

Archosaur Games (9990 HK)

The company is expected to enter the harvest period in 2021-2022

Hong Kong | TMT (Game) Sector | Update Report

13 May 2021

Investment Summary

The 2020 result is in line with expectation

The company's revenue was RMB 1.21 billion (+13.3% YoY) in 2020. Within it, the revenue of the developing and licensing sector /the integrated game publishing and operation sector were RMB 597.3/611.5 million (-27.3% YoY/+148.9% YoY), respectively. In terms of the geographical breakdown, the company's revenue from overseas region in 2020 was RMB 788.3 million (+129.1% YoY), with a revenue proportion of 65.2% (+33.1ppts YoY). The high growth in revenue from overseas region was mainly attributable to the impressive performance of Dragon Raja (龍族幻想). On the other hand, the revenue from domestic region in 2020 was RMB 420.5 million (-41.8% YoY), with a revenue proportion of 34.8% (-33.0ppts YoY). The steep decline in domestic revenue was primarily due to the delay of the launching of the Under the Firmament (鴻圖之下) and The New World (夢想新大陸) in 2020.

The company's GP in 2020 was RMB 925.9 million (+4.1% YoY), with respective GPM at 76.6%(-6.8ppts YoY). The YoY drop in GPM was mainly due to the fact that the revenue proportion of the integrated game publishing and operation sector rose in 2020 and the GPM of the sector is lower in general comparing to the developing and licensing sector, hence dragging down the company's overall GPM (the integrated game publishing and operation sector recognized the full gross billing as revenue, while gross billings' share to payment channels and distribution channels are recognized in the CoGS, hence lower GPM).

In terms of the expenses, the company's R&D expense / selling expense in 2020 were RMB 540.4 million (+38.8% YoY)/RMB 161.0 million (+40.6% YoY), with respective expense ratios of 44.7% (+8.2ppts YoY)/13.3% (+2.6ppts YoY). The increase in both R&D expense and selling expense ratios was mainly attributable to the mismatch in return vs investments (the delays in the launching of games caused a drop in the revenue growth, while the growth rates of expenses were quicker than that of the revenue). The admin expense of the company in 2020 was RMB 138.3 million (+160.9% YoY), with corresponding expense ratio of 11.6% (+6.2ppts YoY). The rose in the admin expense ratio was mainly due to the one-off listing expense recorded in 2020. The adjusted NP of the company in 2020 was RMB 218.8 million (-38.3% YoY), which is in line with our previous forecast.

Maintaining competitive advantages in MMORPG while expanding territory to other game genres

Following the successful launch of Dragon Raja (龍族幻想) in China, the company had successfully launched four new regional versions of Dragon Raja (龍族幻想) in Europe and the Americas, Japan, Southeast Asia and Vietnam with outstanding results. In specific, the Japanese version of Dragon Raja (龍族幻想) became the first Chinese mobile MMORPG to top the Top Free Games Charts of both iOS App Store and Google Play in Japan, once again demonstrating the company's leading R&D and distributing capabilities in MMORPG game genre. On the other hand, the company will continue to expand the game genres in its game portfolio, including SLG and female-oriented game genres. In particular, Under the Firmament (鴻圖之下) launched in October 2020 is the company's first try in SLG and the gross billing of the game exceeded the RMB 100 million mark in the first month since launching.

Buy (Maintain)

CMP HKD 14.52

(Closing price as of 11 May)

TARGET HKD 25.88 (+78%)

COMPANY DATA

O/S SHARES (MN) :	816
MARKET CAP (HKD MN) :	11,841
52 - WK HI/LO (HKD):	28.40/12.30

SHARE HOLDING PATTERN, %

Cresc Chorus Limited	34.13
Perfect World Interactive Entertainment	16.99
Image Frame Investment (HK) Limited	12.88
GIC Private Limited	6.83
Green Particle Limited	6.17

PRICE VS. HIS



Source: Wind, Phillip Securities

KEY FINANCIALS

CNY mn	FY19	FY20	FY21E	FY22E
Net Sales	1,067	1209	2395	4469
Adj. Net Profit	355	219	655	997
Adj. EPS	N/A	0.27	0.80	1.22
Adj. P/E, x	N/A	46.00	15.36	10.10
NS per share	N/A	1.48	2.94	5.48
P/S, x	N/A	8.33	4.20	2.25
ROE, adj (%)	N/A	6.16	15.58	19.17
ROA, adj (%)	N/A	5.47	12.49	13.66

Market closing price as of 11th May

Source: Company Data, Phillip Securities Est.

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Continuous improvement in R&D capabilities to build a solid foundation for future products development

Even in the backdrop of Covid-19 and delay of the game launchings in 2020, the company was still actively improving its R&D capabilities. Among the 458 new employees employed in 2020, roughly 855 of them are R&D personnel. In 2021, the company will continue to increase investment in R&D personnel, including providing competitive salary and incentive plans to attract and retain R&D talents. On the other hand, the company has reached a more long-term and in-depth partnership agreement with the game engine developer Epic Games on the issue of Unreal Engine 5 (UE5) authorization, which makes the company one of the earliest game developers allowed to develop games using the UE5. Based on the intensive experiences of the company on Unreal Engines, we believe the company is capable to continuously develop hit-games using UE5 in the future.

