

FriendTimes Inc. (6820 HK)

Looking into moderate recovery in FY24E

FriendTime's 1H23 results missed our estimates/consensus, with rev -25% YoY and adj. net loss at RMB78mn on declining legacy games and soft new titles. Looking into FY24E, we expect moderate recovery with the launch of the *Twist of the Fate*, and the company to turn a profit with RMB38mn in FY24E. To factor in game softness and potential S&M expenses incurred by new launches, we cut FY23-25E rev by 21.1-25.8%, while trimmed NPM by 1-15ppts. Our DCF-based TP was adjusted to HK\$1.32.

- 1H23 soft on game decline and heavier S&M.** 1H23 rev declined 25% YoY, 34% below consensus, mainly attributable to 1) weaker-than-expected legacy games; 2) soft *A story of Lala's: Rising Star* with S&M scaling back for unsatisfied user retention; and 3) high base due to launch of *Promise of Linyun* in 1H22. Adj. net loss came in at RMB78mn, dragged by promotion of *A story of Lala* and RMB63mn impairment of the deferred tax assets.
- Looking into moderate recovery in FY24E.** Due to the lack of new launches and declining legacy games, 2H23E might still bear pressure (forecasting rev -25% YoY), before the launch of *The Twist the Fate (ToF, 浮生忆玲珑)* in 4Q23E/FY24E. On the flip side, FT is likely to achieve breakeven in 2H23E (forecasting net profit of RMB0.76mn), thanks to stringent cost control on both staffing and project management, along with lower S&M expenses. Looking into FY24E, we expect FT to see moderate recovery (forecasting +23% YoY), backed by contribution of *ToF*. In Jul 2023, the game launched a one-month "Summer Beta Test" with in-game purchases enabled. We expect *ToF* to be launched in 4Q23E/1H24E and achieve meaningful rev contribution in FY24E. Given S&M expenses for launch are front-end loaded, margin might be diluted in the near term. As such, we forecast FY24E rev to achieve positive growth, and turn to a profit with RMB38mn for the whole year.
- Diversified genre and overseas expansion for LT growth.** In 1H23, overseas market accounted for 39% of total rev (vs. 25% in 1H22). Apart from female games, FT will test the water for martial arts game (e.g. Code: WX) and European royalty type (Code: PE) in FY24E. We expect its diversified category & overseas expansion to reduce concentration and bring LT growth.
- Maintain BUY.** To factor in soft game and potential S&M expenses incurred by *ToF*, we cut FY23-25E rev by 21.1-25.8%, while trimmed NPM by 1-15ppts. Our DCF-based TP was adjusted to HK\$1.32.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	1,616	1,524	1,142	1,401	1,592
YoY change (%)	-26%	-6%	-25%	23%	14%
Adj. net income (RMB mn)	275	25	(80)	38	206
Adj. EPS (RMB)	0.13	0.01	(0.04)	0.02	0.09
YoY growth (%)	-45%	-91%	NA	NA	438%
Consensus EPS (RMB)	NA	NA	0.09	0.18	0.25
P/E (x)	5.3	58.6	NA	38.4	7.1
P/S (x)	1.0	1.1	1.4	1.2	1.0
Yield (%)	17.4%	8.7%	NA	1.3%	6.8%
ROE (%)	17%	2%	NA	2%	11%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$1.32
(Previous TP)	HK\$1.45
Up/Downside	+76%
Current Price	HK\$0.75

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	1,657
Avg 3 mths t/o (HK\$ mn)	0.28
52w High/Low (HK\$)	1.23/ 0.76
Total Issued Shares (mn)	2,181

Source: Bloomberg

Shareholding Structure

Eternal Heart Holding	43.0%
Warm Sunshine	8.7%
Ling Long Holding	8.6%

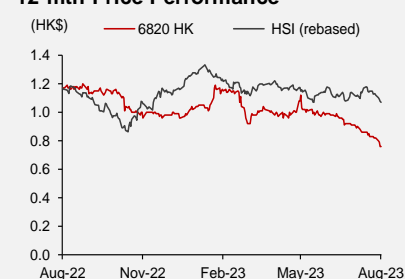
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-16.5%	-11.5%
3-mth	-29.6%	-23.3%
6-mth	-34.5%	-25.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Figure 1: 1H23 financial review

