

4 May, 2023

Homeland Interactive Technology | 03798.HK

Acceptable short-term setbacks can be absorbed by strong core business

STOCK RATING

BUY

TARGET PRICE

HK\$ 2.27

Homeland Interactive Technology (03798.HK) reported a YoY 37.0% growth in the total revenue to RMB 1,562.9mn for the year ended Dec 2022, but it recorded a disappointing 65.3% gross margin and 29.8% net margin, resulting in a YoY 6.9% decline in the bottom-line, miss our estimates. The Group also announced a final dividend of HKD 0.14/share, representing a FY payout ratio of ~50%.

A more conservative approach is required on expenses: The operating expense ratio boomed to 48.9% for the year ended Dec 2022 due to the i) rebounding offline marketing like competition sponsorship, ii) heavy marketing input on short video platforms, and iii) expansion of teams. We are concerned about the cost control policy and the marginal effect on user acquisition, and we believe that a more conservative online marketing plan is inevitable to maintain the profit margin because an additional marketing budget will be allocated for “Cat Keeper” etc.

Irreversible decrease in the GM: The channel costs rallied YoY 113.8% to about RMB 422.6mn for the year ended Dec 2022, and it was primarily attributable to the surging contribution from third-party platforms like Tencent, short video platforms and smartphone manufacturers. We admit that the gross margin plunged faster than our expectation, but it is a reasonable and foreseeable trend because of the ballooning traffic directed from these platforms. Given the strong reliance on the third-party distribution channels, it is expected that the gross margin will remain at a lower level.

Acceptable short-term setbacks can be absorbed by strong core business: As mentioned in our previous reports, we believe that Homeland Interactive Technology (03798.HK) has abundant resources and buffers for trial and error, including the adoption of new marketing strategies and the exploration of new business segments. In our opinion, the headwinds are temporary and they have no material impact on the cash-generating business, asset quality and the attractive dividend policy (~8.6% dividend yield), we need more evidence (e.g. significant growth deceleration / deterioration of asset quality) before changing our views. Besides, a positive signal for the mahjong industry was released in China, a new assessment center was set up by the Mahjong International League and Hangzhou Branch of China Qi-Yuan in late 2022, the 《麻將運動技術技能等級評定管理辦法》 and 《關於推動麻將項目賽事體系標準化建設的實施意見》 were announced to re-position mahjong to professional sports games. We remain positive about the long-term prospect of the Group, but we agree that the Group needs adjustment on its operation in the short term. We, thus, cut the profit estimates by 16.8% - 26.7%, and we slash the TP to HKD 2.27/share and downward adjust the rating to “BUY”.

COMPANY UPDATE

H F NGO, Brian, CFA

SENIOR ANALYST

briango@westbullsec.com.hk

+852 3896 2965

 2701 – 2703, 27/F, Infinitus Plaza, 199 Des Voeux Rd
 Central, Sheung Wan, HK

Homeland Interactive Tech (03798.HK)

Stock Rating (Previous Rating) **BUY** (STRONG BUY)

Target Price (Previous TP) **HK\$ 2.27** (HK\$ 2.58)

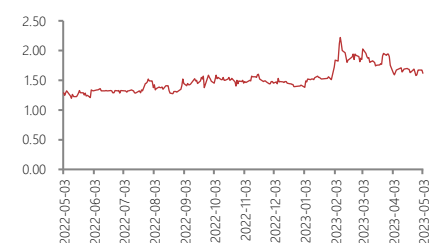
 Current Price **HK\$ 1.62**

 52-Week Range **HK\$ 1.18 – 2.40**

 Market cap. (HKD, bn) **HK\$ 2.1**

RMB, mn	22(A)	23(E)	24(E)	25(E)
Revenue	1,562.9	1,712.1	1,901.0	1,999.3
Gross Profit	1,020.6	1,120.0	1,257.1	1,312.3
Gross Margin	65.3%	65.4%	66.1%	65.6%
Net Profit	465.7	478.9	593.9	647.7
EPS	0.372	0.373	0.463	0.505
P/S	3.7	3.8	3.1	2.8
P/E	1.1	1.1	1.0	0.9
ROE	28.8%	24.4%	25.2%	22.9%

Performance	1 mth	3 mth	6 mth	1 year
Absolute	0.0%	-12.0%	9.5%	25.4%
Relative to HSI	3.5%	-2.9%	-19.0%	32.1%



