

# Fulu Holdings Ltd. (2101 HK)

## One-stop virtual goods boutique

As a third-party virtual goods leader in China, Fulu is expected to surf the growing online entertainment & lifestyle tailwinds with COVID-19 benefit. We expect its revenue/ adj. net profit to grow at 38%/34% CAGR in FY20-23E, driven by vendor expansion, strong game and entertainment GMV and VAS monetization. Initiate with BUY with DCF-based TP at **HK\$12.0**. Fulu is still at a high growth stage, and its SaaS initiatives could unlock its TAM and valuation.

- **A pioneer with one-stop virtual goods and services.** Fulu is the largest third-party virtual goods and service provider in China, according to F&S, in terms of revenue in 2019. Backed by its strong connection with participants and innovative operation, we forecast its revenue/adj. net profit to surge at 38%/34% CAGR in FY20-23E, thanks to rising online entertainment & lifestyle tailwinds and VAS expansion.
- **Well-positioned to seize opportunities in online entertainment & lifestyle.** Given its online business nature, we believe Fulu is resilient to COVID-19, and would benefit from the rising demand for online entertainment, games, and online lifestyle. According to F&S, the market size of China third-party virtual goods and services in entertainment/game/lifestyle are expected to grow at 18.2%/12.1%/12.9% CAGR in 2019-2024E. We expect Fulu's entertainment & games to see 29%/46% GMV CAGR in FY20-23E, with more time spent shift to online leisure and consumption.
- **Bearing fruits with innovative model and VAS enhancement.** With innovative "connect + service" model, Fulu connects sizable well-known vendors and diversified virtual goods sales channels. We believe its strong connections and high-qualified services would lead to rising consumer traffic, attract more clients, help customer efficiency, and in turn drive GMV performance. Besides, we expect Fulu to continuously increase its VAS solutions to help clients improve efficiency and boost GMV. We estimate its VAS solutions to grow at 36% CAGR in FY20-23E, accounting for 21% of total revenue in FY22E.
- **Initiate with BUY.** We set our DCF-based TP at **HK\$12.0 (implying 13x/11x FY22/23E P/E)**, slightly lower than industry average. Further catalysts: 1) potential solid earnings results; 2) strong topline growth; and 3) SaaS initiatives.

### Earnings Summary

| (YE 31 Dec)              | FY19A    | FY20A    | FY21E    | FY22E    | FY23E    |
|--------------------------|----------|----------|----------|----------|----------|
| Revenue (RMB mn)         | 242      | 328      | 560      | 706      | 854      |
| YoY growth (%)           | 15.8     | 35.7     | 70.6     | 26.0     | 21.0     |
| Adj. net income (RMB mn) | 106      | 153      | 230      | 313      | 369      |
| Adj. EPS (RMB)           | NA       | NA       | 0.57     | 0.77     | 0.91     |
| YoY growth (%)           | NA       | NA       | NA       | 34.7     | 16.9     |
| Consensus EPS (RMB)      | NA       | NA       | NA       | NA       | NA       |
| P/E (x)                  | NA       | NA       | 13.7     | 10.2     | 8.7      |
| P/S (x)                  | NA       | NA       | 5.6      | 4.5      | 3.8      |
| ROE (%)                  | 41.7     | 13.9     | 19.7     | 22.4     | 22.0     |
| Net gearing (%)          | Net cash | Net cash | Net cash | Net cash | Net cash |

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Initiation)

|               |          |
|---------------|----------|
| Target Price  | HK\$12.0 |
| Up/Downside   | +28%     |
| Current Price | HK\$9.4  |

### China Internet Sector

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 sophiehuang@cmbi.com.hk

### Stock Data

|                          |             |
|--------------------------|-------------|
| Mkt Cap (HK\$ mn)        | 3,760       |
| Avg 3 mths t/o (HK\$ mn) | 6.18        |
| 52w High/Low (HK\$)      | 10.66/ 5.04 |
| Total Issued Shares (mn) | 400         |

Source: Bloomberg

### Shareholding Structure

|             |       |
|-------------|-------|
| Fu Xi       | 34.8% |
| Zhang Yuguo | 11.5% |
| Shui Yingyu | 5.3%  |

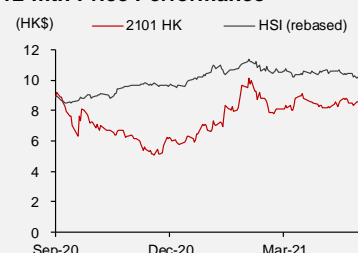
Source: Bloomberg

### Share Performance

|       | Absolute | Relative |
|-------|----------|----------|
| 1-mth | 11.5%    | 14.2%    |
| 3-mth | -8.5%    | -1.5%    |
| 6-mth | 48.0%    | 37.6%    |

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

**Auditor: Ernst & Young**

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## Investment Thesis

### **pioneer with one-stop virtual goods and services.**

Fulu is the largest third-party virtual goods and service provider in China, according to F&S, in terms of revenue in 2019. Backed by its strong connection with participants and innovative operation, we forecast its revenue/adj. net profit to surge at 38%/34% CAGR in FY20-23E, thanks to rising online entertainment & lifestyle tailwinds and VAS expansion.

### **Well-positioned to seize opportunities in online entertainment & lifestyle.**

Given its online business nature, we believe Fulu is resilient to COVID-19, and would benefit from the rising demand for online entertainment, games, and online lifestyle. According to F&S, the market size of China third-party virtual goods and services in entertainment/game/lifestyle are expected to grow at 18.2%/12.1%/12.9% CAGR in 2019-2024E. We expect Fulu's entertainment & games to see 29%/46% GMV CAGR in FY20-23E, with more time spent shift to online leisure and consumption.

### **Bearing fruits with innovative model and VAS enhancement.**

With innovative "connect + service" model, Fulu connects sizable well-known vendors and diversified virtual goods sales channels. We believe its strong connections and high-qualified services would lead to rising consumer traffic, attract more clients, help customer efficiency, and in turn drive GMV performance. Besides, we expect Fulu to continuously increase its VAS solutions to help clients improve efficiency and boost GMV. We estimate its VAS solutions to grow at 36% CAGR in FY20-23E, accounting for 21% of total revenue in FY22E.

### **Initiate with BUY.**

We set our DCF-based TP at **HK\$12.0 (implying 13x/11x FY22/23E P/E)**, slightly lower than industry average. Further catalysts: 1) potential solid earnings results; 2) strong topline growth; and 3) SaaS initiatives.

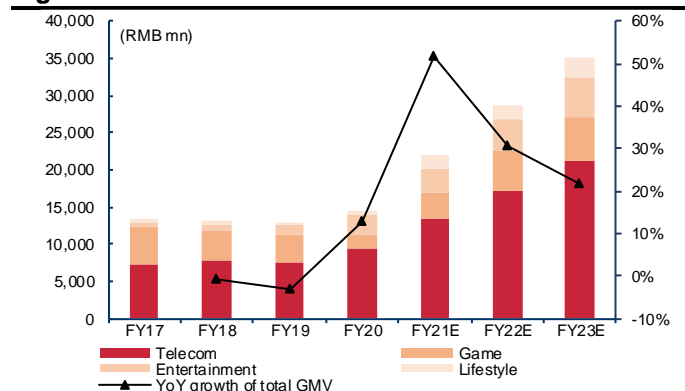
## Focus Charts

Figure 1: Overview of Fulu's business



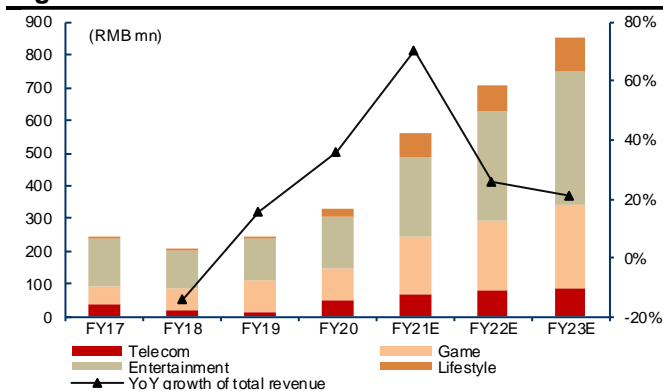
Source: Company data, F&S; Notes refer to Figure 6

Figure 2: 34% GMV CAGR in FY20-23E



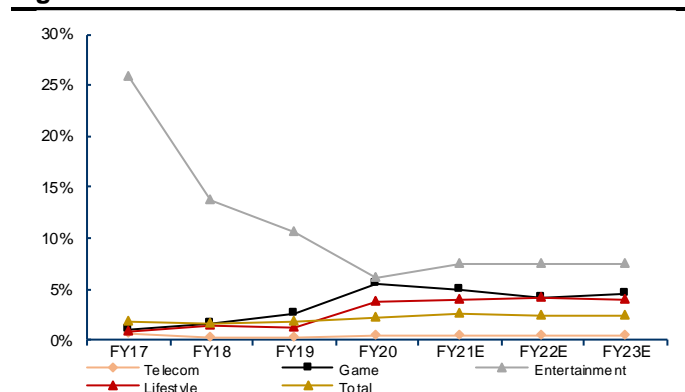
Source: Company data, CMBIS estimates

Figure 3: 38% revenue CAGR in FY20-23E



Source: Company data, CMBIS estimates

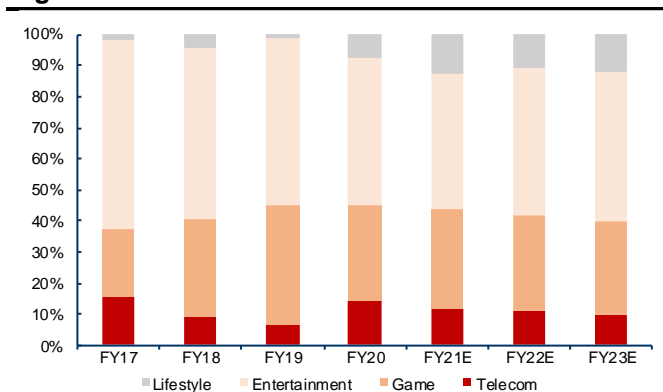
Figure 4: Take rate trend



Source: Company data, CMBIS estimates

Notes: Take rate= Revenue/ GMV

Figure 5: Revenue breakdown



Source: Company data, CMBIS estimates

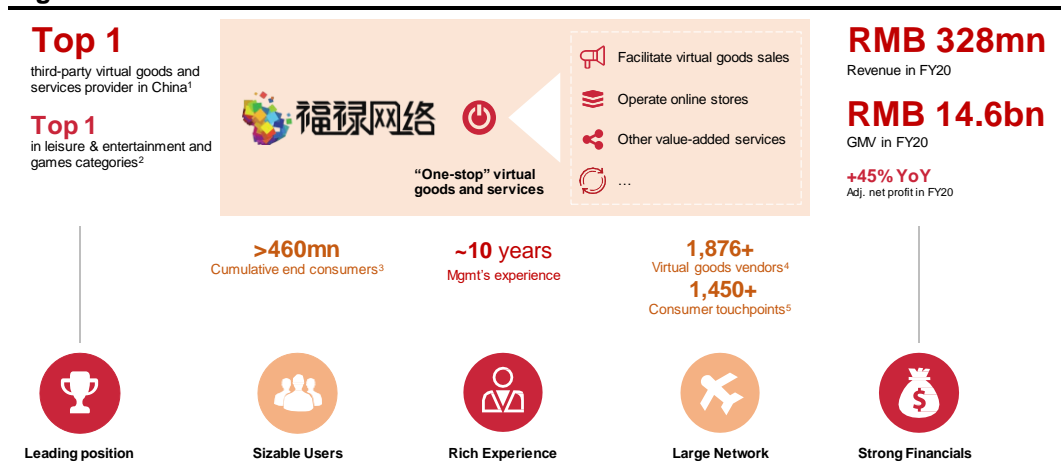
## Company Overview

### A pioneer with one-stop virtual goods and service

#### Leading third-party virtual goods and services provider

Incorporated in 2009, Fulu is a third-party provider of diversified virtual goods and comprehensive virtual goods-related services. Through its signature open platform, the Company facilitates virtual goods transactions by connecting virtual goods vendors with consumer touchpoints, and offers “one-stop” value-added services for platform participants. According to Frost & Sullivan, the Company ranked Top 1 among third-party virtual goods and services providers in China in terms of FY19 revenue, and Top 1 in both leisure & entertainment and games categories in terms of FY19 GMV.

Figure 6: Fulu's business overview



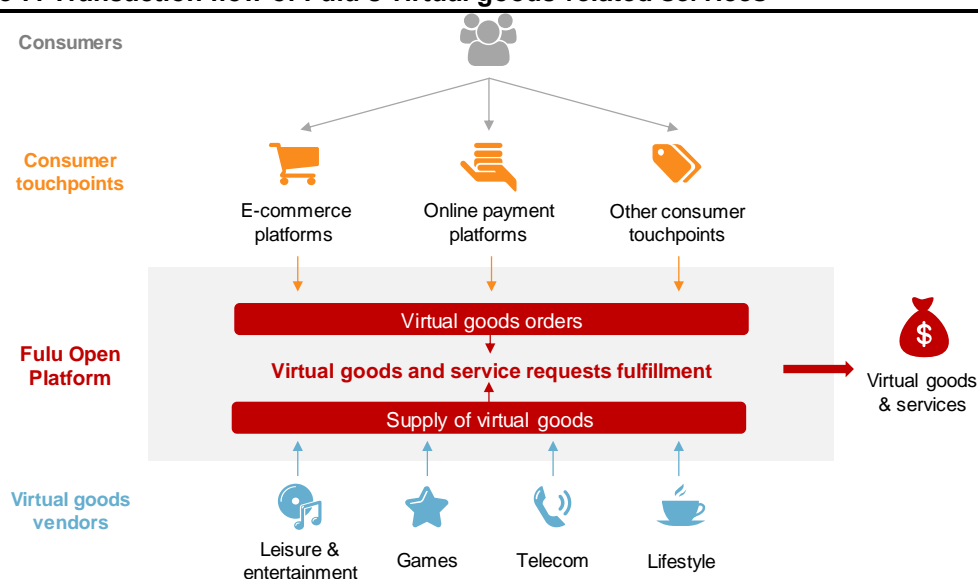
Source: Company data, CMBIS

Notes: 1) According to Frost & Sullivan, in terms of FY19 revenue; 2) According to Frost & Sullivan ranking of third-party virtual goods and services providers in China in terms of FY19 GMV; 3) From its reception to 31 Mar 2020; 4) As of 31 Dec 2020; 5) In the twelve months ended 31 Mar 2020.

