

# China Internet Sector

## Embracing a new normal of regulation

We are positive on internet momentum ahead, with sector regulation overhang gradual to lift, well-guided financials and attractive valuation (19x FY22E P/E). Although detailed policies are yet over (or lasting 3-6 months), we believe most worst-case scenarios have been priced in, and market has accepted the new normal of regulation. 4Q21 would be a good timing to accumulate the key names (Meituan, Tencent, NetEase) over a 12-month horizon, as we expect sector sentiment will be boosted by: 1) ecommerce to bottom out in 3Q21E; 2) upcoming game licenses resumption; and 3) solid FY22E outlook with easy base. Risk reward is favorable currently, given limited valuation & earnings downside. Our pecking order: Meituan > Tencent > NetEase > PDD > BABA > BILI > Kuaishou > Zhihu; Top pick: Meituan.

- Where are we?** After nearly one-year regulation cycle, we believe the market has factored in much of the policies headwinds, including anti-trust law, data security, minor protections, content supervision and social responsibility. China Internet stocks' prices have corrected 45% from Feb's peak, mainly on tightening regulations, intensified competition and traffic normalization to weigh on its organic growth and LT margin outlook. Looking ahead, we believe the fundamental valuation floor has been built, with top frame of regulations competed. More detailed regulatory measures might continue, but are well anticipated by the market. Sector valuation at 18x FY22E P/E (close to 5-year historical trough) is attractive, and we suggest to buy the dips.
- What to expect in 3Q21E & FY22E?** Sector sentiment will be further boosted by: 1) ecommerce to bottom out in 3Q21E; 2) upcoming game licenses resumption; and 3) strong seasonality for consumer internet in 4Q21E. We expect sector to see re-rating in FY22E, given gradual regulation easing and solid growth outlook with easy base. We forecast industrial earnings growth at 26% CAGR in FY21-23E. Games would see multiple key titles to launch in FY22E, while consumer internet would see further upside from CGP and livestreaming ecommerce. In the long run, suggest to eye on three thesis: 1) Gen Z; 2) short video; and 3) CGP.
- Selective in upcoming sector re-rating.** Our pecking order of consumer internet is: Meituan > PDD > BABA, while entertainment preference is: Tencent > NetEase > Bilibili > Zhihu, supported by their intact fundamentals.

### Valuation Table

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Rating	CMBI TP	PE			PS		
							FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
<b>China Internet Giants</b>												
Tencent	700 HK	579,888	HKD	470	BUY	640	27.7	22.9	19.0	6.4	5.4	4.6
Alibaba	BABA US	446,731	USD	165	BUY	255	18.1	15.2	12.4	3.1	2.6	2.2
Baidu	BIDU US	56,587	USD	163	BUY	248	18.9	15.6	12.2	2.9	2.5	2.2
JD	JD US	125,187	USD	80	NA	NA	58.2	38.4	24.4	0.8	0.7	0.6
Meituan	3690 HK	221,138	HKD	281	BUY	383	NA	NA	81.8	7.8	5.6	4.3
Pinduoduo	PDD US	108,623	USD	87	BUY	175	NA	74.5	32.2	6.4	4.5	3.4
NetEase	NTES US	67,957	USD	101	BUY	120	24.2	20.8	17.8	5.0	4.3	3.8
Didi	DIDI US	39,744	USD	8	NA	NA	75.9	NA	52.7	1.3	1.1	0.9
Kuaishou	1024 HK	51,516	HKD	96	BUY	110	NA	NA	NA	4.1	3.0	2.3
Average							37.2	31.2	31.5	4.2	3.3	2.7
<b>Pan-entertainment</b>												
Bilibili	BILI US	29,012	USD	75	BUY	110	NA	NA	NA	9.6	6.7	4.9
Kuaishou	1024 HK	51,516	HKD	96	BUY	110	NA	NA	NA	4.1	3.0	2.3
Zhihu	ZH US	4,756	USD	8	BUY	15	NA	NA	NA	10.3	5.6	3.4
Average							28.0	23.6	19.0	5.4	3.8	2.9
Average							22.2	18.6	17.2	5.3	3.8	3.0

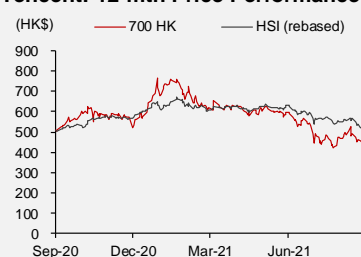
Source: Company data, Bloomberg, CMBIS estimates; outliers excluded from PE average

**OUTPERFORM**  
(Maintain)

### China Internet Sector

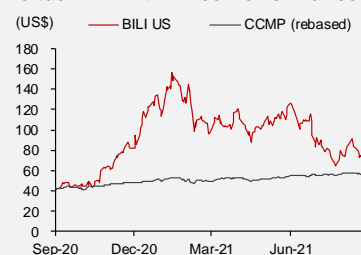
**Sophie Huang**  
 (852) 3900 0889  
 sophiehuang@cmbi.com.hk

#### Tencent: 12-mth Price Performance



Source: Bloomberg

#### Meituan: 12-mth Price Performance



Source: Bloomberg

## A new normal of regulation

### Regulation tightening yet over, but almost priced in.

After near one-year regulation cycle, we believe the market has factored in much of the policies headwinds, including anti-trust law, data security, minor protection, content supervision and social responsibility. China Internet stocks' prices have corrected 45% from Feb's peak, mainly on tightening regulations, intensified competition and traffic normalization to weigh on its organic growth and LT margin outlook. Looking ahead, we believe the fundamental valuation floor has been built, with top frame of regulations competed. More detailed regulatory measures might continue, but are well anticipated by the market.

**Near term: data security would be ongoing regulation priority.** With gradual fruits from anti-trust and minor protection measures in past few months, strengthening data security would be ongoing priority, including industry data classification, data security supervision, and critical information infrastructure identification. Market concerns lie on three themes: 1) cross-border data issue; 2) Fintech data supervision; and 3) PIPA<个人信息保护法> and algorithmic recommendation management. We expect tightening data security would pose profound impact on apps' operation and ads attribution, targeting & modelling, which might hurt ads sentiment & Fintech short-term sentiment but impact manageable. In the long run, it would be meaningful to promote the regulated development of digital economy.

**Longer term: core internet margin will be limited by taking more social responsibility.** We expect valuation rationality & LT margin visibility to be key topics in 2022E, under a new normal regulation. Despite potential mild margin recovery ahead, core internet margin would be limited by taking more social responsibility, tightening regulation and intensifying competition in the long run, thus affecting its earnings growth outlook. However, earnings sustainability remains intact. Core internet margin dilution might lead to slightly lower multiple, but current sector valuation (18x FY22E P/E, at 5-year historical trough) is not demanding, considering estimated industrial earnings growth at 26% CAGR in FY21-23E.