Peers comparison

		Mkt. Cap.	P/E	Fw. P/E	P/B	P/S	Revenue	GM	ROE
		(HKD, mn)	(%)	(%)	(%)	(%)	(HKD, mn)	(%)	(%)
00434.HK	Boya	337.0	4.3	-	0.2	0.7	437.0	65.5	3.7
02660.HK	Zengame	3,167.5	4.0	-	1.6	1.5	2,058.1	64.4	45.5
06899.HK	Ourgame	269.5	-	-	0.8	1.1	253.5	38.5	(10.5)
	<i>Average</i>	1,258.0	4.1	-	0.9	1.1	916.2	56.1	12.9
00302.HK	CMGE	6,633.9	-	-	1.0	2.2	3,160.2	41.0	(3.6)
00484.HK	Forgame	142.3	-	-	0.2	1.1	132.9	5.1	(3.1)
00700.HK	Tencent	3,248,230.8	15.1	19.7	4.0	5.1	645,740.4	43.1	24.6
00797.HK	7 Road	6,470.0	18.9	-	3.0	9.9	629.5	48.3	16.1
02022.HK	Digi Hollywood	128.0	-	-	0.5	1.4	87.3	41.8	(15.5)
02100.HK	Baioo	1,171.5	99.3	-	0.6	1.0	1,093.1	38.4	0.6
02400.HK	XD Inc	11,530.9	-	71.2	5.4	2.9	3,995.1	53.5	(26.4)
	<i>Average</i>	467,758.2	44.5	45.4	2.1	3.4	93,548.3	38.7	(1.0)
03798.HK	Homeland	2,143.3	5.1	-	1.0	1.1	1,819.9	65.3	28.8

Source: Bloomberg, West Bull Securities

Risk factors

- Significant impact on user acquisition if Homeland Interactive Technology (03798.HK) control the marketing expenses
- Erosion of profit margin by the marketing cost
- Unable to maintain the dividend distribution policy in the future
- Unable to bring a change to the market by the re-positioning of mahjong games in China
- Keen competition brought by the ballooning marketing input from peers
- Indirect competition from other online games
- Slower-than-expected progress in the overseas market exploration and games development

Financial Statement

PnL					Balance Sheet				
(RMB, mn)	2022 (A)	2023 (E)	2024 (E)	2025 (E)	(RMB, mn)	2022 (A)	2023 (E)	2024 (E)	2025 (E)
Revenue	1,562.9	1,712.1	1,901.0	1,999.3	PPE	52.9	51.4	48.3	46.1
<i>YoY growth</i>	<i>37.0%</i>	<i>9.5%</i>	<i>11.0%</i>	<i>5.2%</i>	Intangible assets	1.1	0.9	0.8	0.8
COGS	(542.3)	(592.1)	(643.9)	(687.1)	Others	441.6	451.9	532.7	616.9
Gross profit	1,020.6	1,120.0	1,257.1	1,312.3	Non-current assets	495.5	504.2	581.9	663.8
Other income	73.9	52.6	59.8	67.2	Inventories	-	-	-	-
Operating expenses	(759.6)	(702.7)	(750.9)	(762.8)	Trade receivables	192.9	230.9	238.8	254.2
Operating profit	335.0	469.9	566.0	616.6	Cash & cash equivalents	1,163.3	1,516.6	1,865.0	2,217.1
Finance expenses	-	-	-	-	Others	253.5	198.3	226.2	261.4
JV & Ass.	41.0	45.0	72.6	79.8	Current assets	1,609.8	1,945.8	2,330.0	2,732.7
Profit before tax	376.0	514.9	638.6	696.4	Total assets	2,105.3	2,450.0	2,911.9	3,396.5
Tax	(26.3)	(36.1)	(44.7)	(48.8)	LT borrowings	-	-	-	-
Others	116.0				Others	36.6	34.3	34.8	33.0
Net profit	465.7	478.9	593.9	647.7	Non-current liabilities	36.6	34.3	34.8	33.0
<i>YoY growth</i>	<i>13.1%</i>	<i>2.8%</i>	<i>24.0%</i>	<i>9.1%</i>	Trade payables	93.6	107.2	108.9	119.3
					ST borrowings	-	-	-	-
					Others	181.1	180.1	182.6	181.8
					Current liabilities	274.7	287.3	291.5	301.1
					Total liabilities	311.3	321.6	326.3	334.1
					Non-controlling interests	(0.4)	(0.4)	(0.4)	(0.4)
					Controlling interests	1,794.4	2,128.9	2,586.0	3,062.8
					Total equities	1,794.0	2,128.5	2,585.6	3,062.4