#### On the back of enriched sceneries and a huge consumer base

Fulu connects virtual goods vendors in different industries with a wide variety of consumer touchpoints. Through its open platform, the Company helps many well-known virtual goods vendors in China, including leading online video platforms, top online game producers and major telecom operators, to monetize their products and services, as well as consumer touchpoints, such as well-known e-commerce platforms and online payment platforms, to enhance their consumer experience.

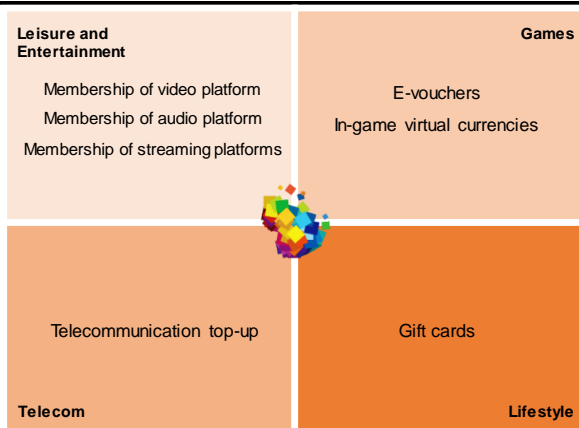
Deep connections with both vendors and consumers form the basis for Fulu's prominence. In the twelve months ended 31 Mar 2020, the Company brought virtual goods from over 910 vendors to over 1,450 consumer touchpoints, where the monthly average number of consumers who made purchases totalled 12.8mn in 2019.

**Figure 7: Transaction flow of Fulu's virtual goods-related services**

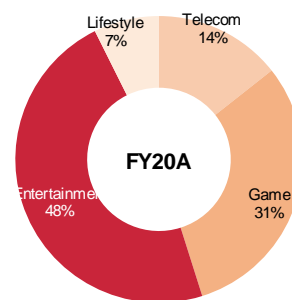
Source: Company data, CMBIS

**Not only telecommunications, but more...**

Fulu launched its business in the telecommunications industry in 2012 by providing mobile top-up services, and gradually extended its reach to leisure & entertainment, games and lifestyle industries. The Company currently offers a diverse set of virtual goods, including membership cards, virtual currencies, top-up services and gift cards for various platforms, and is expanding its offering of value-added services.

**Figure 8: Fulu provides a diverse set of virtual goods**

Source: Company data, CMBIS

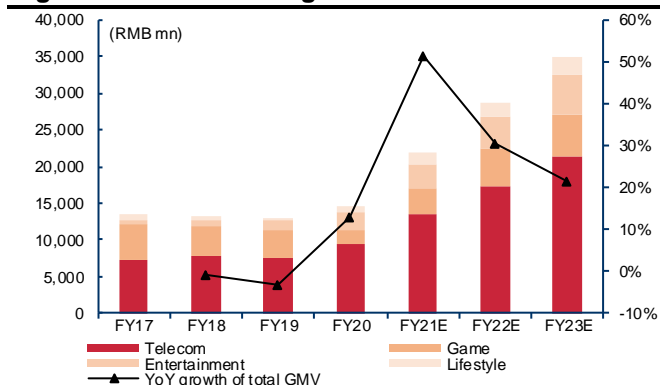
**Figure 9: Revenue breakdown by service type**

Source: Company data, CMBIS

### Strong financial growth

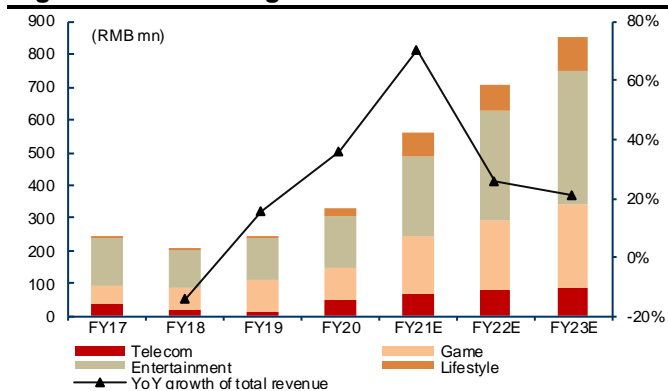
The majority of Fulu's revenue comes from commissions charged on a transactional basis as a percentage of sales. Revenue reached RMB 328mn in FY20, while GMV reached RMB 14.6bn. Adj. net profit was RMB 153mn in FY20, with an adj. net margin of 47%.

**Figure 10: Fulu's GMV growth**



Source: Company data, CMBIS estimates

**Figure 11: Revenue growth**



Source: Company data, CMBIS estimates

## Investment Summary

### Surfing on the growing online entertainment & lifestyle tailwinds

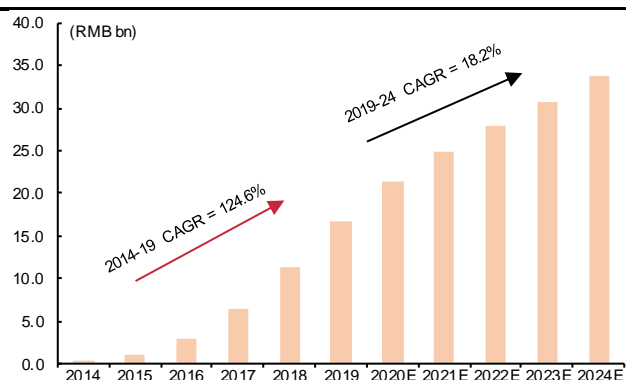
#### Resilient to COVID-19 on its online business

Despite its location in Wuhan, Fulu proved to be more resilient to COVID-19 for its online business. Recall that Fulu's GMV/ orders are highly dependent on the performance of online virtual goods vendors (e.g. Online leisure and entertainment, Games, Telecommunications, lifestyle services), which still performed well in 2020. The majority of its consumer touchpoints are e-commerce platforms, payment channels, which bore limited impact from potential new spikes of COVID-19. Since it offers virtual goods and services in the domestic market, we expect Fulu to see a minimal negative impact on its business, given that: 1) customers are online; 2) consumption sceneries are online; and 3) business operation might be slightly suspended, but would see quick recovery after work resumption.

#### Well positioned to capture booming demand from entertainment & games

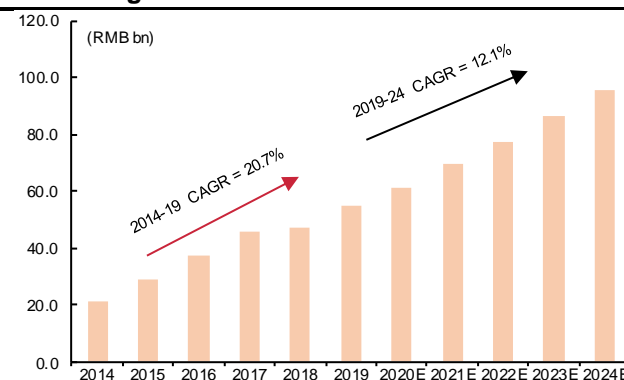
**Bullish on entertainment & games' upside.** According to F&S, the market size of China third-party virtual goods and services in entertainment & game are expected to grow at 18.2%/12.1% CAGR in 2019-2024E. The market share of the leisure and entertainment industry is expected to grow rapidly from 2019 to 2024 due to rising paying users and enhanced intellectual property protection. As online entertainment companies launch membership systems and require consumers to pay fees for accessing exclusive content, consumers gradually develop the habit of paying for high-quality virtual products.

**Figure 12: Market size of third-party virtual goods and services in entertainment in China**



Source: F&S

**Figure 13: Market size of third-party virtual goods and services in game in China**



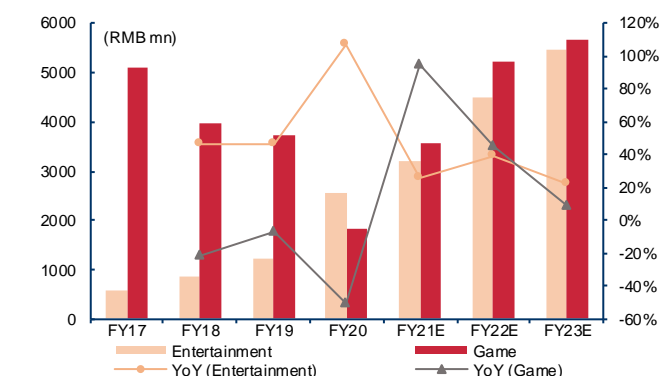
Source: F&S

**Online entertainment & games to benefit from COVID-19.** We expect game & entertainment customers to see strong growth in FY21E, with more time spent shift to online leisure & MAU post the epidemic outbreak, further benefiting Fulu's GMV. Mobile games could directly benefit. According to GPC's China Gaming Industry Report, China's gaming industry grew 20.7%/ 3.7% in revenues/ users in 2020. Fulu optimized game product structure in 2020 to drive rev up despite a 50% drop in GMV, and we expect the improved GPM to sustain in 2020-23E. Apart from games, we expect that epidemic and content premiumization would pose a positive impact on the subscription of online video, benefiting iQIYI and Tencent video, which are Fulu's key customers. We expect online video players to see strong subscriber growth in 2021, driven by stronger user engagement and hot titles launched.



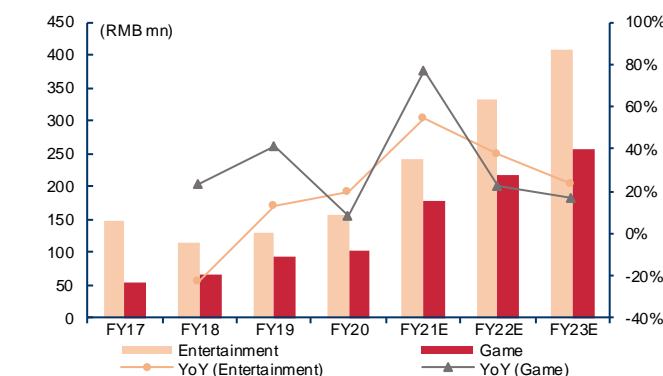
**Expecting entertainment & games to see 29%/46% GMV CAGR in FY20-23E.** Backed by solid demand and Fulu's effective operation, we expect entertainment & games to see 29%/46% GMV CAGR in FY20-23E, while telecommunications with 31% CAGR.

**Figure 14: GMV of entertainment & games**



Source: Company data, CMBIS estimates

**Figure 15: Revenue of entertainment & games**

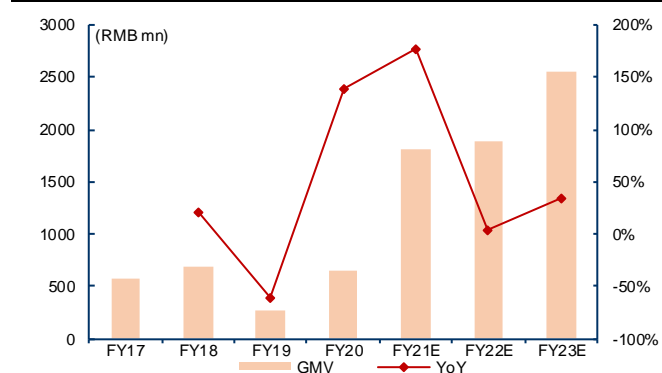


Source: Company data, CMBIS estimates

### Benefiting from consumption shift to online lifestyle

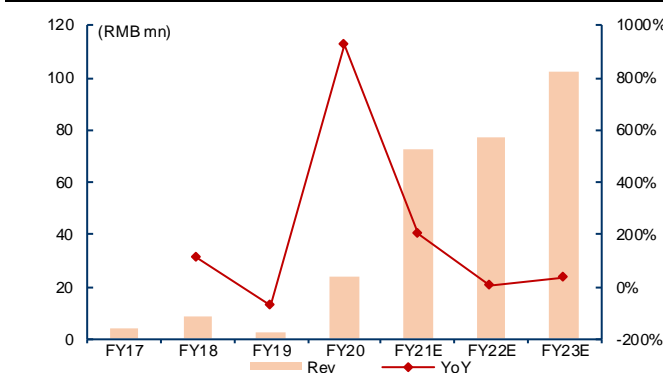
According to F&S, the market size of third-party virtual goods and services in the lifestyle industry is expected to grow at 12.9% CAGR in 2019-2024E, supported by increasing online consumption and tech improvement. On top of that, we expect COVID-19 would stimulate offline consumption shift to online, including food delivery, online grocery, etc. We forecast Fulu's lifestyle GMV to grow at 58% CAGR in FY20-23E.

