. According to App Annie, Sanqi ranked Top 6 in China mobile game publishers in 2Q19. With initial fruits in SEA market, we expect Sanqi to proactively explore other promising regions, like Japan, Korea, Europe and USA.
- Initiate with BUY.** We set our DCF-based TP at **RMB30** (implying **26x** P/E in FY20E), slightly higher than industry average, for its strong pipeline and high-effective marketing. **Key risks:** regulation uncertainty, grossing decline of hot titles, weak performance of newly-launched games.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	6,189	7,633	12,340	14,324	16,514
YoY growth (%)	17.9	23.3	61.7	16.1	15.3
Net income (RMB mn)	1,621	1,009	2,098	2,415	2,777
EPS (RMB)	0.76	0.47	0.99	1.14	1.31
YoY growth (%)	NA	-37.8	108.0	15.1	15.0
P/E (x)	32.8	52.7	25.3	22.0	19.1
P/S (x)	8.6	7.0	4.3	3.7	3.2
Yield (%)	0.4	0.8	1.7	1.9	2.2
ROE (%)	22.2	16.5	27.0	26.0	25.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Initiation)

Target Price **RMB30.0**
 Up/Downside **+14.7%**
 Current Price **RMB26.2**

China Internet Sector

Sophie Huang
 (852) 3900 0889
 sophiehuang@cmbi.com.hk

Stock Data

Mkt Cap (RMB mn)	52,806
Avg 3 mths t/o (RMB mn)	525.5
52w High/Low (RMB)	25/9.0
Total Issued Shares (mn)	2,112

Source: Bloomberg

Shareholding Structure

Li Weiwei	19.1%
Zeng Kaitian	17.5%
Wu Weihong	5.3%

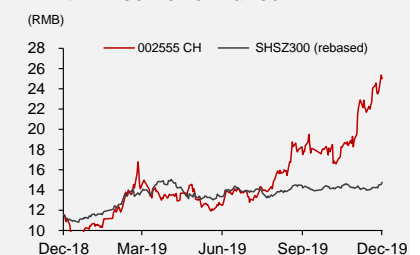
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	33.7%	30.0%
3-mth	38.9%	37.9%
6-mth	101.5%	84.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Investment Summary

Leveraging chuanqi-themed MMPRPGs to strengthen position

Proven successful record in chuanqi-themed MMORPGs

Backed by its successful record of chuanqi-themed MMORPGs (e.g. Chuanqi Baye (传奇霸业)), Sanqi will continue strengthen its position in chuanqi-themed types development. Sanqi was famous for its Jiguang Studio (极光网络工作室), which developed eight hot titles of chuanqi-theme in five years (e.g. Archangel Sword (大天使之剑), Yidaochuanshi (一刀传世), Chuanqi Baye (传奇霸业)). We see high visibility for Sanqi to step up launching high quality hot titles, backed by its reputable R&D team and highly effective marketing.

Figure 1: Top titles of chuanqi-theme (传奇系列)



Source: Company, CMBIS

Figure 2: Sanqi's gaming business



Source: Company, CMBIS

Figure 3: Performance of key titles

Launch Time	Title		Performance
2014.06	大天使之剑	Archangel Sword	Grossing ~RMB320mn in 60 days
2014.12	传奇霸业	Chuanqi Baye	Grossing ~RMB300mn in 80 days
2016.07	永恒纪元	Eternal Crusade	Total grossing ~RMB4bn
2017.09	大天使之剑H5	Archangel Sword H5	Grossing ~RMB100mn in 24 days
2018.07	血盟荣耀	Glory of the Blood Alliance	Monthly Grossing ~RMB30mn
2019.02	一刀传世	Yi Dao Chuan Shi	Grossing Rank Top 5

Source: Company, App Annie, CMBIS

Multifaceted publishing network and effective marketing

Sanqi structures an extensive game publishing network in a bid to reach broader player base. Its multifaceted distribution network consists of application stores, third-party open platforms and social network platforms (e.g. Tencent, iQiyi, Youku). Moreover, Sanqi excelled itself with strong data analytics, to select high-ROI production, enhance monetization mechanism, and achieve user targeting in cost-effective marketing strategy.

