

## SECTOR UPDATE

### Internet – China

#### 3Q22 Game Market Remains Weak After Lockdowns

We expect China's 3Q22 game revenue performance to be weak or below the street's estimates, an 11% further drop in September's grossing. The games being approved in Sep 22 are mainly from smaller players, while Tencent has yet to receive a new game approval since Jul 21, which has become a laggard to the company. We remain cautiously optimistic at this juncture pending the resumption of near-term sentiment. Maintain MARKET WEIGHT.

#### WHAT'S NEW

- **Overview of NPPA's 13 September new game approvals.** The National of Press and Publication Administration (NPPA) approved 73 domestic games on 13 September, vs August/July/June approvals of 69/67/60. Online game developers such as Netease (9999 HK), XD Inc (02400 HK), and ZQGame (300052 CH) were some of the smaller players which had their games approved by the NPPA, while gaming giant Tencent was absent from the list. According to the data, mobile games still account for a larger portion of the new games being approved. The new game approval was solely dedicated to domestic developed games only, whereas overseas games (to be published in China) have not had any approvals since 28 Jun 21.
- **Mobile game revenue growth worsened in September.** Mobile game grossing in China saw further weakening in September with an 11% yoy decline (vs. -8% and -6% in August and July). According to Sensor Tower, Tencent's top 10 highest grossing mobile games (by month) declined 9% mom and 23% yoy due to the high base of Supercell and decline in grossing of PUBGM (-48% yoy). Meanwhile, Netease saw a 15% mom and 38% yoy decline in Sep 22 partly dragged by significant grossing decline of Knives Out Japan. In terms of 3Q22 performance (by top 10 highest grossing mobile games), Tencent and Netease both declined by 27%/24% yoy respectively in game grossing.
- **Tencent: Lack of new growth drivers for top-line.** Tencent's mobile grossing dropped 3% yoy (domestic: flat; international: -23% yoy). The weakness can be seen across multiple game titles due to weaker domestic sentiment and relaxation of lockdown measures in the international market which reduced time spent on online games. Despite absence of new games being approved by NPPA, top-line is supported by "League of Legends" with 69% growth mom due to the new version and Honour of Kings (HoK) saw revenue growth of 6% yoy in September, driven by the seasonal expansion pack launched that month. We cut our game revenue growth to -6% yoy in 3Q22 for Tencent from a previous 5% yoy growth.
- **Netease: Game grossing plunged in September.** Netease mobile grossing dropped 41% yoy in September (domestic: -46% yoy; international: -38% yoy). The decline in Sep 22 was due to poor performance from Diablo Immortal which dropped by 48% mom with its ranking dropping to seventh position. Since Diablo Immortal first debuted in July, it had been experiencing robust growth, delivering top-line growth of 234% mom in August and ranked as the sixth highest grossing mobile title globally. The decline in Diablo Immortal and other game titles is offset by top-line growth of Onmyoji which registered a growth of 122% mom after three months of negative growth. Hence, we remain cautiously optimistic on the company due to the uncertainties which are yet to stabilise. We cut our game revenue to 15% yoy growth in 3Q22 for Netease from the previous 22% yoy growth.

#### PEER COMPARISON

Company	Tickers	Rec	Price @ 18 Oct 22 (LC\$)	Target Price (LC\$)	Upside/ (Downside) to TP (%)	Market Cap (LC\$m)	-----PE-----			-----EV/EBITDA-----			-----EV/Sales-----			ROE 2022F (%)
							2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	
Tencent	700 HK	BUY	254.4	347	36.4	2,444,478	19.8	16.6	13.7	14.2	11.3	10.4	4.2	3.8	3.3	22.3
Netease	9999 HK	HOLD	112.9	123	8.9	370,763	16.3	14.3	13.0	10.9	9.7	8.6	2.6	2.4	2.1	19.9

Source: Bloomberg, UOB Kay Hian

## MARKET WEIGHT

(Maintained)