Cash Flow

(RMB, mn)					Financial Ratio				
	2022 (A)	2023 (E)	2024 (E)	2025 (E)		2022 (A)	2023 (E)	2024 (E)	2025 (E)
Profit before tax	512.7	514.9	638.6	696.4	Gross margin	65.3%	65.4%	66.1%	65.6%
Finance expenses	-	-	-	-	Operating margin	21.4%	27.4%	29.8%	30.8%
Finance income	(30.1)	(28.2)	(36.8)	(45.2)	Net profit margin	29.8%	28.0%	31.2%	32.4%
D&A	21.5	18.2	15.4	15.6	Adj. EBITDA profit margin	21.6%	29.4%	32.5%	33.4%
Others	(193.0)	(74.5)	(110.4)	(121.3)	Return on Equity	28.8%	24.4%	25.2%	22.9%
Change in working capital	(70.8)	68.4	(32.3)	(38.7)	Return on Asset	24.3%	21.0%	22.2%	20.5%
CFO	240.3	498.8	474.6	506.9	Current ratio	586.1%	677.3%	799.2%	907.6%
					Quick ratio	519.7%	629.5%	742.6%	841.1%
CAPEX	(68.4)	(11.3)	(8.8)	(9.3)	Cash ratio	423.5%	527.9%	639.7%	736.3%
Others	9.4	23.6	31.0	37.9	Debt-to-Equity ratio	-	-	-	-
CFI	(59.0)	12.4	22.2	28.6	Net Debt-to-Equity ratio	-64.8%	-71.3%	-72.1%	-72.4%
Shares issuance	-	-	-	-					
Net borrowings	-	-	-	-					
Dividend paid	(92.9)	(151.0)	(143.7)	(178.2)					
Others	(56.4)	(6.9)	(4.8)	(5.2)					
CFF	(149.2)	(157.9)	(148.4)	(183.4)					
FCFE	171.9	487.6	465.8	497.6					
FCFF	171.9	487.6	465.8	497.6					

Source: Company data, West Bull Securities

West Bull Securities is a dedicated small/mid cap stock brokerage house. Find our research on: Bloomberg, factset.com, Capital IQ, Refinitiv, Wind, Choice and 同花顺.

Ratings of West Bull Securities:

STRONG BUY	: absolute upside of >50% over the next 12 months
BUY	: absolute upside of >10% over the next 12 months
HOLD	: absolute return of -10% to +10% over the next 12 months
SELL	: absolute downside of >10% over the next 12 months
STRONG SELL	: absolute downside of >50% over the next 12 months

Investors should assume that West Bull Securities is seeking or will seek investment banking or other related businesses with the companies in this report.

Analyst certification: The views expressed in this report accurately reflect the analyst's personal views of the subject securities and that the analyst has not received and will not receive direct or indirect compensation in exchange for expressing specific recommendations or views in this report.

Disclaimer:

This research report is not an offer to sell or the solicitation of an offer to buy or subscribe for any securities. The securities referred to in this report may not be eligible for sale in some jurisdictions. The information contained in this report has been compiled by the Research Department of West Bull Securities Limited ('West Bull Securities') from sources that it believes to be reliable but no representation, warranty or guarantee is made or given by West Bull Securities Securities or any other person as to its accuracy or completeness. All opinions and estimates expressed in this report are (unless otherwise indicated) entirely those of West Bull Securities as of the date of this report only and are subject to change without notice. Neither West Bull Securities nor any other person, accepts any liability whatsoever for any loss howsoever arising from any use of this report or its contents or otherwise arising in connection therewith. Each recipient of this report shall be solely responsible for making its own independent investigation of the business, financial condition and prospects of the companies referred to in this report. West Bull Securities and their respective officers, directors and employees, including persons involved in the preparation or issuance of this report, may from time to time (1) have positions in, and buy or sell, the securities of companies referred to in this report (or related investments); (2) have a consulting, investment banking or broking relationship with any company referred to in this report; and (3) to the extent permitted under applicable law, have acted upon or used the information contained or referred to in this report including effecting transactions for their own account in an investment (or related investment) in respect of any company referred to in this report, prior to or immediately following its publication. This report may not have been distributed to all recipients at the same time. This report is issued only for the information of and may only be distributed to professional investors and dealers in securities and must not be copied, published, reproduced or redistributed (in whole or in part) by any recipient for any purpose. Any recipient of this report who requires further information regarding any securities referred to in this report should contact the relevant office of West Bull Securities located in such recipient's home jurisdiction.

Copyright© West Bull Securities Limited. All rights reserved.