

# 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

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### 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

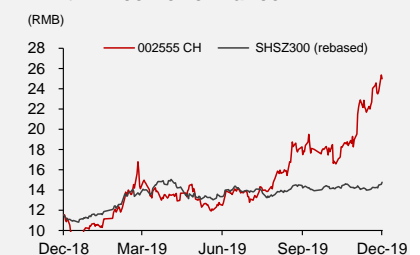
Li Weiwei	19.1%
Zeng Kaitian	17.5%
Wu Weihong	5.3%
Source: Bloomberg	

### 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	Key publishing network
1	斗罗大陆 <b>Soul Land</b>	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 <b>Fairy Ceremony</b>	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

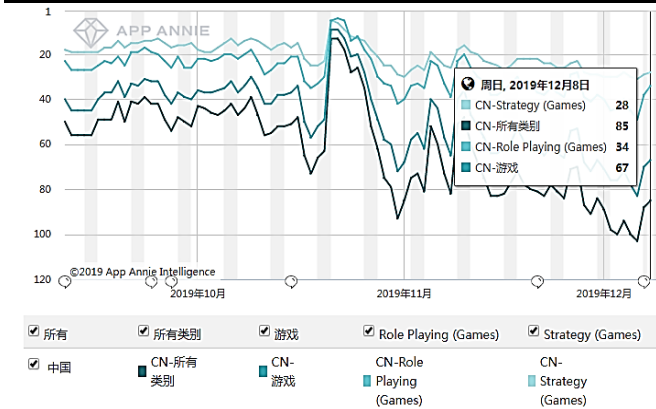
Its three top titles of The Soul Land (斗罗大陆), Yi Dao Chuan Shi (一刀传世), Jing Ling Sheng Dian (精灵盛典), which were launched in 2019, still performed well in 3Q19. The Soul Land (斗罗大陆) and Yi Dao Chuan Shi (一刀传世) ranked Top 40 in iOS grossing games, while Jing Ling Sheng Dian (精灵盛典) still ranked Top 10. Jing 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



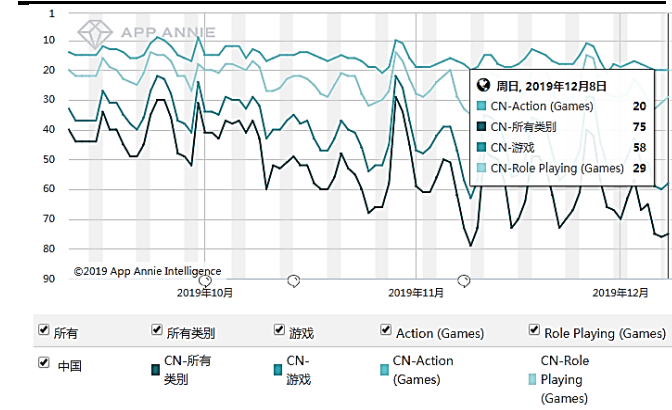
Source: App Annie, CMBIS

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

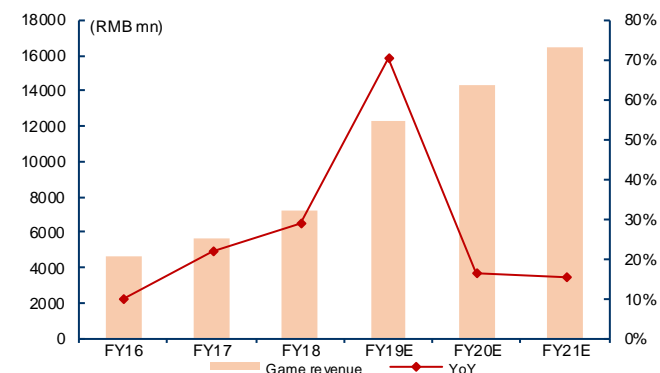
### From MMORPGs to SLG, RPG, and more.