**Figure 16: GMV of lifestyle**



Source: Company data, CMBIS estimates

**Figure 17: Revenue of lifestyle**



Source: Company data, CMBIS estimates

### Expecting total GMV/ revenue to grow at 34%/38% CAGR in FY20-23E.

We expect Fulu's GMV/revenue to grow at 34%/38% CAGR in FY20-23E, boosted by deeper penetration of mobile payments, shift in consumption habits online and intellectual property protection improvement. By segments, lifestyle could deliver highest growth with 58% GMV CAGR, while game/ telecom / entertainment with 46%/31%/29% CAGR in FY20-23E.

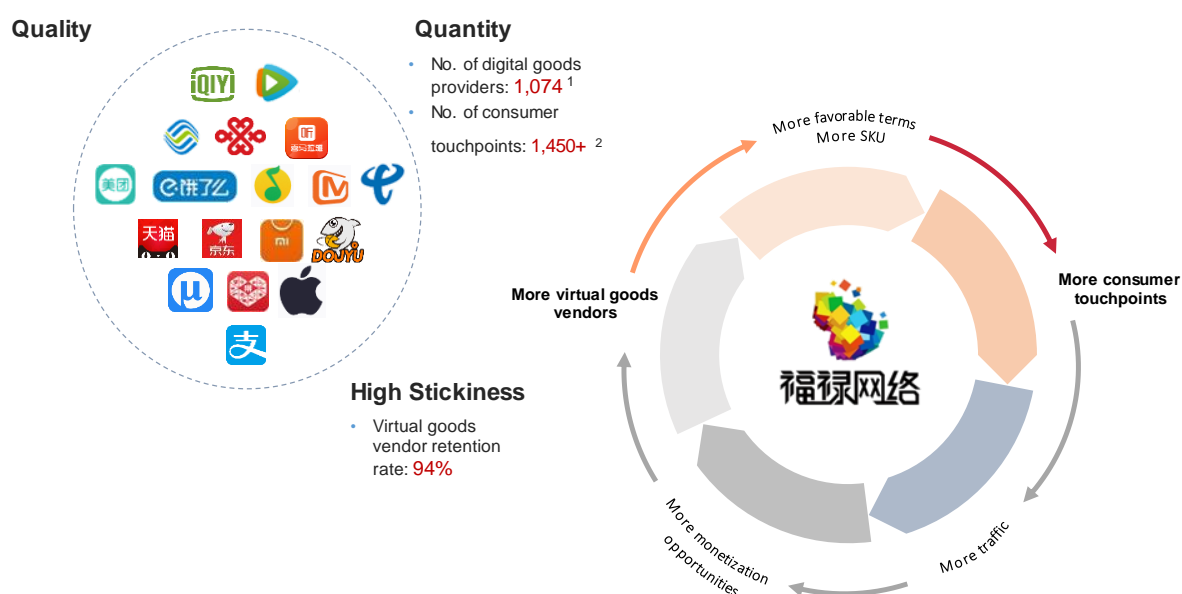
## Bearing fruits from innovative “connect + service” model

**Strong connection with both to B and to C sides to drive network effect**

We expect Fulu's open platform to continuously strengthen its connection with its participants, including virtual goods vendors and consumer touchpoints. With one-stop value-added services, Fulu had no. of virtual goods providers of 1,074, no. of consumer touchpoints 1,450+. Its virtual goods retention surpassed 94%, suggesting high stickiness. Fulu serves leaders in diversified industries, including Ximalaya.fm (喜马拉雅) in entertainment, Top 10 online game developers in game, Top 3 telecom operators in telecommunications, and well-known companies (e.g. Meituan Dianping (美团点评), Ele.me (饿了么)) in lifestyle. We expect its well-known client coverage would help it expand more virtual goods vendors.

As Fulu connects more consumer touchpoints, we expect it to be an increasingly important sales channel for virtual goods vendors, building stronger relationships with, and receiving more favorable terms from, vendors. This makes Fulu more attractive to consumer touchpoints, leading to increased consumer traffic, which in turn helps virtual goods vendors monetize their businesses more effectively.

**Figure 18: Fulu's model**

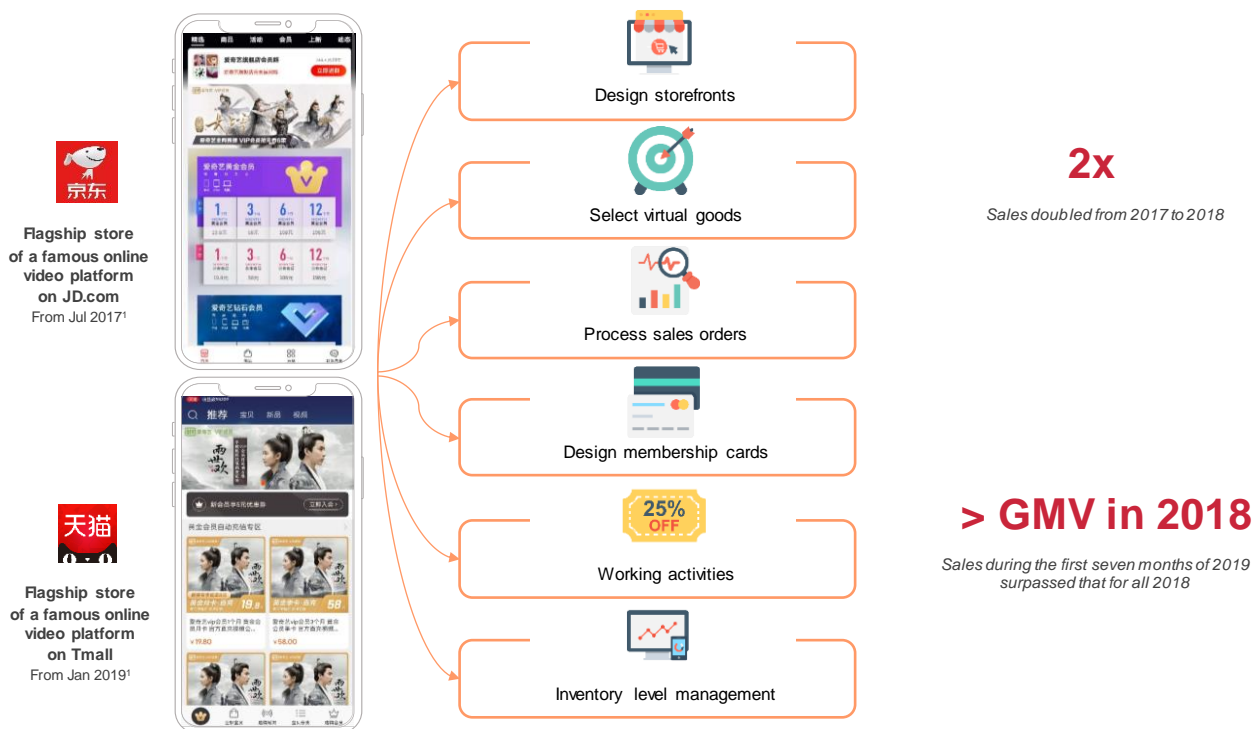


Source: Official website, Company data

Notes: 1) In 2020; 2) In 2019

**High qualified services to help customer efficiency.**

Fulu provides services, including operating online stores, targeted marketing, facilitating virtual goods transactions, to help clients achieve higher GMV and operating efficiency. For instance, Fulu helped a famous leisure and entertainment content provider on JD.com from Jul 2017 and Tmall from Jan 2019, the online video platform's sales doubled from 2017 to 2018, and sales during the first seven months of 2019 surpassed that for all 2018. We expect its one-stop services and satisfactory performance would in turn attract and retain more clients with stronger GMV growth.

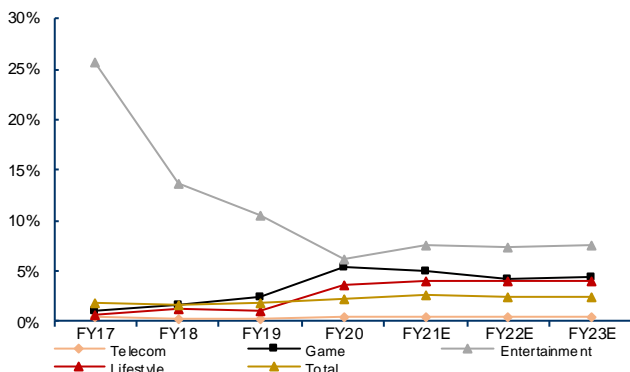
**Figure 19: Case Study: Operating Online Stores for Virtual Goods Vendors**

Source: Company data

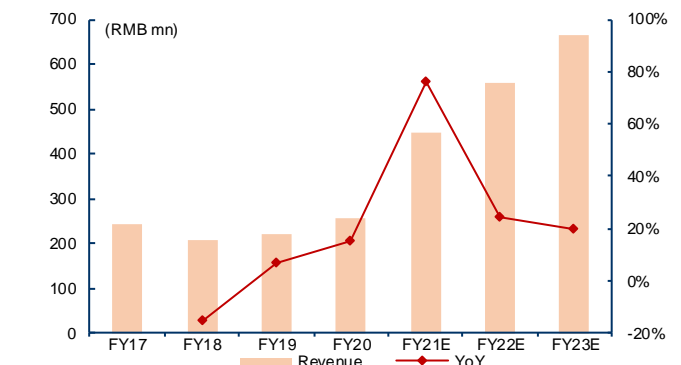
Notes: The time from which Fulu operated online stores for this customer on that e-commerce platform

**Game & lifestyle take rate to ramp up**

Backed by its enhanced services and satisfactory performance, we expect its game/lifestyle take rate to be 4.2%/4.1% in FY22E, which still largely lag behind that of entertainment. Telecommunications take rate could be flat for its mature business, and entertainment take rate would normalize to around 7-9% in FY20-22E, in our view.

**Figure 20: Take rate trends**

Source: Company data, CMBIS estimates

**Figure 21: Virtual goods-related services estimate**

Source: Company data, CMBIS estimates

## Enhanced monetization with VAS expansion

### Tech initiatives and algorithm optimization to enhance monetization

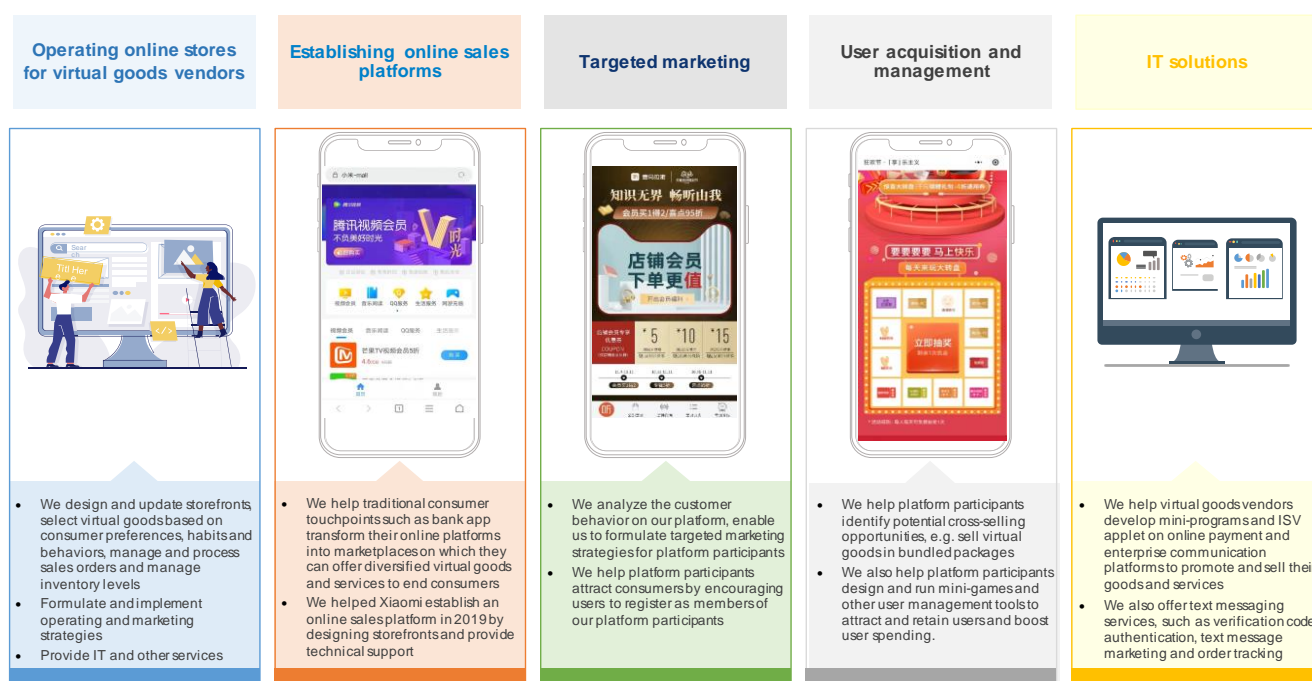
**A virtuous cycle from building on data to monetizing data.** Until 31 Mar 2020, Fulu reached over 460mn consumers and over 280mn orders. We believe that the volume of service data enables Fulu to understand virtual goods consumption trends, make better business decisions, expand its industry coverage, and further boost GMV growth.

**Leveraging data analytics to achieve precise targeting with better operation.** Backed by a dedicated R&D team and substantial investment in innovation, Fulu excelled itself with competitive data analytics to achieve more precise targeting. Fulu's open platform has an average response time of approximately 35 milliseconds. Its platform also passed the Alibaba Cloud's penetration test and has demonstrated strong security. We see high visibility for Fulu to improve efficiency for clients and enhance GMV performance via its big data capability.