**Figure 1: Regulation glance**

	Subsector	Antitrust	Data security/Algorithms	Social welfare	Minors protection	Content regulation
<b>E-commerce</b>	Ecommerce	√	√	√		
	Livestreaming ecommerce				√	√
	OTA		√			
	Local Life	√	√	√		
<b>Online Entertainment</b>	Gaming				√	√
	LFV				√	√
	SFV		√		√	√
	Livestreaming				√	√
	Online Music	√				√
<b>Ads</b>	Ads		√			√

Source: CMBIS

## Eyes on game license resumption, short video sharing gain and CGP momentum

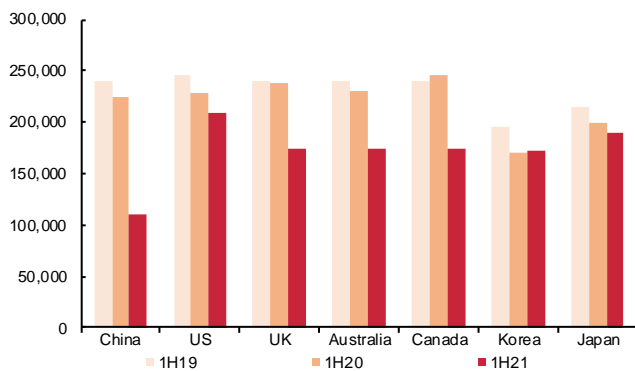
Game to see further upside from new titles, with license resumption as ST catalyst

**Near term: Initial success from new key titles to boost 4Q21E recovery.**

We believe 3Q21E soft game momentum was well anticipated by the market, with limited new titles, tough base and teenage gaming anti-addiction. In the near term, we expect game sentiment to be boosted by: 1) upcoming license approval; and 2) new titles to drive 4Q21E acceleration.

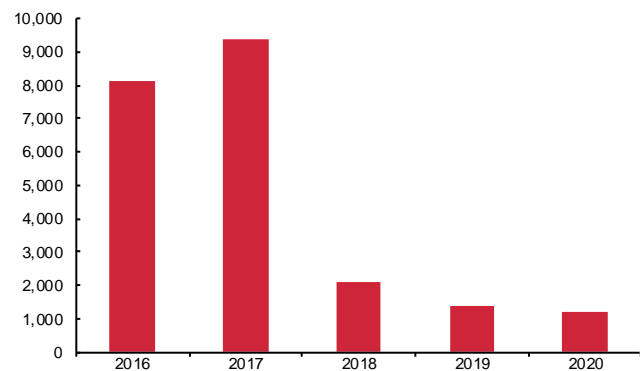
For the license, we expect the pending period would not be worse than 2018 case (from 29 Mar to 19 Dec). Top players (Tencent and NetEase) could be relatively defensive given their strong licensed game reserve. We expect limited financial impact from license pressure, as key titles of Tencent and NetEase have already got approvals. Specifically, Happy Potter (NetEase) and LoLM (Tencent) launched on 9 Sep and 8 Oct, respectively, and the other top titles, Diablo Immortal and DnFM (both with license), are expected to launch in 2022.

**Figure 2: Number of mobile games in App Store**



Source: Qimai

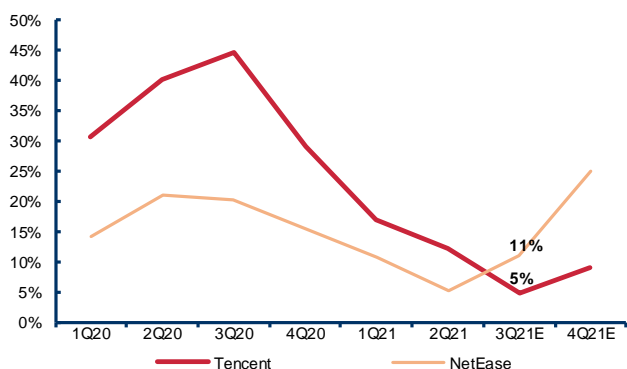
**Figure 3: Number of approved game licenses**



Source: SAPPRFT

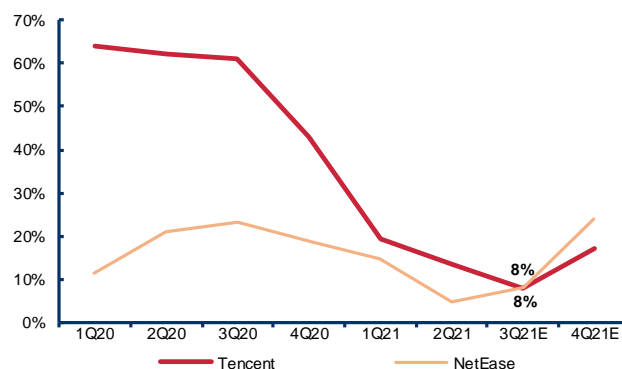
**4Q21E would see grossing rebound for TOP2 players. For Tencent,** we expect strong LoLM to drive its 4Q21 game momentum. LoLM ranked TOP2 in iOS grossing rank after its launch on 8 Oct, and we estimate its first monthly grossing at RMB1.5bn. Coupled with overseas contribution, we expect 4Q21E games rev +9% YoY (vs. +5% YoY in 3Q21E). **For NetEase,** Harry Potter ranked TOP1/2 in its first month after launch, and kept stable at TOP2-7 in 2nd month. We estimate its grossing in first month/4Q21E at RMB1.5bn/RMB2.5bn, to boost 4Q21E game rev +25% YoY.

Figure 4: 3Q21E game growth of TOP2 platforms



Source: Company data, CMBIS estimates

Figure 5: Mobile game growth of TOP2 platforms



Source: Company data, CMBIS estimates

### Longer term: A strong product cycle ahead, with stepping up overseas expansion.

After traffic normalization, we expect game industry growth to be driven by product cycle and overseas expansion, as China's gaming population growth tapering off in 2020.

We anticipate the major trends in the game industry in the near term to be: 1) game premiumization, 2) stepping-up overseas expansion, 3) stable competition landscape with duopoly; and 4) heightened focus on minor protection.

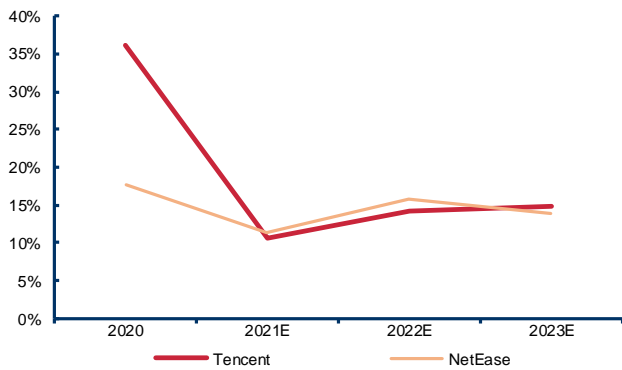
We expect top-tier players and emerging boutique to benefit from game premiumization. The premiumization trend is substantiated by limited game licenses, slower gaming population growth, and technology advancement. We believe game development will require higher investment and longer production cycle, pressuring long-tail CPs. In terms of profitability, potential higher rev sharing for CPs in the long run would improve CP's margin.

For top players, both Tencent and NetEase have strong pipeline in 2022 to strengthen its market position, with focus on IP titles and mobile versions of MMORPG/MOBA.