Figure 4: Top 10 mobile games with ads expenditure in 3Q19

Rank	Title	English Name	Key publishing network
1	斗罗大陆	Soul Land	Baidu Feeds, Ali UC, Huge amount engine, Tencent Ads
2	复古传奇	Retro legend	Huge amount engine, Ali UC, Tencent Ads, Baidu Feeds
3	精灵盛典	Fairy Ceremony	Huge amount engine, Baidu Feeds, Doyu, Ali UC
4	公益传奇	Charity Legend	Ali UC, Youku
5	天王传奇	Uranus Legend	Douyu, Baidu Feeds, NetEase, Ali UC
6	黎明: 奇迹MU	Dawn: Miracle MU	Baidu Feeds, Ali UC, Huge amount engine
7	至尊之刃	Extreme Blade	Huge amount engine, Baidu Feeds, Baidu Baiqingting, Qilin Magician
8	大话西游	Journey to the West	Huge amount engine, Tencent Ads, NetEase, Weibo
9	至尊蓝月	Extreme Blue Moon	Huge amount engine, Baidu Feeds, Ali UC, Tencent Ads
10	全民漂移3D	National Drift 3D	Huge amount engine, Tencent Ads, Unity Ads, Kuaishou

Source: App Growing, CMBIS

Exploring deeper collaboration with short video to capture younger generation

In order to capture younger generation and enhance promotion efficiency, Sanqi has also collaborated with short video platforms (e.g. Douyin, Bilibili) to publish and promote games since 2018. For instance, Eternal Crusade (永恒纪元) achieved eye-catching performance, supported by Douyin's operation. Yi Dao Chuan Shi (一刀传世) ranked high in grossing, thanks to its effective promotions in Douyin, Weibo and Bilibili.

Category diversification to deliver ongoing pipeline**Expanding IPs to widen its game genres**

By investing in excellent IP content platforms and IP production enterprises, Sanqi seeks to gain access to quality IPs and strong relationship with IP owners and content providers. Besides, Sanqi is still exploring more opportunities in eSports. We expect Sanqi to proceed with investment in IP fields to realize strategic synergies and build IP-oriented game ecosystem.

Figure 5: Part of Sanqi's game reserve

No.	Game	English Name
1	明日幻想 (暂定名)	Fantasy of Tomorrow
2	云上城之歌 (暂定名)	Song of the Cloud City
3	超能球球 (暂定名)	Chao Neng Qiu Qiu
4	光明冒险 (暂定名)	Glory Adventure
5	代号DG	Code DG
6	街区英雄 (暂定名)	Street Hero
7	代号NB	Code NB
8	代号YZD	Code YZD
9	代号S	Code S
10	暗黑后裔	Dark Ascendant
11	江山与美人	Country and Beauty
12	代号SF	Code SF
13	代号TARO	Code TARO
14	代号MK4	Code MK4
15	斗罗大陆3D	Soul Land 3D

Source: Company, CMBIS

Jing Ling Sheng Dian (精灵盛典) to gain tractions

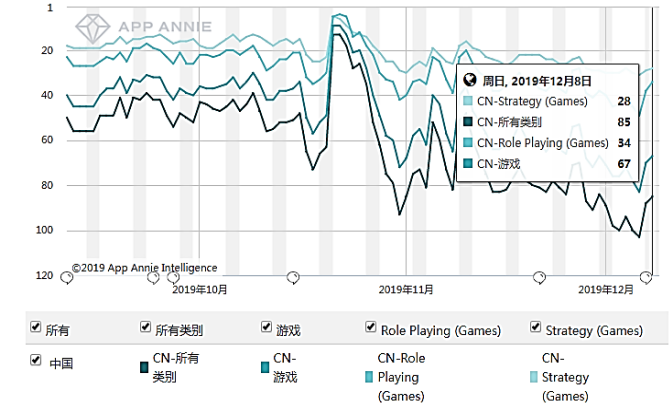
Its three top titles of The Soul Land (斗罗大陆), Yi Dao Chuan Shi (一刀传世), Jing Ling Sheng Dian (精灵盛典), which were launched in 2019, still performed well in 3Q19. The Soul Land (斗罗大陆) and Yi Dao Chuan Shi (一刀传世) ranked Top 40 in iOS grossing games, while Jing Ling Sheng Dian (精灵盛典) still ranked Top 10. Jing Ling Sheng Dian (精灵盛典) gained tractions, with its unique points system (积分系统) and higher paying ratio.

Figure 6: The Soul Land (斗罗大陆)



Source: Company, CMBIS

Figure 7: Grossing rank of The Soul Land



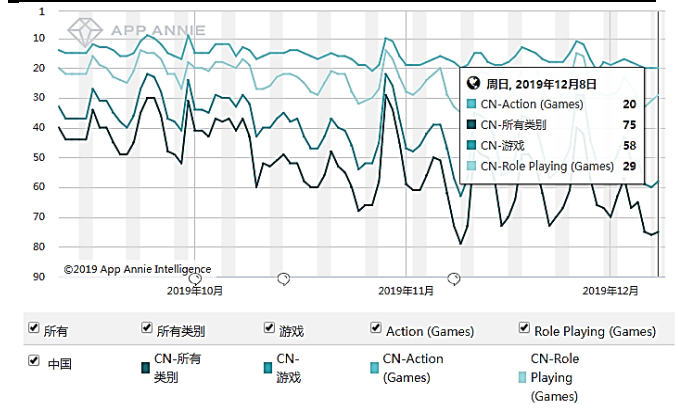
Source: App Annie, CMBIS

Figure 8: Yi Dao Chuan Shi (一刀传世)