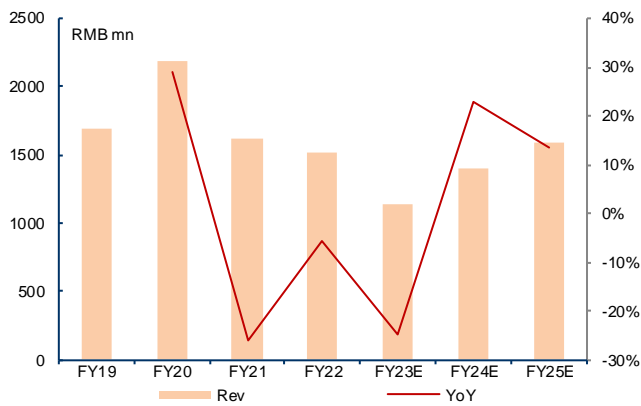
RMB ('000), Dec-YE	1H20	1H21	1H22	1H23	YoY
Revenue	1,050,260	833,007	826,057	620,342	-25%
Cost of sales	(361,351)	(272,705)	(253,312)	(207,728)	
Gross profit	688,909	560,302	572,745	412,614	-28%
Sales and marketing expenses	(379,030)	(280,810)	(469,968)	(276,068)	
Research and development expenses	(130,694)	(178,181)	(169,112)	(160,019)	
General and administrative expenses	(21,680)	(31,340)	(34,036)	(24,977)	
Other income	17,646	11,676	17,157	34,013	
Operating (loss)/profit	175,151	81,647	(83,214)	(14,437)	
Finance costs	(50)	(11)	(26)	(156)	
Share of loss of an associate	(175)	(1,733)	(910)	-	
Changes in fair value of equity investment measured at fair value through profit or loss	(2,734)	2,212	10,096	(1,977)	
Profit before taxation	172,192	82,115	(74,054)	(16,570)	
Income tax expense	(9,076)	48,176	1,092	(1,367)	
Deferred tax				(63,007)	
Profit for the year	163,116	130,291	(72,962)	(80,944)	
Adj. profit for the year	163,116	156,037	(58,461)	(77,911)	
Margin Analysis					
Gross margin	66%	67%	69%	67%	
Operating margin	17%	10%	-10%	-2%	
Adj. net margin	16%	19%	-7%	-13%	
Growth Analysis					
Revenue	35%	-21%	-1%	-25%	
Gross profit	39%	-19%	2%	-28%	
Operating profit	9%	-53%	NA	NA	
Net profit	9%	-20%	NA	NA	

Source: Company data, CMBIGM estimates

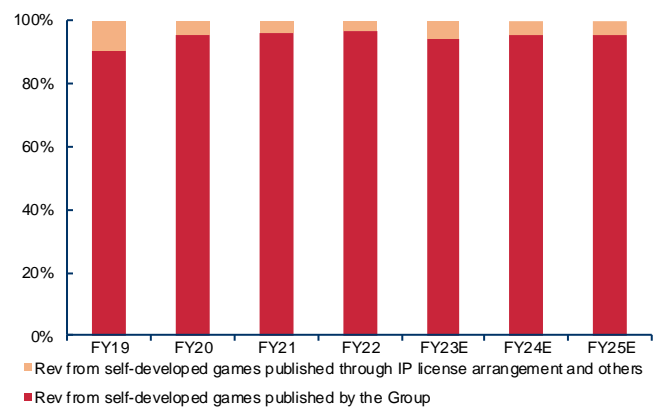
Figure 2: FT's financials forecasts in FY23-25E

RMB mn, Dec-YE	FY21	FY22	FY23E	FY24E	FY25E	23-25E CAGR
Revenue	1,616	1,524	1,142	1,401	1,592	18%
Cost of sales	(527)	(480)	(371)	(448)	(509)	
Gross profit	1,089	1,044	771	953	1,083	19%
Sales and marketing expenses	(456)	(647)	(459)	(561)	(501)	
Research and development expenses	(365)	(357)	(308)	(329)	(334)	
General and administrative expenses	(67)	(70)	(47)	(55)	(56)	
Other income	39	48	25	29	29	
Operating (loss)/profit	241	17	(18)	37	220	
Finance costs	(0)	(0)	(0)	(0)	(0)	
Share of loss of an associate through profit or loss	(3)	(1)	(2)	(2)	(2)	
Profit before taxation	234	24	(18)	41	222	
Income tax expense	42	1	1	(2)	(16)	
Profit for the year	275	25	(80)	38	206	
Non-controlling interests	-	-	-	-	-	
Net profit attributable to equity shareholders	275	25	(80)	38	206	
Margin Analysis						
Gross margin	67%	68%	68%	68%	68%	
Operating margin	15%	1%	-2%	3%	14%	
Net margin	17%	2%	-7%	3%	13%	
Growth Analysis						
Revenue	-26%	-6%	-25%	23%	14%	
Gross profit	-26%	-4%	-26%	24%	14%	
Operating profit	-56%	-93%	NA	NA	490%	
Net profit	-45%	-91%	NA	NA	438%	

