

FriendTimes Inc. (6820 HK)

Investing in R&D to deliver premium games

FriendTimes delivered soft 1H21, with revenue/adj. net profit -21%/-4% YoY. Topline miss was attributed to lack of large-scale new games and soft legacy games, partly offset by flagship *FoE*'s strong overseas performance. Market concerns about minor protection regulations and delayed game licenses are well priced in, in our view. We cut topline by 39-41% in FY21-23E for soft legacy game and key pipeline delay, and trimmed adj. NPM by 2.0-3.5ppts to reflect higher R&D and tax. Maintain BUY with TP lowered to HK\$2.5 (14.7x/10.9x FY21/22E P/E). Suggest moving onto key pipeline games in 2H21E/2022E.

- Soft 1H21 partly offset by overseas expansion.** 1H21 rev -21% YoY to RMB833mn, 29%/30% of our/market's FY21E full-year estimates. Lack of large-scale new games and soft legacy games (*Legend of Empress* <熹妃传>/*Royal Chaos* <熹妃Q传> launched 7/5 years ago) was partly offset by *FoE*'s <浮生为卿歌> strong performance abroad. 1H21 overseas rev +48% YoY to 28% rev mix, and GPM +2ppts YoY as proprietary channel contributed 15% of domestic grossing. OPM -7ppts YoY to 10%, due to mixed effects from R&D investment ramp-up (R&D/rev +9ppts YoY), slight G&A increase, and disciplined S&M control. Excluding SBC, adj. NPM +3ppts YoY to 19%.
- Key pipeline title delayed to improve gameplay.** FriendTimes aims to strengthen leadership in female-oriented games by polishing key pipeline titles, with *Promise of Lingyun* <凌云诺> and *A Story of Lala's: Rising Star* <杜拉拉升职记> expected in 2H21E/2022E. Strategic flagship product *Code: FS2* (sequel of *FoE*) might enter beta testing in 2H22E. Backed by successive investment in R&D studios, FriendTimes ramps up a pipeline for continuous overseas expansion, such as simulation game *Code: W* (in beta testing).
- Regulatory risks manageable.** Market concerns lie in minor protection regulations and delayed game licensed. We believe regulatory risks are manageable (minor grossing mix <0.02%; *PoL* license granted in May) and well-priced in, and suggest focusing on performance of key pipeline games.
- Maintain BUY.** FriendTimes is trading at 8.8x/6.5x FY21/22E P/E, largely below industry average of 16.3x/13.8x. We cut topline by 39-41% in FY21-23E to reflect soft legacy game and key pipeline delay, and trimmed adj. NPM by 2.0-3.5ppts for heightened R&D and tax. Maintain BUY with TP lowered to HK\$2.5 (14.7x/10.9x FY21/22E P/E).

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	1,689	2,182	1,737	2,094	2,371
YoY change (%)	15%	29%	-20%	21%	13%
Adj. net income (RMB mn)	416	504	310	421	503
Adj. EPS (RMB)	0.19	0.23	0.14	0.19	0.23
YoY growth (%)	23%	21%	-44%	37%	20%
Consensus EPS (RMB)	NA	NA	0.27	0.35	0.44
P/E (x)	6.6	5.4	8.8	6.5	5.4
P/S (x)	2.0	1.5	1.9	1.6	1.4
Yield (%)	0.0	8.7%	7.2%	3.8%	7.2%
ROE (%)	32%	32%	15%	17%	17%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$2.5
(Previous TP)	HK\$4.0
Up/Downside	+68.9%
Current Price	HK\$1.5

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	3,228
Avg 3 mths t/o (HK\$ mn)	2.40
52w High/Low (HK\$)	3.1/ 1.3
Total Issued Shares (mn)	2,181

