

21 November 2014

IGG (8002.HK)

Looking forward for new potential flagship games

Rating: **Accumulate**

HONG KONG | SOFTWARE | COMPANY UPDATES

- IGG's 3Q revenue grew 132% yoy and 9.1% qoq, gross profit increased 121% yoy and 7.4% qoq. Profit attributable to shareholders up 303% yoy, while decreased 6% qoq.
- GPM further dropped to 70.8% while NPM sharply down to 34.8% from 40.3% in 2Q, still higher than the 31% in 1Q.
- The company missed the game launching schedule. Only 1 self made game, 1 third party game and 1 social app were published in 3Q.
- Due to the release of 2 impressive new self made mobile games in October, we decide to wait until the 4Q results. We maintain IGG's rating as "Accumulate" with the same target price of HK\$ 3.95.

Financial Highlights

The 3Q revenue for IGG amounted to US\$ 52.2 mn, grew 132% yoy and 9.1% qoq. The speeded up on qoq revenue growth of Castle Clash (3Q: 13.5% vs 2Q: 5.4%) offset the slowing qoq growth on other mobile games (3Q: 15% vs 2Q: 60%). The gross profit increased 121% yoy and 7.4% qoq to US\$ 36.9 mn, with GPM further dropped to 70.8%. Profit attributable to shareholders up 303% yoy to US\$ 18.1 mn, while decreased 6% qoq. Diluted interim earnings per share amounted to US\$ 1.27 cent.

How we view this

The revenue was in line with our expectation. 3Q revenue growth was about the same as 2Q (3Q: 9.1% vs 2Q: 8.6%), which suffered from serious declining when compared with the 20.1% quarterly growth in 1Q. The slow revenue growth in both 2Q and 3Q was with the same reason: lack of new games launching. In 2Q, there were only 2 third party games released, while in 3Q, only 1 self developed game, 1 third party game and 1 social networking application were published. However, 2 self developed mobile games – "Clash of Gangs" and "Gods Rush" had been delayed the launching to Oct. We had searched for the above two games on Google Play and found that they were both very impressive to players. In about one month since launching, both of the games obtained over 1 million downloads, with very good comments and over 4-star ratings.

Investment Action

Although both the 2Q and 3Q financial figures showed the slowing down of revenue growth, we still believe that the company would be able to shift the revenue contributor from Castle Clash to other games. As mentioned above, the two new self developed games may be the growth drivers in the future and we will wait until the 4Q results for these two games. Thus, we maintain IGG's rating as "Accumulate" with the same target price HK\$ 3.95, equivalent to 10x/8.9x of 2014 and 2015 forecasted EPS plus interim net cash of HK\$ 0.46 per share.

Key Financial Summary

FYE Dec	FY12	FY13	FY14E	FY15E	FY16E
Revenue (USD mn)	43	88	203	253	286
Net Profit (USD mn)	(13)	7	65	74	74
EPS (HKD)	(0.195)	0.055	0.349	0.393	0.398
P/E (X)	(17.8)	63.3	9.9	8.8	8.7
BVPS (HKD)	(0.810)	1.175	1.141	1.558	1.980
P/B (X)	(4.3)	3.0	3.0	2.2	1.8
DPS (HKD)	0.000	0.016	0.100	0.114	0.114
Div. Yield (%)	0.0%	0.5%	2.9%	3.3%	3.3%

Source: PSR est.

Downgraded to Accumulate

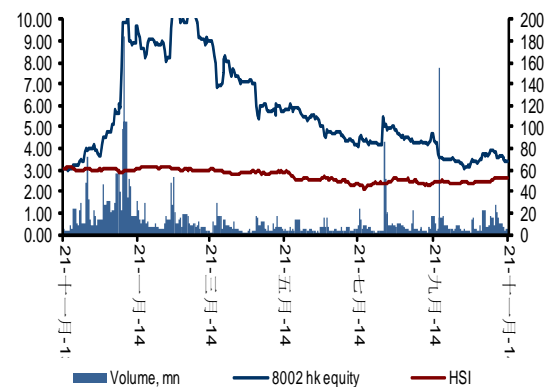
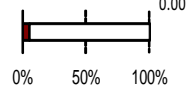
Target Price (HKD)	3.95
Forecast Dividend (HKD)	0.10
Closing Price (HKD)	3.44
Potential Upside	14.8%

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 October 31 2014, the company has over 200 millions registered player accounts and 19.7 millions monthly active users around 180 countries.