Source: Company, CMBIS

Figure 9: Grossing rank of Yi Dao Chuan Shi



Source: App Annie, CMBIS

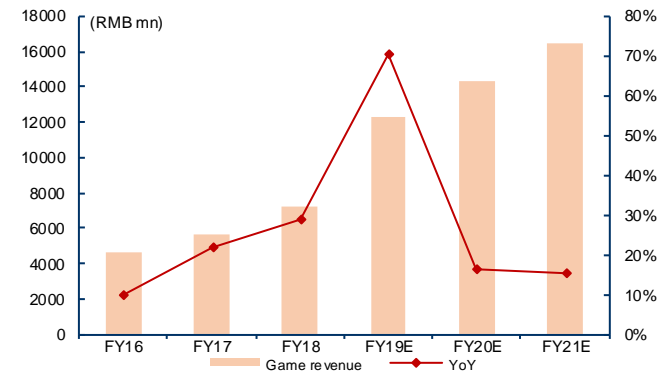
From MMORPGs to SLG, RPG, and more.

Unlike most listed peers who are highly dependent on several flagships, Sanqi excelled itself with diversified and strong portfolio and pipeline to deliver stable performance. Apart from MMORPGs games, Sanqi expanded its game category into diversified types, including SLG, ARPG, casual games, etc. For instance, its RPG game - The Soul Land H5 once hit Top 10 grossing rank, with monthly grossing over RMB100mn, after launched in 1Q19. We expect its ongoing category expansion to help it gain shares and tap into younger generations.

Expecting game revenue to soar at 29% CAGR in FY18-21E

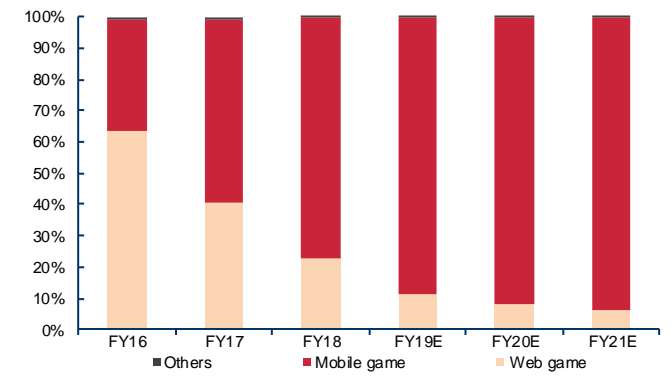
With eye-catching performance of hot titles launched in 2019, we forecast its game sector to grow 70%/16%/15% YoY in FY19/20/21E. We think FY19E performance has well acknowledged by the market, and further catalysts will derive from FY20E pipeline (e.g. self-developed games NB, YZD; licensed games MK4, DIG, etc.).

Figure 10: Game revenue estimates



Source: Company data, CMBIS estimates

Figure 11: Game revenue mix change



Source: Company data, CMBIS estimates

Stepping-up overseas expansion to tap into broader market

Apart from strengthening its leading position in domestic market, Sanqi steps up its overseas expansion path by leveraging its advantage in traffic operation and precise marketing. According to App Annie, Sanqi ranked Top 6 in China mobile game publishers in 2Q19.

Initial fruits from SEA market, while exploring Japan, South Korea, US and other markets

As one of the overseas expansion pioneer, Sanqi has accumulated rich experience in globalization since 2012. Sanqi excelled itself with multiple advantages, including: 1) powerful payment risk management; 2) deep relationship and successful record to lock promising games agents; 3) strong global products reserve, including Western Magic SLG game Code MH(代号 MH) and ARPG game An Hei Hou Yi (暗黑后裔); 4) strong traffic operation to precise targeting groups.

Sanqi achieved initial success in SEA market, backed by eye-catching performance of Eternal Crusade (永恒纪元)、Feng Xian (封仙). For instance, Eternal Crusade (永恒纪元) ranked Top 1 in Grossing rank in HMT (港澳台), SG, Malaysia, Indonesia, Thailand, South Korea, and etc. After that, Sanqi also proactively explored other promising regions, like Japan and South Korea.