Source: Company data, CMBIGM estimates

Figure 3: FT rev estimates (2019-2025E)

Source: Company data, CMBIGM estimates

Figure 4: Rev mix trend (2019-2025E)

Source: Company data, CMBIGM estimates

Figure 5: FriendTimes key game pipeline in 2023 & 2024

Title	Chinese title	License	Genre	Launch date (est.)	Details
Twist of the Fate	浮生忆玲珑	Y	PRG	4Q23/1H24	A new generation of female-oriented traditional Chinese-style mobile game, is inherited from the Fate of the Empress (浮生為卿歌), which creates a new theme adopts next-generation engine effects, artistic production techniques and innovative gameplay features, aiming to bring players a free, realistic and multifaceted gameplay experience.
Code: WX	代号: 武侠	N	MMO	2024	A role-playing strategy game set in a fictional Chinese-style wuxia world, featuring the classic martial arts as its core. The game illustrates an unrestrained and pleasant world of wuxia, creating stereoscopic and realistic martial artists, and a multi-dimensional wuxia epic.
Code: PE	代号: PE	N	Strategy	2024	A female-oriented role-playing game set in a fictional European royal world. The game portrays the Western royal family with immersive audio-visual experiences and a multi-dimensional storytelling approach, creating a dynasty of legendary queen. Players will enter the royal world, experience the struggle for power, enjoy emotional interactions, and cast a generation of queen legends.

Source: Company data, CMBIGM

Maintain BUY; TP at HK\$1.32

To factor in existing game decline and potential S&M expenses incurred by ToF, we cut FY23-25E rev by 21.1-25.8%, while trimmed NPM by 1-15ppts for conservative estimates.

We maintain BUY rating, but adjust DCF-based TP to HK\$1.32 from HK\$1.45. Game softness has been well priced in recent price weakness, and 1H23 would be earnings trough as its existing key games turned profitable. We expect the potential launch of *ToF* to help it rebound, and diversified genre and overseas expansion might bring LT growth. Key catalysts: 1) potential breakeven in 2H23E; 2) *ToF* to be launched in 4Q23E/1H24E.

Figure 6: CMBIGM estimates vs consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	1,142	1,401	1,592	1,721	2,221	2,475	-33.6%	-36.9%	-35.7%
Gross profit	771	953	1,083	1,179	1,521	1,695	-34.6%	-37.4%	-36.1%
Operating profit	(18)	37	220	167	403	545	NA	-90.8%	-59.6%
Adj. net profit	(80)	38	206	200	384	527	NA	-90.0%	-60.9%
Adj. EPS (RMB)	(0.04)	0.02	0.09	0.09	0.18	0.25	NA	-90.1%	-61.4%
Gross margin	67.5%	68.0%	68.0%	68.5%	68.5%	68.5%	-1.0ppts	-0.5ppts	-0.5ppts
Operating margin	-1.6%	2.7%	13.8%	9.7%	18.1%	22.0%	-11.3ppts	-15.5ppts	-8.2ppts
Adj. net margin	-7.0%	2.7%	12.9%	11.6%	17.3%	21.3%	-18.7ppts	-14.6ppts	-8.3ppts

Source: CMBIGM estimates, Bloomberg

Figure 7: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Revenue	1,142	1,401	1,592	1,539	1,816	2,018	-25.8%	-22.8%	-21.1%
Gross profit	771	953	1,083	1,047	1,235	1,372	-26.3%	-22.8%	-21.1%
Operating profit	(18)	37	220	131	258	297	NA	-85.5%	-26.0%
Adj. net profit	(80)	38	206	125	246	278	NA	-84.4%	-25.9%
Adj. EPS (RMB)	(0.04)	0.02	0.09	0.06	0.11	0.13	NA	-84.4%	-25.9%
Gross margin	67.5%	68.0%	68.0%	68.0%	68.0%	68.0%	-0.5ppts	0.0ppts	0.0ppts
Operating margin	-1.6%	2.7%	13.8%	8.5%	14.2%	14.7%	-10.1ppts	-11.5ppts	-0.9ppts
Adj. net margin	-7.0%	2.7%	12.9%	8.1%	13.5%	13.8%	-15.1ppts	-10.8ppts	-0.8ppts