**Tencent:** Key new titles include LoLM (2021) and DnFM (2022E). We expect these two titles to contribute annual grossing of RMB20bn. On the other hand, international games would see higher rev mix (forecasting 22% of total mobile game rev in FY22E, up from 19% in FY21), backed by solid PUBG and stepping-up overseas M&A.

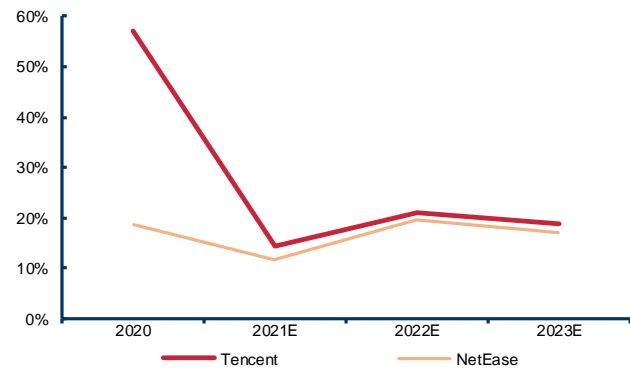
**NetEase:** Key new titles include Harry Potter: Magic Awaken (2021), Diablo: Immortal (2022E), Justice Mobile <逆水寒> (2022E), LoR: Rise to War <指环王> (2022E or later). We expect HP and Diablo to deliver 21% of total mobile grossing in FY22E. NetEase bore initial fruits in Japan and Korea expansion, and would step up overseas presence into European & US markets. Through localization and differentiated product offerings, NetEase's Knives Out and Identity V gained tractions in Japan and Korea. Backed by popular global IPs (e.g. Harry Potter, Diablo), we believe NetEase can leverage such capabilities in other markets. Mgmt target its international games to contribute 50% of total game rev in the long run (30% in 3-5 years), from 10% in 2021E.

Figure 6: Games YoY growth of TOP2 platforms



Source: Company data, CMBIS estimates

Figure 7: Mobile game YoY growth of TOP2 players



Source: Company data, CMBIS estimates

Figure 8: Key titles in pipeline for major game companies

Company	Game	Type	Release	Details
Tencent	LoL Mobile	MOBA	8 Oct 2021	Top 1 MOBA端游
	DNF Mobile	RPG	2022	
	Dawn Awakening <黎明觉醒>	SOC	TBC	Lightspeed & Quantum Studio (developer of Peacekeeper Elite)
NetEase	Harry Potter: Magic Awaken	RPG	9 Sep 2021	Harry Potter IP game
	Diablo: Immortal	ARPG	2022	Based on Blizzard's PC/console game; beta tested on 15 Jul 2021
	Justice Mobile <逆水寒>	MMORPG	2022	First beta testing in Aug 2021
	LoR: Rise to War	SLG	2022	
CMGE	Dynasty Warriors <真三国无双霸>	ARPG	5 Aug 2021	IP from Japan's Koei; distributed by Tencent
	All Star Battle <全明星激斗>	ARPG	2022	SNK IP; distributed by ByteDance
	Legends of Sword and Fairy 7 <仙剑奇侠传 七>	MMORPG	15 Oct 2021	Based on PC game IP; available on multiple platforms

Source: Company data, TapTap

### Online gaming 3Q21E preview

**Tencent:** We expect Tencent to deliver largely in-line 3Q21E, with rev/adj. net profit +15%/0% YoY, 2%/0% below consensus. We believe the market has well anticipated games deceleration (forecasting +5% YoY), given limited new titles, tough base and teenage gaming anti-addiction. Suggest to move into 4Q21E game momentum, with strong LoLM performance (ranked TOP2 in iOS grossing). We estimate LoLM to generate annual grossing of RMB10bn, contributing 2%/4% of FY21/22E mobile game rev. FBS would be solid (rev +32% YoY), to partly offset soft ads (forecasting +13% YoY in 3Q21E). With sector regulation overhang to gradual lift, we believe market focus would shift to its fundamentals. Prudent 3Q21E has been priced in, and we expect Tencent to see re-rating in a 6-month horizon, with upcoming catalysts and better outlook in FY22E. We keep our financials largely unchanged, and maintain our TP at HK\$640 (31x FY22E P/E).

**NetEase:** 3Q21E would be mild, with estimated topline/bottom line +15%/-2% YoY. By segment, game/ Youdao/ others rev +11%/70%/20% YoY in 3Q21E, in our estimates. We believe market would focus more on its 4Q21E trend with strong HP, rather than 3Q21 earnings (limited HP contribution). We estimate 4Q21E mobile games to accelerate to +25% YoY, from 11% in 3Q21E, in which HP to deliver grossing at RMB1.5bn in its first month, and contribute 3% of total mobile grossing in 4Q21E. 3Q21E PC would see eye-catching performance (forecasting +25% YoY), with strong Naraka <永劫无间> sales (forecasting RMB2bn grossing in 3Q21E). Margin would be slightly diluted by investment loss, but well acceptable. Maintain BUY, with SOTP-based TP of US\$123.

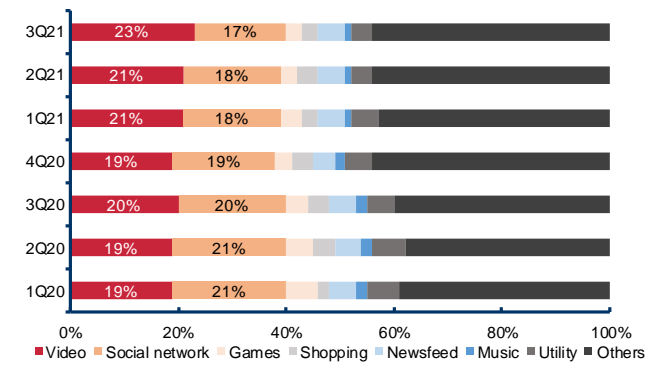
### Short/middle videos to continuously gain share

Online entertainment sector has stepped into a relatively mature stage, with traffic normalization and tightening content regulation. **We suggest to keep selective in pan-entertainment, and suggest to eye on short & middle video platforms (Douyin, Kuaishou, Bilibili),** which continuously gain share on user time spent. We turn more prudent on long-videos, traditional livestreaming and music players, which are limited by soft user trend, higher competition pressure, heavier content cost with lower ROI and regulation tightening (e.g. minor protection, content regulation).

For short & middle video platforms, we expect Kuaishou/Bili/Zhihu to deliver upbeat 3Q21E, with solid user metrics and financials, supported by seasonality, Olympics events and higher marketing efficiency. Kuaishou/Bili/Zhihu MAU +12%/32%/39% in 3Q21E, in our estimates. Monetization on track (Kuaishou/Bili/Zhihu rev +30%/62%/112% in 3Q21E), while margin would be better-than-feared.

