

### SECTOR UPDATE

#### Internet – China

Resumption Of New Games Approval; A Boon To Investor Sentiment

The NPPA had on the 11 April officially announced approval for 45 domestic games, ending an eight-month hiatus of online game approval (vs nine months in 2018). The games being approved are mainly from Baidu, XD.com, Lilith Games and 37Games, whereas Tencent and Netease are not in the list. We remain cautiously optimistic given the resumption will improve near-term sentiment. However, any meaningful financial contribution from the approval of new games should take at least one year to realise. Maintain MARKET WEIGHT.

#### WHAT'S NEW

- **Overview of the notice released by the NPPA.** A total of 45 new games has been approved, compared with 87 new games approved in Jul 21 (prior to the start of the suspension). Mobile games developed by Baidu, XD.com, Lilith Games and 37Games such as BangBang Rabbit, FlashParty, Life of The Party, and Dream of Voyage were among those approved by the NPPA based on the notice released yesterday. 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.
- **Our thoughts on the resumption.** Back in Aug 21, the suspension by NPPA was started to protect minors from wasting too much time/money on playing games, and to implement restrictions on chaotic/sub-standard online game content. We believe the resumption implies that the overall online gaming industry has met the compliance requirements. This will revitalise market sentiment on the gaming industry and boost the confidence of game companies to invest in and carry out R&D for new games.
- **Tencent's and NetEase's game performance well on track even without new game approval.** According to SensorTower, Tencent's and NetEase's weekly mobile game grossing reached levels seen during 2022's CNY in mid-March, partly due to the lockdowns. We believe the resilient grossing from legacy games, along with new game releases (Tencent's Black Desert Mobile on 26 April, NetEase's Dead By Daylight Japan on 28 April) and Banhao resumption should point to game revenue re-acceleration in 2H22 for both Tencent and NetEase. We are confident that game titles of both gaming giants will be included in the approval list in the coming months. Even without the new game approval this month, Tencent still has a backlog of >10 approved games in hand. Meanwhile for NetEase, the company still has four titles in hand - Diablo, Eggy Go, Roar of War and Vive Le Football – in addition to the localisation of Harry Potter: Magic Awakened in overseas markets should provide near-term support to its top-line growth. We forecast Tencent/NetEase online game revenues to grow by 6%/16% respectively in 1Q22.
- **A quick recap of the 2018 incident.** The nine-month suspension imposed since Apr 18 was due to the organisational reshuffling as the responsibility for the games industry was transferred from the Ministry of Culture and Tourism (MCT) to State Administration of Press, Publication, Radio, Film and Television (SAPPRFT), which is now known as NPPA. Due to the backlog after a nine-month hiatus, the NPPA had approved an average of 247 games per month for a period of four months before normalising to an average of <150 games approved each month. NPPA published the Dec 18 new game approval on 9 Jan 20, which sent share prices of Tencent and NetEase up by 3.8% and 6.6% respectively.

#### PEER COMPARISON

Company	Tickers	Rec	Price @ 12 Apr 22 (LC\$)	Target Price (LC\$)	Upside/(Downside) To TP (%)	Market Cap (US\$m)	PE			EV/EBITDA			EV/Sales			ROE
							2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2022F (%)
Tencent	700 HK	BUY	366.40	502.00	37.0	449,423	25.8	23.0	20.9	9.6	16.4	15.4	5.6	4.9	4.4	12.0
Netease	9999 HK	BUY	148.40	187.00	26.0	63,530	18.7	19.5	15.3	21.8	20.5	17.0	4.8	4.6	4.0	20.0

Source: Bloomberg, UOB Kay Hian

### MARKET WEIGHT

(Maintained)

#### STOCK PICKS

Company	Ticker	Rec	Share Price (HK\$)	Target Price (HK\$)
Tencent	700 HK	BUY	366.40	502.00
Netease	9999 HK	BUY	148.40	187.00

Source: Bloomberg, UOB Kay Hian

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### ESSENTIALS

- **Earnings impact may take 12 months to reflect.** Based on historical data, we notice that Tencent's online game top-line growth was rather sensitive towards the suspension of new game approvals as compared with Netease. Tencent's online game revenue growth hit a trough in 1Q19 and eventually normalised to 25% growth in 4Q19 (with absolute revenue back to pre-suspension level). This is because online game companies typically need to take at least 9-12 months to finalise their approved games by conducting several rounds of public testing, discussing licensing agreements with relevant IP holders (if the game was developed using third-party IP right) and going through marketing and promotional activity before the game can be officially launched.