#### SECTOR PICKS

Company	Ticker	Rec	Share Price (HK\$)	Target Price (HK\$)
Tencent	700 HK	BUY	254.40	347.00

Source: UOB Kay Hian

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## ESSENTIALS

- **International games continue to deliver weak performance.** According to Sensor Tower, the global mobile gaming market had a total download volume of 4.6b, which marked a decline of 1.6% yoy due to global macro volatility and post-COVID-19 gaming behaviour normalisation. The Chinese mobile gaming market remains to be the largest contributor, contributing 28.5% of downloads.
- **Outlook overshadowed by regulatory uncertainties.** The NPPA mandate issued in Aug 21 outlined the rules to combat addiction among minors in the country by implementing limitation on chaotic/sub-standard online game content. With stringent restrictions, the lack of growth drivers for Tencent and Netease was reflected in their pressured top-line growth. Despite gradual resumption of new games approval since Apr 22, the number of new games being approved is still lower than pre-suspension. While we have seen policy risks subsiding within the industry, key things to watch out for the coming months are: a) resumption of new game approvals for Tencent and Netease, b) monthly game grossing performance, and c) a potential revival in the launch of Netease's Diablo Immortal.

## EARNINGS REVISION

- We cut Netease's revenue and earnings by 3.5% and 2% for 2022. We cut Tencent's revenue and earnings by 3% and 2% for 2022 on weaker online game growth.

## VALUATION/RECOMMENDATION

- **Maintain BUY on Tencent (700 HK) with a lower target price of HK\$347.00** with only 12x PE multiple for its game valuation. We forecast game revenue to decline by 6% yoy in 3Q22 and remain flatish yoy for 2022. The company may still be poised for valuation re-rating should the NPPA resume its approval for Tencent's games. The company now is trading at 16x 2023F PE, 2x STD below historical average. Our target price implies 23x 2023F PE against its historical average of 30x. We prefer Tencent in the online game universe for a value pick.
- **Downgrade Netease (9999 HK) to HOLD with a lower target price of HK\$123.00 (US\$127.00)**, due the volatile game grossing performance and lower-than-expected game revenue growth. We forecast Netease revenue and earnings CAGR of 9% and 10% over the next three years. The company now is trading at 14x PE, in line with its historical average. Our target price implies 14.3x 2023F PE against 10% EPS CAGR over the next three years.

## SECTOR CATALYST AND RISK

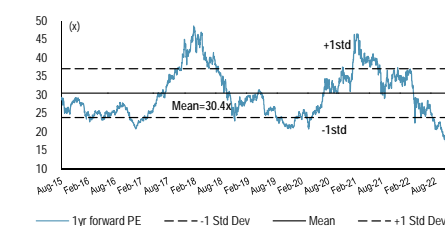
- **Catalysts:** a) Increasing user stickiness, b) continue improvement on paying users, launch of new genre and expansion packs.
- **Risks:** a) Regulatory risk (ie further restriction on time/money spent), b) smaller players continue to gain market share via unconventional distribution channels.

