

CMGE Technology (302 HK)

Looking into improving profitability in 2H23E

CMGE delivered above-industrial rev growth (+25% YoY) and profitability in 1H23. Looking ahead, we expect 2H23E to see rev acceleration and stronger earnings, for: 1) rising contribution from newly launched games in 1H23; 2) several key titles to be launched in 4Q23E; 3) R&D to decline with lower outsourcing cost and manageable S&M. We think pipeline delay has been partially priced in recent stock price, and the delay would be acceptable for fierce competition and high TAC in summer. We trimmed its earnings forecast by 28%-39% in FY23-25E to reflect 2H23E pipeline reschedule. Our DCF-based TP was adjusted to HK\$3.2.

■ **1H23 with above-industrial growth and profitability.** Rev +24.6% YoY in 1H23, below our estimates, primarily attributable to resilient legacy games and several new launches, such as Sword and Fairy: Wen Qing <新仙剑之挥剑问情>, Rakshasa Street: Chosen One <镇魂街>, Cultivation Fantasy <我的御剑日记>, Bottom line achieved breakeven with profit of RMB76mn in 1H23 (suggesting adj. NPM at 5%), backed by higher-than-expected other income at RMB70mn and disciplined S&M, partially offset by lower GP and higher R&D expenses. 1H23 GPM declined to 34% from 41% in 1H22, due to 1) higher commission shared by publishing channels; 2) higher amortization of IP royalties on the publishing of IP games (e.g. Ultraman: The Gathering).

■ **Pipeline delay partially priced in, and look into strong earnings in 2H23E.** In 2H23E, two titles would be rescheduled to launch in 4Q23E, including Hoop City 3v3 <全民街篮, licensed/4Q23>, and Soul Land: Shrek College <斗罗大陆: 史莱克学院, 4Q23>. Given fierce competition and high TAC in summer, we view this delay as acceptable. As the blockbuster game, Sword and Fairy World <仙剑世界> has obtained licenses for both mobile and PC versions and several rounds of testing will begin before launch by the end of 2023. With rising contribution from newly launched games in 1H23, we expect 2H23E to see rev acceleration and margin improvement. Mgmt. guided R&D expenses to decline YoY for lower outsourcing cost, and S&M/rev ratio at 10% in 2H23E, attributable to 1) brand effect of IPs, 2) higher user retention with effective operating, and 3) multiple distribution channels to achieve high ROI.

■ **Maintain BUY.** We trimmed its earnings by 28%-39% in FY23-25E to reflect 2H23E pipeline reschedule. Our DCF-based TP was adjusted to HK\$3.2, with multiple rolling over to 15x FY24E P/E. The stock is trading at 10x/7x FY23/24E P/E, with limited downside risk, in our view.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	3,957	2,714	3,435	4,477	5,372
YoY change (%)	4%	-31%	27%	30%	20%
Adj. net income (RMB mn)	630	(196)	365	516	672
Adj. EPS (RMB)	0.27	(0.07)	0.13	0.19	0.24
YoY growth (%)	-22%	NA	NA	41%	30%
Consensus EPS (RMB)	NA	NA	0.21	0.27	0.34
P/E (x)	4.7	NA	9.6	6.8	5.2
P/S (x)	0.7	1.1	0.9	0.7	0.5
Yield (%)	3%	3%	3%	3%	3%
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$3.20**
 (Previous TP **HK\$3.52**)
 Up/Downside **+124%**
 Current Price **HK\$1.43**

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	3,964
Avg 3 mths t/o (HK\$ mn)	20.36
52w High/Low (HK\$)	2.71/ 1.10
Total Issued Shares (mn)	2,753
Source: Bloomberg	

Shareholding Structure

Fairview Ridge Investment	25.2%
Pegasus Network	10.7%
C&T Services	5.2%
Source: Bloomberg	

Share Performance

	Absolute	Relative
1-mth	-18.3%	-11.8%
3-mth	-26.9%	-23.7%
6-mth	-34.2%	-26.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Figure 1: 1H23 financial review