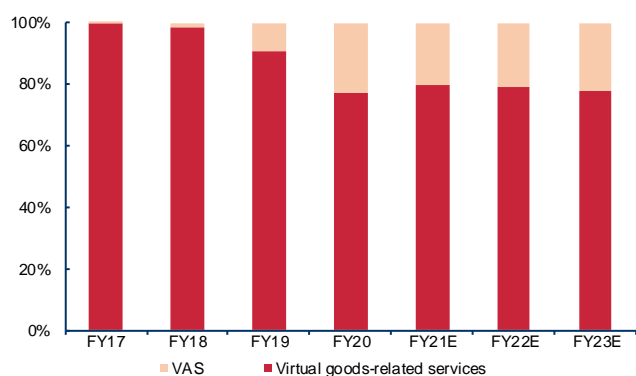
### Enriched VAS solutions to boost transaction performance

We expect Fulu to continuously increase its VAS solutions to help clients improve efficiency and boost GMV. Apart from traditional online stores operation, membership management, IT solutions, Fulu further provides with corporate welfare, ISV develop, and game levelling services. We expect its VAS solutions to grow at 36% CAGR in FY20-23E, accounting for 21% of total revenue in FY22E (vs. 23% in FY20).

**Figure 22: Case Study: Operating Online Stores for Virtual Goods Vendors**

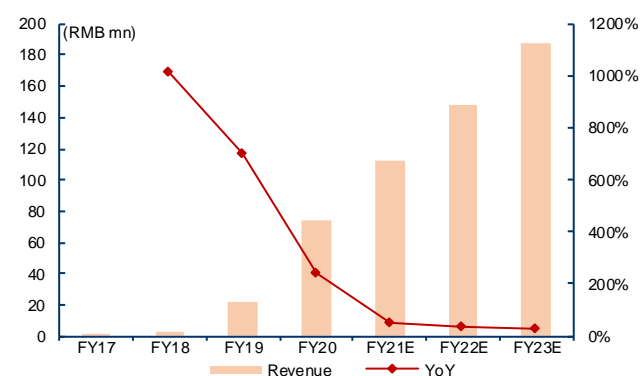


Source: Company data

**Figure 23: Higher revenue mix of VAS**

Source: Company data, CMBIS estimates

Note: VAS refers to value-added service

**Figure 24: VAS growth estimate**

Source: Company data, CMBIS estimates

Note: VAS refers to value-added service

## Industry Analysis

### Overview of China's virtual goods and services industry

Leisure and entertainment, games, telecommunications and lifestyle services make up the four pillars of virtual goods and services in China, one of the world's largest and fastest growing virtual goods and services markets by GMV, according to Frost & Sullivan.

**Leisure and Entertainment.** Leisure and entertainment virtual goods vendors offer virtual goods such as membership services and in-app virtual currencies to access audio, musical, paid-knowledge, live streaming, education, sports and other content on their platforms.

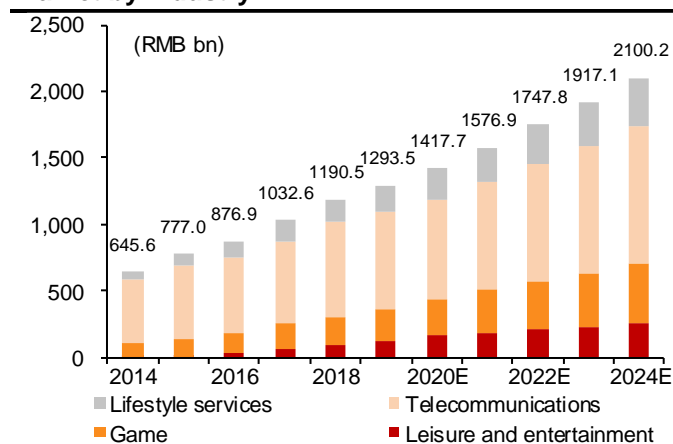
**Games.** Game producers offer virtual goods that players can use in games to speed up in-game rewards or buy virtual accessories and character upgrades, such as game characters, costumes, skills, tools, equipment and other in-game consumables or functions.

**Telecommunications.** Telecom operators charge telephone fees and sell data usage packages to consumers.

**Lifestyle.** Lifestyle services primarily include food, clothing, housing and transportation services. Lifestyle services providers offer virtual goods such as prepaid cards, gift cards and digital coupons used in a variety of contexts, such as restaurants, hotels and shops.

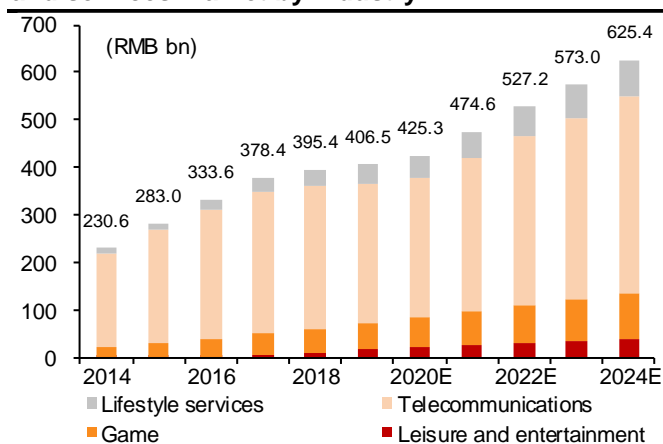
According to Frost & Sullivan, in terms of GMV, China's virtual goods and services market grew from RMB 645.6bn in 2014 to RMB 1,293.5bn in 2019, representing a CAGR of 14.9%.

**Figure 25: Size of China's virtual goods and services market by industry**

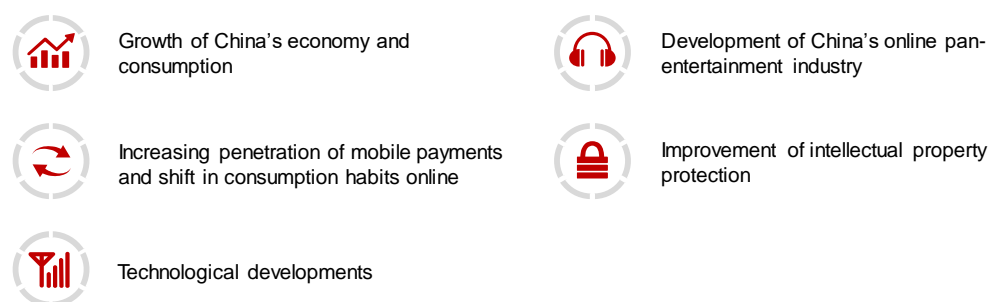


Source: Frost & Sullivan, CMBIS

**Figure 26: Size of China's third-party virtual goods and services market by industry**



Source: Frost & Sullivan, CMBIS

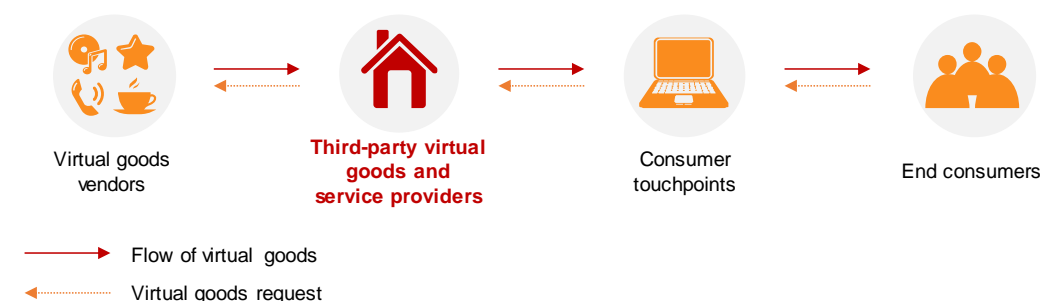
**Figure 27: Growth drivers of China's virtual goods and services market**


Source: Frost &amp; Sullivan, CMBIS

## The rise of third-party virtual goods and services providers

Third-party virtual goods and services providers are platforms that connect virtual goods vendors and consumer touchpoints. Third-party virtual goods and services providers typically offer both virtual goods-related services and value-added services, such as online sales platform setting-up, online store operations and marketing and IT services.

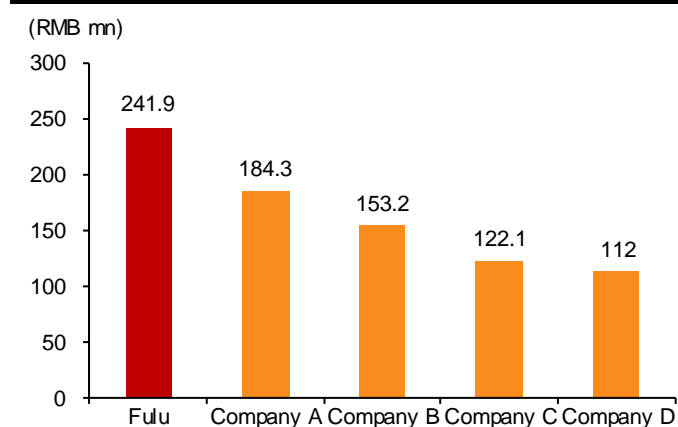
Vast consumer data and extensive operating experience across many industries enables third-party virtual goods and services providers to provide tailored solutions based on consumers' needs, which in turn increases consumer satisfaction and monetization potential of users for virtual goods vendors and consumer touchpoints. As a result, virtual goods vendors and consumer touchpoints have increasingly relied on third-party virtual goods and services providers to attract and retain users and boost user activity.

**Figure 28: The role of third-party virtual goods and services providers**


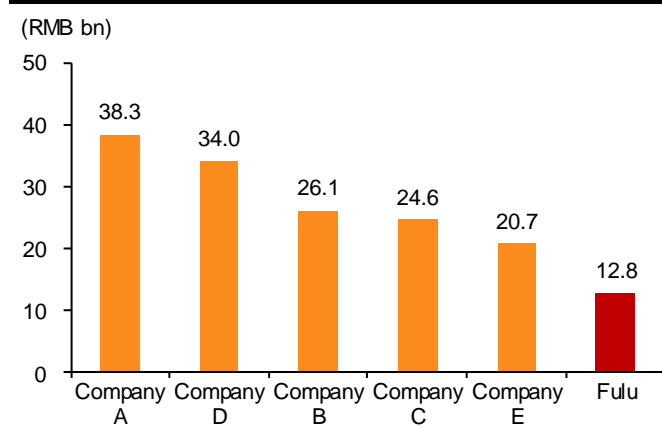
Source: Frost &amp; Sullivan, CMBIS

## Top 1 among third-party virtual goods and services providers in terms of revenue

According to Frost & Sullivan, China's third-party virtual goods and services industry is relatively concentrated, with the top 10 participants accounting for approximately 48.1% of the total GMV in 2019. In 2019, Fulu ranked No. 1 in terms of revenue and No. 6 in terms of GMV among third-party virtual goods and services providers.

**Figure 29: Ranking of third-party virtual goods and services providers by revenue, China, 2019**


Source: Frost &amp; Sullivan, CMBIS

**Figure 30: Ranking of third-party virtual goods and services providers by GMV, China, 2019**


Source: Frost &amp; Sullivan, CMBIS

**Figure 31: Fulu's ranking among virtual goods and services providers in China (2019), by segment**

| Segment            | Rank | Revenue (RMB mn) | GMV (RMB bn) | Market share by GMV |
|--------------------|------|------------------|--------------|---------------------|
| Entertainment      | 1    | 130.5            | 1.2          | 7.6%                |
| Game               | 1    | 93.4             | 3.7          | 6.6%                |
| Telecommunications | 7    | 15.6             | 7.7          | 2.6%                |
| Lifestyle          | 5    | 2.3              | 0.3          | 0.7%                |

Source: Frost &amp; Sullivan, CMBIS

## Opportunities for virtual goods and services providers in China

According to Frost & Sullivan, the following opportunities are available for virtual goods and services providers in China:

- 1. Cloud Services.** The cloud service market caters to the demands of virtual goods vendors and consumer touchpoints by providing them with comprehensive, easily deployable and intelligent business solutions. The sales value of China's e-commerce market increased from RMB 2.8tn in 2014 to RMB 10.6tn in 2019, representing a CAGR of 30.5%. This has led to increased demand for cloud services, and in particular, PaaS (Platform as a Service) and SaaS (Software as a Service) services, which allow users to develop, run and manage applications without building and maintaining the infrastructure typically associated with developing and launching applications. The usefulness of cloud services, as well as supportive government policy, are fueling a trend for enterprises to establish "one-stop" cloud service platforms.
- 2. Southeast Asia Market.** Driven by a growing consumer base and improved internet infrastructure, Southeast Asia's virtual goods and services industry has significant growth potential. According to Frost & Sullivan, the market size of Southeast Asia's virtual goods and services industry grew from a GMV of US\$16.3bn in 2014 to US\$39.5bn in 2019 and is expected to further grow to US\$70.2bn in 2024. Certain third-party virtual goods and services providers are cooperating with Internet giants to seek expansion in Southeast Asia Markets. Those who possess strong services and operating capabilities are well-positioned to capitalize on the growth of Southeast's virtual goods and services industry.



## Entry barriers for China's virtual goods and services market

According to Frost & Sullivan, China's virtual goods and services market has the following entry barriers as shown below:

**Figure 32: Entry barriers for China's virtual goods and services market**

| Barrier   | Explanation  |
|---|--|
| Industry experience                                   | Third-party virtual goods and services providers must have a deep understanding of consumer needs and market trends, which comes with industry experience, to establish competitive advantage over peers.                                      |
| Business relationships                                | Successful third-party virtual goods and services providers typically have strong business relationships with virtual goods vendors and consumer touchpoints, enabling them to establish networks, obtain stable supply and attract consumers. |
| Full spectrum of services and innovation capabilities | As the industry consolidates, third-party virtual goods and services providers must meet evolving consumer preferences and diversify revenue sources by innovating products and services.  |
| Operating capabilities                                | Third-party virtual goods and services providers typically must have strong operating capabilities and professional operating teams, which enable them to help virtual goods vendors and consumer touchpoints increase operating efficiency.   |

Source: Frost & Sullivan, CMBIS

## Peers Comparison

### Operating comparison

#### A boutique in the niche SaaS market

SaaS (Software as a Service) services belong to a niche market currently gaining steam thanks to the rapid growth of China's e-commerce market. SaaS services cater to the demands of virtual goods vendors and consumer touchpoints by providing them with comprehensive, easily deployable and intelligent business solutions. With SaaS, virtual goods vendors and consumer touchpoints can adopt ready-for-use and advanced software technologies to improve efficiency without incurring the time and costs required to develop these strategies on their own.

