

AVISTA Insight

Online Game Sector

An unexpected 300 times oversubscription was recorded a few weeks ago when Forgame Holdings Limited (“Forgame”) went IPO on the HKSE. The stock price rose more than 30% on the very first day of trading and closed at HK\$67.5. It kept climbing on the following days and reached a record of HK\$73.95. IGG Inc., a Singapore mobile game developer, was also listed on the Gem Board of HKSE on 18th October. With the initial offering price of HK\$2.8, its share used to reach an incredible HK\$4.7 on the first day of trading. People would ask: Why would it be?

Industry Leader Listed on Market Average

According to Enfodesk Research, Forgame is one of the leading web game providers in the market with a share of around 10%. As one of the a market leader, a premium would often be charged to its offering price. However in this case, its target IPO price was reasonably ranged from HK\$55 to HK\$43 for an expected 2013 P/E ratio of 12X to 9.5X which is around the market average. A quality stock with a reasonable price tag seems to be one of the reasons of the oversubscription.

Superior Location and Perfect Timing

The IPO market is no longer flourishing as it was in the past years. IPO has been banned for some years in China in order to make way for the financial reform. And in the U.S., Chinese companies are no longer so welcomed as before since the outbreak of the Chinese private company scandals in 2011. Hong Kong therefore inevitably becomes the best way-out for those companies which are urgently seeking funding and investment. On the other hand, the Hong Kong market has waited for a quality listing for a long time. Especially for the online gaming industry, since there is no leading company in such industry (except Tencent or Netdragon with more than 40X and 77X P/E respectively) went public in Hong Kong in the last few years. The listing of Forgame and IGG, as the first movers in years, filled the starving Hong Kong investors in a perfect timing.

The Fundamentals

The gaming industry has gone through different stages of progression in the last few years. The developing momentum has shifted from massively multiple online games (“MMOG”) to web games (“WG”) and mobile games (“MG”). Forgame is a WG focused company but has ambitiously expanded into the MG market and launched its first but successful MG right before its IPO. We believe that the move has largely stimulated the investors’ interest in the company. The story repeated on IGG which is also a MG focused game developer.

Contact Us

Email: Info@avaval.com

Website: www.avaval.com

Hong Kong Office

Address: Suite 807, 8th Floor,
AXA Centre, 151 Gloucester Road,
Wan Chai, Hong Kong
Tel: +852 3907 0680
Fax: +852 3914 6388

Shanghai Office

Address: Suite 1502,
Haitong Securities Tower,
No. 689 Guangdong Road,
Huangpu District, Shanghai, PRC
Tel: +86 21 5306 7311
Fax: +86 21 3316 0292

Beijing Office

Address: Suite 703,
Beijing Silver Tower, No.2 North
DongSanHuan Road,
Chaoyang District, Beijing, PRC
Tel: +86 10 6410 6230

The information contained in this material has been compiled by AVISTA from source that it believes to be reliable and the opinions, analysis, forecasts, projections and expectations contained are based on such information and are expressions of belief only. No representation, warranty or guarantee is made or given by AVISTA or any other person as to its accuracy or completeness. All opinions and estimates expressed in this material are subject to change without notice.

This material is not intended to be relied upon a forecast, research, or investment advice, and is not a recommendation, offer or solicitation to buy or sell any securities or to adopt any investment strategy.

Copyright 2013 AVISTA. All rights reserved. This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of AVISTA.

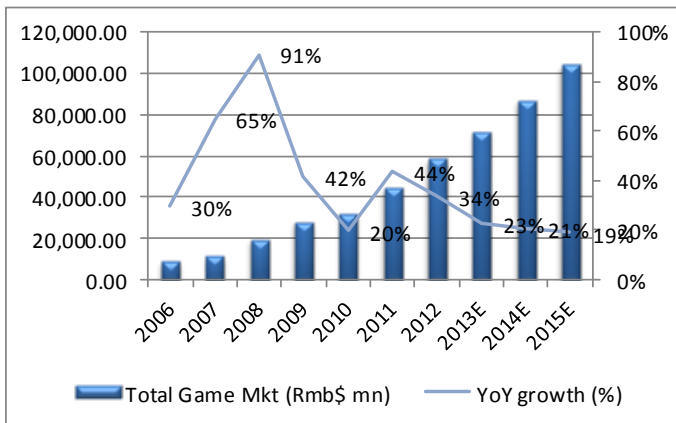
Online Game Sector

What's next?

