

# FriendTimes Inc. (6820 HK)

## Looking beyond 1H20 earnings

FriendTimes delivered soft 1H20 results, with topline/bottom line +34.5% /8.7% YoY. Topline was in line while earnings was below buy-side expectation of 15%-20% YoY. We suggest investors to look beyond 1H20 earnings, and expect profit to unlock in 2H20E after ToE breakeven. New games pipeline slightly delayed, but we expect minimal financial impact in FY20E. To reflect its existing games decline, we trimmed its earnings by 11%/5%/1% in FY20/21/22E, but maintain our TP of HK\$4.0 (15x FY20E P/E) for industrial valuation rebound. Maintain BUY with low valuation. License of modern woman game would be the next catalyst.

- Soft 1H20 priced in.** 1H20 revenue grew 34.5% YoY, in line with our estimates. Adj. net profit came in at RMB163mn, up 8.7% YoY, below market expectation of 15%-20%, mainly on existing games decline, deferred revenue and lower ToE contribution in 1Q and Android share (~20%). ToE still performed well in 3Q20E, and we keep positive on 2H20E earnings growth. We think market overreacted to 1H20 results, and we suggest to buy on dips.
- ToE intact in 2H20E.** ToE kept stable at Top 15-20 in grossing rank in Aug (vs. Top 30-50 in Jan, Top 20-25 in Feb, Top 12-20 in Mar, Top 9-15 in Apr, Top 5-15 in May & Jun, Top 10-15 in Jul), with daily grossing at RMB3.0-4.0mn. We estimate its monthly grossing at around RMB100mn in Aug, (vs. RMB40mn/60mn/80mn/100mn+/120mn/120-150mn in Jan/ Feb/ Mar/ Apr/ May/ Jun & Jul). ToE has achieved breakeven in 1H20, and we expect higher margin in 2H20E with lighter S&M efforts (50% of 1H20). ToE *South Korea version* was estimated to achieve breakeven in Oct, with RMB15mn monthly grossing. Mgmt guided 30% net margin for ToE, backed by higher paying ratio and ARPU.
- Minimal financial impact from pipeline delay.** We suggest market to eye on further new titles in 2021E, including modern woman (1Q21), casual elimination and female Xianxia games. (e.g. <此生无白>). The delay of modern woman game & Fate: The Loved Journey would pose minimal financial impact, as we did not factor in other new games in FY20E forecast.
- Maintain BUY.** The stock is trading at 10x FY20E P/E, largely below industry average of 15x. We suggest to look beyond 1H20E results, and eye on new titles in 2021E. We trimmed its earnings by 11%/5%/1% in FY20/21/22E, but maintain our TP of HK\$4.0 (15x/12x FY20/21E P/E) with higher P/E multiple for industrial valuation rebound (from 13.5x FY21 P/E to 15x FY21 P/E).

### Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	1,464	1,689	2,185	2,673	3,145
YoY change (%)	109%	15%	29%	22%	18%
Adj. net income (RMB mn)	337	416	519	654	787
Adj. EPS (RMB)	0.15	0.19	0.24	0.30	0.36
YoY growth (%)	185%	23%	25%	26%	20%
Consensus EPS (RMB)	NA	NA	0.27	0.34	0.38
P/E (x)	15.7	12.7	10.2	8.1	6.7
P/S (x)	4.0	3.5	2.7	2.2	1.9
Yield (%)	0.0	0.0	4.1%	4.1%	4.4%
ROE (%)	59%	32%	26%	25%	23%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

**BUY (Maintain)**

Target Price	HK\$4.0
(Previous TP)	HK\$4.0
Up/Downside	+45.0%
Current Price	HK\$2.7

### China Internet Sector

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### Stock Data

Mkt Cap (HK\$ mn)	5,929
Avg 3 mths t/o (HK\$ mn)	26.11
52w High/Low (HK\$)	4.08/0.75
Total Issued Shares (mn)	2,188