RMB mn, Dec-YE	1H21	2H21	1H22	2H22	1H23	YoY
Revenue	2,180	1,776	1,233	1,481	1,535	25%
Cost of sales	(1,341)	(1,143)	(732)	(870)	(1,019)	
Gross profit	840	634	501	611	516	3%
Sales and distribution expenses	(225)	(272)	(115)	(123)	(120)	
Administrative expenses	(184)	(262)	(313)	(418)	(352)	
Other income	34	203	30	34	70	
Operating (loss)/profit	465	302	104	103	114	10%
Finance costs	(11)	(13)	(16)	(19)	(10)	
Share of loss of an associate	(2)	(0)	(7)	(10)	10	
Profit before tax	423	228	(19)	(156)	43	NA
Income tax expense	(44)	(13)	(6)	(35)	8	
Profit for the year	378	216	(25)	(191)	51	NA
Adjusted net profit	402	228	(16)	(180)	76	NA

Margin Analysis

Gross margin	39%	36%	41%	41%	34%	
Operating margin	21%	17%	8%	7%	7%	
Adj. net margin	18%	13%	-1%	-12%	5%	

Source: Company data, Bloomberg

Figure 2: CMGE's financial forecasts

RMB mn, Dec-YE	FY21	FY22	FY23E	FY24E	FY25E
Revenue	3,957	2,714	3,435	4,477	5,372
Game publishing	2,820	2,114	2,689	2,396	2,948
Game development	905	453	583	1,813	2,131
IP licensing	232	147	162	267	294
Cost of sales	(2,483)	(1,602)	(2,253)	(2,865)	(3,384)
Gross profit	1,473	1,112	1,182	1,612	1,988
Selling and distribution expenses	(498)	(238)	(309)	(410)	(500)
Administrative expenses	(446)	(731)	(676)	(783)	(913)
Other expenses	(31)	(193)	(34)	(38)	(34)
Operating profit	499	(50)	162	380	540
Other income and gains	237	64	209	164	168
Finance costs	(24)	(35)	(23)	(20)	(21)
Share of profits and losses of JV	(4)	(0)	-	-	-
Share of profits and losses of associates	(2)	(17)	19	(0)	1
Pre-tax profit	705	(38)	368	524	687
Tax	(57)	(41)	(37)	(52)	(69)
Profit for the period from continuing operations	648	(80)	331	471	619
Profit for the period from a discontinued operation	-	-	-	-	-
Profit for the period	594	(217)	331	471	619
MI	(18)	(12)	0	0	0
Net profit attributable to ordinary shareholders	612	(205)	331	471	619
Adj. net profit	630	(196)	365	516	672

Margin Analysis

Gross margin	37%	41%	34%	36%	37%
Operating margin	13%	-2%	5%	8%	10%
Net margin	16%	-7%	11%	12%	13%

Growth Analysis

Revenue	4%	-31%	27%	30%	20%
Gross profit	20%	-25%	6%	36%	23%
Operating profit	17%	NA	NA	134%	42%
Net profit	-22%	NA	NA	41%	30%

Source: Company data, CMBIGM estimates

Maintain BUY with lower TP at HK\$3.2

To reflect 2H23E pipeline reschedule, we trimmed its earnings forecast by 28%-39% in FY23-25E. FY23E rev would grow 27% YoY, with adj. net profit at RMB365mn. Looking into FY24E, we expect rev acceleration ahead, backed by: 1) several key titles rescheduled to launch in 4Q23E, thus contributing more rev in FY24E; and 2) grossing upside from Sword and Fair World <仙剑世界>. Our DCF-based TP was adjusted to HK\$3.2, implying 15x FY24E P/E, in line with industrial average of domestic peers.