## TENCENT, NETEASE, BILI GROSSING AND MARKET SHARE PERFORMANCE

Tencent	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	2022	3Q22
International grossing % yoy	12.2	2.0%	6.0%	-25.0%	-27.0%	-40.0%	-36.0%	-21.0%	-23.0%	-31.0%	-27.0%
International mkt share %	4.8%	4.5%	4.7%	4.4%	4.4%	3.8%	3.5%	4.4%	3.9%	4.2%	3.9%
Domestic grossing % yoy	-8.0%	-9.0%	1.0%	7.0%	9.0%	-4.0%	-8.0%	15.0%	0.0%	4.0%	-8.0%
Domestic grossing % mom	27.0%	-9.0%	6.0%	8.0%	-1.0%	-15.0%	7.0%	-5.0%	-9.0%	3.0%	-10.0%
Netease	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	2022	3Q22
International grossing % yoy	-9.0%	-28.0%	-22.0%	-5.0%	-29.0%	-29.0%	-8.0%	-29.0%	-38.0%	-22.0%	-19.0%
International mkt share %	1.2%	1.1%	1.0%	1.1%	1.1%	0.9%	1.2%	0.9%	0.7%	1.0%	-11.0%
Domestic grossing % yoy	-13.0%	-31.0%	-11.0%	4.0%	9.0%	4.0%	-9.0%	6.0%	-42.0%	6.0%	-19.0%
Domestic grossing % mom	-6.0%	-20.0%	12.0%	19.0%	5.0%	-17.0%	-4.0%	14.0%	-15.0%	16.0%	-11.0%
Bili	Jan-22	Feb-22	Mar-22	Apr-22	May-22	Jun-22	Jul-22	Aug-22	Sep-22	2022	3Q22
International grossing % yoy	-8.0%	28.0%	75.0%	28.0%	-69.0%	-13.0%	84.0%	20.0%	-77.0%	-43.0%	-23.0%
International mkt share %	0.08%	0.05%	0.04%	0.03%	0.04%	0.19%	0.1%	0.05%	0.0%	0.10%	0.1%
Domestic grossing % yoy	63.0%	0.0%	46.0%	-33.0%	-53.0%	-25.0%	122.0%	-43.0%	29.0%	-39.0%	13.0%
Domestic grossing % mom	-19.0%	-41.0%	-14.0%	15.0%	57.0%	18.0%	67.0%	-44.0%	-2.0%	22.0%	48.0%