Figure 12: Sanqi's performance in overseas market

Title	Area	Performance
永恒纪元 Eternal Crusade	HK, Macao, Taiwan	Top 1 Grossing
	Singapore	Top 1 Grossing
	Malaysia	Top 1 Grossing
	Vietnam	Top 1 Grossing
	Philippines	Top 1 Grossing
	Indonesia	Top 2 Grossing
	Turkey	Top 2 Grossing
	Thailand	Top 3 Grossing
	Korea	Top 3 Grossing
镇魔曲 Town magic	Taiwan	Top 3 Grossing
封仙 Feng Xian	Singapore	Top 2 Grossing
	Malaysia	Top 2 Grossing
诛仙 Jade Dynasty	Thailand	Top 4 Grossing

Source: Company, App Annie, CMBIS

Expanding international footprint backed by robust localization

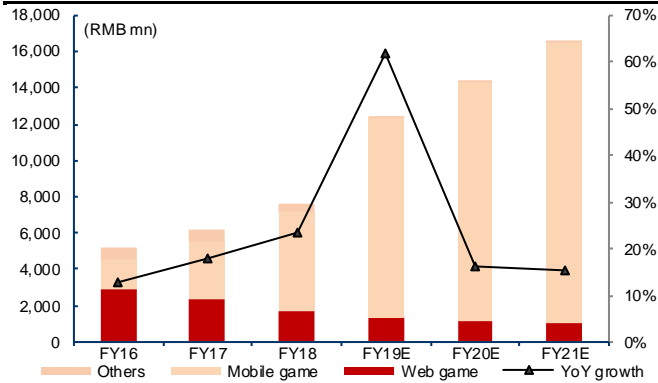
We believe Sanqi's extensive global experience and strong localization capabilities can help it to structurally and artistically modify its game offerings through local language scripts and other in-game features specifically redesigned to meet the differentiated gameplay needs and preferences of users from diverse geographical markets. For example, Eternal Crusade (永恒纪元) designed local clothes and mounts feature in its games published in Vietnam and Thailand.

Financial Analysis

Revenue Breakdown

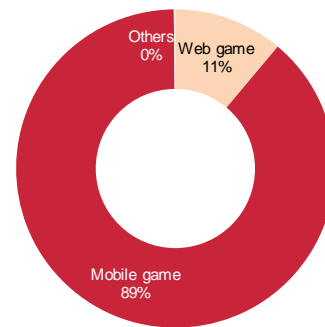
We forecast Sanqi' revenue will grow at 62%/16%/15% YoY in FY19/20/21E, in which mobile game business devotes most of total revenue. We expect revenue from games to ramp up to RMB12.3bn in FY19E with a CAGR of 29% in FY18-21E. The robust growth is mainly driven by strong performance of three hot titles launched in 2019. Further catalysts will derive from FY20E pipeline (e.g. self-developed games NB, YZD; licensed games MK4, DIG, etc.).

Figure 13: Revenue growth estimates



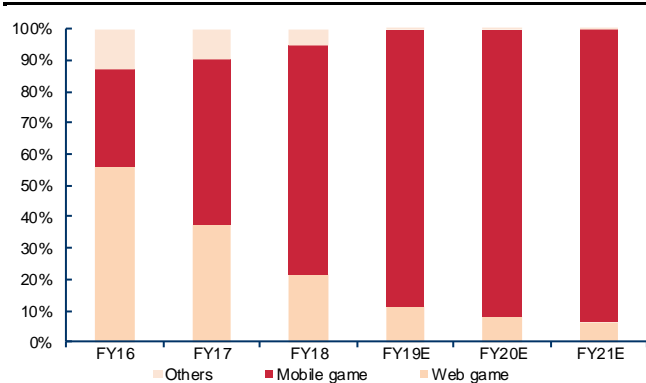
Source: Company data, CMBIS estimates

Figure 14: FY19E revenue breakdown



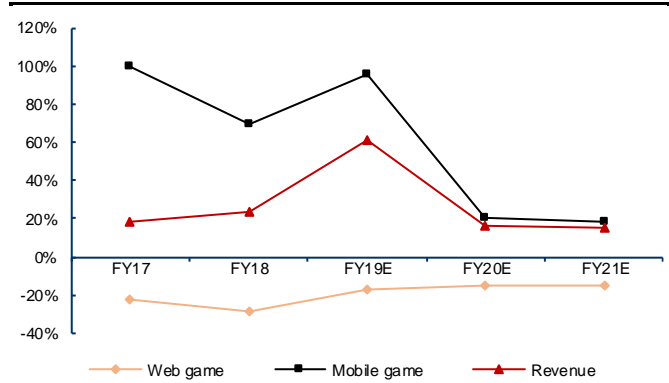
Source: CMBIS estimates

Figure 15: Revenue breakdown estimates



Source: Company data, CMBIS estimates

Figure 16: Revenue growth estimates



Source: Company data, CMBIS estimates

Income Statement

We expect better margin outlook, and forecast its adj. net profit to grow at 40% CAGR in FY18-21E, mainly driven by 29% revenue CAGR and improving operating margin (19% in FY20E, vs. 10% in FY18).

We expect gross margin to pick up in FY19E, for higher revenue mix from mobile game (with higher GPM). In terms of operating margin, we expect its S&M expense ratio to pick up from FY19E for heavier promotion efforts on new game, while R&D, G&A expense ratio to decline for operating leverage. Overall, we expect its adj. net margin up to 17% in FY19/20/21E.