Source: Bloomberg

### Shareholding Structure

Eternal Heart Holding	42.8%
Warm Sunshine	8.6%
Ling Long Holding	8.5%

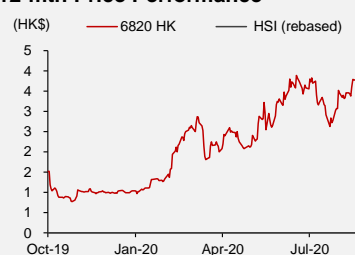
Source: Bloomberg

### Share Performance

	Absolute	Relative
1-mth	37.5%	34.4%
3-mth	43.8%	31.1%
6-mth	52.4%	58.2%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

### Related Reports

- Investments to enrich category- 7 Jul 2020
- More catalysts to come – 9 Jun 2020
- Moving to strong FY20E with eye-catching ToE – 30 Mar 2020
- “Tale of Empress” strong momentum to continue – 28 Feb 2020

**Figure 1: Earnings revision**

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	2,185	2,673	3,145	2,385	2,764	3,176	-8.4%	-3.3%	-1.0%
Gross Profit	1,418	1,740	2,054	1,548	1,799	2,074	-8.4%	-3.3%	-1.0%
Operating Profit	561	708	854	633	744	861	-11.3%	-4.9%	-0.9%
Adj. net profit	519	654	787	586	688	794	-11.4%	-4.9%	-0.9%
Adj. EPS (RMB)	0.24	0.30	0.36	0.27	0.31	0.36	-11.4%	-4.9%	-0.9%
Gross Margin	65%	65%	65%	65%	65%	65%	+0.0ppts	+0.0ppts	+0.0ppts
Operating Margin	26%	26%	27%	27%	27%	27%	-0.9ppts	-0.4ppts	+0.0ppts
Adj. net margin	24%	24%	25%	25%	25%	25%	-0.8ppts	-0.4ppts	+0.0ppts

Source: CMBIS estimates

**Figure 2: CMBIS estimates vs consensus**

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	2,185	2,673	3,145	2,599	3,237	3,524	-15.9%	-17.4%	-10.7%
Gross Profit	1,418	1,740	2,054	1,702	2,124	2,302	-16.7%	-18.1%	-10.8%
Operating Profit	561	708	854	613	792	861	-8.4%	-10.6%	-0.8%
Adj. net profit	519	654	787	582	731	799	-10.7%	-10.6%	-1.5%
Adj. EPS (RMB)	0.24	0.30	0.36	0.27	0.34	0.38	-13.8%	-13.6%	-6.7%
Gross Margin	65%	65%	65%	66%	66%	65%	-0.6ppts	-0.5ppts	-0.0ppts
Operating Margin	26%	26%	27%	24%	24%	24%	+2.1ppts	+2.0ppts	+2.7ppts
Adj. net margin	24%	24%	25%	22%	23%	23%	+1.4ppts	+1.9ppts	+2.3ppts

Source: CMBIS estimates, Bloomberg

**Figure 3: FriendTimes' 1H20 review**

RMB ('000), Dec-YE	1H19	1H20	YoY
<b>Revenue</b>	<b>780,709</b>	<b>1,050,260</b>	<b>35%</b>
Cost of sales	(283,306)	(361,351)	28%
<b>Gross profit</b>	<b>497,403</b>	<b>688,909</b>	<b>39%</b>
Sales and marketing expenses	(203,663)	(379,030)	86%
Research and development expenses	(107,258)	(130,694)	22%
General and administrative expenses	(27,580)	(21,680)	-21%
Other income	2,364	17,646	646%
<b>Operating (loss)/profit</b>	<b>161,266</b>	<b>175,151</b>	<b>9%</b>
Finance costs	(146)	(50)	-66%
Share of loss of an associate	(152)	(175)	15%
Changes in fair value of equity investment measured at fair value through profit or loss	-	(2,734)	
<b>Profit before taxation</b>	<b>160,968</b>	<b>172,192</b>	<b>7%</b>
Income tax expense	(10,951)	(9,076)	-17%
<b>Profit for the year</b>	<b>150,017</b>	<b>163,116</b>	<b>9%</b>

