

16 June 2014

IGG (8002.HK)

Surged income from Castle Clash probably brings more than double revenue

HONG KONG | SOFTWARE | COMPANY ANALYSIS

Rating:

Buy

- IGG's 1Q14 revenue of US\$ 44.1 millions, grew 205.5% yoy, equals over 50% of its 2013 total turnover. Among that, 84% is contributed by its flagship game "Castle Clash" (CC) launched in July 2013. Profit attributable to shareholders turnarounds to US\$ 13.6millions profit, already exceeded the total 2013 net profit of US\$ 6.9millions. Earnings per share amounted to US\$ 1 cent.
- With cooperation with Tencent in promoting CC, it is expected IGG could further enhance its market share in PRC. Only 22.3% of the revenue from CC comes from IOS as at 1Q14, there is still a large room to grow.
- We give IGG an initial rating of "BUY" with target price HK\$ 7.18, equivalent to 19.9x/15x of 2014 and 2015 forecasted EPS.

Financial Highlights

IGG has announced its 1Q14 result with revenue of US\$ 44.1 millions, grew 205.5% yoy, and which is already accounted for over 50% of its 2013 total turnover. Among that, US\$ 29.2millions is contributed by its flagship game "Castle Clash" launched in July 2013, which accounted for 84% of the mobile games income. Profit attributable to shareholders turnarounds from 1Q13's US\$ 3.9millions loss to US\$ 13.6millions profit, which is already exceeded the total 2013 net profit of US\$ 6.9millions. Basic earnings per share amounted to US\$ 1 cent.

How we view this

IGG has obtained a very handsome FY13 and 1Q14 performance, which is mainly due to "Castle Clash" (CC). After its cooperation with Tencent, it is expected IGG could further enhance its market share in PRC. On the other hand, only 22.3% of the revenue from CC comes from IOS as at 1Q14, which IOS is launched 3 months later than Android. Although the revenue from IOS already increases 124.1% to US\$ 6.5millions in 1Q14 compared with US\$ 2.9millions in 2013, there is still a large room to grow.

Investment Action

Therefore, based on the high growth on CC and more new games will be launched this year, together with the potential benefit brings by the cooperation with Dynam (6889.HK) to develop pachinko machines. We give IGG an initial rating of "BUY" with target price HK\$ 7.18, equivalent to 19.9x/15x of 2014 and 2015 forecasted EPS.

Key Financial Summary

FYE	12/12	12/13	12/14F	12/15F
Operating Profit (USD mn)	(13)	8	74	100
Net Profit, adj. (USD mn)	(13)	7	63	84
EPS (HKD)	0.195	0.055	0.361	0.479
P/E (X)	(28.3)	100.6	15.3	11.5
BVPS (HKD)	(0.81)	1.07	1.14	1.62
P/B (X)	(6.8)	5.2	4.9	3.4
DPS (HKD)	0	0.016	0.077	0.103
Div. Yield	0.00%	0.30%	1.40%	1.90%

Source: Bloomberg, PSR est.

*All multiples & yields based on current market price

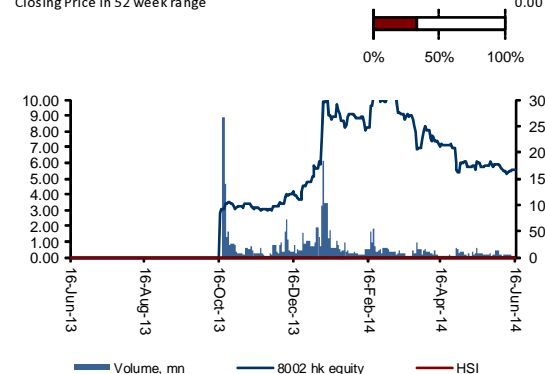
Target Price (HKD)	7.18
Forecast Dividend (HKD)	0.08
Closing Price (HKD)	5.52
Potential Upside	30.1%

Company Description

IGG is a global online games development and operation company with head office in Singapore and work offices in US, Canada, China and Philippine. As at March 31 2014, the company has over 147 millions registered player accounts and 14.5 millions monthly active users around 180 countries.

Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD Mn)	7,513
Enterprise Value (HKD Mn)	6,462.05
52 week range (HKD)	2.92 - 10.92
Closing Price in 52 week range	0.00



Major Shareholders

1. IDG Group	21.16%
2. Cai Zongjian	15.01%
3. Chi Yuan	11.63%

Valuation Method

PE

Analyst

Kay Ng

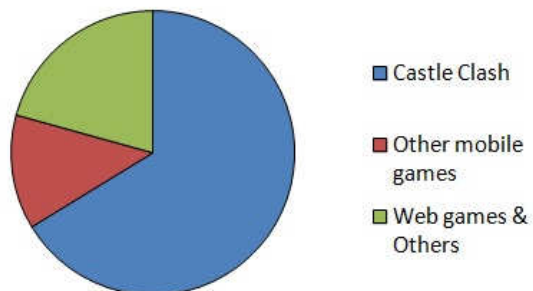
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The flagship game “Castle Clash” contributes most of the growth

According to IGG’s financial report, the revenue from its flagship mobile game “Castle Clash” (CC) accounted 84% of the total mobile game revenue and 66.3% of the total turnover. CC was launched in July 2013 and with less than a year time, the Monthly Active Users (MAU) grew to 9.4 millions.