Source: CMBIGM estimates, Bloomberg

Figure 8: DCF valuation

DCF Valuation (RMB mn)									
	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	
EBIT	(18)	41	222	348	383	410	435	448	
Tax	1	(2)	(16)	(24)	(31)	(37)	(43)	(45)	
D&A	39	36	33	32	30	29	28	27	
Change in working capital	(15)	6	5	5	6	6	6	7	
CAPEX	(38)	(38)	(38)	(42)	(44)	(45)	(46)	(48)	
FCF	(31)	42	206	319	345	363	379	389	
FCF Growth			396%	54%	8%	5%	4%	3%	
PV	(31)	36	156	210	198	181	164	1,306	
Terminal Value									3,068

Assumptions

WACC	14.9%
Tax rate	10.0%
Risk free rate	3.53%
Cost of debt	6.0%
Beta	1.30
Market risk return	11.4%
Cost of equity	14.9%
Long term growth	2.0%

Equity Value

PV	2,220
minus: Net debt(RMB mn)	(369)
minus: Minority interest(RMB mn)	0
Equity Value(RMB mn)	2,589
FX	0.9
Stock price (HK\$)	1.32

		WACC				
		13%	14%	15%	16%	17%
Terminal growth rate	0.5%	1.45	1.34	1.25	1.16	1.09
	1.0%	1.48	1.36	1.27	1.18	1.10
	1.5%	1.51	1.39	1.29	1.20	1.12
	2.0%	1.55	1.42	1.32	1.22	1.14
	2.5%	1.59	1.45	1.35	1.24	1.15
	3.0%	1.64	1.49	1.37	1.26	1.17
3.5%	1.69	1.53	1.41	1.29	1.19	

Source: CMBIGM estimates, Bloomberg

Figure 9: Comps table

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Rating	CMBI TP	PE			PS			FY23-25 EPS CAGR
							FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	
FriendTimes	6820 HK	212	HKD	0.8	BUY	1.3	NA	38.4	7.1	1.4	1.2	1.0	NA
Domestic Game													
Tencent	700 HK	408,420	HKD	335	BUY	458	20.1	17.0	15.0	4.8	4.3	3.9	15%
NetEase	NTES US	65,482	USD	102	BUY	123	18.2	16.7	15.2	4.5	4.1	3.7	6%
XD Inc	2400 HK	1,036	HKD	17	NA	NA	50.8	20.3	12.4	1.8	1.5	1.2	136%
Kingsoft	3888 HK	5,267	HKD	30	NA	NA	49.6	29.6	23.0	4.3	3.6	3.0	49%
IGG	799 HK	543	HKD	4	NA	NA	NA	5.7	4.9	0.8	0.7	0.7	NA
CMGE	302 HK	570	HKD	2	BUY	4	6.9	5.3	4.4	0.8	0.6	0.5	26%
Archosaur Games	9990 HK	371	HKD	4	NA	NA	14.5	12.2	7.6	1.5	1.4	1.7	NA
Perfect World	002624 CH	3,730	CNY	14	BUY	49	18.2	14.9	12.9	3.1	2.7	2.5	19%
Sanqi Interactive	002555 CH	7,851	CNY	26	BUY	30	16.9	14.7	13.0	3.0	2.7	2.4	14%
Giant Network	002558 CH	3,775	CNY	14	NA	NA	20.8	17.6	15.8	7.7	7.2	6.4	17%
G-bits	603444 CH	3,972	CNY	403	NA	NA	19.2	16.1	14.2	5.3	4.5	4.1	15%
Kingnet Network	002517 CH	4,345	CNY	15	NA	NA	22.0	17.4	14.7	6.5	5.3	4.6	21%
Average							17.4	13.8	12.8	3.3	2.8	2.6	17%
International Game													
Activision Blizzard	ATVI US	71,481	USD	91	NA	NA	21.9	20.9	20.0	7.5	7.3	7.0	5%
Electronic Arts	EA US	32,694	USD	121	NA	NA	17.5	15.9	15.0	4.3	4.0	3.9	11%
Take-Two	TTWO US	23,822	USD	140	NA	NA	42.8	18.7	16.5	4.3	3.0	2.9	65%
ROBLOX	RBLX US	18,034	USD	29	NA	NA	NA	NA	NA	5.5	4.7	4.1	NA
Nintendo	7974 JT	54,867	JPY	6,180	NA	NA	19.4	22.4	22.1	5.0	5.2	5.0	-6%
Bandai Namco	7832 JT	15,462	JPY	3,396	NA	NA	23.0	20.8	19.2	2.2	2.1	2.0	9%
Square Enix	9684 JT	4,531	JPY	5,409	NA	NA	16.6	15.2	15.3	1.8	1.8	1.8	4%
Z Holdings	4689 JT	21,365	JPY	409	NA	NA	31.5	25.8	21.6	1.7	1.6	1.4	21%
CyberAgent	4751 JT	3,017	JPY	872	NA	NA	50.3	21.7	16.4	0.6	0.6	0.5	73%
Sony	6758 JT	104,573	JPY	12,130	NA	NA	16.9	15.2	13.9	1.3	1.2	1.2	11%
Capcom	9697 JT	10,853	JPY	5,957	NA	NA	36.6	33.0	30.0	10.8	9.5	8.8	10%
Oriental Land	4661 JT	64,245	JPY	5,168	NA	NA	80.3	66.3	57.8	15.4	13.2	12.3	19%
Nexon	3659 JT	15,862	JPY	2,717	NA	NA	20.4	19.0	17.2	5.5	5.1	4.8	9%
Average							24.7	20.8	18.8	3.6	3.3	3.1	8%
Average							23.1	17.4	15.7	3.5	3.1	2.9	13%