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

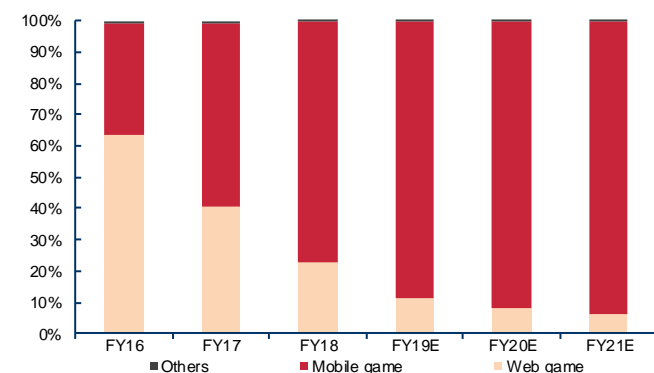
With eye-catching performance of hot titles launched in 2019, we forecast its game sector to grow 70%/16%/15% YoY in FY19/20/21E. We think FY19E performance has well acknowledged by the market, and further catalysts will derive from FY20E pipeline (e.g. self-developed games NB, YZD; licensed games MK4,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

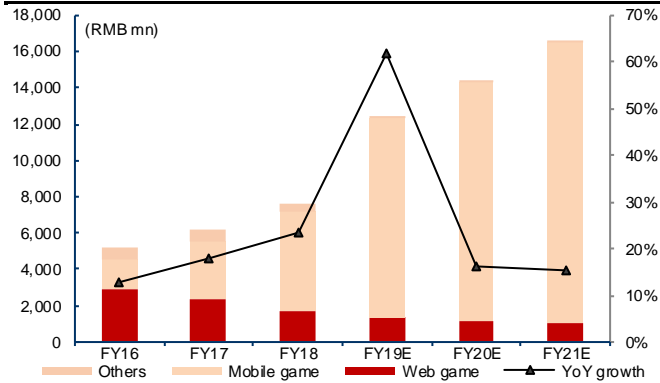
We believe Sanqi's extensive global experience and strong localization capabilities can help it to structurally and artistically modify its game offerings through local language scripts and other in-game features specifically redesigned to meet the differentiated gameplay needs and preferences of users 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

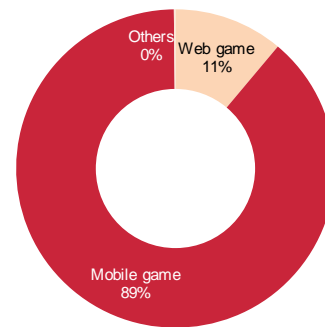
We forecast Sanqi' revenue will grow at 62%/16%/15% YoY in FY19/20/21E, in which mobile game business devotes most of total revenue. We expect revenue from games to ramp up to RMB12.3bn in FY19E with a CAGR of 29% in FY18-21E. The robust growth is mainly driven by strong performance of three hot titles 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**



