16 Jan 2023

CMB International Global Markets | Equity Research | Sector Update

招銀国际 CMB INTERNATIONAL
招商银行全资附属机构 A Wholly Owned Subsidiary Of China Merchants Bank

OUTPERFORM (Maintain)

China Internet

2022 online game market recap

China online game market revenue decreased by 10% YoY to RMB266bn in 2022 (2021: +6% YoY), as per CNG. Apart from high base impact, the main causes were the suspension of game license approval and strengthening minor protection. 4Q22 China online gaming revenue continued to decline by 2% QoQ and 19% YoY to RMB58bn (3Q22: -19% YoY). But we are positive on the 2023 sector outlook and forecast sector revenue will return to positive growth track by 2Q23E, supported by the normalisation of game license approval, more game launches and high-base effect wears-off. CNG data shows that the user traffic remained stable in China gaming market last year. Hence, the resumption of license approvals and improved consumption sentiment should help per user gaming spending to rebound in 2023. We prefer leading online games players Tencent and NetEase, due to their: 1) strong game pipeline; 2) solid leadership in the domestic market; 3) investment for growth in the overseas gaming development and publishing infrastructure.

- **4Q22 gaming market revenue dropped on weak user paying willingness.** The number of gaming users was flat YoY at 664mn in 2022, while the ARPU was down 10% YoY to RMB400, per CNG and our estimates. The soft paying willingness was primarily due to lack of quality new games and overall weak consumption sentiment, in our view. The top 10 mobile games by revenue in Nov 2022 were all launched before 2022 and have been operated by 4.3 years on average based on our estimates. In terms of segment performance, China mobile gaming market revenue declined by 14% YoY to RMB193bn in 2022 (2021: +8% YoY), with its 4Q22 revenue down by 26% YoY (3Q22: -25% YoY). PC gaming market was resilient, with revenue up by 4% YoY to RMB61bn in 2022, thanks to the solid performance of several legacy titles such as Tencent's League of Legends and NetEase's Fantasy Westward Journey.
- **Overseas gaming revenue growth was weak in 4Q22 but remains strategic focus for Chinese game developers.** Overseas revenue from China's self-developed games was down by 4% YoY to US$17bn in 2022 (2021: +17% YoY), as several key overseas markets experienced post-pandemic normalisation period and saw decline in user spending on mobile games. US/Japan mobile gaming market revenue was down by 8/18% YoY in 2022, with Japan's revenue already close to the pre-pandemic level, according to Sensor Tower. Despite short-term challenges in the overseas market, overseas business became a more important revenue contributor to China's gaming companies. Overseas revenue accounted for 30% of global revenue of China gaming companies in 2022, up from 28% in 2021.
- **Expect 8/3% YoY games revenue growth for Tencent and NetEase in 2023E.** We forecast Tencent's online games revenue to rebound by 8% YoY in 2023E, mainly driven by domestic launch of highly-anticipated titles such as Valorant, Undawn and Pokemon United. We also expect its international game revenue growth to reaccelerate, due to the launch of new titles and high-base effect wearing off. For NetEase, we estimate online games revenue to increase by 3% YoY in 2023E. NetEase's several highly-anticipated games like Justice Mobile are still pending for approval, which should further accelerate its games revenue growth in 2023/2024E once approved. Though uncertainty remains, the further normalisation of game license approval (e.g. approval of imported game licenses in Dec) since Nov 2022 could be a key catalyst for NetEase.

China Internet Sector

Saiyi HE, CFA
(852) 3916 1739
hesaiyi@cmbi.com.hk

Wentao LU
luwentao@cmbi.com.hk

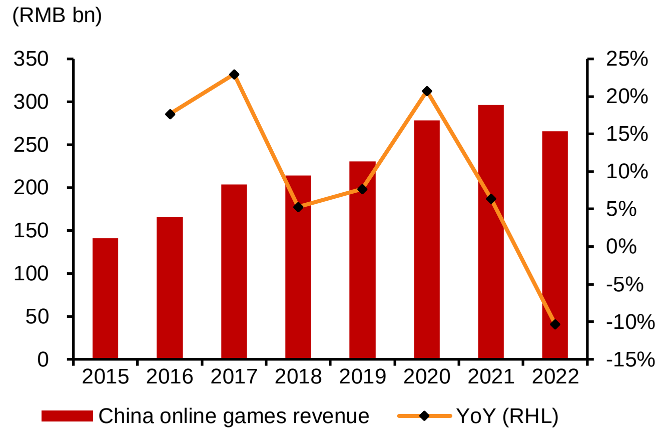
Ye TAO
franktao@cmbi.com.hk

Related Reports

1. China Internet - November online game market recap – 29 Dec
2. China Internet – Quality growth and further digitization penetration provide growth support – 19 Dec
3. Bilibili (BILI US) - Focus on more sustainable growth – 30 Nov
4. NetEase (NTES US) – Preparing for next strong product cycle – 18 Nov
5. Tencent (700 HK) – Return to earnings growth track – 17 Nov
6. China Internet – Social entertainment 3Q22 preview: remains under pressure – 10 Nov
7. Tencent (700 HK) –Ecosystem value and growing diversification – 28 Oct
8. Bilibili (BILI US) - User base and engagement growth are crucial – 26 Oct
9. NetEase (NTES US) –Sturdy game and content developing leader – 24 Oct