We consider Fulu to be a boutique in this niche market, as it provides virtual goods-related SaaS solutions for virtual goods vendors and consumer touchpoints, among whom there is a growing demand for SaaS.

#### Key players comparison: Fulu vs. Baozun, Shopify

Baozun (BZUN US) and Shopify (SHOP US) are notable players in the e-commerce industry providing online retailers with similar services including marketing, store operations, and customer engagement. In addition, the three companies share the same payment model where platform participants are charged commissions as a percentage of sales. Compared to its peers, Fulu distinguishes itself as the only SaaS provider serving entirely virtual goods merchants.

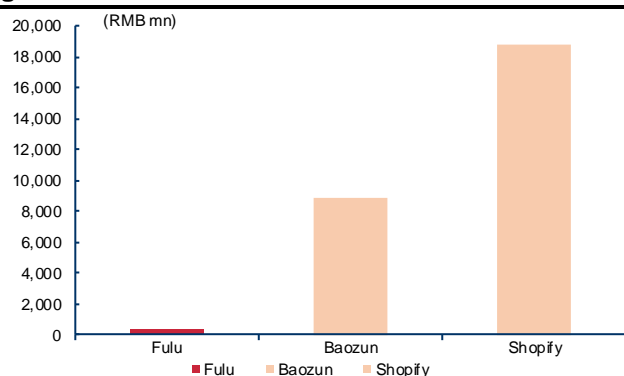
**Figure 33: Operating comparison between Fulu, Baozun and Shopify**

|  | Fulu  | Baozun  | Shopify   |
|--|---|---|---|
| Ticker   | 2101 HK   | BZUN US   | SHOP US   |
| Incorporation date                                       | 2009  | 2006  | 2004  |
| Vendor type  | Entirely virtual goods vendors  | Mostly real goods vendors   | Mostly real goods vendors   |
| Revenue breakdown by source (most recent financial year) | 1) Virtual goods-related services: 77%<br>2) Online store operation services: 21%<br>3) Others: 2%                      | 1) as retailer: 44%<br>2) as facilitator: 56%                         | 1) Subscription solutions: 31%<br>2) Merchant solutions: 69%  |
| Services   | Store operation, targeted marketing, establishing online sales platforms, user acquisition and management, IT solutions | Store operation, digital marketing, customer management, IT solutions | Value-added services for online retailers including payments, marketing, shipping and customer engagement |

Source: Company data, CMBIS

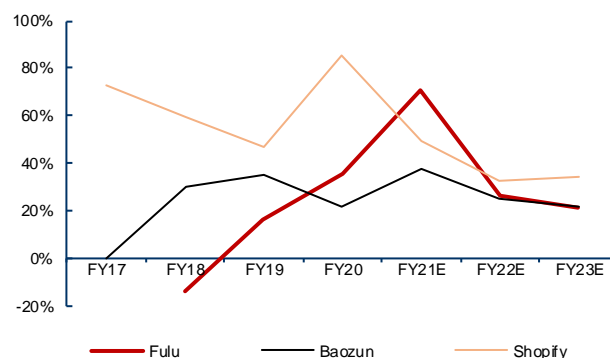
## Financial comparison

**Figure 34: FY20 Revenue**



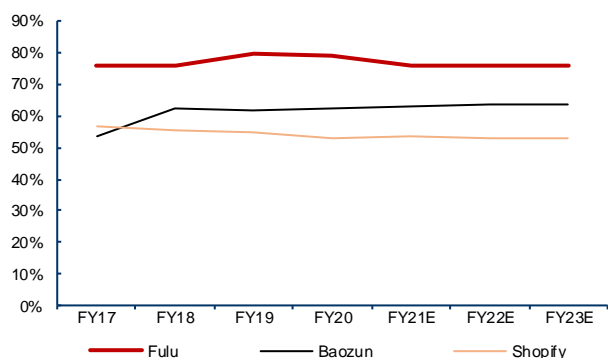
Source: Bloomberg, CMBIS

**Figure 35: Revenue growth**



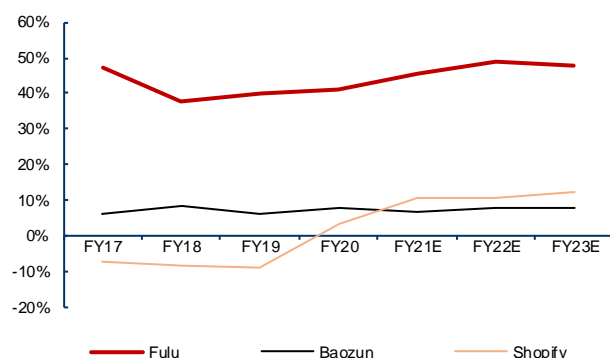
Source: Bloomberg, CMBIS estimates

**Figure 36: Gross margin**



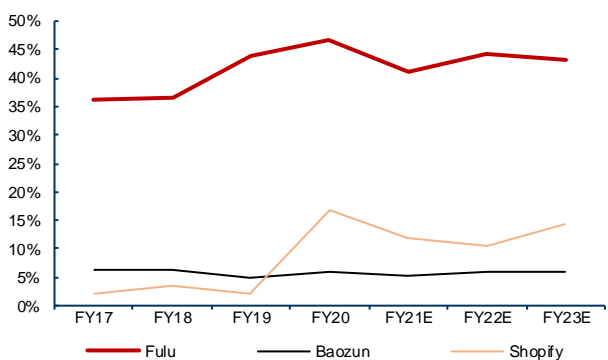
Source: Bloomberg, CMBIS estimates

**Figure 37: Operating margin**



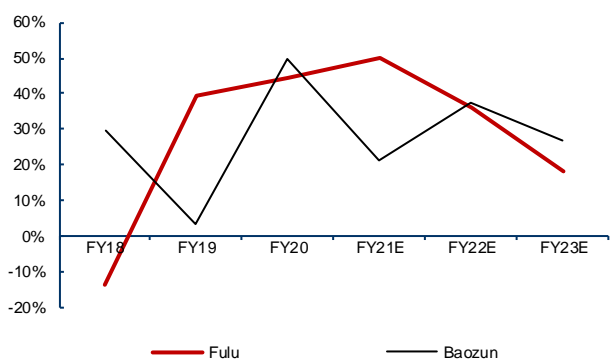
Source: Bloomberg, CMBIS estimates

**Figure 38: Adj. net margin**



Source: Bloomberg, CMBIS estimates

**Figure 39: Adj. net profit growth**



Source: Bloomberg, CMBIS estimates

Note: Shopify's adj. net income is expected to grow 1333% in FY21E due to low base

## Financial Analysis

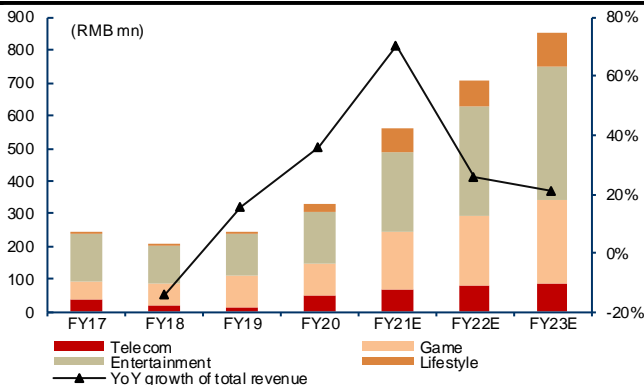
### Revenue breakdown

We forecast Fulu revenue to grow at 71%/26%/21% YoY in FY21/22/23E, in which virtual goods-related services will still devote the largest revenue contribution, while VAS is the long-term growth driver.

**Games with a higher revenue mix.** By segments, we expect Telecom would still be the largest GMV contribution, with a 60% share in FY22E. Lifestyle would see a higher GMV mix, up to 7% in FY22E from 4% in FY20. In terms of revenue, game and entertainment could still be key contributors, with 16% and 18% revenue mixes in FY22E. Order growth could be the primary driver, while ASP and take rate trends differentiate by segments.

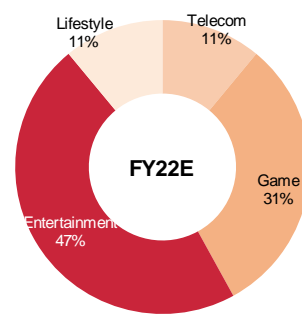
**VAS to contribute 21% of total revenue in FY22E.** Based on our estimates, revenue from VAS solutions will account for 20%/21% in FY21/22E, at a CAGR of 36% in FY20-23E.

Figure 40: Revenue growth estimates



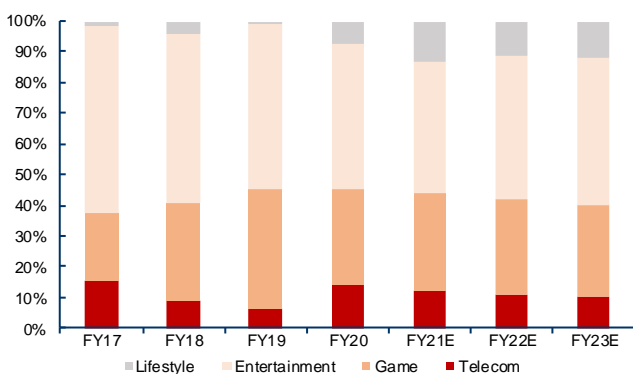
Source: Company data, CMBIS estimates

Figure 41: FY22E revenue breakdown



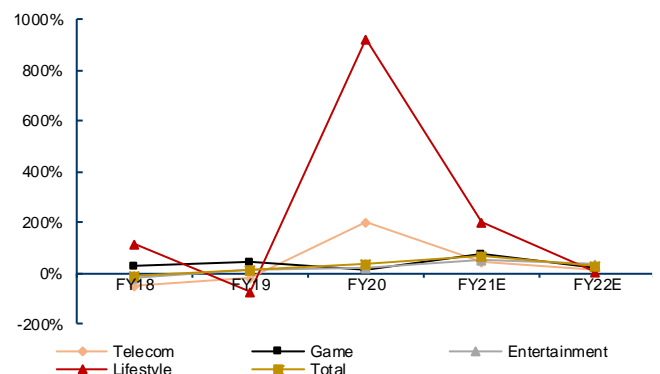
Source: CMBIS estimates

Figure 42: Revenue mix change

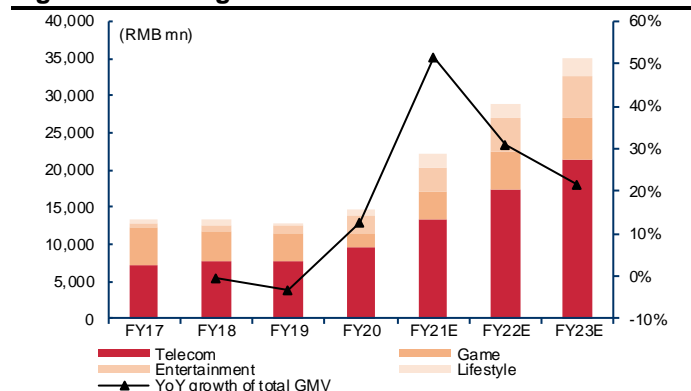


Source: Company data, CMBIS estimates

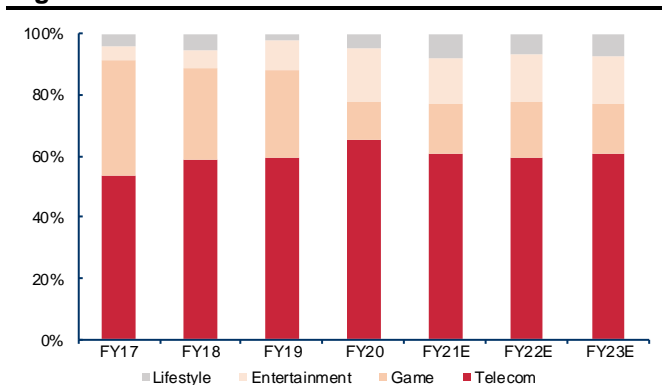
Figure 43: Revenue growth (by segment)



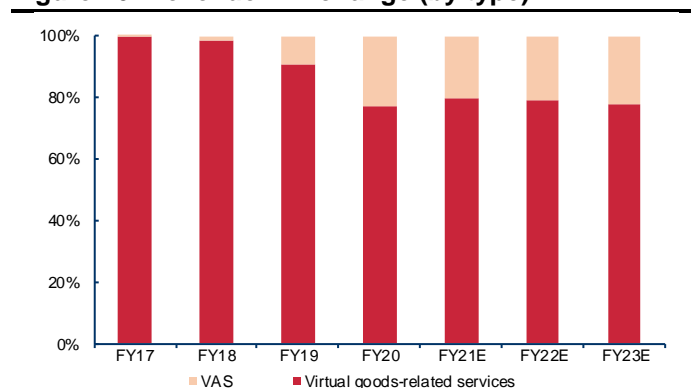
Source: Company data, CMBIS estimates

**Figure 44: GMV growth estimates**

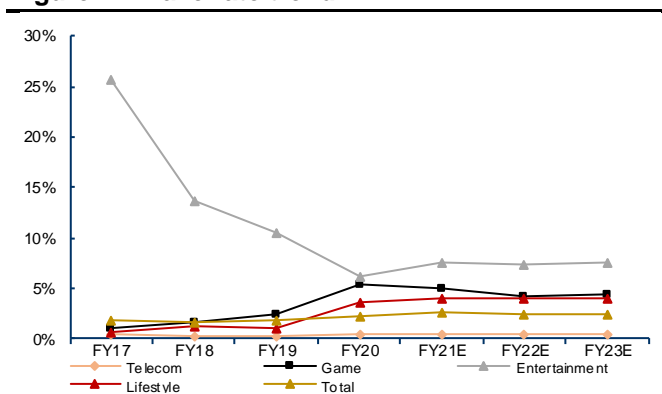
Source: Company data, CMBIS estimates

**Figure 45: GMV breakdown**

Source: Company data, CMBIS estimates

**Figure 46: Revenue mix change (by type)**

Source: Company data, CMBIS estimates

**Figure 47: Take rate trend**

Source: Company data, CMBIS estimates

## Income Statement

We forecast 34% adj. net profit CAGR for Fulu in FY20-23E, mainly driven by 38% revenue CAGR, and rebounding operating margin.