Company Data

Raw Beta (Past 2yrs weekly data)	N/A
Market Cap. (HKD bn)	4,710
Enterprise Value (HKD mn)	3,493.00
52 week range (HKD)	2.97 - 10.92
Closing Price in 52 week range	0.00



Major Shareholders

1. Cai Zongjian	15.01%
2. IDG Group	13.91%
3. Chi Yuan	11.63%
4. Temasek Holdings (Private) Limited	8.77%

Valuation Method

PE

Analyst

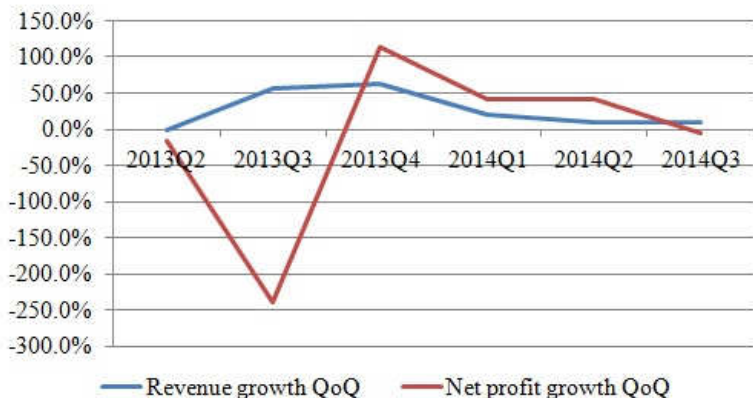
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The QoQ growth slowed down, margins narrow

Both the revenue and net profit growth suffered serious declining from the peak in 4Q2013 due to the high base generated from the publishing of Castle Clash in July 2013. Net profit growth was more fluctuated, which dropped to -6% in the 3Q2014.

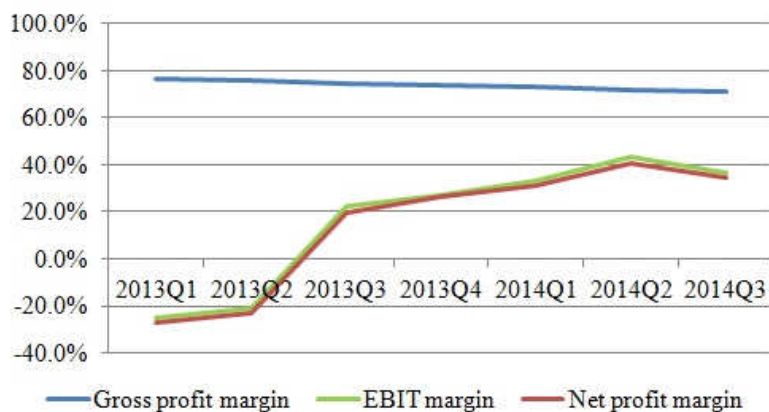
The gross profit margin was slightly dropped in each quarter while EBIT and net profit margins started narrowing from the peak in 2Q. The yoy increase of sale & marketing, admin and R & D expenses were 130%, 62% and 81% respectively, coupled with slowed revenue growth, implied higher cost to revenue ratio.

Fig 1 QoQ growth on revenue and net profit



Source: Company reports

Fig 2 Quarterly margins



Source: Company reports

Game launching schedule missed

In both 2Q and 3Q, the company missed the game launching schedule. Only 2 third party games were published in 2Q.