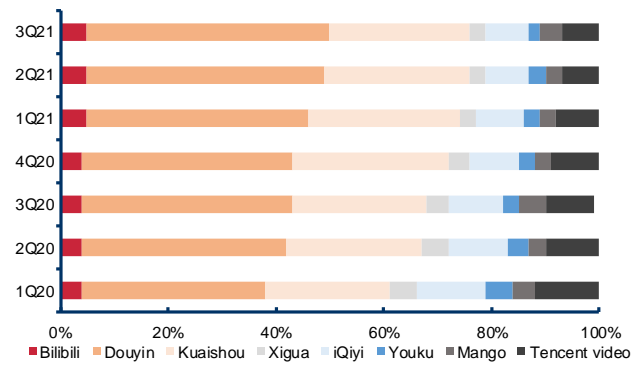
In the long run, key short & middle video platforms put priority on user expansion, content enhancement and monetization diversification. We expect fierce competition to continue in FY22E, with high content cost and heavier S&M efforts. Key platforms will still stay net loss position in FY22E, but with better margin outlook (forecasting Kuaishou/Bilibili/Zhihu to breakeven in FY25/27/23E). We forecast Kuaishou/Bili/Zhihu MAU up to 557mn/314mn/128mn, +5%/28%/34% YoY in FY22E, while rev +17%/41%/87% YoY.

Figure 9: Video at TOP1 segment in time spent



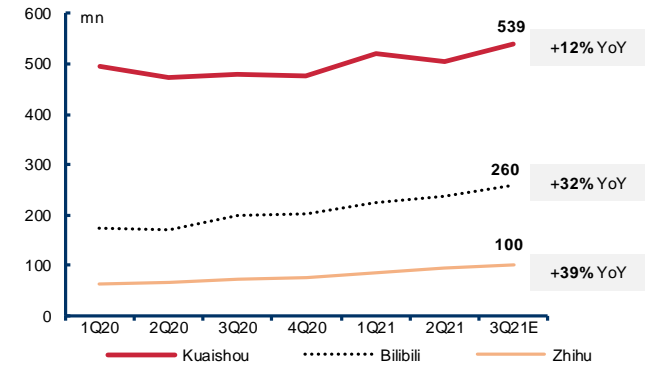
Source: QuestMobile

Figure 10: SFV & MFV to gain share in time spent



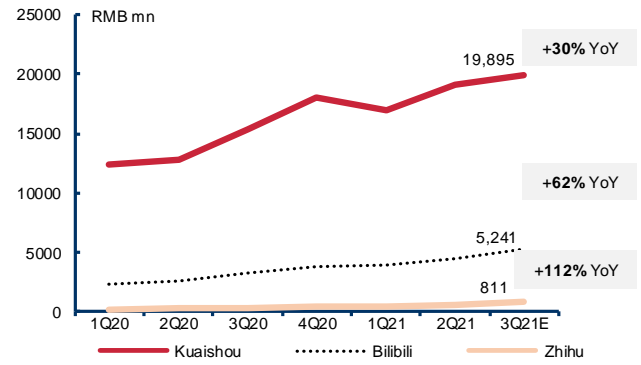
Source: QuestMobile

Figure 11: 3Q21E MAU estimate of key platforms

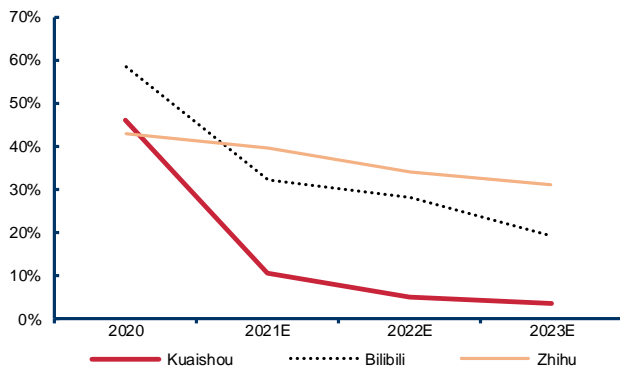


Source: Company data, CMBIS estimates

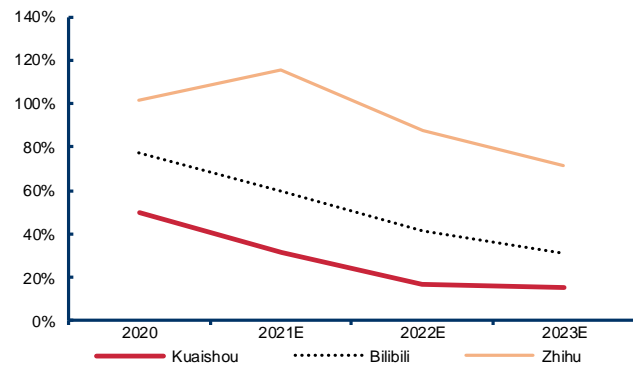
Figure 12: 3Q21E rev estimate of key platforms



Source: Company data, CMBIS estimates

**Figure 13: MAU YoY growth of key platforms**

Source: Company data, CMBIS estimates

**Figure 14: Rev YoY growth of key platforms**

Source: Company data, CMBIS estimates

**Online entertainment 3Q21E preview**

**Kuaishou:** We expect Kuaishou to deliver solid 3Q21 results, with better-than-expected user metrics & margin, while topline to stay on track. DAU (+18% YoY) and time spent would pick up in 3Q21E, thanks to summer holiday seasonality, Olympics events and higher user acquisition efficiency. We expect 3Q21E rev +30% YoY, in which live streaming /ads/ ecommerce -5%/+72%/+40% YoY. Despite 4ppts QoQ drop in GPM, adj. NPM would be better than previous guidance due to improving S&M efficiency. We keep our full-year rev forecast unchanged but slightly raise its margin by 1.5/0.5ppts in FY21/22E, with higher TP at HK\$136. Valuation at 3.0x FY22E P/S is relatively attractive (50% discount to Bili).

**Bilibili:** 3Q21E momentum would be on track, with rev +62% YoY and bottom line at -RMB1.7bn. By segment, game/ ads/ VAS rev +13%/129%/87% YoY in 3Q21E, in our estimates. We expect its MAU up 32% YoY to 260mn, backed by effective user expansion and seasonality. Games would be moderate in 3Q21E, with strong jointed distributed titles (e.g. Harry Potter) to offset limited new titles and tightening regulations. Overseas expansion and existing games would be near-term driver, given pending license approval. Ads momentum continued (forecasting +129% YoY), despite challenging ads environment. GPM will drop 2ppts QoQ, but well priced in. We keep our financials largely unchanged, with TP at US\$110.

