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Report Review of May 2023

Hong Kong | INVESTNOTES REPORTS REVIEW

Sectors:

TMT, Semiconductors, Consumer & Healthcare (Eric Li)

TMT, Food (Elvis Kwok)

TMT, Semiconductors, Consumer, Healthcare (Eric Li)

This month I released reports of Oriental Watch Holdings Limited(00398.HK).

Oriental Watch Holdings Limited (Oriental Watch) that founded in 1961, has developed an extensive retail shop network in the Greater China area, and has become one of the largest watch retailers. Company carries around a hundred prestigious brands, in particular, famous Swiss brands such as Rolex, Tudor, Piaget, Vacheron Constantin, IWC, Jaeger-LeCoultre, Girard Perregaux, Longines, Omega, etc. Company operates a total of 12 shops in HK SAR and Macau SAR, including Oriental Watch Company, La Suisse Watch Company, Rolex and Tudor Boutique and Breitling Boutique. In 2004, company expanded its watch retail business to Mainland China. Since then, company has opened a number of outlets and boutiques covering various cities in Mainland, China. Subsequently, company has further expanded its businesses to Taiwan region. As at 30 September 2022, company operates 44 retail points (including associate retail stores) in the Greater China region, and 1 online store in each of the Mainland China and HK respectively.

In 1HFY2023 (for the six months ended 30 September 2022), company's revenue decreased by 10.0% yoy to HK\$1,674 million, which was mainly attributable to the decrease in revenue in the Mainland China market as a result of business interruptions due to such lockdown policy and restrictions. In line with the decrease in revenue, gross profit decreased by 6.9% to HK\$537 million, with gross profit margin increased by 1.1 percentage points to 32.1%, and profit attributable to owners of the company decreased by 9.6% to HK\$151 million. Basic EPS were 31.03 HK cents, down 9.2% yoy. Interim dividend of 7.8 HK cents per share (1HFY2022: 8.6 HK cents per share) and a special dividend of 23.5 HK cents per share (1HFY2022: 25.8 HK cents per share).

In Hong Kong, the COVID-19 pandemic situation has been under control since the first quarter of 2022. Yet, clouded by market uncertainty, the market sentiment remained cautious with the value of total retail sales decreased by 1.3% yoy during the first nine months of the year. However, sales of jewelry, watches and clocks, and valuable gifts recorded a slight increase of 0.2% during the same period. Despite the uncertain retail market sentiment, Hong Kong operation still outperformed the market with revenue increased by 6.1% to HK\$504 million for the period, accounting for 30.1% of the overall revenue, segment profit increased by 81.8% to HK\$42.75 million.

Revenue from Mainland China operation decreased by 15.4% to HK\$1,101 million, accounting for 65.8% of the overall revenue, segment profit decreased by 23% to HK\$189.86 million.

Looking ahead, although China and Hong Kong have entered the road to normal after the epidemic, with the uncertainty from the increase in interest rate, and the management also expects consumers to become more conservative in consumption, especially on purchasing of high-end luxury goods. Hence, the business will be under some pressure over the upcoming periods.

TMT, Food (Elvis Kwok)

This month I released one report, CMGE (302.HK).

CMGE (302.HK) is a global IP game ecological company. As of December 31, 2022, the Group has a huge IP reserve, including 64 authorized IPs and 68 self-owned IPs, totaling 132 IPs. According to data from Analysys, apart from Tencent Games, the Group is the Chinese game publisher with the largest number of IP reserves, and the Chinese game publisher with the largest number of mobile IP games launched in the past two years. The Group's revenue sources mainly come from three parts, namely game distribution, game development and intellectual property (IP) licensing.

A review of 2022 Results

For the year ended 31 December 2022, the company's revenue amounted to 2.71 billion (RMB, the same below), decreasing 31.4% YoY. The cost of sales amounted to 1.6 billion, decreasing 35.5% YoY. Gross profit amounted to 1.11 billion, decreasing 24.6% YoY. Gross profit margin was 41%, a slight increase of 3.7 percentage points YoY. The loss during the period amounted to 210 million, turning from profit to loss YoY. The adjusted net loss amounted to 200 million, turning from profit to loss YoY.

Business features

The company's business mainly revolves around the IP of a large number of well-known cultural products and works of art that it owns, such as from popular animations, novels and movies. The company's well-known film and television IPs include licenses from Disney, Warner Bros., Universal Studios' Star Wars, Disney All-Stars, DC Comics, and Minions. Comics IP includes the famous Japanese comics "One Piece", "Naruto", "Dragon Ball", etc. The film and game IP includes the famous Chinese fairy tale series "Xuan Yuan Sword" and "Sword and Fairy".

Gaming business

The company's game publishing revenue from 2018 to 2022 accounted for 88%, 84%, 78%, 71% and 77.9% of the total revenue respectively. The data reflects that the company is gradually releasing the value of its IP and the development of its self-developed game business. Income gradually no longer depends on a single business. However, as the company was greatly affected by the suspension of the game license in the first half of 2022, the new game failed to obtain the license and go online in time to replace the existing self-developed and publishing games with declining popularity, and there was no large-scale IP authorization. Income can only rely on existing publishing games, and the overall income has dropped significantly.