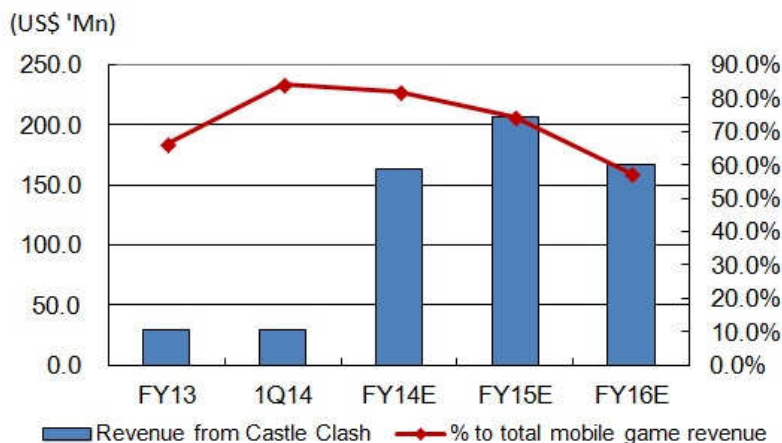
Fig 1 1Q14 Revenue Mix



Source: Company reports

It is expected the growth on revenue would continue in 2014 since IGG has cooperated with Tencent to launch CC exclusively in Tencent mobile game platform and Tencent will be solely responsible for its marketing and promotion in PRC. However, since the product life is comparatively short for mobile games, it is expected the growth momentum will shift to other mobile games after 2015 and revenue from CC begins to drop. The company plans to launch 35-40 new games this year.

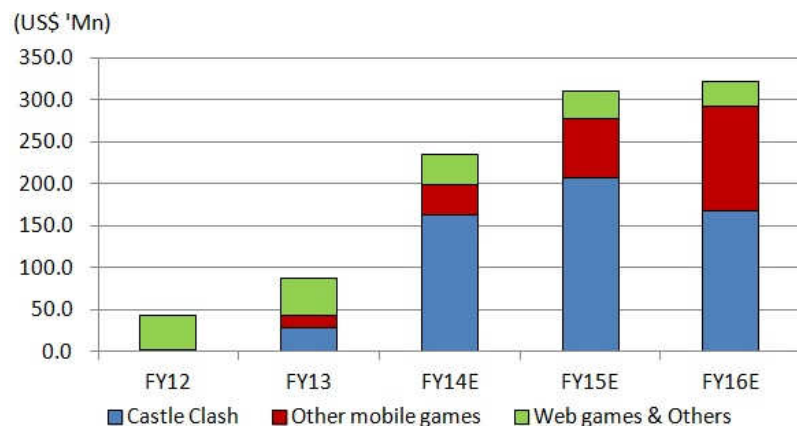
Fig 2 Revenue from Castle Clash estimates



Source: PSR, Company report

Before the launch of CC, web games contributed for US\$ 32.6 millions, 75.6% of the total revenue of in 2012 and mobile games just accounted for 5.1% of the total turnover. Situation changed after IGG turned its focus on mobile games development and operation. At the end of 2013, mobile games accounted for 49.7% of the total revenue. As at Mar 31 2014, mobile games accounts for 79.3% of the total revenue. It is expected the portion would continue to grow and the income from web games and others would shrink conversely.

Fig 3 Revenue mix estimates

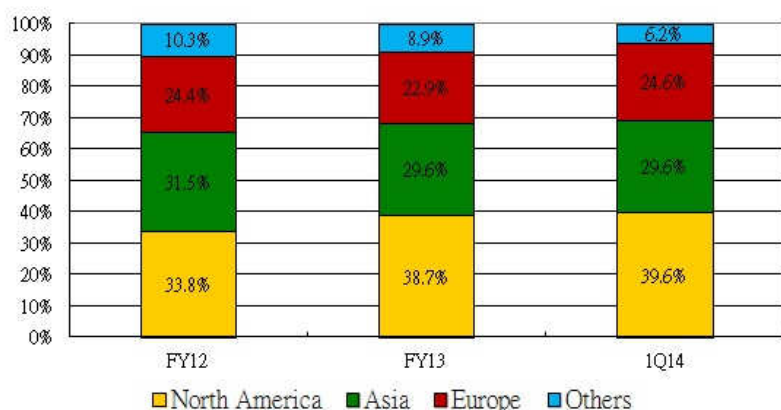


Source: PSR, Company report

Business scattered around the world

As at March 31 2014, IGG has over 147 millions registered player accounts and 14.5 million MAU around 180 countries in the world. The company has work offices in US, Canada, China and Philippine, and placed a large portion of its development staffs in China to lower the personnel cost. As at the first quarter of 2014, 39.6% of total revenue comes from North America, while 29.6% and 24.6% come from Asia and Europe respectively. The largest part of revenue comes from North America, which continues to grow from 33.8% in 2012, but revenue from Asia and other countries besides Europe pull back. However, with the marketing cooperation with Tencent and the launch of CC in Tencent mobile games platform, we believe the revenue from Asia would grow in 2014.