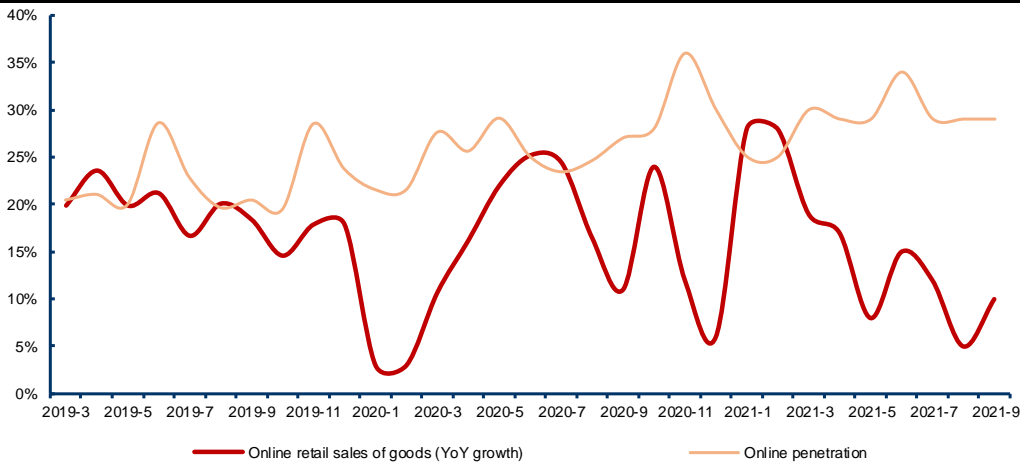
**Zhihu:** We expect Zhihu to deliver solid 3Q21E results, with rev +112% YoY (in line with consensus) and net loss at RMB166 (vs. consensus at -RMB224mn). MAU would reach 100mn (+39% YoY) for the first time, with higher time spent and user acquisition efficiency. Despite soft ads environment and moderate season, we believe Zhihu's CCS would still trend well in 3Q21E (rev +6x YoY, with rising clients and CPC) and momentum will continue in 4Q21E given strong ecommerce campaign. Prudent traditional ads (+10% QoQ in 3Q21E) was well anticipated by the market. We keep our annual topline largely unchanged with DCF-based TP at US\$15.

## Ecommerce to bottom out, with CGP as LT driver

### Moving into 4Q21 strong seasonality, with eyes on “11.11”.

We expect ecommerce growth to recover in 4Q21E, with strong seasonality. Online retail sales of goods rebounded to +10% YoY in Sep 2021 (vs. +8% YoY in Aug), with higher online retail penetration (+1ppts MoM). By category, online food and apparel sales still bear pressure, while cosmetics, Electronics & appliances, Mobile & communications sales rebounded. “11.11” would relatively boost consumption willing and drive 4Q21 recovery, with initial eye-catching performance of livestreaming ecommerce in pre-sale period.

**Figure 15: Online retail sales YoY growth**



Source: NBS, CMBIS

### Expecting GMV at double-digit growth in FY22E.

Looking ahead, we expect China ecommerce GMV +16% YoY in FY22E (targeting 6% CAGR in FY21-25E, according to MOFCOM<商务部>), in which PDD and short video platforms continue to gain share. Key drivers would derive from: 1) deeper penetration from lower tier cities, e.g. Jingxi, Taobao Deal; 2) livestreaming initiatives; and 3) cross-selling and stronger engagement from CGP.

Market would focus on three key thesis: 1) impact from dismantling walled gardens; 2) the evolution of competition landscape; and 3) livestreaming & content ecommerce momentum.

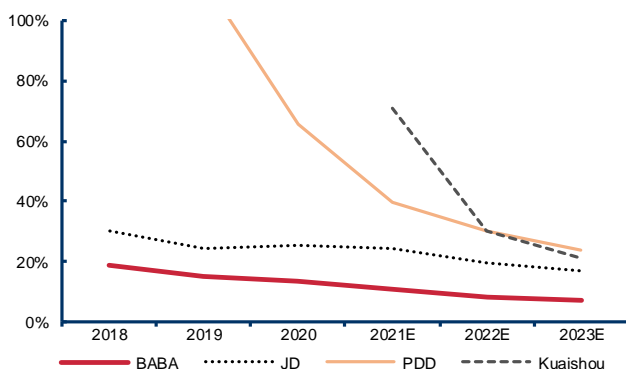
- **Walled garden impact needs more time to reflect.** With dismantling walled gardens, we expect BABA (esp. Taobao Deal) to benefit from incremental traffic and improved user experience in the short term. However, we should note that Taobao and WeChat are not fully integrated, creating hurdles to convert WeChat users to Taobao buyers. While WeChat users can open JD/PDD links and shop with their WeChat accounts, they cannot purchase Taobao items without logging into their Taobao accounts. In the long run, there is also tradeoff between incremental traffic and merchants ads into private domain.
- **Competition landscape: PDD and short video platforms continue to gain share.** In FY22E, we forecast BABA/JD/PDD GMV +8%/20%/30% YoY, while Bytedance/Kuaishou to contribute 13% of total GMV (forecasting +31% YoY). BABA would see some benefit from Taobao Deal and dismantling walled gardens, but still with rising competition pressure. PDD would be the fastest player (among traditional platforms). We expect it to leverage CGP initiatives to boost purchase frequency (+5% YoY), while ARPU see large upside (forecasting +20% YoY, still at 30% of that BABA) despite short-term dilution from CGP. Bytedance & Kuaishou's GMV ramped up quickly, with total GMV close to PDD, in our estimates. We see high visibility for ecommerce sector



to deliver slight margin improvement in FY22E, backed by operating leverage & narrowing loss of new biz to offset continuous social responsibility cost.

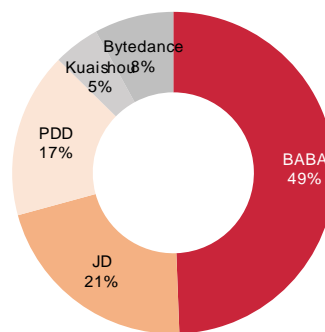
- **Eyes on livestreaming & content ecommerce momentum.** We expect market focus shift to livestreaming & content ecommerce trend, with key platforms' potential listing. Short video platforms would prioritize on brand merchant expansion, bettering targeting, offering enrichment and hosts initiatives.

**Figure 16: China ecommerce GMV YoY growth**



Source: Company data, Bloomberg, CMBIS estimates  
Notes: BABA GMV refers to estimated Taobao+Tmall GMV in fiscal year

**Figure 17: Top players' mkt share (by GMV) in 2022E**



Source: Company data, CMBIS estimates

## CGP still in high growth trajectory, with accelerated consolidation and improving UE.

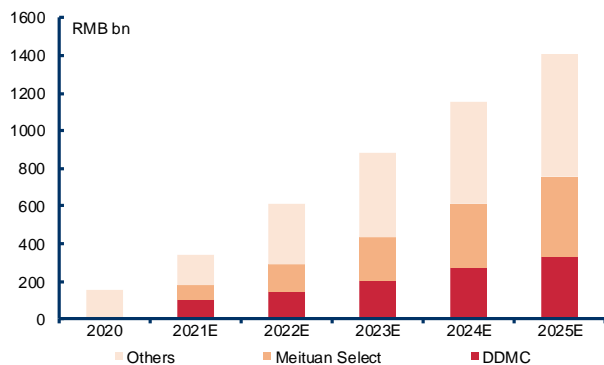
**Heading into 4Q21E CGP seasonality.** In Sep, average daily orders of tier 1 players reached 30mn in Sep (based on channel check), suggesting sequential growth in 3Q21E (double-digit QoQ growth), despite slower expansion pace (in line with tightening regulations). We suggest to move into 4Q21E CGP strong seasonality, with better UE and rising orders to continue.

**Battle continues, but user experience & fulfillment matters more than subsidies.** For landscape evolving, CGP tends to see accelerating consolidation (e.g. the close of Tongcheng Life), given heavier financial pressure amid intensified competition and regulation tightening. Despite Jingxi and Taocaicai stepped up their investment in CGP, we don't expect those players to threaten Meituan & PDD's leadership. In the next 2-3 years, the players will develop regional advantage and repetitively gain share from each other. Battle continues, but user experience & fulfillment matters more than subsidies.

