

# NetDragon (777.HK)

## Gaming business performed brilliantly; Education business dropped due to cyclicity of tender business

Hong Kong | TMT | Company Report

12 September 2019

### Investment Summary

NetDragon mainly engaged in gaming and education. The group announced its interim results, where the gaming business performed brilliantly, with segment profit increased by 85.4% YoY. Besides, the new game “Vow of Heroes” will be launched in the second half of 2019. In the future, the Group will try to monetize its education business in order to become profit-making. We adopted sum of the parts valuation, deriving a TP of HKD 29.75, and reiterate a “Buy” rating with a potential return of approximately 58.1%. (Closing price at 10 Sep 2019)

### Annual result update

In the first half of this year, the gaming business performed brilliantly, with revenue up by 51.6% YoY to RMB 1.58 billion; segment profit increased by 85.4% YoY to RMB 970 million. During the period, the revenue of the Group's three major IP “Eudemons”, “Hero Evolved” and “Conquer Online” increased significantly, at 57%, 27% and 43% respectively. Regarding Eudemons, the Eudemons PC version launched a new expansion packs on June 30 this year. The group also said there will be two expansion packs every year, which will help maintain the popularity of the game. As for Hero Evolved, the group tried to cooperate with other IP to create IP crossover collaboration effect. This year, the group cooperated with the Japanese anime IP “Overlord” and domestic IP “Rakshasa Street” on Hero Evolved to maintain the driver for the revenue growth. In addition, the group also added a new leisure game mode - Auto Chess in “Hero Evolved Pocket Version”, which helps keep the game fresh and attract new users.

At present, the group has more than 10 games in the development or testing stage, and it is expected that “Vows of Heroes”, “Heroes of Ages” and “Eudemons Legends” will be launched in the second half of this year. “Vows of Heroes” will be the star product, focusing on the two-dimensional market. The group has planned to cooperate with the domestic ACG film sharing website Bilibili to release the game, hoping to direct the target users more effectively. Although the license of these three games have not yet been granted, the group said that the license approval has reached the national level, and it is believed that it will be approved in a short period of time.

### Buy

CMP HKD 18.82

(Closing price at 10 Sep 2019)

TARGET HKD 29.75 (+58.1%)

#### COMPANY DATA

O/S SHARES (MN) :	530
MARKET CAP (HKDMN) :	9,984
52 - WK HI/LO (HKD):	24.50 / 11.28

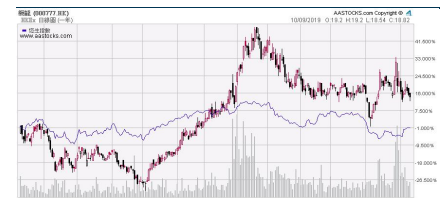
#### SHARE HOLDING PATTERN , %

Liu Dejian	47.75
He Zhicheng	14.62
Zhou Quan	13.72

#### PRICE PERFORMANCE , %

	1M	3M	1Y
NetDragon	3.52	-4.95	19.11
HSI	2.15	-1.05	-1.08

#### RETURN VS. HSI



Source: Aastocks, Phillip Securities (HK) Research

#### KEY FINANCIALS

RMB mn	FY17	FY18	FY19F	FY20F
Revenue	3,868	5,038	5,735	7,042
Net Profit	(89)	477	784	828
EPS, RMB	(0.041)	1.024	1.515	1.601
PER, x	N/A	16.72	11.31	10.70
BVPS, RMB	8.99	9.26	10.43	11.63
P/BV, x	1.91	1.85	1.64	1.47
ROE, %	(0.5)	11.5	15.4	14.5

Source: Company reports, Phillip Securities Est.

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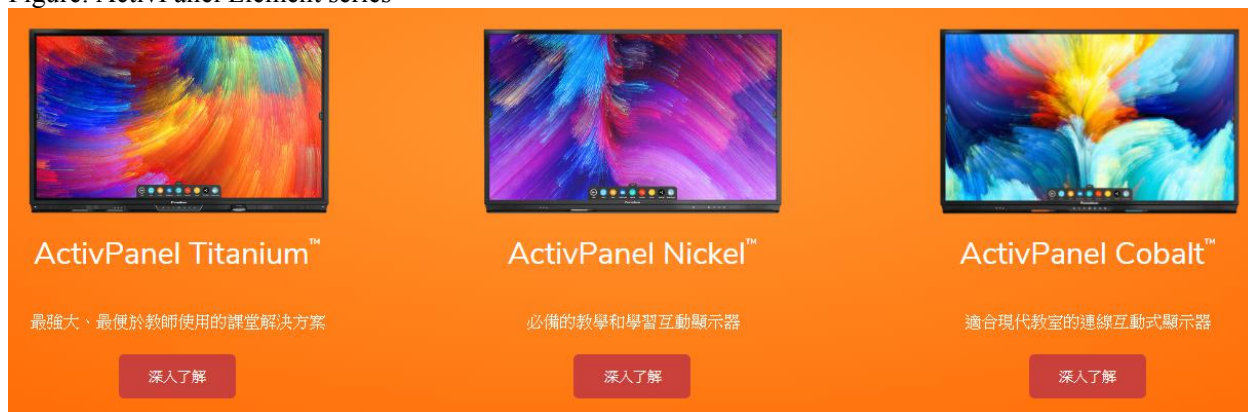
Figure: Gaming pipeline



Source: Company report, Phillip Securities (HK) Research

In the first half of this year, the revenue from education business decreased by 24.2% YoY to RMB 1.05 billion, due mainly to the tender business from Russia in the first half of last year, but not in the first half of this year. In addition, the segmental loss increased to RMB 310 million due to the cyclical nature of the Russian tender and the six-month performance of Edmodo (two months last year). If the Russian tender order is deducted, the education revenue will increase by 5% YoY. The Group expects that tender business will be resumed in the second half of 2019 and 2020. The Group signed a memorandum of understanding with the Egyptian Ministry of Education in the first half of the year to undertake the design and supply of 265,000 "Pop-up Classrooms". Promethean launched a new product line (Element series) in the second quarter of this year, and the market responded well. After deducting Russian tender orders, the shipments in the first half of the year increased by 28% YoY.