Fig 4 Geographical source of revenue

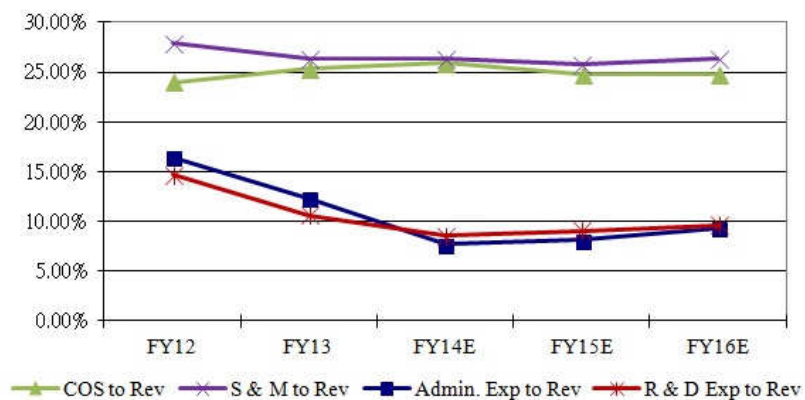


Source: PSR, Company report

Cost stays, expenses have not follow the rapid raise of revenue

The 1Q14 cost of sales and selling & distribution expense increases around 255%, to US\$ 11.1millions and US\$ 11.9millions respectively. COS and Selling expense are expected to maintain at around 25% to 26% of revenue. However, the administration and R&D expenses are not able to catch up with the rapid revenue grows during a short period. Both of the ratio are expected to drop from 15% in 2012 to below 10%, lead to a better EBIT margin this year.

Fig 5 Costs as percentage of revenue estimates



Source: PSR, Company report

Valuation

IGG has obtained a very handsome FY13 and 1Q14 performance, which is mainly due to “Castle Clash” (CC). After its cooperation with Tencent, it is expected IGG could further enhance its market share in PRC. On the other hand, only 22.3% of the revenue from CC comes from IOS as at 1Q14, which IOS is launched 3 months later than Android. Although the revenue from IOS already increases 124.1% to US\$ 6.5millions in 1Q14 compared with US\$ 2.9millions in 2013, there is still a large room to grow. Therefore, based on the high growth on CC and more new games will be launched this year, together with the potential benefit brings by the cooperation with Dynam (6889.HK) to develop pachinko machines. We give IGG an initial rating of “BUY” with target price HK\$ 7.18, equivalent to 19.9x/15x of 2014 and 2015 forecasted EPS.

Potential Risks

The growth on Castle Clash slow down;
Fail to carry on the growth with new games;

	FY12	FY13	FY14E	FY15E	FY16E
Valuation Ratios					
P/E (X)	(28.3)	100.6	15.3	11.5	11.9
P/B (X)	(6.8)	5.2	4.9	3.4	2.7
EV/EBITDA (X)	(499.2)	782.2	86.9	64.6	67.0
Dividend Yield (%)	0.0%	0.3%	1.4%	1.9%	1.8%
Per share data (HKD)					
EPS	(0.195)	0.055	0.361	0.479	0.465
DPS	0.000	0.016	0.077	0.103	0.100
BVPS	(0.810)	1.072	1.136	1.615	2.079
Outstanding Shares (basic, mn)	534.81	983.07	1,361.00	1,361.00	1,361.00
Growth & Margins (%)					
Growth					
Revenue	-97.9%	103.9%	167.4%	31.7%	4.0%
EBIT	-106.8%	-163.8%	800.6%	34.4%	-3.5%
Margins					
Gross profit margin	76.0%	74.7%	74.1%	75.1%	75.2%
EBT margin	-30.0%	9.4%	31.6%	32.3%	30.0%
Net Profit Margin	-31.1%	7.9%	26.9%	27.1%	25.3%
Key Ratios					
ROE (%)	3.8%	0.8%	5.1%	4.7%	3.6%
ROA (%)	-10.0%	0.7%	4.7%	4.5%	3.4%
Income Statement (USD mn)					
Revenue	43	88	235	310	322
Cost of revenue	(10)	(22)	(61)	(77)	(80)
Gross profit	33	66	174	233	242
Selling & Marketing expenses	(12)	(23)	(62)	(80)	(85)
Administrative expenses	(7)	(11)	(18)	(25)	(30)
R & D expenses	(6)	(9)	(20)	(28)	(31)
Other income, net	0	0	0	0	0
Fair value adjustments on convertible PS	(21)	(14)	0	0	0
Operating profit	(13)	8	74	100	97
Taxation	(0)	(1)	(11)	(16)	(15)
Profit After Tax	(13)	7	63	84	82
Loss from discontinued operation	(0)	0	0	0	0
Net Profit	(13)	7	63	84	82
EPS (USD)	(0.025)	0.007	0.047	0.062	0.060

Source: Company, PSR

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Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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