**Expecting Meituan Select and DDMC to be major dominators eventually.** We expect Meituan Select and DDMC to lead the market in the long run, accounting for 50%-60% market share (in our estimate). Meituan excelled itself with outstanding execution and offline BD network, franchisees and grid warehouses, while DDMC can use second-tier brands and money-for value products to penetrate lower cities, with advantages in: 1) main app's traffic support, 2) cost savings of agricultural products, and 3) efficient, youthful teams.

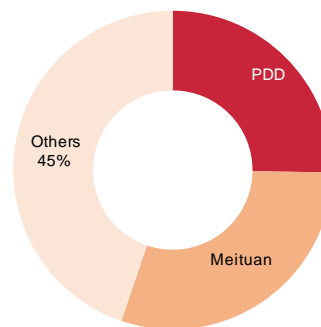
Both Meituan Select and DDMC performed well (similar daily orders and trend), and each with an ace card. But we expect Meituan should benefit more from CGP, since Meituan could leverage CGP to enter into e-commerce ecosystem (as a new driver), while DDMC aims to boost the repurchase rate on its main app (as existing driver).

**Figure 18: CGP GMV YoY growth**



Source: Industry data, CMBIS estimates

**Figure 19: Top players' mkt share (by GMV) in 2025E**



Source: CMBIS estimates

**Figure 20: Operation metrics of key CGP players**

	FY21E GMV (RMB bn)	Average Daily Orders (3Q21E) (mn)	Unit Price (RMB) (RMB)
DuoDuo MaiCai	98	26~30	9
Meituan Select	84	26~30	7.5
Xingsheng Select	NA	10~13	~12

Source: expert insights and channel check, CMBIS

### Ecommerce & lifestyle 3Q21E preview

**BABA:** We expect 2QFY22 rev/ adj. net profit +33% YoY/-27% YoY, in which core commerce/ cloud/ DME rev +35%/29%/9% YoY and adj. EBITA margin at 14%. 2QFY22E CMR deceleration to continue (forecasting +7% YoY), with soft consumption amid COVID cases, macro moderation and tightening regulation. Taobao deals and Taocaicai users performed well, but meanwhile would dampen core margin with stepping-up investment. We trimmed our FY22-24E earnings forecast by 1%-2%, with lower TP at US\$255. Despite ST weak macro and market sentiment, we view BABA's valuation as relatively defensive.

**PDD:** We forecast 3Q21 rev +102% YoY, GMV +48% YoY, with adj. net loss at RMB0.8bn (vs. consensus RMB0.2bn). GMV trends well, backed by solid non-discretionary growth, rising user engagement and repurchasing rate. Given more aggressive user acquisition & cold chain establishment, PDD would see quarterly margin volatility (net loss in 3Q21E), but is well anticipated by the market. We believe 2Q21 convinced investors of its long-term profit visibility. DDMC's daily orders climbed up to ~30mn in Sep (+14% QoQ), with OPM at around -15%, based on expert insights and cross check. In the long run, we keep positive on its CGP potential, by leveraging its advantages in agricultural goods, sizable user traffic, high exposure in low-tier cities and natural synergies with PDD portal.

**Meituan:** Meituan's 3Q21E would be relatively moderate but well-anticipated, limited by COVID-19 resurgence, natural disasters and regulation. We forecast rev +37% YoY (in line with consensus) and bottom line at -RMB5.6bn (vs. consensus of -RMB5.1bn). By segment, food delivery would see rev deceleration (+26% YoY) and margin volatility (OPM at 3%) with higher subsidies in 3Q21E, but was well-guided. New social insurance would also be acceptable. COVID-19 & flood would pose one-off impact on in-store biz in 3Q21E (forecasting rev +31% YoY, with OPM at 40%), while long-term trend would be intact. We estimate new biz rev +70% YoY, while net loss at RMB10.5bn in 3Q21E (Meituan Select ~RMB7.5bn) with improving UE. We reiterate our confidence on its LT organic growth with high barrier, and view its ST headwinds manageable. We keep our financials largely unchanged, and maintain our TP of HK\$383. Suggest to buy the dips with regulatory overhang to lift.

## Selective in upcoming sector re-rating

### Good entry point in 4Q21, with favourable risk reward.

We expect sector to see re-rating in FY22E, given gradual regulation easing and solid growth outlook with easy base. We forecast industrial earnings growth at 26% CAGR in FY21-23E. Sector sentiment will be further boosted by: 1) ecommerce to bottom out in 3Q21E; 2) upcoming game licenses resumption; and 3) strong seasonality for consumer internet in 4Q21E. Sector valuation was trading at 18x FY22E P/E, close to 5-year historical trough. Risk reward is favorable, and suggest to buy the dips.

### Prefer consumer internet, in which Meituan still as Top Pick.

Given traffic normalization and intensified competition, we believe subsectors or companies continued to diverge from each other. We suggest to keep selective in upcoming sector re-rating. By segment, we prefer consumer internet > short/middle video > games > ads, while cautious on traditional livestreaming and long-form video.

Our pecking order of consumer internet is: **Meituan > PDD > BABA**, while entertainment preference is: **Tencent > NetEase > Bilibili > Kuaishou > Zhihu**, supported by their solid 3Q21E outlook and intact fundamentals. Our top pick is **Meituan**, given: 1) 40% FY20-23E rev CAGR with expanding TAM; 2) strong high barrier and competitive advantage in local life and digital operation; 3) new initiatives (e.g. CGP, ride hailing) to unlock valuation; and 4) high LT margin visibility with UE enhancement. We believe near-term concerns have been priced in and more prudent monetization outlook was well-guided. 4Q21 would be a good entry point, for attractive valuation and regulatory overhang to lift.