Figure 3: CMBIGM estimates vs consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	3,435	4,477	5,372	4,880	6,474	8,074	-29.6%	-30.9%	-33.5%
Gross profit	1,182	1,612	1,988	1,915	2,578	3,129	-38.3%	-37.5%	-36.5%
Operating profit	162	380	540	562	804	913	-71.1%	-52.7%	-40.8%
Adj. net profit	365	516	672	593	774	932	-38.5%	-33.3%	-27.8%
EPS (RMB)	0.13	0.19	0.24	0.21	0.27	0.34	-37.5%	-30.7%	-27.5%
Gross margin	34.4%	36.0%	37.0%	39.3%	39.8%	38.8%	-4.9ppts	-3.8ppts	-1.8ppts
Operating margin	4.7%	8.5%	10.1%	11.5%	12.4%	11.3%	-6.8ppts	-3.9ppts	-1.3ppts
Net margin	10.6%	11.5%	12.5%	12.2%	12.0%	11.5%	-1.5ppts	-0.4ppts	+1.0ppts

Source: Company data, Bloomberg, CMBIGM estimates

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	3,435	4,477	5,372	5,350	7,403	8,436	-35.8%	-39.5%	-36.3%
Gross profit	1,182	1,612	1,988	2,193	3,035	3,459	-46.1%	-46.9%	-42.5%
Operating profit	162	380	540	721	987	1,130	-77.5%	-61.5%	-52.2%
Adj. net profit	365	516	672	601	812	931	-39.2%	-36.4%	-27.8%
EPS (RMB)	0.13	0.19	0.24	0.22	0.29	0.34	-39.2%	-36.4%	-27.8%
Gross margin	34.4%	36.0%	37.0%	41.0%	41.0%	41.0%	-6.6ppts	-5.0ppts	-4.0ppts
Operating margin	4.7%	8.5%	10.1%	13.5%	13.3%	13.4%	-8.7ppts	-4.8ppts	-3.3ppts
Net margin	10.6%	11.5%	12.5%	11.2%	11.0%	11.0%	-0.6ppts	+0.6ppts	+1.5ppts

Source: Company data, CMBIGM estimates

Figure 5: DCF valuation

DCF Valuation (Rmb mn)										
	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E
EBIT	390	544	709	886	1,074	1,268	1,463	1,653	1,837	2,010
Tax	(37)	(52)	(69)	(133)	(161)	(190)	(219)	(248)	(276)	(302)
D&A	40	37	39	41	43	45	47	50	52	55
Change in working capital	91	(337)	(286)	(289)	(292)	(295)	(298)	(301)	(304)	(307)
CAPEX	(30)	(30)	(30)	(32)	(33)	(35)	(36)	(38)	(40)	(42)
FCF	454	161	363	473	631	793	956	1,116	1,269	1,414
FCF Growth		-65%	126%	31%	33%	26%	21%	17%	14%	11%
PV	454	140	275	313	363	398	417	424	420	3,967
Terminal Value										12,334

Assumptions	
WACC	14.8%
Tax rate	-15.0%
Risk free rate	3.95%
Beta	1.2
Market risk return	13.0%
Cost of equity	14.8%
Long term growth	3.0%

		WACC					
		~	13%	14%	15%	16%	17%
Equity Value	PV	7,172	3.63	3.30	3.02	2.79	2.59
	minus: Net debt (Rmb mn)	(810)	3.72	3.37	3.08	2.83	2.63
	minus: Minority interest (Rmb mn)	0	3.81	3.45	3.14	2.88	2.66
	Equity Value (Rmb mn)	7,982	3.92	3.53	3.20	2.93	2.71
	FX	0.9	4.04	3.62	3.27	2.99	2.75
	Target Price (HK\$) based on DCF	3.20	4.17	3.72	3.35	3.05	2.80
		4.5%	4.32	3.83	3.44	3.12	2.85

