

FriendTimes (6820 HK)

Eyes on mini-game potential and cost control

FriendTimes reported largely in-line FY23 results, which we think has been already priced in. *Twist of the Fate* (ToF2) ranked top 50-70 in terms of iOS grossing in 1Q24 quarter-to-date. We expect ToF2 to keep relatively stable grossing ahead, and the next focus could be: 1) Android channel expansion; 2) overseas versions to be released; and 3) improving S&M efficiency. Mini games perform well, and we expect more titles to unlock grossing potential. Mgmt prioritizes cost discipline in FY24, with personnel adjustment and prudent high-R&D project development. We trim our earnings forecast by 18%-28% for FY24-25E to factor in ToF2's performance, with a lower TP at HK\$1.8.

- **Looking beyond FY23 results.** FriendTimes reported FY23 results, with revenue -31% YoY (2% below our estimates), while adj. net loss reached RMB133mn (largely in line). The net loss position was mainly due to existing games' grossing decline and higher S&M. We think its results performance has been well priced in, and we suggest looking to new game performance and mini game upside in FY24E.
- **ToF2 to keep stable grossing and enhance margin.** After launch on 2 Jan 2024, *ToF2* (浮生忆玲珑) ranked top 50-70 in terms of iOS grossing in 1Q24 QTD. We expect ToF2 to maintain a relatively stable grossing trend ahead, and the next focus could be: 1) Android channel expansion; 2) overseas versions to be released; and 3) improving S&M efficiency. Mgmt prioritizes cost discipline in FY24, with personnel adjustment and prudent high-R&D project development.
- **More titles to come, with mini-games showing upside.** *Ink Sword: Jianghu* (墨劍江湖, martial arts game with license approval) has completed a round of paying tests, and received solid user feedback. We expect it to be released in the summer of 2024, and attract more male users. *Reign of Destiny* (European royalty type) is expected to undergo two rounds of tests in overseas markets in 1H24E and to be released in 2H24E/FY25E. Moreover, FT's mini-game *Promise of Lingyun* (凌雲諾) performed well (monthly grossing >RMB\$5mn), and we expect FT to convert multiple key titles to mini-games, unlocking grossing potential.
- **Maintain BUY.** To factor in ToF's performance, we trim our earnings forecast by 18%-28% for FY24-25E, with a lower TP at HK\$1.8.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	1,524	1,056	1,474	1,933	2,048
YoY growth (%)	(5.7)	(30.7)	39.6	31.1	6.0
Adjusted net profit (RMB mn)	58.0	(131.8)	180.3	256.9	299.4
Diluted EPS (RMB cents)	1.90	(6.10)	8.27	11.78	13.73
YoY growth (%)	(85.0)	NA	NA	42.4	16.6
Consensus EPS (RMB cents)	NA	NA	10.5	25.0	NA
P/S (x)	1.3	1.9	1.4	1.0	1.0
P/E (x)	50.7	NA	11.1	7.8	6.7
Yield (%)	6.2	NA	4.5	6.4	7.5
ROE (%)	1.6	(10.2)	12.4	13.9	14.1

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$1.8
(Previous TP)	HK\$2.0
Up/Downside	80.0%
Current Price	HK\$1.00

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Stock Data

Mkt Cap (HK\$ mn)	2,180.0
Avg 3 mths t/o (HK\$ mn)	3.7
52w High/Low (HK\$)	1.62/0.75
Total Issued Shares (mn)	2180.0

Source: FactSet

Shareholding Structure

Eternal Heart Holdings	43.0%
Warm Sunshine	8.7%

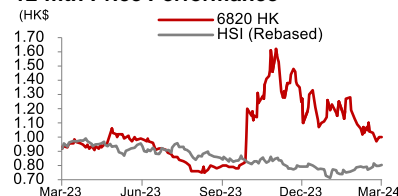
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-10.7%	-12.6%
3-mth	-21.3%	-22.4%
6-mth	25.0%	30.9%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: 2H23 financial review