We expect 2021-2022 will be the harvest period for the company

It is expected that the company will launch 3 titles in 2021, including The New World (夢想新大陸) which was already launched in January 2021 and 2 other games, namely Noah's Heart (諾亞之心) and Project C. Noah's Heart (諾亞之心) is an open world MMORPG game with a "Seamless Sphere-Shaped Map" and is expected to be launched in year mid, while project C is a SLG game and is expected to be launched before the end of the year. On the other hand, the company has 4 other games on its pipeline, including Project A (female oriented), Project B (MMORPG), Sango Heroes (三國群英傳) (MMORPG) and Project D (MMORPG). All 4 of the games are expected to be launched in 2022. Further the company is expected to launch Under the Firmament (鴻圖之下) in different oversea regions in 2021, including Japan, South-East Asia, HK-Macua-Taiwan and etc.

Valuation and investment thesis

We continue to be optimistic about the company's strong R&D capabilities and high probability of hit game output. In addition, Tencent has further accumulated the company's share, increasing its shareholdings to 16.88% from 12.88%, fully demonstrated Tencent's high recognition of the company's R&D capabilities.

Since the game launchings are further delayed, we lowered the company's adjusted net profit for 2021/2022 to RMB 655/997 million from RMB 741/1043 million. We lower our TP to HKD 25.88, with corresponding 2021/2022 adjusted PE at 27.4x/18.0x. We maintain Buy rating. (Market closing price as of 11th May) (exchange rate: RMB 0.85/HKD)

Risk

1) The tightening on Game regulations 2) The Games underperform comparing to expectation 3) Games launching are delayed due to unexpected reasons

Financial Statements

Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	FY18	FY19	FY20	FY21E	FY22E
Revenue	870	1067	1209	2395	4469
Gross Profit	697	890	926	1796	2905
S&M expense	-94	-114	-161	-359	-626
Admin expense	-39	-53	-138	-72	-134
R&D expense	-328	-389	-540	-695	-1117
Other operating gain/(loss)	75	34	-3	0	0
Operating Profit	311	367	83	671	1028
Net finance income	7	-9	-1	42	56
Other non operating expense	-381	-212	-857	0	0
Profit before tax	-64	145	-775	712	1084
Tax	-12	-25	16	-57	-87
NCI	1	-1	0	0	0
Profit for the year	-75	119	-759	655	997
Adjusted profit for the year	311	355	219	655	997
EPS			-0.93	0.80	1.22
Adjusted EPS			0.27	0.80	1.22

Key Financial Data

Dec Y/E	FY18	FY19	FY20	FY21E	FY22E
Valuation Ratio					
P/E ratio, x	N/A	N/A	N/A	15.36	10.10
Adjusted P/E ratio, x	N/A	N/A	46.00	15.36	10.10
P/S ratio, x	N/A	N/A	8.33	4.20	2.25
Per share data (RMB)					
EPS	N/A	N/A	-0.93	0.80	1.22
Adjusted EPS	N/A	N/A	0.27	0.80	1.22
Revenue per Share	N/A	N/A	1.48	2.94	5.48

Growth & Margin

Revenue Growth	-34%	37%	-27%	45%	10%
Operating income growth	11%	18%	-77%	707%	53%
Net income Growth	N/A	N/A	N/A	N/A	52%
Adjusted Net income Growth	-27%	14%	-38%	199%	52%
Gross Profit Margin	80%	83%	77%	75%	65%
Operating profit Margin	36%	34%	7%	28%	23%
Net Profit Margin	-9%	11%	-63%	27%	22%
Adjusted Net Profit Margin	36%	33%	18%	27%	22%

Key Ratios

ROE, Adj	N/A	N/A	6.16%	15.58%	19.17%
ROA, Adj	N/A	N/A	5.47%	12.49%	13.66%

Source: Company, PSHK

Market closing price as of 11th May

Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY18	FY19	FY20	FY21E	FY22E
Non Current Asset					
PPE	10	9	18	18	18
ROU assets	39	42	167	258	399
Intangible assets	34	44	38	43	48
Others	33	27	75	80	100
Total Non Current Assets	115	122	298	399	565
Current Asset					
T/R	281	546	329	845	1647
Prepayments	34	33	40	49	82
Cash and cash equivalents	588	728	3056	3671	4726
Others	531	474	280	280	280
Total Current Assets	1434	1781	3704	4845	6735
Total Assets	1549	1903	4002	5244	7299
Non Current Liabilities					
Lease Liabilities	10	23	133	224	365
Contract Liabilities	14	10	10	34	63
Others	1201	1434	0	0	0
Total Non Current Liabilities	1225	1467	142	258	428
Current Liabilities					
Lease Liabilities	23	15	32	32	32
T/P	165	157	206	585	1336
Contract Liabilities	67	62	65	158	295
Others	16	33	7	7	7
Total Current Liabilities	271	266	310	782	1670
Total Equity	53	170	3549	4204	5201
Total Liabilities and Equity	1549	1903	4002	5244	7299

Cashflow Statement

Dec Y/E, RMB mn	FY18	FY19	FY20	FY21E	FY22E
Profit (loss) before tax	-64	145	-775	712	1084
CFO	135	101	457	653	1094
CFI	397	58	154	-25	-26
CFF	-342	-24	1901	-13	-13
Net Change in Cash	190	135	2512	615	1055
Foreign exchange	41	5	-184	0	0
Cash and CE at Y/E	615	728	3056	3671	4726

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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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