Source: CMBIGM estimates, Bloomberg

Figure 6: Comps table

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Rating	CMBI TP	PE			PS			FY23-25 CAGR
							FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	
CMGE	302 HK	509	HKD	1.4	BUY	3.2	9.6	6.8	5.2	0.9	0.7	0.5	36%
Domestic Game													
Tencent	700 HK	398,081	HKD	327	BUY	458	19.6	16.6	14.7	4.7	4.2	3.8	15%
NetEase	NTES US	63,695	USD	99	BUY	125	16.0	15.4	14.1	4.4	4.0	3.6	3%
XD Inc	2400 HK	1,002	HKD	16	NA	NA	52.9	20.3	12.3	1.7	1.4	1.2	136%
Kingsoft	3888 HK	5,257	HKD	30	NA	NA	53.6	32.4	23.9	4.3	3.6	3.1	44%
IGG	799 HK	536	HKD	4	NA	NA	NA	6.8	4.5	0.8	0.7	0.6	NA
FriendTimes	6820 HK	208	HKD	1	BUY	1	39.3	5.5	3.1	1.1	0.8	0.7	112%
Archosaur Games	9990 HK	322	HKD	3	NA	NA	NA	16.5	6.6	1.8	1.4	1.5	NA
Perfect World	002624 CH	3,548	CNY	13	BUY	49	17.4	14.3	12.4	2.9	2.6	2.3	19%
Sanqi Interactive	002555 CH	7,617	CNY	25	BUY	30	16.5	14.4	12.7	2.9	2.6	2.4	14%
Giant Network	002558 CH	3,601	CNY	13	NA	NA	20.0	17.0	15.1	7.6	7.0	6.2	16%
G-bits	603444 CH	3,986	CNY	403	NA	NA	19.9	16.2	14.1	5.5	4.6	4.1	18%
Kingnet Network	002517 CH	4,200	CNY	14	NA	NA	21.4	16.9	14.2	6.3	5.2	4.5	21%
Average							18.7	14.5	12.3	3.3	2.8	2.5	27%
International Game													
Activision Blizzard	ATVI US	72,118	USD	92	NA	NA	21.7	20.5	19.9	7.5	7.4	7.1	6%
Electronic Arts	EA US	32,425	USD	120	NA	NA	17.4	15.8	14.9	4.3	4.0	3.9	11%
Take-Two	TTWO US	24,017	USD	141	NA	NA	43.0	18.8	16.7	4.3	3.1	2.9	66%
ROBLOX	RBLX US	16,536	USD	27	NA	NA	NA	NA	NA	5.1	4.3	3.8	NA
Nintendo	7974 JT	54,800	JPY	6,175	NA	NA	19.4	22.4	21.9	5.0	5.2	5.1	-6%
Bandai Namco	7832 JT	15,551	JPY	3,417	NA	NA	23.2	21.0	19.2	2.2	2.1	2.0	9%
Square Enix	9684 JT	4,521	JPY	5,399	NA	NA	16.7	15.2	15.7	1.8	1.8	1.8	3%
Z Holdings	4689 JT	21,544	JPY	413	NA	NA	30.8	25.6	21.4	1.7	1.6	1.5	20%
CyberAgent	4751 JT	3,116	JPY	901	NA	NA	50.1	22.5	16.9	0.6	0.6	0.6	73%
Sony	6758 JT	103,410	JPY	12,000	NA	NA	16.8	15.1	13.8	1.3	1.2	1.2	11%
Capcom	9697 JT	10,925	JPY	5,999	NA	NA	36.8	33.2	29.8	10.9	9.7	9.0	11%
Oriental Land	4661 JT	63,548	JPY	5,114	NA	NA	79.6	66.0	56.5	15.4	13.2	12.2	18%
Nexon	3659 JT	16,492	JPY	2,825	NA	NA	21.0	19.5	17.8	5.7	5.2	4.9	9%
Average							22.6	20.9	18.9	3.6	3.3	3.1	8%
Average							19.9	17.0	15.5	3.5	3.1	2.8	18%