### EARNINGS REVISION

- We keep our earnings estimates unchanged.

### VALUATION/RECOMMENDATION

- Maintain BUY for Tencent (700 HK) with an unchanged target price of HK\$502.00. Our target price implies 32x 2022F PE against its historical average of 30x.
- Maintain BUY for Netease (9999 HK) with an unchanged target price of HK\$187.00 (US\$120.00). Our target price implies 23x 2022F PE against the company's historical average of 22x.

### SECTOR CATALYST AND RISK

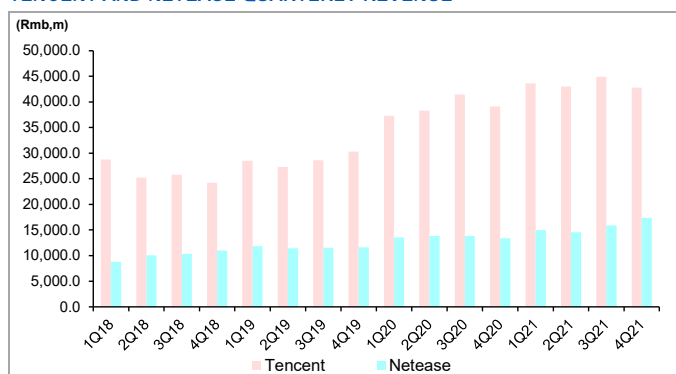
- **Catalysts:** a) Increasing user stickiness, b) continue improvement on paying users, launch of new genre and expansion packs.
- **Risks:** a) Regulatory risk (ie further restriction on time/money spent), b) smaller players continue to gain market share via unconventional distribution channels.

### POLICY ACTION RELATED TO ONLINE GAME AND ENTERTAINMENT INDUSTRY

Date	Policy & Action Taken by Regulators (CNY)	Policy & Action Taken by Regulators (ENG)	Regulations Type	Sector	Company Impacted	Overview
03-Aug-21	新华社：“精神鸦片”竟长成数千亿产业	Xinhua Calling Online Game as Spiritual Opium	Entertainment and game	Entertainment and game	Tencent, Netease, Kingsoft	China State Media Calling Online Game as Spiritual Opium and urged the government to seek solution in curtailing minor's addiction on games
30-Aug-21	国家新闻出版署关于进一步严格管理切实防止未成年人沉迷网络游戏的通知	Further Strict Management in Preventing Online Games Addiction among Minors	Entertainment and game	Entertainment and game	Tencent, Netease, Kingsoft	The NPPA had set online game playing period for the underage (<18years old) at every Fri, Sat, Sun and Public Holiday 8pm-9pm (1hr only). Gamers are required to use real name and identity number during registration.
09-Sep-21	中央宣传部、国家新闻出版署有关负责人约谈腾讯、网易等游戏企业和平台	NPPA and the Propaganda Department of CCP Invited Tencent and Netease for Discussion	Entertainment and game	Entertainment and game	Tencent, Netease	The NPPA and the Propaganda Department of CCP Invited Tencent and Netease for Discussion. The discussed topics include prohibit content sharing with regards to sex, violent, feminine man culture, glorifying money and etc.