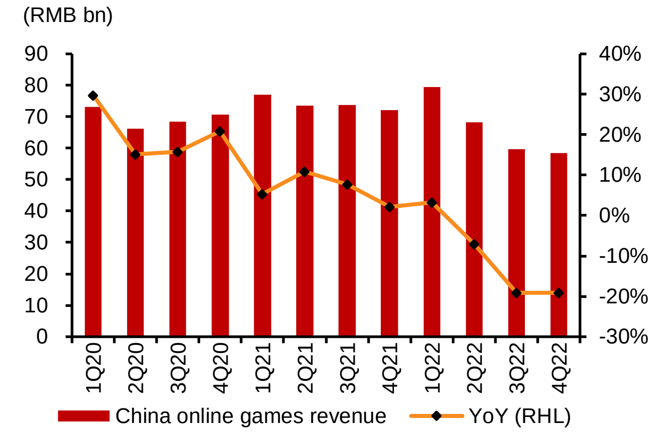
Focus chart

Figure 1: China: online games revenue (annual)



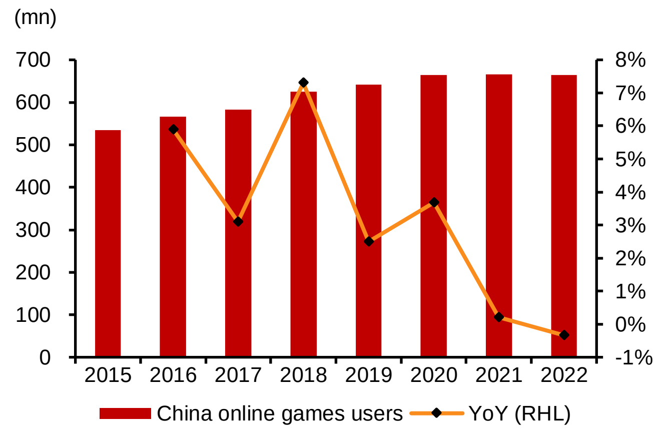
Source: CNG, CMBIGM

Figure 2: China: online games revenue (quarter)



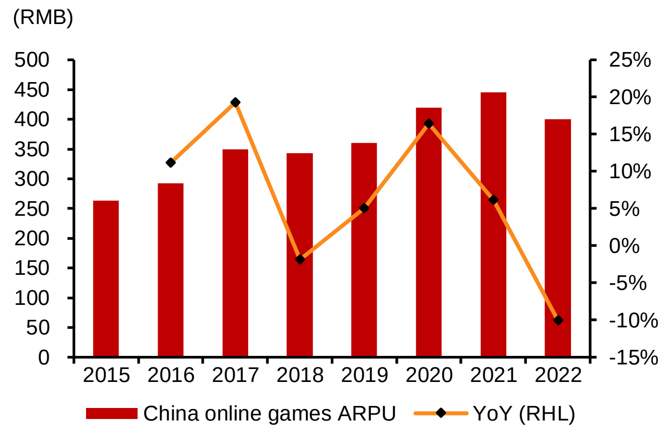
Source: CNG, CMBIGM

Figure 3: China: number of online gaming users



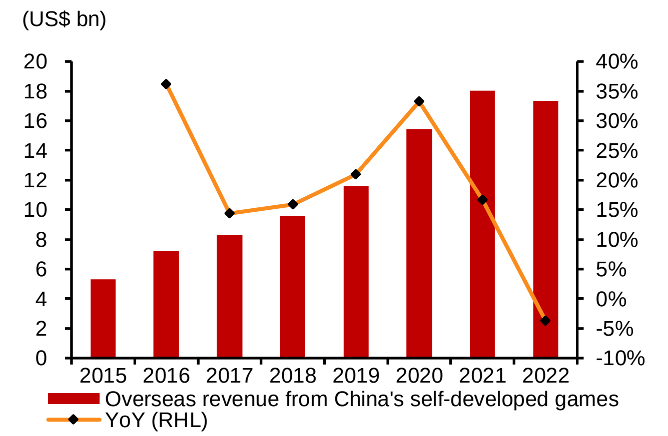
Source: CNG, CMBIGM

Figure 4: China: online gaming ARPU



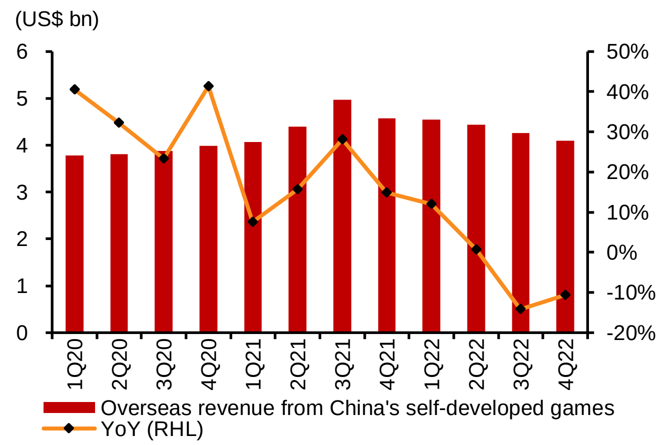
Source: CNG, CMBIGM

Figure 5: Overseas revenue from China's self-developed games (annual)



Source: CNG, CMBIGM

Figure 6: Overseas revenue from China's self-developed games (quarter)



Source: CNG, CMBIGM

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months.

CMBIGM Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM

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

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIS will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I)falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time)("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.,) of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.