Figure 21: Core Internet P/E band



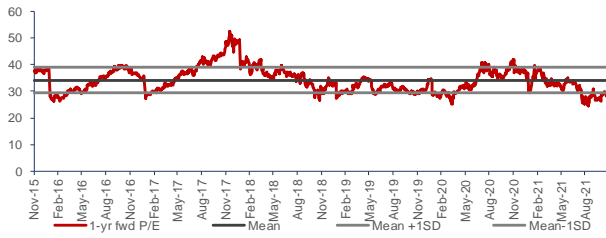
Source: Bloomberg

Figure 22: Core Internet P/S band



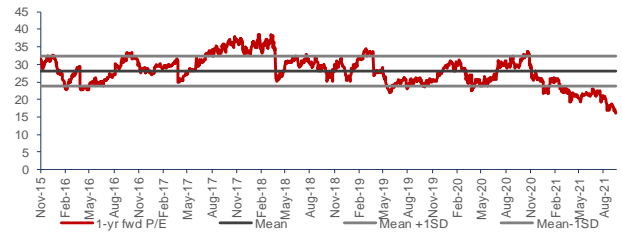
Source: Bloomberg

**Figure 23: Tencent P/E band**



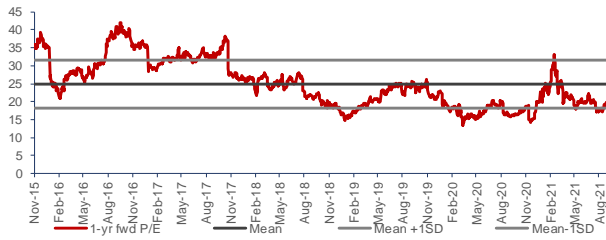
Source: Bloomberg

**Figure 24: BABA P/E band**



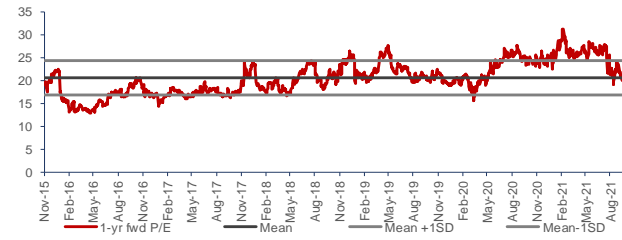
Source: Bloomberg

**Figure 25: Baidu P/E band**



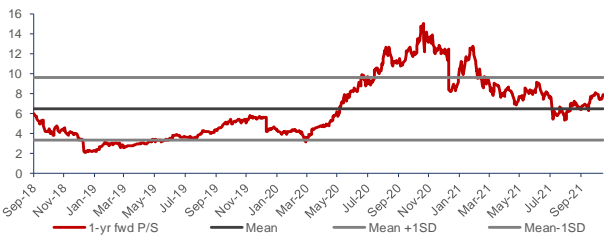
Source: Bloomberg

**Figure 26: NetEase P/E band**



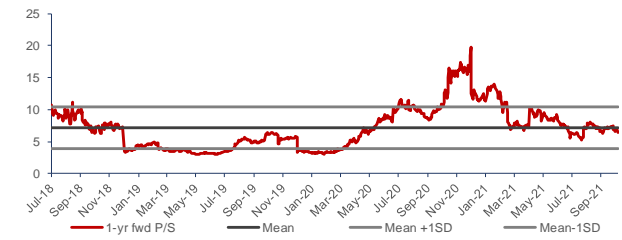
Source: Bloomberg

**Figure 27: Meituan P/S band**



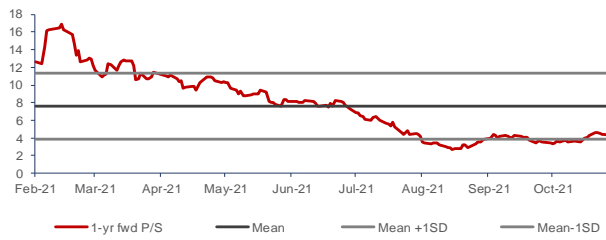
Source: Bloomberg

**Figure 28: PDD P/S band**



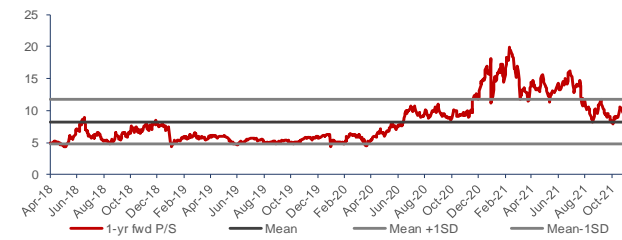
Source: Bloomberg

**Figure 29: Kuaishou P/S band**



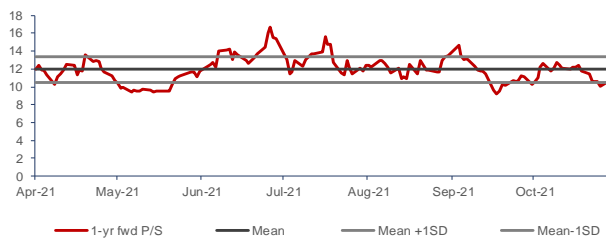
Source: Bloomberg

**Figure 30: Bilibili P/S band**



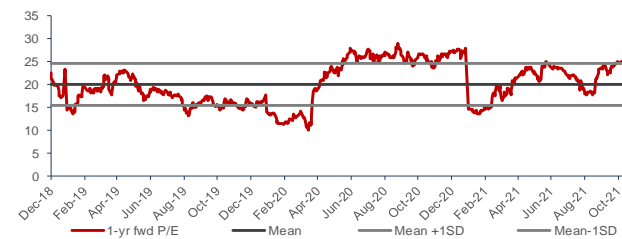
Source: Bloomberg

**Figure 31: Zhihu P/S band**



Source: Bloomberg

**Figure 32: Tongcheng P/E band**



Source: Bloomberg

Figure 33: Peers valuation

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Rating	CMBI TP	PE			PS			EV/EBIT			FY21-23 EPS
							FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	CAGR
<b>China Internet Giants</b>																
Tencent	700 HK	579,888	HKD	470	BUY	640	27.7	22.9	19.0	6.4	5.4	4.6	20.9	19.5	16.5	21%
Alibaba	BABA US	446,731	USD	165	BUY	255	18.1	15.2	12.4	3.1	2.6	2.2	21.9	16.4	12.5	19%
Baidu	BIDU US	56,587	USD	163	BUY	248	18.9	15.6	12.2	2.9	2.5	2.2	21.9	16.6	12.3	22%
JD	JD US	125,187	USD	80	NA	NA	58.2	38.4	24.4	0.8	0.7	0.6	NA	54.4	25.4	52%
Meituan	3690 HK	221,138	HKD	281	BUY	383	NA	NA	81.8	7.8	5.6	4.3	NA	NA	NA	NA
Pinduoduo	PDD US	108,623	USD	87	BUY	175	NA	74.5	32.2	6.4	4.5	3.4	NA	NA	48.7	844%
NetEase	NTES US	67,957	USD	101	BUY	120	24.2	20.8	17.8	5.0	4.3	3.8	23.1	18.8	16.1	16%
Didi	DIDI US	39,744	USD	8	NA	NA	75.9	NA	52.7	1.3	1.1	0.9	NA	NA	NA	NA
Kuaishou	1024 HK	51,516	HKD	96	BUY	110	NA	NA	NA	4.1	3.0	2.3	NA	NA	NA	NA
Average							37.2	31.2	31.5	4.2	3.3	2.7	21.9	25.1	21.9	162%
<b>E-commerce</b>																
Alibaba	BABA US	446,731	USD	165	BUY	255	18.1	15.2	12.4	3.1	2.6	2.2	21.9	16.4	12.5	19%
JD	JD US	125,187	USD	80	NA	NA	58.2	38.4	24.4	0.8	0.7	0.6	NA	54.4	25.4	52%
Pinduoduo	PDD US	108,623	USD	87	BUY	175	NA	74.5	32.2	6.4	4.5	3.4	NA	NA	48.7	844%
Meituan	3690 HK	221,138	HKD	281	BUY	383	NA	NA	81.8	7.8	5.6	4.3	NA	NA	NA	NA
Vipshop	VIPS US	7,607	USD	11	NA	NA	7.6	6.8	5.8	0.4	0.4	0.3	5.5	4.8	4.1	14%
Yatsen	YSG US	1,800	USD	3	NA	NA	NA	NA	NA	1.6	1.2	0.8	NA	NA	NA	NA
Baozun	BZUN US	1,340	USD	17	BUY	28	19.4	13.5	9.7	0.9	0.7	0.6	19.6	11.3	7.7	38%
Average							25.8	29.7	27.7	3.0	2.2	1.8	15.7	21.7	19.7	194%
<b>OTA</b>																
Trip.com	TCOM US	18,238	USD	29	BUY	48	NA	23.9	15.8	5.7	3.9	3.0	NA	31.3	16.9	212%
Tongcheng	780 HK	4,689	HKD	16	BUY	20	21.2	15.4	12.0	3.8	2.9	2.4	22.2	13.9	10.7	31%
Average							21.2	19.6	13.9	4.7	3.4	2.7	22.2	22.6	13.8	121%
<b>Game</b>																
Tencent	700 HK	579,888	HKD	470	BUY	640	27.7	22.9	19.0	6.4	5.4	4.6	20.9	19.5	16.5	21%
NetEase	NTES US	67,957	USD	101	BUY	120	24.2	20.8	17.8	5.0	4.3	3.8	23.1	18.8	16.1	16%
XD Inc	2400 HK	2,675	HKD	43	NA	NA	NA	NA	NA	6.0	4.6	3.7	NA	NA	81.0	NA
Kingsoft	3888 HK	5,811	HKD	33	NA	NA	77.8	33.5	21.8	6.0	4.8	4.0	20.0	12.8	9.6	89%