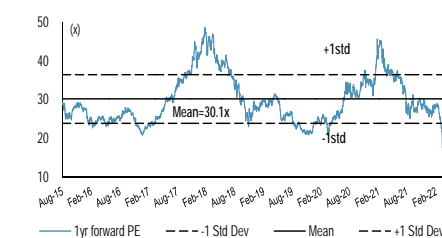
Source: Respective government website, UOB Kay Hian

### TENCENT AND NETEASE QUARTERLY REVENUE



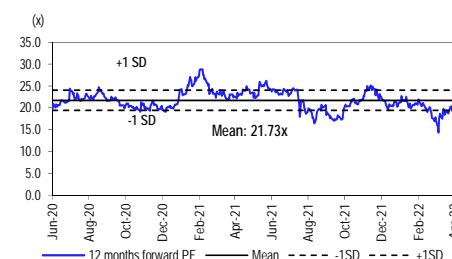
Source: Tencent, Netease, UOB Kay Hian

### TENCENT 12-MONTH FORWARD PE BAND



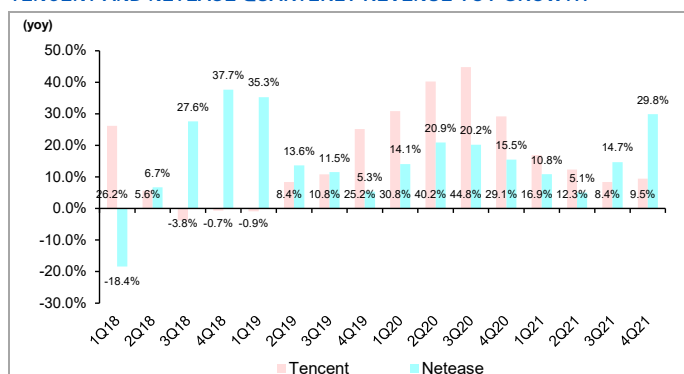
Source: Bloomberg, UOB Kay Hian

### NETEASE 12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

### TENCENT AND NETEASE QUARTERLY REVENUE YOY GROWTH



Source: Tencent, Netease, UOB Kay Hian

### TENCENT GAME PIPELINE FOR 2022

English name	Chinese name	Approval status	Genre	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Rest of 2022
Stairway to Stardom	璀璨星途	Approved	Simulation	Alpha testing 23 July			Beta testing 12 Oct			Public testing 13 Jan			
The Story of Yanxi Palace	延禧攻略之凤凰于飞	Approved	Casual	Beta testing 20 July							Public testing 15 Feb		
Dawn Awakening	黎明觉醒	Approved	Survival	Final testing on 16 July									Public testing delayed to 2022
Black Desert	黑色沙漠	Approved	RPG					Alpha testing delayed		Beta testing on 13 Jan			
An Qu Tu Wei	暗区突围	Approved	FPS		Alpha testing 12 Aug			Beta testing 5 Nov		Beta testing 14 Jan	Beta testing 23 Feb		
Joy of Life	庆余年	Approved	MMORPG	Alpha testing 24 July	Beta testing 18 Aug					Beta testing 20 Jan			
Return of the Royal	重返帝国	Approved	SLG					Alpha testing 15 Nov	Beta testing 10/27 Dec				
Apex Legends Mobile	Apex 英雄 手游	n.a.	Shooting										International soft launch in May 2022

Source: Tencent, UOB Kayhian

### NETEASE GAME PIPELINE FOR 2022

English name	Chinese name	Approval status	Genre	Jul-21	Aug-21	Sep-21	Oct-21	Nov-21	Dec-21	Jan-22	Feb-22	Mar-22	Rest of 2022
Diablo Immortal	暗黑破坏神	Approved	ARPG	Alpha testing on 15 July				Beta testing on 29 Nov				Public testing in 1H22	
Eggy Go	蛋仔派对	Approved	Casual	Banhao approved		Beta testing on 28 Sept			Final testing on 24 Dec				
Roar of War	战争怒吼	Approved	RTS						Alpha testing on 29 Dec				
Vive Le Football	绿茵信仰	Approved	Sports		Alpha testing on 21 Aug					Beta testing on 14 Jan			

Source: netease, UOB Kayhian