As a result, we forecast its adj. net profit to reach RMB2,098mn in FY19E, with adj. net margin up to 17% in FY19E.

Figure 17: Income statement

RMB mn, Dec-YE	FY16	FY17	FY18	FY19E	FY20E	FY21E
Revenue	5,248	6,189	7,633	12,340	14,324	16,514
Cost of sales	(1,941)	(1,948)	(1,811)	(1,896)	(2,305)	(2,787)
Gross profit	3,307	4,241	5,821	10,444	12,019	13,728
Sales and marketing expenses	(1,608)	(1,908)	(3,347)	(7,256)	(8,251)	(9,413)
Research and development expenses	(311)	(436)	(538)	(617)	(702)	(793)
Administrative expenses	(204)	(340)	(246)	(290)	(358)	(438)
Other income	(19)	(38)	(919)	74	36	63
Operating profit	1,165	1,518	771	2,355	2,744	3,147
Non-operating income	164	403	464	64	30	30
Non-operating expenses	10	4	15	10	8	5
Pre-tax profit	1,319	1,917	1,219	2,409	2,766	3,172
Income tax expense	(102)	(80)	(68)	(241)	(290)	(349)
Profit for the year	1,217	1,836	1,151	2,168	2,476	2,823
Non-controlling interests	147	216	143	71	61	46
Net profit attributable to equity shareholders	1,070	1,621	1,009	2,098	2,415	2,777
Margin Analysis						
Gross margin	63%	69%	76%	85%	84%	83%
Operating margin	22%	25%	10%	19%	19%	19%
Net margin	20%	26%	13%	17%	17%	17%
Growth Analysis						
Revenue	NA	18%	23%	62%	16%	15%
Gross profit	NA	28%	37%	79%	15%	14%
Operating profit	NA	30%	-49%	205%	17%	15%
Net profit	NA	51%	-38%	108%	15%	15%

Source: Company data, CMBIS estimates

Balance Sheet

Healthy balance sheet with net cash position in FY19/20/21E

According to our estimates of profit before taxation and change in working capital, Sanqi has strong operating cash inflow in supporting CAPEX in the next three years. Therefore, we believe Sanqi can stay in net cash position in FY19/20/21E. We expect Sanqi to hold RMB2.3bn/RMB3.6bn cash and cash equivalent as of 31 Dec of 2019E and 2020E.

Figure 18: Balance Sheet

RMB mn, Dec-YE	FY16	FY17	FY18	FY19E	FY20E	FY21E
Non-current assets	3,936	5,198	4,214	4,411	4,568	4,702
Fixed asset	303	343	36	63	78	88
LT investment	787	377	556	734	882	1,010
Intangible assets	2,840	4,466	3,594	3,587	3,581	3,576
Others	6	12	27	27	27	27
Current assets	2,451	3,962	4,182	5,702	7,333	9,256
Cash	819	1,581	1,516	2,331	3,598	5,990
Prepayment	292	284	194	203	247	298
Account receivable	1,033	1,328	1,299	1,994	2,315	1,793
Others	306	770	1,174	1,174	1,174	1,174
Current liabilities	1,624	1,518	1,992	2,086	2,397	2,767
Short-term debt	373	372	369	339	309	279
Customer advances	60	85	95	153	178	205
Accounts payable	718	742	1,082	1,133	1,377	1,665
1-year loan	0	28	30	30	30	30
Others	474	291	417	432	504	589
Non-current liabilities	33	355	290	255	226	196
Borrowings	0	311	281	252	222	192
Others	33	44	9	4	4	4
MI	205	270	141	122	92	48
Total equity	4,729	7,287	6,114	7,772	9,278	10,994
Shareholders' equity	4,524	7,017	5,973	7,650	9,186	10,945

Source: Company data, CMBIS estimates

Cash Flow and Working Capital

Solid pipeline to ensure strong operating cash flow

Leveraging its strong pipeline and margin improvement, we expect PW to maintain its strong operating cash inflow trend and record RMB1,590mn / RMB2,494mn of operating cash inflow in FY19/20E, respectively.