RMB ('000), Dec-YE	1H20	1H21	1H22	2H22	1H23	2H23
Revenue	1,050,260	833,007	826,057	698,334	620,342	435,691
Cost of sales	(361,351)	(272,705)	(253,312)	(226,965)	(207,728)	(145,900)
Gross profit	688,909	560,302	572,745	471,369	412,614	289,791
Sales and marketing expenses	(379,030)	(280,810)	(469,968)	(177,300)	(276,068)	(154,712)
Research and development expenses	(130,694)	(178,181)	(169,112)	(188,384)	(160,019)	(185,974)
General and administrative expenses	(21,680)	(31,340)	(34,036)	(35,583)	(24,977)	(25,293)
Other income	17,646	11,676	17,157	30,349	34,013	21,878
Operating (loss)/profit	175,151	81,647	(83,214)	100,451	(14,437)	(54,310)
Finance costs	(50)	(11)	(26)	(13)	(156)	(1,282)
Share of loss of an associate	(175)	(1,733)	(910)	(343)	-	-
Changes in fair value of equity investment measured at fair value through profit or loss	(2,734)	2,212	10,096	(1,611)	(1,977)	(766)
Profit before taxation	172,192	82,115	(74,054)	98,484	(16,570)	(56,358)
Income tax expense	(9,076)	48,176	1,092	(411)	(1,367)	(63,825)
Deferred tax	-	-	-	-	(63,007)	-
Profit for the year	163,116	130,291	(72,962)	98,073	(80,944)	(57,176)
Adj. profit for the year	163,116	156,037	(58,461)	(58,460)	(77,911)	(55,043)
Margin Analysis						
Gross margin	66%	67%	69%	67%	67%	67%
Operating margin	17%	10%	-10%	14%	-2%	-12%
Adj. net margin	16%	19%	-7%	-8%	-13%	-13%
Growth Analysis						
Revenue	35%	-21%	-1%	-15%	-25%	-38%
Gross profit	39%	-19%	2%	-18%	-28%	-39%
Operating profit	9%	-53%	NA	NA	NA	NA
Net profit	9%	-20%	NA	NA	NA	NA

Source: Company data, CMBIGM

Figure 2: FT's financials forecasts in FY24-26E

RMB mn, Dec-YE	FY21	FY22	FY23	FY24E	FY25E	FY26E	24-26E CAGR
Revenue	1,616	1,524	1,056	1,474	1,933	2,048	18%
Cost of sales	(527)	(480)	(354)	(472)	(618)	(655)	-
Gross profit	1,089	1,044	702	1,002	1,314	1,392	18%
Sales and marketing expenses	(456)	(647)	(431)	(489)	(618)	(635)	-
Research and development expenses	(365)	(357)	(346)	(295)	(377)	(389)	-
General and administrative expenses	(67)	(70)	(50)	(49)	(62)	(66)	-
Other income	39	48	56	29	29	29	-
Operating (loss)/profit	241	17	(69)	198	286	332	-
Finance costs	(0)	(0)	(1)	(0)	(0)	(0)	-
Share of loss of an associate through profit or loss	(3)	(1)	-	(1)	(0)	(0)	-
Profit before taxation	234	24	(73)	200	285	333	-
Income tax expense	42	1	(65)	(20)	(29)	(33)	-
Profit for the year	275	25	(138)	180	257	299	-
Non-controlling interests	-	-	-	-	-	-	-
Net profit attributable to equity shareholders	275	25	(138)	180	257	299	29%
Margin Analysis							
Gross margin	67%	68%	67%	68%	68%	68%	-
Operating margin	15%	1%	-7%	13%	15%	16%	-
Net margin	17%	2%	-13%	12%	13%	15%	-
Growth Analysis							
Revenue	-26%	-6%	-31%	40%	31%	6%	-
Gross profit	-26%	-4%	-33%	43%	31%	6%	-
Operating profit	-56%	-93%	NA	NA	44%	16%	-
Net profit	-45%	-91%	NA	NA	42%	17%	-

Source: Company data, CMBIGM estimates

Figure 3: CMBIGM estimates vs consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E
Revenue	1,474	1,933	2,048	2,103	2,614	NA	-29.9%	-26.1%	NA
Gross profit	1,002	1,314	1,392	1,439	1,789	NA	-30.3%	-26.5%	NA
Operating profit	198	286	332	280	361	NA	-29.1%	-20.9%	NA
Adj. net profit	180	257	299	335	544	NA	NA	-52.8%	NA
Adj. EPS (RMB)	0.08	0.12	0.14	0.11	0.25	NA	-21.2%	-52.9%	NA
Gross margin	68.0%	68.0%	68.0%	68.4%	68.4%	NA	-0.4ppts	-0.4ppts	NA
Operating margin	13.5%	14.8%	16.2%	13.3%	13.8%	NA	+0.2ppts	+1.0ppts	NA
Adj. net margin	12.2%	13.3%	14.6%	15.9%	20.8%	NA	-3.7ppts	-7.5ppts	NA