Source: Bloomberg, CMBIGM

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	1,616	1,524	1,142	1,401	1,592
Games	1,616	1,524	1,142	1,401	1,591
Others	0	1	1	1	1
COGS	(527)	(480)	(371)	(448)	(509)
Gross profit	1,089	1,044	771	953	1,083
S&M	(456)	(647)	(459)	(561)	(501)
R&D	(365)	(357)	(308)	(329)	(334)
G&A	(67)	(70)	(47)	(55)	(56)
Other income	39	48	25	29	29
Operating profit	241	17	(18)	37	220
Finance costs	(0)	(0)	(0)	(0)	(0)
Other gains, net	(7)	7	0	4	2
Pre-tax Income	234	24	(18)	41	222
Income Tax	42	1	1	(2)	(16)
MI	-	-	-	-	-
Net profit	275	25	(80)	38	206
Adj. net profit	275	25	(80)	38	206

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Pre-tax Income	234	24	(18)	41	222
D&A	23	42	39	36	33
Change in WC	(2)	106	(15)	6	5
Others	8	(17)	(7)	(14)	(27)
Operating CF	263	155	(1)	68	233
Capex	(57)	(38)	(38)	(38)	(38)
Others	(329)	(43)	10	14	14
Investing CF	(386)	(81)	(28)	(25)	(25)
Equity raised	0	0	0	0	0
Change of debts	0	0	0	0	0
Others	(217)	(225)	(0)	(0)	(0)
Financing CF	(217)	(225)	(0)	(0)	(0)
Net change in cash	(340)	(348)	(29)	43	208
Cash (beg of yr)	1,093	752	404	375	418
FX	(1)	0	0	0	0
Cash (end of yr)	752	404	375	418	626

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	565	556	564	567	572
Fixed asset	279	266	276	279	284
Right-of-use assets	9	9	5	4	3
Intangible assets	3	4	6	7	8
Others	275	277	277	277	277
Current assets	1,241	1,057	894	963	1,190
Cash	752	404	375	418	626
Trade receivables	183	104	103	126	143
Other current assets	307	549	417	419	420
Current liabilities	151	106	136	165	187
Bank loans	-	-	-	-	-
Trade and other payables	117	80	88	107	121
Lease liabilities	1	1	1	1	1
Other current liabilities	33	25	47	57	65
Non-current liabilities	9	10	15	20	22
Contract liabilities	9	10	10	13	14
Lease liabilities	-	0	5	8	8
Others	-	-	-	-	-
Total Equity	1,646	1,497	1,591	1,630	1,836

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Games	100.0	99.9	100.0	99.9	99.9
Others	0.0	0.1	0.0	0.1	0.1
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	(25.9)	(5.7)	(25.1)	22.7	13.6
Gross profit	(25.8)	(4.2)	(26.2)	23.6	13.6
EBIT	(55.7)	(92.8)	NA	NA	490.4
Net profit	(45.3)	(90.9)	NA	NA	437.7
P&L ratios (%)					
Gross Margin	67.4	68.5	67.5	68.0	68.0
Pre-tax margin	14.5	1.6	(1.6)	2.9	13.9
Adj. net margin	17.0	1.6	(7.0)	2.7	12.9
Effective tax rate	(17.8)	(2.8)	5.0	6.0	7.0
Returns (%)					
ROE	16.7	1.7	NA	2.4	11.2
ROA	15.2	1.6	NA	2.5	11.7
Adj. EPS (RMB)	0.13	0.01	(0.04)	0.02	0.09
DPS (RMB)	0.12	0.06	NA	0.01	0.05
BVPS (RMB)	0.75	0.69	0.73	0.75	0.84

Source: Company data, CMBIGM estimates

Disclosures & Disclaimers

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