Popular games

Rakshasa Street: Chosen One is a 3D role-playing action (ARPG) game launched in December 2022 in the style of "China Fashion" (emerging trends that include traditional Chinese style). The theme of the game comes from the popular animation IP Rakshasa Street in the mainland. The game has more than 5 million users who pre-ordered and downloaded the game in mainland China. On the first day of its launch, the number of downloads across all channels exceeded 2 million, and the turnover exceeded 100 million in the first week. It ranked No.1 on the China App Store Free List and No.4 on the Best-Selling List. According to the data survey agency Sensor Tower (the data does not include third-party Android platforms in China or other places, the same below), the game has US \$500,000 in revenue and 30,000 downloads in April 2023. The overall performance of the game is good but compared with the revenue of 3 million USD and the number of downloads of 200,000 in January, the data declines faster, and the game team needs to work hard to maintain the popularity of the game. One Piece: The Voyage is a 3D action game jointly developed by CMGE and Nuverse Game under ByteDance. It launched in May 2021. The theme of the game comes from the famous Japanese animation IP One Piece authorized by CMGE. According to Sensor Tower, the game has USD 3 million in revenue and 100,000 downloads in April 2023. The game has performed

well since its launch, and it still maintains a good turnover and popularity.

IP development

According to Gamma Data's 2021 China Self-developed Game IP Research Report, the group's well-known IP "Xuan Yuan Sword" and "Sword and Fairy" are among China's most influential TOP50 self-developed game IP products. At present, the group is deeply developing the cooperation of the entire industry chain of "Sword and Fairy" IP, covering games, film and television, animation, content literature, music, derivatives, and live entertainment, etc., and hopes to join hands with top partners in related fields to jointly create the "Sword and Fairy" IP universe. The Group currently has three projects worthy of investors' attention, including "Sword and Fairy: Wen Qin", "Sword and Fairy: Yuanqi" and "Sword and Fairy: world". "Sword and Fairy: Wen Qin" is a story-adventure card mobile game, and the license has been approved.

As for "Sword and Fairy: Yuanqi" is a massively multiplayer online roleplaying (MMORPG) mobile game that the company cooperates with Alibaba's Lingxi Interactive Entertainment. It has entered the final test but has not yet obtained the license. Given that Lingxi Interactive Entertainment is good at producing high-quality games, such as its games "Romance of the Three Kingdoms" and "Orient Arcadia" have performed very well. According to the data of Sensor Tower, the former has been ranked among the top ten popular mobile games in the world for a long time after its launch, and the latter ranked first in the overseas revenue growth list of Chinese mobile games in October 2022 after its overseas launch. Considering the massively multiplayer online role-playing game's strong ability to attract money and the good reputation of the research and development company, we expect that the launch of this game may become a catalyst for the company's stock price.

"Sword and Fairy: world" is China's first cross-platform Chinese culture Metaverse game with open world elements, and also the first China's Chinese culture Metaverse entertainment and social platform that provides in-depth experience of virtual reality and allows players to use virtual reality equipment to truly incarnate virtual characters. In addition, the company has become a partner of Baidu's ERNIE Bot, and will apply the technology of ERNIE Bot in the game to realize the function of non-player character (NPC) interaction and more convenient User Generated Content (UGC) creation to enhance player gaming experience. At present, the company plans to launch this game in the first half of 2023. We expect that this game will attract many players to try because of its uniqueness and freshness. However, since the concept of "Sword and Fairy" combined with metaverse is too unique and innovative, investors need to pay attention to factors such as player feedback and game quality after the game is launched to evaluate the game's monetization ability and subsequent performance.

Valuation and recommendation

The uniqueness of CMGE is that the company has many well-known IPs, which can attract players who love the IP to try the game because of the IP. At the same time, other game companies will cooperate with them to develop games because of the IPs owned by CMGE and complement each other. With the re-approval of game licenses in the mainland, the negative factors that mainly affect CMGE have been eliminated. In the first half of 2022, the key games hoarded due to the unapproved licenses are being launched one after another, which is expected to greatly improve the company's revenue in 2023. Also, "Sword and Fairy: Yuanqi" is worth looking forward to by investors. We expect CMGE's net sales amount to RMB 3.96 billion and 50.7 billion in FY2023-2024 respectively, the CAGR of 2022 – 2024 is 23.2%. Corresponding P/S ratio are 1.6/1.2x. While the company's average P/S in the past three years was around 1.86, we give CMGE 1.86 P/S in FY 2023 and a target price of \$3.00 HKD. (Calculated at the exchange rate of RMB to HKD 1.13), with a "buy" rating. (Current price as of May 15)

Fig 1. Performance of Recommended Stocks

Time	Ticker	Company	Analyst	Rating	Price on Recommendation Date	Target Price	Expected Return	Last Month Closing Price	Last Month Return	Closing Price 2M ago	1M Price Chg
20230505	398 HK	Oriental Watch Holdings Limited	EL	Accumulate	4.49	5.14	14.5%	4.30	-4.23%	4.49	-4.23%
20230515	302.HK	CMGE	EK	Buy	2.22	3.00	35.1%	1.99	-10.36%	2.53	-21.34%

A stock is calculated by RMB yuan.

Source: Phillip Securities Research

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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Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
Number 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Heng Feng Road,
Green Tech Tower Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 60911155
Website: www.phillip.com.cn

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website www.phillip.co.th

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005

AUSTRALIA

PhillipCapital Australia

Level 10, 330 Collins Street

Melbourne VIC 3000

Tel (+61) 3 8633 9803

Fax (+61) 3 8633 9899

Website: www.phillipcapital.com.au