Source: Bloomberg

Shareholding Structure

Eternal Heart Holding	43.0%
Warm Sunshine	8.7%
Ling Long Holding	8.6%

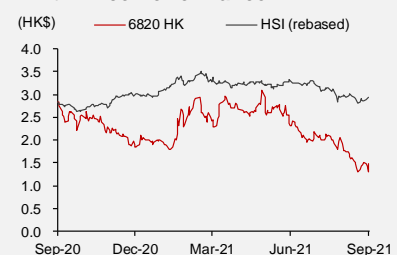
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-36.6%	-36.7%
3-mth	-44.9%	-37.6%
6-mth	-48.0%	-41.2%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: KPMG

Related Reports

- Attractive valuation with new games to come – 24 Mar 2021
- Looking beyond 1H20 earnings – 2 Sep 2020
- Investments to enrich category – 7 Jul 2020

Figure 1: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,737	2,094	2,371	2,844	3,416	3,994	-38.9%	-38.7%	-40.6%
Gross Profit	1,159	1,399	1,584	1,851	2,231	2,608	-37.4%	-37.3%	-39.3%
Operating Profit	336	464	559	654	828	1,004	-48.7%	-44.0%	-44.4%
Adj. net profit	310	421	503	607	766	928	-49.0%	-45.1%	-45.8%
Adj. EPS (RMB)	0.14	0.19	0.23	0.28	0.35	0.42	-49.0%	-45.1%	-45.8%
Gross Margin	66.7%	66.8%	66.8%	65.1%	65.3%	65.3%	+1.6ppts	+1.5ppts	+1.5ppts
Operating Margin	19.3%	22.1%	23.6%	23.0%	24.2%	25.1%	-3.7ppts	-2.1ppts	-1.6ppts
Adj. net margin	17.8%	20.1%	21.2%	21.3%	22.4%	23.2%	-3.5ppts	-2.3ppts	-2.0ppts

Source: CMBIS estimates

Figure 2: CMBIS estimates vs consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	1,737	2,094	2,371	2,695	3,367	4,092	-35.5%	-37.8%	-42.1%
Gross Profit	1,159	1,399	1,584	1,808	2,259	2,744	-35.9%	-38.1%	-42.3%
Operating Profit	336	464	559	652	829	1,054	-48.5%	-44.1%	-47.0%
Adj. net profit	310	421	503	596	759	956	-48.1%	-44.6%	-47.4%
Adj. EPS (RMB)	0.14	0.19	0.23	0.27	0.35	0.44	-48.4%	-45.0%	-47.9%
Gross Margin	66.7%	66.8%	66.8%	67.1%	67.1%	67.1%	-0.4ppts	-0.3ppts	-0.3ppts
Operating Margin	19.3%	22.1%	23.6%	24.2%	24.6%	25.8%	-4.9ppts	-2.5ppts	-2.2ppts
Adj. net margin	17.8%	20.1%	21.2%	22.1%	22.5%	23.4%	-4.3ppts	-2.5ppts	-2.1ppts

Source: CMBIS estimates, Bloomberg

Figure 3: FriendTimes' 1H21 review

RMB ('000), Dec-YE	1H20	1H21	YoY
Revenue	1,050,260	833,007	-21%
Cost of sales	(361,351)	(272,705)	
Gross profit	688,909	560,302	-19%
Sales and marketing expenses	(379,030)	(280,810)	
Research and development expenses	(130,694)	(178,181)	
General and administrative expenses	(21,680)	(31,340)	
Other income	17,646	11,676	
Operating (loss)/profit	175,151	81,647	-53%
Finance costs	(50)	(11)	
Share of loss of an associate	(175)	(1,733)	
Changes in fair value of equity investment measured at fair value through profit or loss	(2,734)	2,212	
Profit before taxation	172,192	82,115	-52%
Income tax expense	(9,076)	48,176	
Profit for the year	163,116	130,291	-20%
Adj. profit for the year	163,116	156,037	-4%