Source: Bloomberg, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue	3,957	2,714	3,435	4,477	5,372
Game publishing	2,820	2,114	2,689	2,396	2,948
Game development	905	453	583	1,813	2,131
IP licensing	232	147	162	267	294
COGS	(2,483)	(1,602)	(2,253)	(2,865)	(3,384)
Gross profit	1,473	1,112	1,182	1,612	1,988
S&M	(498)	(238)	(309)	(410)	(500)
R&D	(446)	(731)	(676)	(783)	(913)
Other expenses	(31)	(193)	(34)	(38)	(34)
Operating profit	499	(50)	162	380	540
Other income	237	64	209	164	168
Finance costs	(24)	(35)	(23)	(20)	(21)
Associates	(7)	(17)	19	(0)	1
Pre-tax Income	705	(38)	368	524	687
Income Tax	(57)	(41)	(37)	(52)	(69)
MI	(18)	(12)	-	-	-
Net profit	612	(205)	331	471	619
Adj. net profit	630	(196)	365	516	672

Cash flow summary

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Pre-tax Income	651	(175)	368	524	687
D&A	132	25	40	37	(10)
Change in WC	(339)	(263)	91	(337)	(286)
Others	(88)	411	(56)	(52)	(70)
Operating CF	356	(2)	443	171	322
Capex	(305)	(300)	(30)	(30)	(30)
Others	(690)	124	0	0	0
Investing CF	(995)	(177)	(30)	(30)	(30)
Equity raised	702	-	-	-	-
Others	(651)	(588)	573	61	332
Financing CF	51	(588)	573	61	332
Net change in cash	51	(588)	573	61	332
Cash (beg of yr)	51	(588)	573	61	332
FX	795	819	237	810	871
Cash (end of yr)	795	819	237	810	871

Balance sheet

YE 31 Dec (RMB mn)	FY21A	FY22A	FY23E	FY24E	FY25E
Non-current assets	4,517	4,923	4,732	4,915	5,117
Fixed asset	9	18	4	0	42
Goodwill	1,108	1,125	1,023	1,023	1,023
Intangible assets	537	539	692	688	687
Others	3,457	3,821	3,742	3,945	4,122
Current assets	3,325	2,231	2,511	3,003	3,704
Cash	819	237	810	871	1,203
Trade receivables	1,052	1,071	927	1,209	1,450
Other current assets	1,454	923	773	923	1,051
Current liabilities	1,788	1,359	1,150	1,164	1,287
Bank loans	765	444	604	524	564
Trade and other payables	867	590	390	483	566
Tax payable	135	133	133	133	133
Other current liabilities	21	192	23	23	23
Non-current liabilities	260	103	75	75	75
Deferred tax liabilities	73	75	75	75	75
Contingent consideration	178	-	-	-	-
Others	8	27	-	-	-
Total Equity	5,794	5,692	6,017	6,679	7,459

Key ratios

YE 31 Dec	FY21A	FY22A	FY23E	FY24E	FY25E
Sales mix (%)					
Game publishing	71.3	77.9	78.3	53.5	54.9
Game development	22.9	16.7	17.0	40.5	39.7
IP licensing	5.9	5.4	4.7	6.0	5.5
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	3.6	(31.4)	26.6	30.3	20.0
Gross profit	20.5	(24.6)	6.3	36.4	23.3
EBIT	16.7	NA	NA	133.9	42.2
Net profit	(21.9)	NA	NA	41.4	30.3
P&L ratios (%)					
Gross Margin	37.2	41.0	34.4	36.0	37.0
Pre-tax margin	17.8	(1.4)	10.7	11.7	12.8
Adj. net margin	15.9	(7.2)	10.6	11.5	12.5
Effective tax rate	(8.8)	23.6	(10.0)	(10.0)	(10.0)
Returns (%)					
ROE	11.2	(3.8)	5.7	7.4	8.8
ROA	8.4	(2.9)	4.6	6.2	7.4

Source: Company data, CMBIGM estimates

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OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
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