We expect more IPOs within the sector in the coming months. Given the market situations of the China and U.S., Hong Kong would likely continue to be the most ideal and obvious choice for Chinese I.T. companies who opt for an IPO.

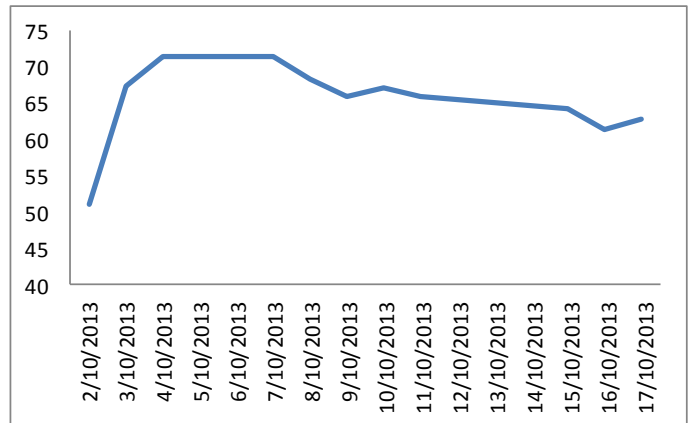
As technology advanced, the mobile market, including mobile phone, mobile application, mobile game, etc., is emerging so fast among the whole I.T. industry. Given such trend we observed, we consider that MG and WG focused online game companies would become increasingly active in the equity market in near future.