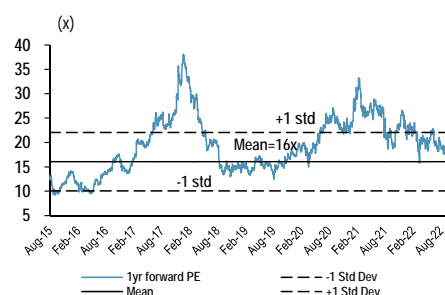
Source: Sensor Tower, UOB Kay Hian

## TENCENT 12-MONTH FORWARD PE BAND



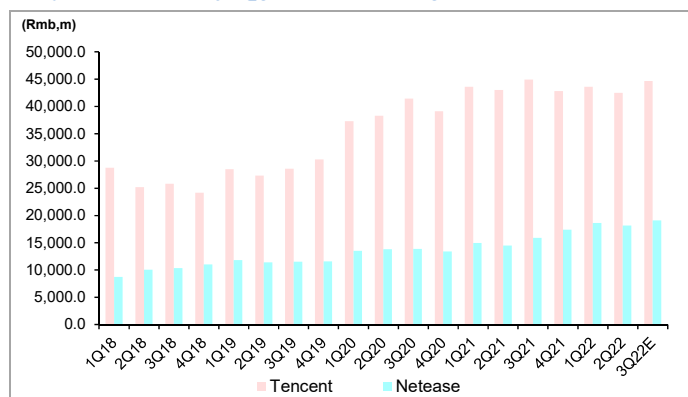
Source: Bloomberg, UOB Kay Hian

## NETEASE 12-MONTH FORWARD PE BAND



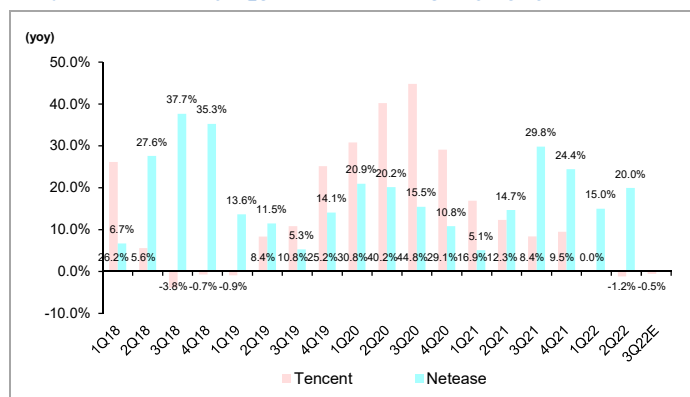
Source: Bloomberg, UOB Kay Hian

### TENCENT AND NETEASE QUARTERLY REVENUE



Source: Tencent, Netease, UOB Kay Hian

### TENCENT AND NETEASE QUARTERLY REVENUE YOY GROWTH



Source: Tencent, Netease, UOB Kay Hian

### ONLINE GAMES COMPANIES

Company	Tickers	Currency	Year End	Price @ 18 Oct 22 (LC\$)	Market Cap (LC\$m)	PE			EV/EBITDA			EV/Sales			ROE 2022F
						2022F	2023F	2024F	2022F	2023F	2024F	2022F	2023F	2024F	(%)
<b>HK-listed Chinese Internet &amp; game companies</b>															
Tencent	700 HK	HKD	12/2021	254.4	2,444,478	19.8	16.6	13.7	14.2	11.3	10.4	4.2	3.8	3.3	22.3
NetEase Inc	9999 HK	HKD	12/2021	112.9	370,763	16.3	14.3	13.0	10.9	9.7	8.6	2.6	2.4	2.1	19.9
Kingsoft Corp Ltd	3888 HK	HKD	12/2021	20.8	28,426	123.1	41.8	26.7	6.7	5.3	4.3	1.8	1.5	1.3	0.8
IGG	799 HK	HKD	12/2021	2.6	3,077	n.a.	25.7	15.6	n.a.	12.4	4.8	0.3	0.3	0.3	-11.2
Netdragon	777 HK	HKD	12/2021	14.8	8,003	5.6	4.6	3.9	2.4	2.2	1.9	0.6	0.5	0.4	17.0
Bilibili	9626 HK	HKD	12/2021	98.8	39,492	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1.9	1.5	1.2	-41.8
XD	2400 HK	HKD	12/2021	16.9	8,119	n.a.	n.a.	17.7	n.a.	n.a.	12.6	1.7	1.2	1.0	-38.1
Average						13.9	15.3	15.1	8.6	8.2	7.1	1.9	1.6	1.4	-4.4
<b>US-listed global Internet &amp; game companies</b>															
Activision Blizzard	ATVI US	USD	12/2021	71.8	56,138	25.6	19.0	17.5	17.1	12.6	11.5	6.3	5.2	5.0	10.9
Electronic Arts	EA US	USD	03/2022	121.0	33,652	16.9	15.9	14.5	11.8	11.1	10.3	4.2	4.0	3.7	11.7
Take-Two	TTWO US	USD	03/2022	117.9	19,627	24.1	16.5	13.0	20.7	14.5	11.3	4.1	3.0	2.6	2.4
Average						22.5	18.0	15.7	16.5	13.2	11.5	5.7	4.8	4.4	18.0
<b>Other game companies</b>															
Nintendo	7974 JT	JPY	03/2022	6115	7,941,489	16.4	17.3	18.2	10.3	10.8	11.4	3.6	3.7	3.7	26.2
Sony	6758 JT	JPY	03/2022	9754	12,300,592	14.1	13.1	11.7	7.4	7.1	6.6	1.3	1.2	1.1	12.9
Nexon	3659 JT	JPY	12/2021	2596	2,247,806	21.0	19.2	16.5	13.7	10.8	9.4	4.7	4.1	3.7	15.1
Ubisoft	UBI FP	EUR	03/2022	27	3,413	13.5	11.7	9.7	4.1	3.7	3.0	1.7	1.5	1.4	4.6
Ncsoft	036570 KS	KRW	12/2021	355500	7,804,655	15.3	14.0	12.3	8.1	7.7	6.7	2.1	2.0	1.8	16.4
Bandai Namco	7832 JT	JPY	03/2022	9831	2,182,482	22.4	20.9	19.3	12.1	11.4	10.5	2.1	2.0	1.9	19.6
Average						16.1	15.2	14.3	9.1	8.3	7.7	2.4	2.2	2.1	14.9

Source: Sensor Tower, UOB Kay Hian

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