### Better long-term margin outlook with higher efficiency and scale effect.

We expect gross margin to remain 76% from FY21E, thanks to 1) higher revenue mix of games, entertainment, lifestyle, which have higher GPM; 2) higher revenue mix of VAS solutions; and 3) decreasing influence of fixed costs due to economies of scale.

Meanwhile, we expect its opex ratio to improve 8ppts/ 3ppts YoY to -30%/ -27% in FY21/22E, mainly attributable to decreasing G&A/Rev ratio and R&D/Rev ratio.

As a result, we forecast adj. net profit to grow 50%/36%/18% YoY in FY21/22/23E to RMB230mn/RMB313mn/RMB369mn, respectively.

Figure 48: Income statement

| RMB mn, Dec-YE                         | FY18       | FY19       | FY20       | FY21E      | FY22E      | FY23E      |
|--|------------|------------|------------|------------|------------|------------|
| <b>Revenue</b>                         | <b>209</b> | <b>242</b> | <b>328</b> | <b>560</b> | <b>706</b> | <b>854</b> |
| Cost of revenue                        | (50)       | (48)       | (68)       | (134)      | (169)      | (205)      |
| <b>Gross profit</b>                    | <b>159</b> | <b>194</b> | <b>260</b> | <b>426</b> | <b>536</b> | <b>649</b> |
| Selling and distribution expenses      | (25)       | (37)       | (62)       | (78)       | (99)       | (120)      |
| Administrative expenses                | (34)       | (48)       | (59)       | (62)       | (55)       | (77)       |
| R&D                                    | (24)       | (21)       | (26)       | (35)       | (43)       | (50)       |
| Others                                 | 4          | 8          | 22         | 5          | 5          | 6          |
| <b>Operating (loss)/profit</b>         | <b>79</b>  | <b>96</b>  | <b>136</b> | <b>255</b> | <b>345</b> | <b>409</b> |
| Financial Cost                         | (7)        | (8)        | (6)        | (3)        | (4)        | (3)        |
| Other expenses                         | (4)        | (3)        | (8)        | (3)        | (3)        | (4)        |
| <b>(Loss)/profit before income tax</b> | <b>68</b>  | <b>85</b>  | <b>122</b> | <b>249</b> | <b>338</b> | <b>401</b> |
| Income taxes (expense)/credit          | (6)        | (5)        | (1)        | (19)       | (25)       | (32)       |
| <b>(Loss)/profit for the year</b>      | <b>63</b>  | <b>81</b>  | <b>121</b> | <b>230</b> | <b>313</b> | <b>369</b> |
| MI                                     | (0)        | (0)        | 0          | 0          | 0          | 0          |
| <b>Net profit</b>                      | <b>63</b>  | <b>81</b>  | <b>121</b> | <b>230</b> | <b>313</b> | <b>369</b> |
| Adjustment:                            |            |            |            |            |            |            |
| Share compensation                     | 14         | 20         | 0          | 0          | 0          | 0          |
| Listing expenses                       | 0          | 6          | 20         | 0          | 0          | 0          |
| <b>Adj. net profit</b>                 | <b>76</b>  | <b>106</b> | <b>153</b> | <b>230</b> | <b>313</b> | <b>369</b> |
| <b>Margin Analysis</b>                 |            |            |            |            |            |            |
| Gross margin                           | 76%        | 80%        | 79%        | 76%        | 76%        | 76%        |
| Operating margin                       | 38%        | 40%        | 41%        | 46%        | 49%        | 48%        |
| Net margin                             | 30%        | 33%        | 37%        | 41%        | 44%        | 43%        |
| Adj. net margin                        | 36%        | 44%        | 47%        | 41%        | 44%        | 43%        |
| <b>Growth Analysis</b>                 |            |            |            |            |            |            |
| Revenue                                | -14%       | 16%        | 36%        | 71%        | 26%        | 21%        |
| Gross profit                           | -15%       | 22%        | 35%        | 63%        | 26%        | 21%        |
| Operating profit                       | -32%       | 21%        | 41%        | 88%        | 35%        | 18%        |
| Net profit                             | -20%       | 28%        | 50%        | 90%        | 36%        | 18%        |
| Adj. net profit                        | -14%       | 39%        | 44%        | 50%        | 36%        | 18%        |

Source: Company data, CMBIS estimates

## Balance Sheet

### Healthy balance sheet with net cash positions in FY21/22/23E

According to our estimates of profit before taxation and change in working capital, Fulu has strong operating cash inflows supporting CAPEX in the next three years. Therefore, we believe Fulu can stay in net cash positions in FY21/22/23E. We expect Fulu to hold RMB639mn/RMB720mn cash and cash equivalent as of 31 Dec 2021E and 2022E.

**Figure 49: Balance Sheet**

| RMB mn, Dec-YE                 | FY18       | FY19       | FY20         | FY21E        | FY22E        | FY23E        |
|--------------------------------|------------|------------|--------------|--------------|--------------|--------------|
| <b>Non-current assets</b>      | <b>17</b>  | <b>16</b>  | <b>166</b>   | <b>38</b>    | <b>46</b>    | <b>58</b>    |
| Fixed asset                    | 3          | 3          | 2            | 4            | 5            | 7            |
| Right-of-use assets            | 5          | 2          | 4            | 10           | 7            | 6            |
| Intangible assets              | 1          | 6          | 7            | 20           | 29           | 41           |
| Others                         | 7          | 5          | 153          | 5            | 5            | 5            |
| <b>Current assets</b>          | <b>396</b> | <b>469</b> | <b>1,228</b> | <b>1,451</b> | <b>1,746</b> | <b>2,084</b> |
| Cash                           | 12         | 9          | 458          | 639          | 720          | 834          |
| Trade receivables              | 32         | 53         | 132          | 99           | 125          | 153          |
| Prepayments, other receivables | 308        | 339        | 570          | 627          | 793          | 966          |
| Others                         | 44         | 68         | 69           | 86           | 108          | 132          |
| <b>Current liabilities</b>     | <b>223</b> | <b>230</b> | <b>286</b>   | <b>316</b>   | <b>387</b>   | <b>460</b>   |
| Trade payables                 | 11         | 23         | 38           | 43           | 55           | 67           |
| Other payables and accruals    | 104        | 118        | 98           | 199          | 252          | 307          |
| Due to related parties         | 2          | 3          | 0            | 0            | 0            | 0            |
| Interest-bearing bank          | 93         | 61         | 139          | 50           | 50           | 50           |
| Others                         | 14         | 24         | 10           | 24           | 30           | 36           |
| <b>Non-current liabilities</b> | <b>3</b>   | <b>1</b>   | <b>2</b>     | <b>8</b>     | <b>5</b>     | <b>5</b>     |
| Lease liabilities              | 3          | 1          | 2            | 8            | 5            | 5            |
| MI                             | 0          | 0          | 0            | 0            | 0            | 0            |
| Total Equity                   | 186        | 254        | 1,106        | 1,165        | 1,399        | 1,678        |
| <b>Shareholders' equity</b>    | <b>186</b> | <b>254</b> | <b>1,106</b> | <b>1,165</b> | <b>1,399</b> | <b>1,678</b> |

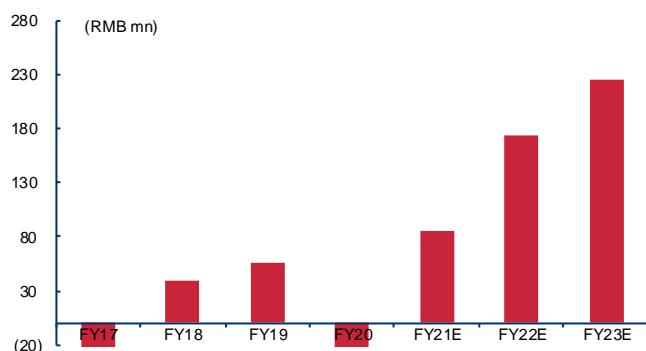
Source: Company data, CMBIS estimates

## Cash Flow and Working Capital

### Strong operating cash flow

Fulu recorded strong net operating cash flows of RMB39mn and RMB57mn in FY18, FY19 respectively, despite the RMB186mn OCF outflow in FY20 due to prepayment of procurement channels. Given its asset-light model and outstanding bargaining power with both customers and suppliers, we expect Fulu to recover strong operating cash inflow trend and record RMB86mn/ RMB175mn/ RMB225mn of operating cash inflow in FY21/22/23E, respectively.

**Figure 50: Operating cash flow projections**



Source: Company data, CMBIS estimates

**Figure 51: Cash flow and working capital analysis**

| RMB mn, Dec-YE               | FY18        | FY19        | FY20         | FY21E       | FY22E       | FY23E       |
|------------------------------|-------------|-------------|--------------|-------------|-------------|-------------|
| <b>Cash Flow</b>             |             |             |              |             |             |             |
| <b>Operating cash flow</b>   | <b>40</b>   | <b>57</b>   | <b>(186)</b> | <b>86</b>   | <b>175</b>  | <b>225</b>  |
| CAPEX                        | (2)         | (7)         | (2)          | (11)        | (14)        | (18)        |
| Others                       | (3)         | 1           | (1)          | 3           | 4           | 4           |
| <b>Investing cash flow</b>   | <b>(5)</b>  | <b>(6)</b>  | <b>(3)</b>   | <b>(7)</b>  | <b>(10)</b> | <b>(14)</b> |
| Proceeds from share issuance | 10          | 0           | 776          | 0           | 0           | 0           |
| Others                       | (37)        | (53)        | (129)        | (32)        | (84)        | (97)        |
| <b>Financing cash flow</b>   | <b>(27)</b> | <b>(53)</b> | <b>647</b>   | <b>(32)</b> | <b>(84)</b> | <b>(97)</b> |
| <b>Cash at period end</b>    | <b>12</b>   | <b>9</b>    | <b>458</b>   | <b>639</b>  | <b>720</b>  | <b>834</b>  |

Source: Company data, CMBIS estimates



## Valuation

### Investment Thesis

We initiate BUY with DCF-based TP of **HK\$12.0**, implying **11x** FY23E P/E. We keep bullish on its growth potential from online entertainment & lifestyle tailwinds and SaaS expansion. Fulu's positive price drivers and catalysts could originate from: 1) potential solid earnings results; 2) strong topline growth; and 3) SaaS initiatives.

### Initiate with BUY

We use DCF valuation as our primary method since it is suitable to apply DCF valuation to internet companies with healthy cash flows in the long run. Assuming a WACC of 13.4% and a terminal growth rate of 3%, our estimated TP is **HK\$12.0**, representing 17x/13x/11x FY21/22/23E P/E, at a discount of industry average of **23.5x/18.4x/14.9x** FY21/22/23E P/E.

Figure 52: DCF valuation

| DCF valuation (RMB mn)   |       |       |       |       |       |       |       |       |       |       |
|--------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                          | 2021E | 2022E | 2023E | 2024E | 2025E | 2026E | 2027E | 2028E | 2029E | 2030E |
| EBIT                     | 255   | 345   | 409   | 502   | 604   | 702   | 793   | 875   | 948   | 1,010 |
| Tax                      | (19)  | (25)  | (32)  | (39)  | (47)  | (54)  | (62)  | (68)  | (74)  | (78)  |
| D&A                      | 5     | 6     | 8     | 8     | 8     | 8     | 9     | 9     | 10    | 10    |
| Working capital          | (156) | (150) | (157) | (165) | (173) | (182) | (191) | (201) | (211) | (221) |
| CAPEX                    | (11)  | (14)  | (18)  | (22)  | (26)  | (32)  | (38)  | (46)  | (55)  | (66)  |
| FCF                      | 74    | 162   | 209   | 284   | 365   | 442   | 511   | 570   | 618   | 655   |
| FCF Growth               |       | 118%  | 29%   | 36%   | 29%   | 21%   | 16%   | 12%   | 8%    | 6%    |
| Terminal Value           |       |       |       |       |       |       |       |       |       | 6,462 |
| PV (FCF+ Terminal Value) | 65    | 126   | 143   | 171   | 194   | 207   | 211   | 208   | 199   | 2,017 |

| Assumptions          |       |
|----------------------|-------|
| WACC                 | 13.4% |
| Tax rate             | 25.0% |
| Risk free rate       | 3.6%  |
| Cost of debt         | 0.0%  |
| Beta                 | 1.20  |
| Market risk return   | 11.8% |
| Cost of equity       | 13.4% |
| Debt/Assets          | 0.0%  |
| Terminal growth rate | 3.0%  |
| Debt value           | 0     |

| Equity Value             |         |
|--------------------------|---------|
| PV                       | 3,542   |
| minus: Net cash          | (458)   |
| minus: Minority Interest | 0       |
| Equity Value (RMB mn)    | 4,000   |
| FX                       | 0.8     |
| Equity Value (HK\$)      | 12.0 TP |

|        |      | WACC |      |      |      |      |
|--------|------|------|------|------|------|------|
|        |      | 11%  | 12%  | 13%  | 14%  | 15%  |
| Growth | 1.5% | 14.7 | 13.1 | 11.3 | 10.7 | 9.8  |
|        | 2.0% | 15.1 | 13.4 | 11.5 | 10.9 | 9.9  |
|        | 2.5% | 15.7 | 13.8 | 11.8 | 11.1 | 10.1 |
|        | 3.0% | 16.2 | 14.2 | 12.0 | 11.4 | 10.3 |
|        | 3.5% | 16.9 | 14.7 | 12.4 | 11.6 | 10.5 |
|        | 4.0% | 17.6 | 15.2 | 12.7 | 11.9 | 10.7 |
|        | 4.5% | 18.4 | 15.8 | 13.1 | 12.2 | 11.0 |

Source: Company data, Bloomberg, CMBIS estimates

## Peer comparison

As for cross-check, we selected five China ecommerce leader and seven ecommerce solution providers as comps for peer comparison.