Margin Analysis

Gross margin	66%	67%
Operating margin	17%	10%
Adj. net margin	16%	19%

Growth Analysis

Revenue	35%	-21%
Gross profit	39%	-19%
Operating profit	9%	-53%
Adj. net profit	9%	-4%

Source: Company data

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	1,689	2,182	1,737	2,094	2,371
Games	1,689	2,182	1,737	2,094	2,371
Others	-	0	0	0	0
COGS	(587)	(714)	(579)	(695)	(787)
Gross profit	1,102	1,468	1,159	1,399	1,584
S&M	(393)	(612)	(513)	(618)	(688)
R&D	(224)	(265)	(278)	(304)	(344)
G&A	(62)	(46)	(69)	(63)	(47)
Other income	24	(2)	37	49	54
Operating profit	447	543	336	464	559
Finance costs	(0)	(0)	(2)	(6)	(9)
Other gains, net	(8)	(16)	(0)	0	0
Pre-tax Income	438	527	334	458	550
Income Tax	(23)	(23)	(50)	(69)	(82)
MI	-	-	-	-	-
Net profit	416	504	283	389	467
Adj. net profit	416	504	310	421	503

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Pre-tax Income	438	527	334	458	550
D&A	13	11	12	52	53
Change in WC	(51)	(21)	(50)	(13)	(10)
Others	(59)	59	(61)	(89)	(104)
Operating CF	342	575	234	408	489
Capex	(139)	(77)	(60)	(60)	(60)
Others	(96)	(51)	14	26	30
Investing CF	(236)	(128)	(46)	(34)	(30)
Equity raised	500	-	0	0	0
Change of debts	-	-	48	48	48
Others	(181)	(222)	(2)	(6)	(9)
Financing CF	319	(222)	46	42	39
Net change in cash	425	225	233	416	498
Cash (beg of yr)	473	893	1,093	1,327	1,743
FX	(4)	(25)	0	0	0
Cash (end of yr)	893	1,093	1,327	1,743	2,241

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	246	388	447	455	462
Fixed asset	202	264	326	336	344
Right-of-use assets	9	8	6	5	4
Intangible assets	8	4	1	1	1
Others	28	113	113	113	113
Current assets	1,265	1,404	1,621	2,073	2,599
Cash	893	1,093	1,327	1,743	2,241
Trade receivables	219	181	156	188	213
Other current assets	153	130	138	141	144
Current liabilities	196	221	192	259	322
Bank loans	-	-	48	96	144
Trade and other payables	135	143	23	28	31
Lease liabilities	3	1	1	1	1
Other current liabilities	58	77	119	134	145
Non-current liabilities	9	5	16	19	21
Contract liabilities	9	5	16	19	21
Lease liabilities	-	-	-	-	-
Others	-	-	-	-	-
Total Equity	1,307	1,566	1,861	2,250	2,717

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Games	100.0	100	100.0	100.0	100.0
Others	0.0	0.0	0.0	0.0	0.0
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	15.3	29.2	(20.4)	20.5	13.2
Gross profit	20.0	33.2	(21.1)	20.7	13.2
EBIT	23.0	21.5	(38.1)	38.0	20.5
Net profit	23.4	21.2	(38.5)	35.8	19.6
P&L ratios (%)					
Gross Margin	65.2	67.3	66.7	66.8	66.8
Pre-tax margin	25.9	24.1	19.2	21.9	23.2
Adj. net margin	24.6	23.1	16.3	18.6	19.7
Effective tax rate	5.2	4.4	15.0	15.0	15.0
Returns (%)					
ROE	31.8	32.1	15.2	17.3	17.2
ROA	27.5	28.1	13.7	15.4	15.3
Adj. EPS (RMB)	0.19	0.23	0.14	0.19	0.23
DPS (RMB)	-	0.12	0.10	0.05	0.10
BVPS (RMB)	0.59	0.71	0.85	1.02	1.24

Source: Company data, CMBIS estimates

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