Figure 1: China Gaming Market Size Projection



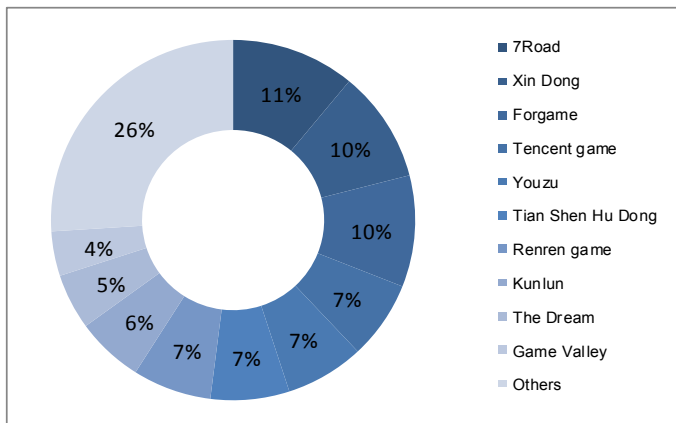
Source: IDC Research, AVISTA Research

Figure 2: Forgame Closing Price



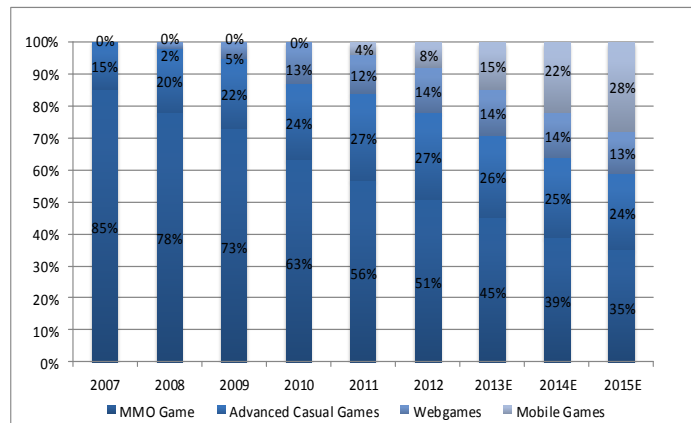
Source: Bloomberg, AVISTA Research

Figure 3: China Gaming Market Share



Source: Enfodesk Research, AVISTA Research

Figure 4: China online game segment breakdown



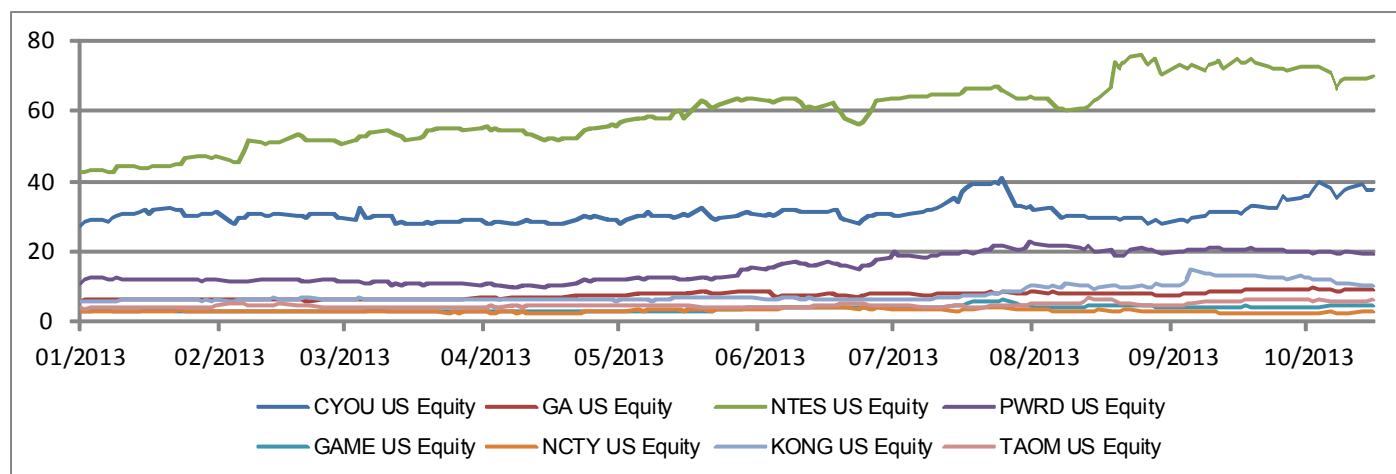
Source: IDC Research, AVISTA Research

Appendix: Peer Group Valuation

Company	Ticker	Ccy	Close price	Mkt Cap (US\$Mn)	EPS Consensus			PE		
					2013	2014	2015	2013E	2014E	2015E
Changyou	CYOU US	USD	32.4	1717	5.7	6.1	6.7	5.9x	5.3x	4.4x
Giant Interactive	GA US	USD	9.1	2168	0.9	1.0	1.1	9.8x	9.2x	8.2x
NetEase	NTES US	USD	72.0	9400	5.5	6.1	6.7	13.1x	12.7x	11.2x
Perfect World	PWRD US	USD	20.3	983	1.5	1.9	2.3	13.5x	10.5x	8.6x
Shanda Games	GAME US	USD	4.2	1125	0.8	0.9	0.9	5.5x	4.9x	4.6x
The9	NCTY US	USD	2.4	73	(3.2)	n.a.	n.a.	-0.7x	n.a.	n.a.
KongZhong	KONG US	USD	12.6	354	0.5	0.6	n.a.	27.9x	21.6x	n.a.
Taomee	TAOM US	USD	6.0	220	0.1	0.2	n.a.	82.3x	40.1x	n.a.
Average								19.7x	14.9x	7.4x

Company	Ticker	PB	PS	ROE	EV/EBITDA			FCF yield (%)		
		2013E	2014E	2015E	2013E	2014E	2015E	2013E	2014E	2015E
Changyou	CYOU US	1.3x	2.2x	24.5%	4.1x	3.9x	3.3x	7%	19%	22%
Giant Interactive	GA US	2.7x	4.9x	32.8%	7.6x	6.3x	5.3x	11%	11%	n.a.
NetEase	NTES US	2.6x	5.8x	20.5%	8.9x	7.6x	6.6x	6%	8%	9%
Perfect World	PWRD US	1.2x	0.3x	13.3%	7.3x	4.8x	3.0x	8%	12%	n.a.
Shanda Games	GAME US	0.9x	1.5x	18.7%	3.0x	2.3x	2.2x	20%	21%	22%
The9	NCTY US	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
KongZhong	KONG US	n.a.	1.8x	n.a.	n.a.	n.a.	n.a.	4%	4%	n.a.
Taomee	TAOM US	n.a.	4.5x	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Average		1.7x	3.0x	22.0%	6.2x	5.0x	4.1x	9%	12%	18%

Figure 5: Peer Group Stock Price



Source: Bloomberg, AVISTA Research