Actually, we noticed that SaaS players (e.g. Shopify, Weimob) delivered higher valuation than traditional 3P solutions providers, for its strong-stickiness subscription model and higher earnings CAGR. We think Baozun could be the most comparable one, for its commission monetization and GMV-driven business. However, Fulu would be more resilient to COVID-19 than Baozun, as majority of Baozun's transaction are physical goods.

Our TP suggested 17x FY21E P/E, 26% discount of peers' average P/E. 26% discount was primarily on its small market cap, liquidity risk and niche market. Its VAS service was still at an early stage, but we think its further monetization will unlock its earnings potential, if executed well.

**Figure 53: Peers valuation**

| Company                                    | Ticker         | Mkt cap<br>(USD mn) | Currency   | Price    | CMBI<br>Rating | CMBI<br>TP | PE          |             |             | PS         |            |            | EV/EBITDA   |             |             | FY21-23<br>CAGR | EPS |
|--|----------------|---------------------|------------|----------|----------------|------------|-------------|-------------|-------------|------------|------------|------------|-------------|-------------|-------------|-----------------|-----|
|  |                |                     |            |          |                |            | FY21E       | FY22E       | FY23E       | FY21E      | FY22E      | FY23E      | FY21E       | FY22E       | FY23E       |                 |     |
| <b>Fulu Holdings</b>                       | <b>2101 HK</b> | <b>484</b>          | <b>HKD</b> | <b>9</b> | <b>BUY</b>     | <b>12</b>  | <b>13.6</b> | <b>10.1</b> | <b>8.6</b>  | <b>5.6</b> | <b>4.5</b> | <b>3.7</b> | <b>15.4</b> | <b>11.4</b> | <b>9.6</b>  | <b>NA</b>       |     |
| <b>Key e-commerce platform</b>             |                |                     |            |          |                |            |             |             |             |            |            |            |             |             |             |                 |     |
| Alibaba                                    | BABA US        | 588,286             | USD        | 217      | BUY            | 303        | 19.4        | 15.6        | 11.7        | 4.1        | 3.4        | 2.8        | 16.2        | 12.8        | 10.6        | 29%             |     |
| JD   | JD US          | 114,897             | USD        | 74       | NA             | NA         | 43.3        | 29.9        | 21.5        | 0.8        | 0.6        | 0.5        | 28.8        | 19.5        | 14.0        | 42%             |     |
| Pinduoduo                                  | PDD US         | 164,181             | USD        | 131      | BUY            | 175        | NA          | 243.4       | 69.9        | 9.9        | 7.1        | 5.2        | NA          | 235.3       | 52.9        | NA              |     |
| Vipshop                                    | VIPS US        | 15,196              | USD        | 22       | NA             | NA         | 12.8        | 10.7        | 9.2         | 0.8        | 0.7        | 0.6        | 8.8         | 7.4         | 6.5         | 18%             |     |
| Meituan Dianping                           | 3690 HK        | 216,305             | HKD        | 276      | BUY            | 401        | NA          | 149.9       | 52.7        | 7.8        | 5.6        | 4.3        | NA          | 87.7        | 39.3        | NA              |     |
| Average                                    |                |                     |            |          |                |            | 27.3        | 21.0        | 36.7        | 5.0        | 3.7        | 2.9        | 19.1        | 14.0        | 25.0        | 24%             |     |
| <b>SaaS/ e-commerce solutions provider</b> |                |                     |            |          |                |            |             |             |             |            |            |            |             |             |             |                 |     |
| Baozun                                     | BZUN US        | 2,860               | USD        | 37       | BUY            | 50         | 27.3        | 19.2        | 14.7        | 1.5        | 1.2        | 1.0        | 17.0        | 12.7        | 10.0        | 36%             |     |
| Shopify                                    | SHOP US        | 150,679             | USD        | 1,215    | NA             | NA         | 289.1       | 248.3       | 150.8       | 34.3       | 25.9       | 19.4       | 301.4       | 231.5       | 139.3       | 38%             |     |
| Weimob                                     | 2013 HK        | 4,836               | HKD        | 17       | NA             | NA         | 198.2       | 113.9       | 47.8        | 10.8       | 8.2        | 6.2        | 93.0        | 48.1        | 25.8        | 104%            |     |
| Oracle                                     | ORCL US        | 226,992             | USD        | 79       | NA             | NA         | 17.7        | 16.4        | 15.3        | 5.6        | 5.5        | 5.3        | 12.8        | 12.5        | 12.0        | 8%              |     |
| Salesforce                                 | CRM US         | 206,377             | USD        | 224      | NA             | NA         | 48.2        | 64.9        | 53.9        | 9.8        | 8.0        | 6.7        | 32.0        | 26.4        | 22.1        | 23%             |     |
| Average                                    |                |                     |            |          |                |            | 30.1        | 33.0        | 33.0        | 11.9       | 9.4        | 7.4        | 38.9        | 24.9        | 17.3        | 41%             |     |
| <b>Software</b>                            |                |                     |            |          |                |            |             |             |             |            |            |            |             |             |             |                 |     |
| Chinasoft International                    | 354 HK         | 3,338               | HKD        | 9        | BUY            | 12         | 17.4        | 13.9        | 11.4        | 1.2        | 1.0        | 0.8        | 12.9        | 10.2        | 7.9         | 24%             |     |
| Kingdee                                    | 268 HK         | 11,753              | HKD        | 26       | NA             | NA         | NA          | NA          | 275.9       | 18.2       | 14.4       | 11.4       | 525.4       | 349.5       | 138.7       | NA              |     |
| Average                                    |                |                     |            |          |                |            | 17.2        | 13.7        | 11.3        | 9.6        | 7.6        | 6.1        | 12.8        | 10.1        | 7.9         | 24%             |     |
| <b>Total average</b>                       |                |                     |            |          |                |            | <b>23.5</b> | <b>18.4</b> | <b>14.9</b> | <b>8.6</b> | <b>6.7</b> | <b>5.3</b> | <b>28.2</b> | <b>19.0</b> | <b>20.2</b> | <b>34%</b>      |     |

Source: Bloomberg

Note: data updated by 21 May 2021; Total average multiple excludes some outliers (e.g. Meituan Dianping, Shopify, Weimob, Kingdee, Salesforce).

## Key Investment Risks

### Risks regarding the industries of the Company and its platform participants

According to Frost & Sullivan, China's virtual goods and services market grew from RMB 645.6bn in 2014 to RMB 1,293.5bn in 2015 by GMV, representing a CAGR of 14.9%. The industry's ability to maintain this level of growth in future periods depends on various economic factors, and risks regarding the internet in general. A downturn in general economic conditions could reduce consumer spending, negatively impacting industry growth rates. Consumers may also become unwilling or less willing to purchase virtual goods via internet for a variety of reasons, including congestion of traffic on the internet, internet outages or delays, increases in the cost of accessing the internet, security and privacy risks, or the perception of the foregoing risks.

As the industry is relatively new, the regulatory is also evolving and expected to remain uncertain for the near future. A change in regulations could reduce demand for the Company's services and solutions and adversely affect profitability. In addition, adverse changes in the industries could reduce demand for the Company's services, increase customer attrition and materially affect results of operations.

### Possible fluctuation of commissions income

The Company derives its revenues substantially from commissions it charges virtual goods vendors for selling virtual goods through the Company platform. The commissions typically represent a percentage of GMV of the virtual goods sold during certain periods, which may vary significantly from period to period and among different virtual goods, transactions and geographic markets. Any decrease in commissions could adversely affect revenues, gross margin, cash flow and results of operations.

### Uncertainty on profitability amidst intense competition

The Company faces significant competition from companies that provide virtual goods and services, which may become more intense as new competitors enter the industry or because of expansion into new sectors. In a competitive environment, it may be challenging for it to attract and retain platform participants, enter into business combinations or alliances or raise additional capital, expand into other market segments, and grow in market share. Failure to compete against current and future competitors would affect its business.

### Potential issues in the Company's relationship with consumer touchpoints

Virtual goods vendors' demand for the Company's services and solutions largely depends on its ability to connect them to diverse consumer touchpoints to broaden the scope of consumers they can reach to monetize their goods and services. As a result, the number and type of consumer touchpoints on the Company's platform significantly affect relationships with virtual goods vendors. If the Company cannot maintain relationships with consumer touchpoints, relationships with virtual goods vendors will suffer as a result. In addition, consumer touchpoints may charge the Company higher commissions by in the future, which would reduce its profit margins.

### Risks regarding the Company's major customers

The Company depends on a limited number of customers for a significant portion of its revenues, from whom it earns commissions on facilitating sales of their products through its platform. Revenue from largest and top five customers accounted for 24.8%, 21.9%, 27.4%, 22.3% and 40.5%, 49.8%, 64.5%, 65.3% of its total revenue in 2017, 2018 and 2019 and 1Q20, respectively. If major customer decreases the amount of transactions facilitated through the Company's platform, or if key customers fail to make timely payments, the Company's operating results and cash flows may be adversely affected, respectively.

## Appendix 1: Regulations

### Regulations on virtual currency and virtual items

On Jun 3, 2010, the MOC promulgated the Interim Measures on Administration of Online Games (《网络游戏管理暂行办法》) (the “Online Game Measures”), which came into effect on Aug 1, 2010 and was further amended on Dec 15, 2017. The Online Game Measures governs the research, development and operation of online games and the issuance and trading services of virtual currency. Pursuant to the Online Game Measure, providers of virtual currency trading services are required to obtain ICB Licenses valid for three years.

On Feb 17, 2011, the MOC promulgated the Internet Culture Administration Tentative Measures (《互联网文化管理暂行规定》) (the “Internet Culture Measures”), most recently amended in December 2017. The Internet Culture Measures require operators engaging in “internet culture activities” to obtain a permit, which includes, among other things, online dissemination of internet cultural products (such as audio-video products, gaming products, performances of plays or programs, works of art and cartoons) and the production, reproduction, importation, publication and broadcasting of internet cultural products. The Internet Culture Measures provided further that any entity engaging in issuance and transaction service of virtual currencies used for online games shall obtain the ICB Licenses.

### Regulations on value-added telecommunications services

On Sep 25, 2000, the State Council promulgated the Telecommunications Regulations of PRC (《中华人民共和国电信条例》) (the “Telecommunications Regulations”), as amended on Jul 29, 2014 and Feb 6, 2016, to regulate telecommunications activities and related operations in China. The Telecommunications Regulations require telecommunications services providers to obtain an operating license prior to the commencement of their operations.

The Administrative Measures on Internet Information Services (《互联网信息服务管理办法》) promulgated by the State Council on Sep 25, 2000 and amended on Jan 8, 2011, further regulated the internet information services as a subsector of the telecommunications industry. “Internet information services” are defined as services that provide information to online users through the Internet. Commercial internet information service providers, and service providers that provide online data processing and transaction processing services (for-profit e-commerce), are required to obtain operating license for their respective category.