Source: Bloomberg, CMBIGM estimates

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	2024E	2025E	2026E	2024E	2025E	2026E	2024E	2025E	2026E
Revenue	1,474	1,933	2,048	2,032	2,295	NA	-27.5%	-15.8%	NA
Gross profit	1,002	1,314	1,392	1,382	1,561	NA	-27.5%	-15.8%	NA
Operating profit	198	286	332	262	334	NA	-24.4%	-14.4%	NA
Adj. net profit	180	257	299	250	312	NA	-27.9%	-17.8%	NA
Adj. EPS (RMB)	0.08	0.12	0.14	0.11	0.14	NA	-27.9%	-17.8%	NA
Gross margin	68.0%	68.0%	68.0%	68.0%	68.0%	NA	0.0ppts	0.0ppts	NA
Operating margin	13.5%	14.8%	16.2%	12.9%	14.6%	NA	+0.5ppts	+0.2ppts	NA
Adj. net margin	12.2%	13.3%	14.6%	12.3%	13.6%	NA	-0.1ppts	-0.3ppts	NA

Source: CMBIGM estimates

Figure 5: DCF valuation

DCF Valuation (RMB mn)							
	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	201	286	333	388	442	500	550
Tax	(20)	(29)	(23)	(31)	(40)	(50)	(55)
D&A	36	33	31	32	33	33	34
Change in working capital	(12)	13	3	3	3	3	3
CAPEX	(38)	(38)	(38)	(39)	(39)	(40)	(40)
FCF	166	265	306	353	399	447	492
FCF Growth		59%	16%	16%	13%	12%	10%
PV	166	230	231	233	229	223	1,898
Terminal Value							3,882

Assumptions

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

Equity Value

PV	3,210
minus: Net debt(RMB mn)	(407)
minus: Minority interest(RMB mn)	0
Equity Value(RMB mn)	3,617
FX	0.92
Stock price (HK\$)	1.80

Source: Bloomberg, CMBIGM estimates

WACC						
Terminal growth rate	~	13%	14%	15%	16%	17%
	0.5%	1.95	1.81	1.70	1.59	1.50
	1.0%	2.00	1.85	1.73	1.62	1.53
	1.5%	2.04	1.89	1.77	1.65	1.55
	2.0%	2.10	1.93	1.80	1.67	1.57
	2.5%	2.15	1.98	1.84	1.71	1.60
	3.0%	2.22	2.03	1.88	1.74	1.63
	3.5%	2.29	2.08	1.93	1.77	1.66

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	1,616	1,524	1,056	1,474	1,933	2,048
Cost of goods sold	(527)	(480)	(354)	(472)	(618)	(655)
Gross profit	1,089	1,044	702	1,002	1,314	1,392
Operating expenses	(849)	(1,027)	(771)	(804)	(1,028)	(1,061)
Selling expense	(456)	(647)	(431)	(489)	(618)	(635)
SG&A expense	(67)	(70)	(50)	(49)	(62)	(66)
R&D expense	(365)	(357)	(346)	(295)	(377)	(389)
Others	39	48	56	29	29	29
Operating profit	(7)	7	(4)	2	(0)	1
Other income	(0)	(0)	(1)	(0)	(0)	(0)
Gain/loss on financial assets at FVTPL	(3)	8	(3)	3	0	1
Share of (losses)/profits of associates/JV	(3)	(1)	0	(1)	(0)	(0)
Pre-tax profit	234	24	(73)	200	285	333
Income tax	42	1	(65)	(20)	(29)	(33)
After tax profit	275	25	(138)	180	257	299
Net profit	275	25	(138)	180	257	299
Adjusted net profit	261	58	(132)	180	257	299