Figure: ActivPanel Element series



Source: Promethean, Phillip Securities (HK) Research

Currently, there are about 106 million registered users in Edmodo, an increase of about 500 million users compared with 101 million at the end of last year, implying its growth is slightly lower than the growth in the second half of 2018 where it added 1 million users monthly. The Group is preparing to launch a homework application "AskMo" in October this year to provide AI-assisted learning and live tutors. In addition, it will launch 1:4 and 1:1 online tutoring in December this year, trying to monetize platform users.

In addition, the Group continued to strengthen the penetration of 101 education PPT. As of June 30, 2019, the number of 101 PPT installation users has reached 6 million, effectively covering more than 10 million students. The Group hopes to complete the development of the 101 Education PPT content distribution platform in the second half of this year, and will pave the way for monetization by enabling consumption of paid value-added contents on the platform.

## Valuation

We adopted sum of the parts valuation and forecast the earnings per share of the gaming business in 2019F to be RMB 3.44, with target PE ratio 8x. As the education business is still loss-making, PS ratio will be used for valuation. We predict the revenue per share of the education business in 2019F to be RMB 4.35, with target PS ratio 2x. With RMB 2.94 net cash per share in 19H1, we derive our TP to be HKD 29.75, 1.6% lower than our previous TP, due to the sharp depreciation in RMB, maintaining a “Buy” rating, implying 58.1% potential upside. (CNY/HKD=0.91)

## Risk

1. Edmodo integration progresses slowly
2. Overseas acquisition fails
3. Gaming revenue growth slows down
4. Policy risk on gaming industry

## Financials

FYE DEC	FY15	FY16	FY17	FY18	FY19F	FY20F
<b>Valuation Ratios</b>						
P/E (X), adj	N/A	N/A	N/A	16.72	11.31	10.70
P/B (X)	1.98	2.20	1.91	1.85	1.64	1.47
Dividend Yield (%)	1.1%	1.1%	1.1%	1.3%	2.0%	2.1%
<b>Per share data (RMB)</b>						
EPS, (Basic)	-0.289	-0.409	-0.041	1.024	1.515	1.601
EPS, (Diluted)	-0.289	-0.409	-0.041	1.023	1.512	1.598
DPS (HKD)	0.20	0.20	0.20	0.25	0.379	0.400
BVPS	8.66	7.78	8.99	9.26	10.43	11.63
<b>Growth &amp; Margins (%)</b>						
<b>Growth</b>						
Revenue	32.1%	119.5%	38.5%	30.2%	13.8%	13.2%
EBIT	-345.9%	129.8%	-77.3%	-430.2%	95.2%	5.1%
Net Profit	-209.4%	26.0%	-62.4%	-636.1%	64.4%	5.7%
<b>Margins</b>						
Gross profit margin	75.3%	56.9%	56.4%	60.5%	65.0%	64.0%
EBIT margin	-18.8%	-19.7%	-3.2%	8.2%	14.0%	13.0%
Net Profit Margin	-14.8%	-8.5%	-2.3%	9.5%	13.7%	12.8%
<b>Key Ratios</b>						
ROA	-3.5%	-4.6%	-1.7%	7.6%	11.0%	10.4%
ROE	-3.2%	-5.0%	-0.5%	11.5%	15.4%	14.5%
<b>Income statement (RMB mn)</b>						
Revenue	1,272	2,793	3,868	5,038	5,735	6,491
EBIT	(239)	(550)	(125)	411	803	844
Operating profit	(152)	(218)	(31)	564	918	971
EBT	(87)	(209)	(32)	568	922	975
Net Profit	(188)	(237)	(89)	477	784	828
Minority Interest	(45)	(34)	(68)	(69)	(20)	(21)
Net profit for owners	(143)	(203)	(21)	546	804	849

Source: Company, Phillip Securities (HK) Research

Exchange rate (0.91) is HKDCNY1Y forward contract price on September 10 from Wind.

(Financial figures as at 10 September 2019)

**PHILLIP RESEARCH STOCK SELECTION SYSTEMS**

<b>Total Return</b>	<b>Recommendation</b>	<b>Rating</b>	<b>Remarks</b>
<b>&gt;+20%</b>	<b>Buy</b>	<b>1</b>	<b>&gt;20% upside from the current price</b>
<b>+5% to +20%</b>	<b>Accumulate</b>	<b>2</b>	<b>+5% to +20% upside from the current price</b>
<b>-5% to +5%</b>	<b>Neutral</b>	<b>3</b>	<b>Trade within ± 5% from the current price</b>
<b>-5% to -20%</b>	<b>Reduce</b>	<b>4</b>	<b>-5% to -20% downside from the current price</b>
<b>&lt;-20%</b>	<b>Sell</b>	<b>5</b>	<b>&gt;20% downside from the current price</b>

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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