IGG	799 HK	1,116	HKD	7	NA	NA	8.2	7.0	6.0	1.3	1.3	1.2	5.4	2.2	1.6	12%
FriendTimes	6820 HK	328	HKD	1	BUY	3	7.2	5.5	4.5	1.2	1.0	0.8	4.1	2.6	NA	29%
CMGE	302 HK	1,124	HKD	3	BUY	6	7.1	6.5	5.1	1.4	1.2	1.0	7.0	6.0	4.5	17%
Archosaur Games	9990 HK	1,079	HKD	10	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Perfect World	002624 CH	5,798	CNY	19	BUY	49	24.9	15.1	12.7	3.6	2.9	2.5	27.4	14.7	12.4	38%
Sanqi Interactive	002555 CH	9,009	CNY	26	BUY	30	21.7	17.4	14.9	3.4	2.9	2.5	17.6	13.8	11.9	20%
Giant Network	002558 CH	3,438	CNY	11	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	9%
Average							24.9	16.1	12.7	3.8	3.1	2.7	15.7	11.3	19.2	28%
<b>Live Streaming</b>																
Hello Inc	MOMO US	2,641	USD	13	HOLD	14	8.0	6.3	5.4	1.2	1.0	1.0	6.5	5.3	4.5	20%
JOYY	YY US	3,803	USD	49	BUY	66	NA	54.8	26.4	1.5	1.3	1.1	NA	NA	4.1	NA
Inke	3700 HK	376	HKD	1	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	33%
Douyu	DOYU US	1,022	USD	3	NA	NA	NA	NA	75.9	0.7	0.7	0.6	NA	NA	NA	NA
Huya	HUYA US	1,987	USD	8	BUY	12	25.5	26.5	14.5	1.1	1.0	0.9	6.8	7.2	3.1	42%
Average							16.8	29.2	30.5	1.1	1.0	0.9	6.6	6.2	3.9	31%
<b>Pan-entertainment</b>																
TME	TME US	13,321	USD	8	BUY	10	21.6	20.5	16.7	2.7	2.4	2.1	24.2	22.3	19.5	12%
iQIYI	IQ US	6,519	USD	8	BUY	13	NA	NA	NA	1.3	1.2	1.1	NA	NA	NA	NA
China Literature	772 HK	7,004	HKD	53	NA	NA	34.4	26.6	21.2	4.7	3.9	3.4	24.4	22.9	17.3	23%
Bilibili	BILI US	29,012	USD	75	BUY	110	NA	NA	NA	9.6	6.7	4.9	NA	NA	NA	NA
Kuaishou	1024 HK	51,516	HKD	96	BUY	110	NA	NA	NA	4.1	3.0	2.3	NA	NA	NA	NA
Zhihu	ZH US	4,756	USD	8	BUY	15	NA	NA	NA	10.3	5.6	3.4	NA	NA	NA	NA
Average							28.0	23.6	19.0	5.4	3.8	2.9	24.3	22.6	18.4	18%
<b>Ad</b>																
Baidu	BIDU US	56,587	USD	163	BUY	248	18.9	15.6	12.2	2.9	2.5	2.2	21.9	16.6	12.3	22%
Weibo	WB US	9,918	USD	44	NA	NA	14.4	13.0	11.4	4.5	4.0	3.6	13.1	11.8	10.1	13%
Mobvista	1860 HK	1,482	HKD	7	BUY	11	53.7	36.3	23.7	2.4	2.1	1.9	NA	51.7	28.2	51%
Duiba	1753 HK	234	HKD	2	BUY	4	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA
Average							29.0	21.6	15.8	3.3	2.9	2.6	17.5	26.7	16.9	28%
<b>CGB</b>																
Dingdong	DDL US	6,033	USD	30	NA	NA	NA	NA	NA	1.9	1.2	0.8	NA	NA	NA	NA
MissFresh	MF US	951	USD	4	NA	NA	NA	NA	NA	0.8	0.5	0.4	NA	NA	NA	NA
Average							NA	NA	NA	1.3	0.9	0.6	NA	NA	NA	NA
<b>SaaS</b>																
Weimob	2013 HK	3,392	HKD	10	NA	NA	NA	NA	NA	7.9	6.1	4.7	NA	NA	NA	NA
Youzan	8083 HK	1,996	HKD	1	NA	NA	NA	NA	NA	7.0	5.1	3.7	NA	NA	NA	NA
KE Holdings	BEKE US	21,877	USD	18	NA	NA	48.1	24.0	16.9	1.8	1.5	1.3	63.2	16.0	9.6	63%
Average							48.1	51.5	32.3	8.2	6.1	4.5	81.2	39.2	24.7	55%
<b>Verticals</b>																
Autohome	2518 HK	5,035	HKD	77	NA	NA	11.7	10.5	10.5	4.3	4.0	3.9	8.3	7.0	6.5	6%
KE Holdings	BEKE US	21,877	USD	18	NA	NA	48.1	24.0	16.9	1.8	1.5	1.3	63.2	16.0	9.6	63%
BZ Kanzhun	BZ US	14,449	USD	35	NA	NA	NA	55.8	26.4	21.5	11.7	7.3	NA	49.5	21.4	133%
Average							29.9	30.1	17.9	9.2	5.8	4.2	35.7	24.2	12.5	67%
<b>Average</b>							<b>21.6</b>	<b>17.5</b>	<b>15.9</b>	<b>4.3</b>	<b>3.2</b>	<b>2.5</b>	<b>23.8</b>	<b>19.6</b>	<b>16.5</b>	<b>26%</b>

Source: Bloomberg

Note: Data updated by 5 Nov 2021; Meituan, JD, PDD, Didi, Trip, Kingsoft, XD, YY and Kanzhun are excluded as outliers in PE and EV/EBIT average calculation

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

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