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	1,241	1,057	1,048	944	1,254	1,561
Cash & equivalents	752	404	396	415	680	976
Account receivables	183	104	87	133	174	184
ST bank deposits	2	2	2	2	2	2
Financial assets at FVTPL	297	405	381	381	381	381
Other current assets	1	137	177	0	0	0
Contract obtaining costs	7	5	4	13	17	18
Non-current assets	565	556	418	455	460	467
PP&E	279	266	242	279	284	291
Right-of-use assets	9	9	8	4	3	2
Deferred income tax	72	73	9	9	9	9
Investment in JVs & assos	5	0	0	0	0	0
Intangibles	13	0	0	0	0	0
Financial assets at FVTPL	45	87	93	93	93	93
Other non-current assets	143	121	65	71	72	72
Total assets	1,807	1,613	1,466	1,399	1,714	2,029
Current liabilities	151	106	256	175	229	242
Short-term borrowings	0	0	147	0	0	0
Account payables	117	80	90	112	147	156
Tax payable	0	0	1	1	1	1
Lease liabilities	1	1	0	1	1	1
Contract liabilities	33	25	16	60	79	84
Non-current liabilities	9	10	6	21	25	26
Obligations under finance leases	0	0	0	8	8	8
Other non-current liabilities	9	10	6	13	17	18
Total liabilities	160	116	262	196	254	268
Share capital	0	0	0	0	0	0
Capital surplus	0	0	0	0	0	0
Retained earnings	1,646	1,497	1,203	1,714	1,970	2,270
Other reserves	0	0	0	0	0	0
Total shareholders equity	1,646	1,497	1,204	1,714	1,971	2,270
Total equity and liabilities	1,807	1,613	1,466	1,910	2,224	2,538

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	234	24	(73)	200	285	333
Depreciation & amortization	23	42	39	36	33	31
Tax paid	(26)	1	(65)	(20)	(29)	(33)
Change in working capital	(2)	106	69	(12)	13	3
Others	34	(17)	77	(13)	(13)	(13)
Net cash from operations	263	155	46	191	290	321
Investing						
Capital expenditure	(56)	(38)	(38)	(38)	(38)	(38)
Acquisition of subsidiaries/ investments	(20)	0	0	0	0	0
Net proceeds from disposal of short-term investments	(299)	(51)	(6)	0	0	0
Others	(10)	367	105	14	14	14
Net cash from investing	(386)	278	60	(25)	(25)	(25)
Financing						
Dividend paid	(215)	0	0	0	0	0
Net borrowings	0	0	147	(147)	0	0
Proceeds from share issues	0	0	0	0	0	0
Share repurchases	0	0	0	0	0	0
Others	(2)	404	249	(0)	(0)	(0)
Net cash from financing	(217)	404	396	(148)	(0)	(0)
Net change in cash						
Cash at the beginning of the year	1,093	752	404	396	415	680
Exchange difference	(1)	(0)	0	0	0	0
Others	0	0	0	0	0	0
Cash at the end of the year	752	404	396	415	680	976
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	(25.9%)	(5.7%)	(30.7%)	39.6%	31.1%	6.0%
Gross profit	(25.8%)	(4.2%)	(32.7%)	42.7%	31.1%	6.0%
Net profit	(45.3%)	(90.9%)	na	na	42.5%	16.6%
Adj. net profit	(45.3%)	(77.8%)	na	na	42.5%	16.6%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	67.4%	68.5%	66.5%	68.0%	68.0%	68.0%
Operating margin	(0.4%)	0.5%	(0.4%)	0.1%	(0.0%)	0.0%
Adj. net profit margin	16.2%	3.8%	(12.5%)	12.2%	13.3%	14.6%
Return on equity (ROE)	17.1%	1.6%	(10.2%)	12.4%	13.9%	14.1%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.5)	(0.3)	(0.2)	(0.2)	(0.3)	(0.4)
Current ratio (x)	8.2	10.0	4.1	5.4	5.5	6.4
Receivable turnover days	41.0	34.3	33.1	27.2	29.0	31.9
Inventory turnover days	0.0	0.0	0.0	0.0	0.0	0.0
Payable turnover days	90.1	74.9	87.9	78.3	76.4	84.3
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	12.2	50.7	NA	11.1	7.8	6.7
P/B	2.0	1.4	1.7	1.2	1.0	0.9
Div yield (%)	7.8	6.2	NA	4.5	6.4	7.5

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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