Figure 19: Cash flow and working capital analysis

RMB mn, Dec-YE	FY16	FY17	FY18	FY19E	FY20E	FY21E
Net income	1,070	1,621	1,009	2,098	2,415	2,777
D&A	174	160	118	81	83	84
Change in WC	(204)	(467)	638	(617)	(40)	898
Others	12	519	190	29	36	(25)
Operating CF	1,052	1,832	1,954	1,590	2,494	3,733
CAPEX	(209)	(1,019)	(324)	(100)	(92)	(89)
Others	(1,308)	(349)	269	(98)	(98)	(98)
Investing CF	(1,518)	(1,368)	(55)	(198)	(190)	(187)
Equity raised	316	496	647	-	-	-
Change of Debts	338	341	(58)	(60)	(60)	(60)
Others	(486)	(527)	(2,558)	(521)	(982)	(1,094)
Financing CF	169	310	(1,969)	(581)	(1,042)	(1,153)
Net change in cash						
Cash (beg of yr)	1,106	819	1,581	1,516	2,331	3,598
FX	10	(13)	5	5	5	0
Cash (end of yr)	819	1,581	1,516	2,331	3,598	5,990

Source: Company data, CMBIS estimates

Valuation

Initiate with BUY

We use DCF valuation as our primary method since it is suitable to apply DCF valuation to emerging companies with healthy cash flows in the long run. Assuming a WACC of 14.1% and a terminal growth rate of 3%, our estimated TP is RMB30, representing 26x FY20E P/E, slightly higher than industry average of 23.5x FY20E P/E.

Figure 20: DCF valuation

DCF Valuation (RMB mn)										
	2020E	2021E	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E
EBIT	2,744	3,147	3,824	4,605	5,498	6,512	7,652	8,925	10,336	11,888
Tax	(290)	(349)	(424)	(511)	(610)	(722)	(848)	(990)	(1,146)	(1,318)
D&A	83	84	88	92	97	102	107	112	118	123
Change in working capital	(40)	898	1,005	1,106	1,216	1,338	1,472	1,619	1,781	1,959
CAPEX	(92)	(89)	(90)	(92)	(94)	(96)	(98)	(100)	(102)	(104)
FCF	2,404	3,691	4,402	5,200	6,108	7,134	8,284	9,567	10,987	12,548
PV	2,108	2,837	2,967	3,072	3,163	3,239	3,298	3,339	3,361	34,699
Terminal Value										116,816

Assumptions

WACC	14.1%
Tax rate	-12.0%
Risk free rate	3.53%
Cost of debt	6.0%
Beta	1.20
Market risk return	11.4%
Cost of equity	14.1%
Debt/Assets	0.0%
Long term growth	3.0%
Debt	0

Equity Value

PV	62,083
minus: Net debt (RMB mn)	(1,581)
minus: Minority interest (RMB mn)	0
Equity Value (RMB mn)	63,663
Shares(mn)	2,125
TP (RMB)	30.0

		WACC					
		~	12%	13%	14%	15%	16%
Terminal growth rate	1.5%	35.2	31.4	28.0	25.5	23.3	
	2.0%	36.2	32.2	28.6	26.0	23.6	
	2.5%	37.4	33.0	29.3	26.5	24.1	
	3.0%	38.6	33.9	30.0	27.1	24.5	
	3.5%	40.0	35.0	30.7	27.7	25.0	
	4.0%	41.6	36.1	31.6	28.4	25.5	
	4.5%	43.3	37.4	32.5	29.1	26.1	

Source: Company data, Bloomberg, CMBIS estimates

Peers comparison

We selected six games comps (Tencent, NetEase, Kingsoft, Perfect World, Sanqi, Giant) as peers comparison. Average FY20E P/E of China games are 23.5x.

Our DCF-based TP implies 26x FY20E P/E, which is slightly higher than industry average of 23.5x. However, we think our implied multiple is not demanding, since 1) most comps are with limited game pipeline, and highly reliable on single game performance; 2) Sanqi is expected to see solid game growth, backed by highly effective marketing; and 3) Sanqi's FY20E P/E at 26x is in line with industry average of A shares.