According to the interim report, IGG planned to release 4 self developed games, 1 third party game and 1 social networking application in 3Q. However, there were only 1 self made game, 1 third party game and 1 social app launched in 3Q.

The launching of 2 self developed games – “Clash of Gangs” and “Blood and Blade” were delayed until the 4Q, while 1 new game “Gods Rush” was also published in October.

Fig 3 Launching pipeline in 3Q

	Game type	Status	Launched month	DL user
Deck Heroes	Self made	On shelf	July	>500,000
Link Messenger	Social	On shelf	August	>1 million
Brave Trials	Third party	On shelf	August	N/A
Clash of Gangs	Self made	On shelf	October	>1 million
Gods Rush	Self made	On shelf	October	>1 million
Blood and Blade	Self made	On shelf	Just launched	N/A
Galaxy Online 3	Missed			

Source: Company reports

After searched on the Google Play, we found that “Clash of Gangs” and “Gods Rush” received very good comments and over 1 million downloads in just one month time.

Clash of Gangs

A combat strategy game which similar to Castle Clash with gangs theme. Graphics improved with 3D layout.

Fig 4 Clash of gangs snapshot on Google Play



Source: Google Play

Gods Rush

A scrolling RPG strategy game alike the famous Chinese game DOTA Legend with myth theme.

Fig 5 Gods Rush snapshot on Google Play



Source: Google Play

Potential Risks

- The growth on Castle Clash slow down;
- Game launching missed schedule;
- Fail to carry on the growth with new games;
- Potential dilution of 83mn stock options, accounted for 6% of outstanding stake.

	FY12	FY13	FY14E	FY15E	FY16E
Valuation Ratios					
P/E (X)	(17.6)	62.7	9.9	8.8	8.6
P/B (X)	(4.2)	2.9	3.0	2.2	1.7
EV/EBITDA (X)	(269.8)	422.8	49.7	43.9	42.9
Dividend Yield (%)	0.0%	0.5%	2.9%	3.3%	3.3%
Per share data (HKD)					
EPS (diluted)	(0.195)	0.055	0.349	0.393	0.398
DPS	0.000	0.016	0.100	0.114	0.114
BVPS (basic)	(0.810)	1.175	1.141	1.558	1.980
Outstanding Shares (basic, mn)	534.81	896.39	1,368.00	1,368.00	1,368.00
Outstanding Shares (diluted, mn)	534.81	983.07	1,451.00	1,451.00	1,451.00
Growth & Margins (%)					
Growth					
Revenue	-97.9%	103.9%	130.7%	24.7%	12.9%
EBIT	-106.8%	-163.8%	751.0%	13.1%	2.4%
Margins					
Gross profit margin	76.0%	74.7%	71.4%	71.0%	70.0%
EBT margin	-30.0%	9.4%	34.6%	31.4%	28.5%
Net Profit Margin	-31.1%	7.9%	32.2%	29.0%	26.0%
Key Ratios					
ROE (%)	3.8%	0.8%	5.2%	4.3%	3.4%
ROA (%)	-10.0%	0.7%	4.8%	4.0%	3.3%
Income Statement (USD mn)					
Revenue	43	88	203	253	286
Cost of revenue	(10)	(22)	(58)	(73)	(86)
Gross profit	33	66	145	180	200
Selling & Marketing expenses	(12)	(23)	(46)	(58)	(67)
Administrative expenses	(7)	(11)	(14)	(20)	(25)
R & D expenses	(6)	(9)	(16)	(22)	(27)
Other income, net	0	0	0	0	0
Fair value adjustments on convertible PS	(21)	(14)	0	0	0
Operating profit	(13)	8	70	80	81
Taxation	(0)	(1)	(5)	(6)	(7)
Profit After Tax	(13)	7	65	74	74
Loss from discontinued operation	(0)	0	0	0	0
Net Profit	(13)	7	65	74	74
EPS (USD)	(0.025)	0.008	0.048	0.054	0.054

Source: Company, PSR

PHILLIP RESEARCH STOCK SELECTION SYSTEMS

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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