



Market Cap Bt8.3bn – Opium for the mind

We did recommend the stock last month, and it rallied pretty well by 40%. To raise our confidence that the stock/business will not only be a pandemic winner or drop dramatically after the situation eases, we recently updated with K.Pramoth Sudjitporn, Chairman and Founder. The meeting gave us a more understanding of the growing gaming industry and AS's business transformations during the past five years (from downturn to upturn). Also, the information makes us believe that the share price rally is justified and reasonable, with potential upside left.

Nowadays, we can not deny that the gaming industry is one of the global megatrends driven by rising internet penetration, a higher number of people with access to smartphones in emerging markets, and better/faster telcos infrastructure. Based on ResearchAndMarkets and Valuates Report (the research firms), the global gaming industry is expected to grow by 11-12% CAGR during the next five years (from the current of US\$176bn). Asia Pacific accounts for half of the total, while Southeast Asia (SEA) should be at ~US\$5-6bn, suggesting an ample opportunity for capture.

AS used to have revenue of ~Bt1.5-2bn and earnings of ~Bt260-300mn in 2010-12. With a strong ambition to be a regional game publisher/developer those old days, they overinvested by making a rush purchase of games and acquiring game publishers in Indonesia & the Philippines. An overinvestment was a colossal mistake, which led them to book high SG&A expenses on marketing & staff costs as well as impairment losses on game inventories & assets afterward. During 2014-16, its operations turned terrible, with losses from Bt220mn up to Bt475mn each year. Likewise, its market cap dropped from its peak at Bt5.4bn in 2012 to ~Bt300mn in 2019.

Every dog has its day. There are some tailwinds for the industry in the past five years. The number of Chinese and Korean game developers has been skyrocketing due to the gaming industry boom, pushing game investment costs down by more than half due to competition. Meanwhile, most of the publishers in SEA had dropped out from the market due to a lack of economies of scale (one single country), which could not compete with regional/global players in terms of the investment budget and networks. These are supportive factors for the industry. Thanks to AS's solid background/footprint in SEA and decent turnaround plan, the company has managed to get through the tough times.

AS started turning around their business by i) cutting expenses/headcounts from 1,000 employees across the region to only 350, ii) shifting strategy to target more on a mobile gaming platform, iii) focusing on being only a publisher, not a developer, and iv) expanding footprint across the SEA countries by launching games based in Thailand (reduce costs). The developments have started to bear fruit since 2019. In 2020, the COVID pandemic/lockdown measures and new game launches boosted demand and consumer behavior, led AS to book record-high earnings of Bt307mn. And we expect AS should have another record in 2021 at ~Bt450-500mn driven by surging demand during the lockdown in SEA and new game launches in 2H21.

The stock has surged by 10x in a year. The big questions here are i) how long will the rally last, ii) will earnings dramatically drop after the lockdown measures ease, and iii) how to justify valuations. We believe that short-term earnings could be impressive; 2Q21 earnings should come in Bt110-120mn (record high level) despite no new game launches in the quarter. AS is launching a new mobile game in the Philippines, 'Cabal Mobile' in August, with ~500k players in the closed beta version. This renowned PC game will be on a mobile platform, which could support operating

performance in 2H21. In addition, they have another four games in their launching pipeline in 2H21-1Q22. So, we expect quarterly earnings to reach a record high again in 3Q21.

Looking ahead after the ease of lockdown measures, existing games' surged demand would taper off, and subscribers would eventually reduce. Thus, the company would have to launch new mobile games to attract new subscribers and cushion revenue. Meanwhile, mgmt is planning to penetrate the new market territories such as Indonesia, Vietnam, and India, which would expand its addressable market of each game. Hence, we think it is premature to expect a drastic drop in earnings next year. An interesting case study could be in 1Q21; its earnings were at Bt105mn driven by a new game launch in Malaysia, 'Mohun Online', without lockdown measures in SEA. So, we believe that new game launches and new markets will be the key to sustain earnings and the share price in the longer run.

Finally, this year we expect EPS to come in Bt1.1-1.2 EPS; the stock trades at 16-17x FY21E PE. Most of the global gaming stocks have an average historical trading range of ~25-35x. With solid short-term earnings momentum and robust OP cash flow/cash on hand for future investments, we believe AS has the potential to somewhat catch up with its peers at 25x PER, implying a PO of Bt30/sh or 54% upside. In the worse case, if 2022 earnings dropped to the 2020 level, the fair value could drop to Bt15/sh based on the derating PER at 20x or 23% downside. Overall, the risk/reward profile remains attractive for a short-term momentum play.

Source: Kiatnakin Phatra Securities Public Company Limited

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