Figure 21: Peers valuation

Company	Ticker	Mkt.Cap (USD mn)	Currency	Price	P/E			P/S			EV/EBITDA			FY19-21 EPS CAGR
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	
Leaders														
Tencent	700 HK	453,672	HKD	378	33.7	28.0	23.1	8.5	6.8	5.6	24.5	20.1	16.8	21%
Alibaba	BABA US	555,243	USD	207										
Baidu	BIDU US	42,685	USD	123	22.6	18.0	13.9	2.8	2.5	2.3	18.6	11.8	10.2	28%
JD	JD US	50,580	USD	35	35.0	25.4	19.2	0.6	0.5	0.5	22.6	15.7	12.2	35%
Meituan	3690 HK	78,109	HKD	103	338.7	79.2	36.8	5.7	4.3	3.4	119.8	51.4	26.7	203%
Pinduoduo	PDD US	44,960	USD	39	NA	544.7	52.1	10.3	6.2	4.5	NA	NA	774.0	NA
NetEase	NTES US	38,985	USD	305	19.3	18.8	17.1	4.2	4.0	3.6	14.2	12.8	11.7	8%
Average					27.8	22.8	18.5	5.7	4.3	3.5	37.1	21.7	123.7	53%
Ecommerce														
Alibaba	BABA US	555,243	USD	207										
JD	JD US	50,580	USD	35	35.0	25.4	19.2	0.6	0.5	0.5	22.6	15.7	12.2	35%
Pinduoduo	PDD US	44,960	USD	39	NA	544.7	52.1	10.3	6.2	4.5	NA	NA	774.0	NA
Vipshop	VIPS US	9,266	USD	14	14.8	11.9	10.9	0.7	0.7	0.6	10.5	8.3	7.6	16%
Babytree	1761 HK	388	HKD	2	NA	NA	232.3	5.5	4.5	3.5	NA	NA	22.9	NA
Average					26.1	20.4	25.4	4.9	3.6	2.8	18.8	14.1	166.3	24%
OTA														
Ctrip	TCOM US	20,059	USD	34	25.5	21.2	17.1	3.9	3.5	3.0	24.6	19.4	15.4	22%
Tongcheng-elong	780 HK	3,446	HKD	13	17.1	13.6	10.9	3.3	2.7	2.2	10.4	7.7	6.1	24%
Tuniu	TOUR US	287	USD	2	NA	22.1	11.9	0.9	0.9	0.8	NA	NA	NA	NA
Average					21.3	19.0	13.3	2.7	2.3	2.0	17.5	13.5	10.8	3%
Game														
Tencent	700 HK	453,672	HKD	378	33.7	28.0	23.1	8.5	6.8	5.6	24.5	20.1	16.8	21%
NetEase	NTES US	38,985	USD	305	19.3	18.8	17.1	4.2	4.0	3.6	14.2	12.8	11.7	7%
Kingsoft	3888 HK	3,447	HKD	19	NA	71.7	40.7	3.1	2.3	1.8	141.7	28.6	17.6	NA
Perfect World	002624 CH	7,406	CNY	41	24.9	21.4	18.7	6.1	5.2	4.6	20.2	17.8	16.0	15%
Sanqi Interactive	002555 CH	7,553	CNY	26	25.4	21.9	19.4	4.3	3.7	3.3	19.6	17.1	14.7	14%
Giant Interactive	002558 CH	5,177	CNY	18	32.3	27.3	25.6	8.6	7.7	6.9	NA	NA	NA	12%
Average					27.1	23.5	20.8	5.8	5.0	4.3	19.6	17.0	14.8	17%
Live streaming														
MOMO	MOMO US	7,554	USD	36	13.0	10.9	9.5	3.1	2.6	2.3	11.3	7.9	6.7	19%
YY	YY US	4,525	USD	56	14.0	10.4	7.5	1.2	1.0	0.8	9.7	6.6	3.8	38%
Inke	3700 HK	272	HKD	1	4.5	2.4	2.4	NA	NA	NA	NA	NA	NA	38%
Huya	HUYA US	3,803	USD	17	38.8	22.9	15.4	3.2	2.3	1.9	39.5	16.3	10.5	65%
Average					17.6	11.6	8.7	2.5	2.0	1.7	20.2	10.3	7.0	39%
Entertainment														
Tencent Music	TME US	18,788	USD	11.5	29.4	23.9	17.9	5.2	4.1	3.2	24.6	18.7	13.6	28%
iQiyi	IQ US	14,352	USD	19.7	NA	NA	NA	3.5	3.0	2.5	27.8	16.3	9.0	-48%
China Literature	772 HK	4,333	HKD	33.3	29.6	24.2	20.6	4.4	3.8	3.3	17.3	13.5	11.6	21%
Bilibili	BILI US	5,857	USD	18.0	NA	NA	102.6	6.1	4.2	3.2	NA	252.3	29.9	NA
Average					29.5	24.0	47.0	4.8	3.8	3.1	23.3	75.2	16.0	0%
Ads														
Baidu	BIDU US	42,685	USD	123.2	22.6	18.0	13.9	2.8	2.5	2.3	18.6	11.8	10.2	30%
Weibo	WB US	10,113	USD	44.9	16.5	15.8	13.8	5.7	5.3	4.7	14.0	12.9	11.3	10%
Sina	SINA US	2,590	USD	37.3	13.3	13.3	10.7	1.2	1.1	1.0	5.3	4.9	4.1	14%
Mobvista	1860 HK	662	HKD	3.4	15.4	9.8	6.4	1.2	1.0	0.8	15.3	8.0	5.5	46%
Duiba	1753 HK	646	HKD	4.6	20.2	8.4	5.9	2.3	1.6	1.2	16.8	5.3	3.6	232%
58.com	WUBA US	9,299	USD	62.2	16.3	18.8	17.2	4.2	3.7	3.3	17.2	14.8	12.4	0%
Average					17.4	14.0	11.3	2.9	2.5	2.2	14.5	9.6	7.8	33%
Total Average					20.8	17.3	16.7	4.0	3.3	2.8	23.2	23.3	41.0	29.6%

Source: Bloomberg

Note: Data updated by 18 Dec 2019

Key Investment Risks

Key investment risks might derive from: 1) Uncertainty in regulations; 2) slower-than-expected launch of new games; and 3) grossing decline of hot titles.