**Margin Analysis**

Gross margin	64%	66%
Operating margin	21%	17%
Net margin	19%	16%

Source: Company data

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	1,464	1,689	2,185	2,673	3,145
Games	1,464	1,689	2,185	2,673	3,145
Others	0	-	-	-	-
<b>COGS</b>	(546)	(587)	(767)	(933)	(1,091)
<b>Gross profit</b>	918	1,102	1,418	1,740	2,054
S&M	(422)	(393)	(634)	(775)	(912)
R&D	(136)	(224)	(218)	(254)	(283)
G&A	(32)	(62)	(44)	(48)	(57)
Other income	36	24	39	45	52
<b>Operating profit</b>	363	447	561	708	854
Finance costs	(1)	(0)	(4)	(6)	(9)
Other gains, net	(1)	(8)	0	(0)	(0)
<b>Pre-tax Income</b>	361	438	557	702	844
Income Tax	(25)	(23)	(38)	(48)	(57)
MI	0	-	-	-	-
<b>Net profit</b>	337	416	519	654	787
<b>Adj. net profit</b>	337	416	519	654	787

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Pre-tax Income</b>	361	438	557	702	844
D&A	9	10	6	11	44
Change in WC	23	(51)	(35)	(18)	(17)
Others	(49)	(23)	(50)	(63)	(76)
<b>Operating CF</b>	344	375	479	632	795
Capex	(61)	(80)	(70)	(60)	(60)
Others	6	9	15	22	28
<b>Investing CF</b>	(55)	(71)	(55)	(38)	(32)
Equity raised	-	500	-	-	-
Change of debts	-	-	60	48	48
Others	(124)	(10)	(4)	(6)	(9)
<b>Financing CF</b>	(124)	490	56	42	39
<b>Net change in cash</b>	165	794	481	635	802
Cash (beg of yr)	305	473	1,266	1,747	2,382
FX	2	-	-	-	-
<b>Cash (end of yr)</b>	473	1,266	1,747	2,382	3,184

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	113	246	255	304	320
Fixed asset	78	202	223	273	289
Right-of-use assets	13	9	3	3	2
Intangible assets	1	8	1	1	1
Others	20	28	28	28	28
<b>Current assets</b>	623	1,265	1,960	2,643	3,492
Cash	473	893	1,747	2,382	3,184
Trade receivables	132	219	197	241	283
Other current assets	18	153	16	21	26
<b>Current liabilities</b>	149	196	197	271	345
Bank loans	-	-	60	108	156
Trade and other payables	82	135	31	37	44
Lease liabilities	5	3	3	3	3
Other current liabilities	62	58	103	123	143
<b>Non-current liabilities</b>	14	9	20	24	28
Contract liabilities	11	9	20	24	28
Lease liabilities	2	-	-	-	-
Others	-	-	-	-	-
<b>Total Equity</b>	573	1,307	1,998	2,652	3,439

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
Games	100.0	100.0	100.0	100.0	100.0
Others	0.0	0.0	0.0	0.0	0.0
<b>Total</b>	100.0	100.0	100.0	100.0	100.0
<b>Growth rate (%)</b>					
Revenue	109.1	15.3	29.4	22.3	17.7
Gross profit	112.4	20.0	28.7	22.7	18.0
EBIT	146.6	23.0	25.6	26.2	20.6
Net profit	185.4	23.4	25.0	25.9	20.3
<b>P&amp;L ratios (%)</b>					
Gross Margin	62.7	65.2	64.9	65.1	65.3
Pre-tax margin	24.7	25.9	25.5	26.2	26.8
Adj. net margin	23.0	24.6	23.8	24.5	25.0
Effective tax rate	6.8	5.2	6.8	6.8	6.8
<b>Returns (%)</b>					
ROE	58.7	31.8	26.0	24.7	22.9
ROA	45.7	27.5	23.5	22.2	20.6
Adj. EPS (RMB)	NA	0.19	0.24	0.30	0.36
DPS (RMB)	-	-	0.10	0.10	0.11
BVPS (RMB)	NA	0.59	0.91	1.21	1.56

Source: Company data, CMBIS estimates

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