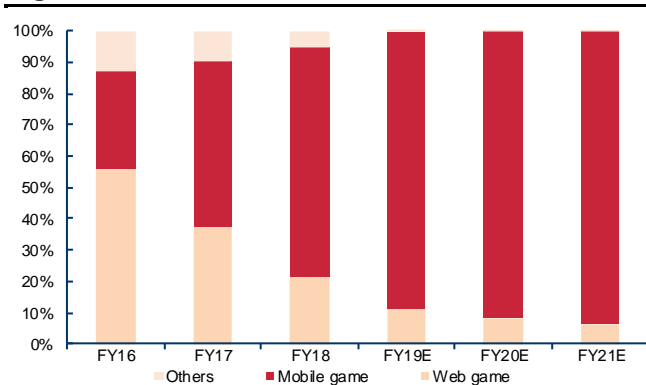
Source: Company data, CMBIS estimates

**Figure 14: FY19E revenue breakdown**



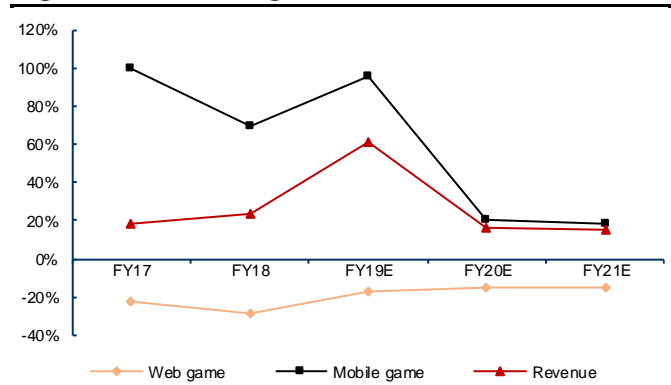
Source: CMBIS estimates

**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
<b>Revenue</b>	<b>5,248</b>	<b>6,189</b>	<b>7,633</b>	<b>12,340</b>	<b>14,324</b>	<b>16,514</b>
Cost of sales	(1,941)	(1,948)	(1,811)	(1,896)	(2,305)	(2,787)
<b>Gross profit</b>	<b>3,307</b>	<b>4,241</b>	<b>5,821</b>	<b>10,444</b>	<b>12,019</b>	<b>13,728</b>
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
<b>Operating profit</b>	<b>1,165</b>	<b>1,518</b>	<b>771</b>	<b>2,355</b>	<b>2,744</b>	<b>3,147</b>
Non-operating income	164	403	464	64	30	30
Non-operating expenses	10	4	15	10	8	5
<b>Pre-tax profit</b>	<b>1,319</b>	<b>1,917</b>	<b>1,219</b>	<b>2,409</b>	<b>2,766</b>	<b>3,172</b>
Income tax expense	(102)	(80)	(68)	(241)	(290)	(349)
<b>Profit for the year</b>	<b>1,217</b>	<b>1,836</b>	<b>1,151</b>	<b>2,168</b>	<b>2,476</b>	<b>2,823</b>
Non-controlling interests	147	216	143	71	61	46
<b>Net profit attributable to equity shareholders</b>	<b>1,070</b>	<b>1,621</b>	<b>1,009</b>	<b>2,098</b>	<b>2,415</b>	<b>2,777</b>
<b>Margin Analysis</b>						
Gross margin	63%	69%	76%	85%	84%	83%
Operating margin	22%	25%	10%	19%	19%	19%
Net margin	20%	26%	13%	17%	17%	17%
<b>Growth Analysis</b>						
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
<b>Non-current assets</b>	<b>3,936</b>	<b>5,198</b>	<b>4,214</b>	<b>4,411</b>	<b>4,568</b>	<b>4,702</b>
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
<b>Current assets</b>	<b>2,451</b>	<b>3,962</b>	<b>4,182</b>	<b>5,702</b>	<b>7,333</b>	<b>9,256</b>
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
<b>Current liabilities</b>	<b>1,624</b>	<b>1,518</b>	<b>1,992</b>	<b>2,086</b>	<b>2,397</b>	<b>2,767</b>
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
<b>Non-current liabilities</b>	<b>33</b>	<b>355</b>	<b>290</b>	<b>255</b>	<b>226</b>	<b>196</b>
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
<b>Shareholders' equity</b>	<b>4,524</b>	<b>7,017</b>	<b>5,973</b>	<b>7,650</b>	<b>9,186</b>	<b>10,945</b>