## Appendix 2: Company Background

Figure 54: Key milestones

| Year | Event   |
|------|---|
| 2009 | Wuhan Fulu was founded  |
| 2010 | Launched platform Kamen website (卡門網) to provide virtual goods and services   |
| 2012 | Launched mobile top-up services<br>Launched TSC services for applications   |
| 2014 | Launched top-up services for video platforms and mobile games<br>Launched MALL services and started operation of online stores  |
| 2015 | Launched virtual goods related services for music and sports platforms  |
| 2017 | Launched virtual goods related services for live streaming platforms, including sale of membership and traffic acquisition services   |
| 2018 | Launched virtual goods related services for lifestyle service providers such as restaurants, bakeries and online grocery stores   |
| 2019 | Expanded virtual goods related services for the leisure and entertainment industry by beginning to provide services to online education content providers<br>Began helping virtual goods vendors develop mini-programs and ISV applet<br>Launched text messaging services, including verification code authentication, text message marketing, multimedia messaging and order tracking<br>Launched Fulu Open Platform |

Source: Company data, CMBIS

Figure 55: Awards and recognitions

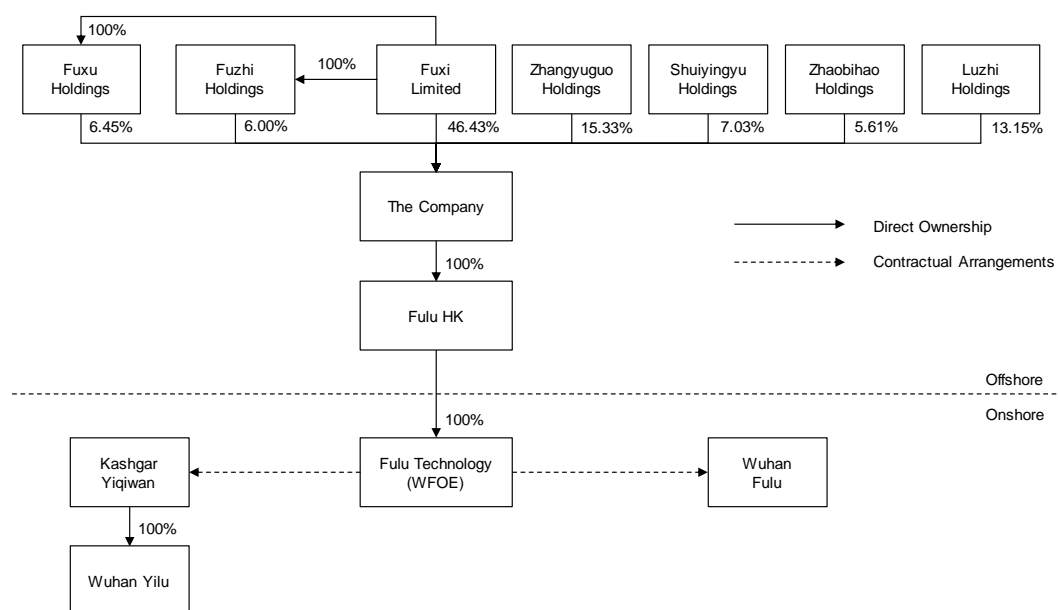
| Year          | Award/Recognition   | Awarding Institution/Authority   |
|---------------|---|--|
| 2019          | Top 20 High Growth High Technology Enterprise in Optic Valley<br>(光谷高科技高成長 20 強)              | Deloitte China<br>(德勤中國)   |
| 2018 and 2019 | Gold Seeds Enterprise<br>(金種子企業)  | The Local Bureau of Financial Affairs of Wuhan City<br>(武漢市地方金融工作局)  |
| 2019          | Gazelle Award (瞪羚獎)   | The Management Commission of Wuhan East Lake High-tech Development Zone<br>(武漢東湖新技術開發區管理委員會)                                       |
| 2018          | High and New Technology Enterprise Qualification<br>(高新技術企業)                                  | The Science and Technology Bureau, the Finance Bureau and the State Tax Bureau of Hubei Province<br>(湖北省科學技術廳、湖北省財政廳、國家稅務總局湖北省稅務局) |
| 2018          | New Industry and Innovative Enterprise<br>(新興產業和創新創業企業)                                       | The Management Commission of Wuhan East Lake High-tech Development Zone<br>(武漢東湖新技術開發區管理委員會)                                       |
| 2017          | TOP 10 Most Commercially Valuable Internet Enterprise in Optic Valley<br>(光谷互聯網最具商業價值 TOP 10) | The Management Commission of Wuhan East Lake High-tech Development Zone<br>(武漢東湖新技術開發區管理委員會)                                       |
| 2017          | Outstanding Internet Enterprise<br>(互聯網+優秀企業)   | The Management Commission of Wuhan East Lake High-tech Development Zone<br>(武漢東湖新技術開發區管理委員會)                                       |

Source: Company data, CMBIS

Figure 56: Employees breakdown

| Function                 | Number of employees | % of total |
|--------------------------|---------------------|------------|
| Operations               | 149                 | 32.9%      |
| Customer service         | 111                 | 24.5%      |
| Research and development | 106                 | 23.4%      |
| Business development     | 21                  | 4.6%       |
| General administration   | 37                  | 8.2%       |
| Management               | 29                  | 6.4%       |
| <b>Total</b>             | <b>453</b>          | <b>100</b> |

Source: Company data, CMBIS

**Figure 57: Corporate structure**

Source: Company data, CMBIS

**Figure 58: Management profile**

| Name                      | Age | Position   | Roles and Responsibilities  | Date of joining the Group | Date of appointment as Director |
|---------------------------|-----|--|---|---------------------------|---------------------------------|
| Mr. Fu Xi<br>(符熙)         | 31  | Chairman of the Board, executive Director, and Chief Executive Officer | The Group's strategies, corporate culture and oversees senior management                    | Mar-09                    | Oct-19                          |
| Mr. Zhang Yuguo<br>(张雨果)  | 33  | Executive Director and senior vice president                           | Operation of the Fulu Open Platform; operation and development of e-commerce business       | May-09                    | Oct-19                          |
| Mr. Shui Yingyu<br>(水英聿)  | 33  | Executive Director and senior vice president                           | Risk control and management as well as daily business operation                             | Nov-10                    | Oct-19                          |
| Mr. Zhao Bihao<br>(赵笔浩)   | 39  | Executive Director and senior vice president                           | Branding, marketing, as well as investments and financing                                   | Apr-13                    | Oct-19                          |
| Mr. Mao Feng<br>(茅峰)      | 41  | Executive Director, Chief Financial Officer and vice president         | Financial management, financing, and investor relations.                                    | Jul-18                    | Jan-20                          |
| Mr. Li Wai Chung<br>(李伟忠) | 42  | Independent Non-executive Director                                     | Responsible for addressing conflicts and giving strategic advice on business and operations | Jan-20                    | Jan-20                          |
| Ms. Wang Yuyun<br>(王雨云)   | 42  | Independent Non-executive Director                                     | Responsible for addressing conflicts and giving strategic advice on business and operations | Jan-20                    | Jan-20                          |
| Mr. Wong Sincere<br>(黄诚思) | 56  | Independent Non-executive Director                                     | Responsible for addressing conflicts and giving strategic advice on business and operations | Jan-20                    | Jan-20                          |

Source: Company data, CMBIS

## Financial Summary

### Income statement

| YE 31 Dec (RMB mn)      | FY19A       | FY20A       | FY21E        | FY22E        | FY23E        |
|-------------------------|-------------|-------------|--------------|--------------|--------------|
| <b>Revenue</b>          | <b>242</b>  | <b>328</b>  | <b>560</b>   | <b>706</b>   | <b>854</b>   |
| Telecom                 | 16          | 47          | 67           | 78           | 85           |
| Game                    | 93          | 101         | 179          | 219          | 256          |
| Entertainment           | 131         | 156         | 241          | 332          | 410          |
| Lifestyle               | 2           | 24          | 73           | 78           | 102          |
| <b>COGS</b>             | <b>(48)</b> | <b>(68)</b> | <b>(134)</b> | <b>(169)</b> | <b>(205)</b> |
| <b>Gross profit</b>     | <b>194</b>  | <b>260</b>  | <b>426</b>   | <b>536</b>   | <b>649</b>   |
| S&M                     | (37)        | (62)        | (78)         | (99)         | (120)        |
| G&A                     | (48)        | (59)        | (62)         | (55)         | (77)         |
| R&D                     | (21)        | (26)        | (35)         | (43)         | (50)         |
| Others                  | 8           | 22          | 5            | 5            | 6            |
| <b>Operating profit</b> | <b>96</b>   | <b>136</b>  | <b>255</b>   | <b>345</b>   | <b>409</b>   |
| Finance cost            | (8)         | (6)         | (3)          | (4)          | (3)          |
| Other expenses          | (3)         | (8)         | (3)          | (3)          | (4)          |
| <b>Pre-tax Income</b>   | <b>85</b>   | <b>122</b>  | <b>249</b>   | <b>338</b>   | <b>401</b>   |
| Income Tax              | (5)         | (1)         | (19)         | (25)         | (32)         |
| MI                      | (0)         | -           | -            | -            | -            |
| <b>Net profit</b>       | <b>81</b>   | <b>121</b>  | <b>230</b>   | <b>313</b>   | <b>369</b>   |
| <b>Adj. net profit</b>  | <b>106</b>  | <b>153</b>  | <b>230</b>   | <b>313</b>   | <b>369</b>   |

### Cash flow summary

| YE 31 Dec (RMB mn)        | FY19A       | FY20A        | FY21E       | FY22E       | FY23E       |
|---------------------------|-------------|--------------|-------------|-------------|-------------|
| <b>Pre-tax Income</b>     | <b>85</b>   | <b>122</b>   | <b>249</b>  | <b>338</b>  | <b>401</b>  |
| D&A                       | 4           | 4            | 5           | 6           | 8           |
| Change in WC              | (51)        | (319)        | (156)       | (150)       | (157)       |
| Others                    | 19          | 6            | (12)        | (19)        | (26)        |
| <b>Operating CF</b>       | <b>57</b>   | <b>(186)</b> | <b>86</b>   | <b>175</b>  | <b>225</b>  |
| Capex                     | (7)         | (2)          | (11)        | (14)        | (18)        |
| Interests                 | 0           | 3            | 3           | 4           | 4           |
| Others                    | 1           | (4)          | -           | -           | -           |
| <b>Investing CF</b>       | <b>(6)</b>  | <b>(3)</b>   | <b>(7)</b>  | <b>(10)</b> | <b>(14)</b> |
| Equity raised             | -           | 776          | -           | -           | -           |
| Change of debts           | (31)        | 77           | 40          | -           | -           |
| Others                    | (22)        | (206)        | (72)        | (84)        | (97)        |
| <b>Financing CF</b>       | <b>(53)</b> | <b>647</b>   | <b>(32)</b> | <b>(84)</b> | <b>(97)</b> |
| <b>Net change in cash</b> | <b>(3)</b>  | <b>458</b>   | <b>46</b>   | <b>81</b>   | <b>114</b>  |
| Cash (beg of yr)          | 12          | 9            | 593         | 639         | 720         |
| FX                        | -           | (9)          | -           | -           | -           |
| <b>Cash (end of yr)</b>   | <b>9</b>    | <b>458</b>   | <b>639</b>  | <b>720</b>  | <b>834</b>  |

### Balance sheet

| YE 31 Dec (RMB mn)             | FY19A      | FY20A        | FY21E        | FY22E        | FY23E        |
|--------------------------------|------------|--------------|--------------|--------------|--------------|
| <b>Non-current assets</b>      | <b>16</b>  | <b>166</b>   | <b>38</b>    | <b>46</b>    | <b>58</b>    |
| Fixed asset                    | 3          | 2            | 4            | 5            | 7            |
| Right-of-use assets            | 2          | 4            | 10           | 7            | 6            |
| Intangible assets              | 6          | 7            | 20           | 29           | 41           |
| Others                         | 5          | 153          | 5            | 5            | 5            |
| <b>Current assets</b>          | <b>469</b> | <b>1,228</b> | <b>1,451</b> | <b>1,746</b> | <b>2,084</b> |
| Cash                           | 9          | 458          | 639          | 720          | 834          |
| Trade receivables              | 53         | 132          | 99           | 125          | 153          |
| Prepayments                    | 339        | 570          | 627          | 793          | 966          |
| Others                         | 68         | 69           | 86           | 108          | 132          |
| <b>Current liabilities</b>     | <b>230</b> | <b>286</b>   | <b>316</b>   | <b>387</b>   | <b>460</b>   |
| Trade payables                 | 23         | 38           | 43           | 55           | 67           |
| Other payables                 | 118        | 98           | 199          | 252          | 307          |
| Due to related parties         | 3          | -            | -            | -            | -            |
| Interest-bearing bank          | 61         | 139          | 50           | 50           | 50           |
| Others                         | 24         | 10           | 24           | 30           | 36           |
| <b>Non-current liabilities</b> | <b>1</b>   | <b>2</b>     | <b>8</b>     | <b>5</b>     | <b>5</b>     |
| Lease liabilities              | 1          | 2            | 8            | 5            | 5            |
| MI                             | -          | -            | -            | -            | -            |
| Total Equity                   | 254        | 1,106        | 1,165        | 1,399        | 1,678        |
| <b>Shareholders' equity</b>    | <b>254</b> | <b>1,106</b> | <b>1,165</b> | <b>1,399</b> | <b>1,678</b> |

### Key ratios

| YE 31 Dec                 | FY19A        | FY20A        | FY21E        | FY22E        | FY23E        |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| <b>Sales mix (%)</b>      |              |              |              |              |              |
| Telecom                   | 6.5          | 14.4         | 12.0         | 11.0         | 10.0         |
| Game                      | 38.6         | 30.8         | 32.0         | 31.0         | 30.0         |
| Entertainment             | 54.0         | 47.5         | 43.0         | 47.0         | 48.0         |
| Lifestyle                 | 1.0          | 7.4          | 13.0         | 11.0         | 12.0         |
| <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                   | 15.8         | 35.7         | 70.6         | 26.0         | 21.0         |
| Gross profit              | 21.9         | 34.5         | 63.5         | 26.0         | 21.0         |
| EBIT                      | 21.4         | 41.2         | 88.3         | 35.3         | 18.3         |
| Net profit                | 39.2         | 44.5         | 50.1         | 36.1         | 18.1         |
| <b>P&amp;L ratios (%)</b> |              |              |              |              |              |
| Operating margin          | 39.7         | 41.3         | 45.6         | 48.9         | 47.8         |
| Pre-tax margin            | 35.3         | 37.3         | 44.5         | 47.9         | 47.0         |
| Adj. net margin           | 43.8         | 46.7         | 41.1         | 44.3         | 43.3         |
| Effective tax rate        | (2.0)        | (0.4)        | (3.4)        | (3.6)        | (3.7)        |
| <b>Returns (%)</b>        |              |              |              |              |              |
| ROE                       | 41.7         | 13.9         | 19.7         | 22.4         | 22.0         |
| ROA                       | 21.9         | 11.0         | 15.4         | 17.5         | 17.2         |

Source: Company data, CMBIS estimates



# Disclosures & Disclaimers

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

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

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