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	6,189	7,633	12,340	14,324	16,514
Film & TV	5,629	7,247	12,340	14,324	16,514
Games	560	385	-	-	-
COGS	(1,948)	(1,811)	(1,896)	(2,305)	(2,787)
Gross profit	4,241	5,821	10,444	12,019	13,728
S&M	(1,908)	(3,347)	(7,256)	(8,251)	(9,413)
Admin.Exp.	(340)	(246)	(290)	(358)	(438)
R&D	(436)	(538)	(617)	(702)	(793)
Others	(38)	(919)	74	36	63
Operating profit	1,518	771	2,355	2,744	3,147
Non-operating Rev	403	464	64	30	30
Non-operating Exp	4	15	10	8	5
Pre-tax Income	1,925	1,250	2,429	2,782	3,182
Income Tax	(80)	(68)	(241)	(290)	(349)
Less: MI	216	143	71	61	46
Net profit	1,621	1,009	2,098	2,415	2,777

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	1,621	1,009	2,098	2,415	2,777
D&A	160	118	81	83	84
Change in WC	(467)	638	(617)	(40)	898
Others	519	190	29	36	(25)
Operating CF	1,832	1,954	1,590	2,494	3,733
Capex	(1,019)	(324)	(100)	(92)	(89)
Associates	-	1	2	3	4
Others	(349)	268	(100)	(101)	(102)
Investing CF	(1,368)	(55)	(198)	(190)	(187)
Equity raised	496	647	-	-	-
Change of Debts	341	(58)	(60)	(60)	(60)
Others	(374)	1,310	1,451	2,363	3,606
Financing CF	464	1,899	1,391	2,304	3,546
Net change in cash	762	(65)	815	1,266	2,393
Cash (beg of yr)	819	1,581	1,516	2,331	3,598
FX	(13)	5	5	5	-
Cash (end of yr)	1,581	1,516	2,331	3,598	5,990

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	5,198	4,214	4,411	4,568	4,702
Fixed asset	343	36	63	78	88
LT investment	377	556	734	882	1,010
Intangible assets	4,466	3,594	3,587	3,581	3,576
Others	12	27	27	27	27
Current assets	3,962	4,182	5,702	7,333	9,256
Cash	1,581	1,516	2,331	3,598	5,990
Restricted cash	284	194	203	247	298
Account receivable	940	1,299	1,994	2,315	1,793
Others	1,158	1,174	1,174	1,174	1,174
Current liabilities	1,518	1,992	2,086	2,397	2,767
Short-term debt	372	369	339	309	279
Customer advances	85	95	153	178	205
Accounts Payable	742	1,082	1,133	1,377	1,665
1-year loan	28	30	30	30	30
Others	291	417	432	504	589
Non-current liabilities	355	290	255	226	196
Borrowings	311	281	252	222	192
Others	44	9	4	4	4
MI	270	141	122	92	48
Total Equity	7,287	6,114	7,772	9,278	10,994
Shareholders' equity	7,017	5,973	7,650	9,186	10,945

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
Film & TV	90.9	95.0	100.0	100.0	100.0
Games	9.1	5.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	17.9	23.3	61.7	16.1	15.3
Gross profit	28.2	37.3	79.4	15.1	14.2
EBIT	28.6	37.4	79.5	15.1	14.2
Net profit	51.4	(37.8)	108.0	15.1	15.0
P&L ratios (%)					
OPM	24.5	10.1	19.1	19.2	19.1
Pre-tax margin	31.1	16.4	19.7	19.4	19.3
Net margin	22.6	22.4	15.6	16.0	15.8
tax rate	(1.3)	(0.9)	(2.0)	(2.0)	(2.1)
Returns (%)					
ROE	22.2	16.5	27.0	26.0	25.3
ROA	17.7	12.0	20.7	20.3	19.9
Per share					
EPS (RMB)	0.76	0.47	0.99	1.14	1.31
DPS (RMB)	0.10	0.20	0.42	0.48	0.55
BVPS (RMB)	0.74	0.71	1.10	1.69	2.82

Source: Company data, CMBIS estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIS Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIS

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Securities Limited ("CMBIS") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIS does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIS recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIS, solely for the purpose of supplying information to the clients of CMBIS or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIS nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIS has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIS provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIS may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIS may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIS may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIS does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIS may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIS.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIS.

For recipients of this document in the United States

This report is intended for distribution in the United States to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this research report by its acceptance hereof represents and agrees that it shall not distribute or provide this research report to any other person.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.

Notes: CMBIS or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months.