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
<b>Net income</b>	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)
<b>Operating CF</b>	<b>1,052</b>	<b>1,832</b>	<b>1,954</b>	<b>1,590</b>	<b>2,494</b>	<b>3,733</b>
CAPEX	(209)	(1,019)	(324)	(100)	(92)	(89)
Others	(1,308)	(349)	269	(98)	(98)	(98)
<b>Investing CF</b>	<b>(1,518)</b>	<b>(1,368)</b>	<b>(55)</b>	<b>(198)</b>	<b>(190)</b>	<b>(187)</b>
Equity raised	316	496	647	-	-	-
Change of Debts	338	341	(58)	(60)	(60)	(60)
Others	(486)	(527)	(2,558)	(521)	(982)	(1,094)
<b>Financing CF</b>	<b>169</b>	<b>310</b>	<b>(1,969)</b>	<b>(581)</b>	<b>(1,042)</b>	<b>(1,153)</b>
<b>Net change in cash</b>						
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)
<b>FCF</b>	<b>2,404</b>	<b>3,691</b>	<b>4,402</b>	<b>5,200</b>	<b>6,108</b>	<b>7,134</b>	<b>8,284</b>	<b>9,567</b>	<b>10,987</b>	<b>12,548</b>
<b>PV</b>	<b>2,108</b>	<b>2,837</b>	<b>2,967</b>	<b>3,072</b>	<b>3,163</b>	<b>3,239</b>	<b>3,298</b>	<b>3,339</b>	<b>3,361</b>	<b>34,699</b>
<b>Terminal Value</b>										<b>116,816</b>

Assumptions	
<b>WACC</b>	<b>14.1%</b>
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%
<b>Long term growth</b>	<b>3.0%</b>
<b>Debt</b>	<b>0</b>

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

		WACC					
Terminal growth rate	~	12%	13%	14%	15%	16%	
	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	<b>30.0</b>	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		
					FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	EPS	CAGR	
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
<b>Revenue</b>	<b>6,189</b>	<b>7,633</b>	<b>12,340</b>	<b>14,324</b>	<b>16,514</b>
Film & TV	5,629	7,247	12,340	14,324	16,514
Games	560	385	-	-	-
<b>COGS</b>	<b>(1,948)</b>	<b>(1,811)</b>	<b>(1,896)</b>	<b>(2,305)</b>	<b>(2,787)</b>
<b>Gross profit</b>	<b>4,241</b>	<b>5,821</b>	<b>10,444</b>	<b>12,019</b>	<b>13,728</b>
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
<b>Operating profit</b>	<b>1,518</b>	<b>771</b>	<b>2,355</b>	<b>2,744</b>	<b>3,147</b>
Non-operating Rev	403	464	64	30	30
Non-operating Exp	4	15	10	8	5
<b>Pre-tax Income</b>	<b>1,925</b>	<b>1,250</b>	<b>2,429</b>	<b>2,782</b>	<b>3,182</b>
Income Tax	(80)	(68)	(241)	(290)	(349)
Less: MI	216	143	71	61	46
<b>Net profit</b>	<b>1,621</b>	<b>1,009</b>	<b>2,098</b>	<b>2,415</b>	<b>2,777</b>

### Cash flow summary

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

### Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Non-current assets</b>	<b>5,198</b>	<b>4,214</b>	<b>4,411</b>	<b>4,568</b>	<b>4,702</b>
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
<b>Current assets</b>	<b>3,962</b>	<b>4,182</b>	<b>5,702</b>	<b>7,333</b>	<b>9,256</b>
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
<b>Current liabilities</b>	<b>1,518</b>	<b>1,992</b>	<b>2,086</b>	<b>2,397</b>	<b>2,767</b>
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
<b>Non-current liabilities</b>	<b>355</b>	<b>290</b>	<b>255</b>	<b>226</b>	<b>196</b>
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
<b>Shareholders' equity</b>	<b>7,017</b>	<b>5,973</b>	<b>7,650</b>	<b>9,186</b>	<b>10,945</b>

### Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
<b>Sales mix (%)</b>					
Film & TV	90.9	95.0	100.0	100.0	100.0
Games	9.1	5.0	0.0	0.0	0.0
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Growth rate (%)</b>					
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
<b>P&amp;L ratios (%)</b>					
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)
<b>Returns (%)</b>					
ROE	22.2	16.5	27.0	26.0	25.3
ROA	17.7	12.0	20.7	20.3	19.9
<b>Per share</b>					
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

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