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China Online Gaming | Asia Pacific

2Q23 Preview: Shift Focus to Fundamentals

Heading into 2Q earnings season, we recommend shifting focus to fundamentals – revenue is the big focus for 2Q; profit and pipeline sustainability for 3Q. Given the divergent growth amongst our A-share game coverage, we prefer OW 37IE over EW Perfect World and G-bits.

Share prices have come down 25-35% from May-Jun peak for 37IE, Perfect World, and G-bits, versus CSI300 +~5%, mostly because valuation multiples have contracted. We believe the market will increasingly focus on earnings from here on, with 2Q being the start of a growth up-cycle.

2Q23 – Focus on revenue re-acceleration: Revenue to grow by 13% yoy/20% qoq for 37IE, 30% yoy/23% qoq for PW, and 7% yoy/20% qoq for G-bits, we estimate. During 2Q, both 37IE and PW released blockbuster titles that are pivotal to growth for 2Q and beyond; while G-bits' new release was relatively less meaningful. We expect PW to register the highest revenue growth amongst the three, but it's partially due to a lower base; while, PW's TLBB 2 performance likely fell short of our expectation given [preliminary earnings miss](#). Net profit growth will likely be under pressure given front-loaded marketing expenses, but this should be within market expectations. We forecast net profit to decline 15% yoy for 37IE, 48% for PW, but remain flat for G-bits.

3Q23 – Focus on net profit re-acceleration and pipeline sustainability: For revenue, we expect 37IE (+25% yoy) to outperform the other two in 3Q, given more resilient grossing from recently released games, and richer pipeline reserve. PW (+17% yoy) will likely lag, given TLBB 2's significant grossing decay and license approval bottleneck. G-bits (+19% yoy) remains a wild card, as we have low visibility on the release schedule of its rich license-approved pipeline. For net profit, blockbuster releases in 2-3Q, lower marketing expenses, and an easy comp all set the stage for a growth re-acceleration in 3Q. We forecast net profit to grow 51% yoy for 37IE, 36% for PW, and 36% for G-bits.

OW 37IE the key pick, given the best combination of near-term growth visibility, rich pipeline reserve, and long-term upside (overseas success). Recent share price weakness has pulled valuation to a much more attractive level – 18x 2023e P/E. Strong 2Q result and removal of [investigation overhang](#) are key catalysts. **EW Perfect World**, as growth outlook becomes gloomy in 2H23, and we see downside risk to consensus forecasts. **EW G-bits** as near-term growth is less attractive than peers and pipeline scheduling remains uncertain.

Lower price targets for 37IE to Rmb34.4 and PW to Rmb13.8, as we adjust our forecasts to reflect the latest pipeline outlook, and lower target P/E multiples reflecting less optimistic market sentiment and potential competition concerns.

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GREATER CHINA MEDIA

Asia Pacific

Industry View

In-Line

WHAT'S CHANGED

Perfect World Co Ltd

(002624.SZ)

Price Target

From

Rmb17.70

To

Rmb13.80

37 Interactive Entertainment

(002555.SZ)

Price Target

From

Rmb37.90

To

Rmb34.40

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Key Charts

2Q23 Preview

Exhibit 1: 37IE: 2Q23 preview

Rmb mn	2Q2022	1Q2023	2Q2023E	2Q2023E	% YoY	% QoQ	% MSe vs.	FY2022	FY2023E	FY2023E	% YoY	% MSe vs.
			MSe	Cons.			Cons.		MSe	Cons.		Cons.
Revenue	4,003	3,765	4,514	4,160	13%	20%	9%	16,406	17,446	17,958	6%	-3%
Cost of sales	700	819	714	817	2%	-13%	-13%	3,049	2,957	3,477	-3%	-15%
Gross profit	3,303	2,945	3,800	3,343	15%	29%	14%	13,357	14,489	14,481	8%	0%
% gross margin	83%	78%	84%	80%	1.7ppt	5.9ppt	3.8ppt	81%	83%	81%	1.6ppt	2.4ppt
S&M expense	2,033	1,918	2,573	2,173	27%	34%	18%	8,733	9,478	9,487	9%	0%
G&A expense	101	126	118	118	17%	-6%	0%	526	568	553	8%	3%
R&D expense	221	200	221	228	0%	11%	-3%	905	877	957	-3%	-8%
Operating expenses	2,362	2,251	2,921	2,539	24%	30%	15%	10,195	10,959	11,028	7%	-1%
Operating profit	941	694	878	804	-7%	27%	9%	3,162	3,530	3,453	12%	2%
% gross margin	24%	18%	19%	19%	-4.1ppt	1.0ppt	0.1ppt	19%	20%	19%	1.0ppt	1.0ppt
Total non-op	61	172	29		-52%	-83%		139	258		86%	
Net profit (reported)	935	775	798	784	-15%	3%	2%	2,954	3,315	3,342	12%	-1%
% net margin	23%	21%	18%	19%	-5.7ppt	-2.9ppt	-1.1ppt	18%	19%	19%	1.0ppt	0.4ppt
Net profit (normalized)	881	670	822		-7%	23%		2,883	3,283		14%	
% net margin	22%	18%	18%		-3.8ppt	0.4ppt		18%	19%		1.2ppt	

Source: Company data, Visible Alpha consensus, Morgan Stanley Research (E) estimates

Exhibit 2: PW: 2Q23 preview

Rmb mn	2Q2022	1Q2023	2Q2023E	2Q2023E	% YoY	% QoQ	% MSe vs.	FY2022	FY2023E	FY2023E	% YoY	% MSe vs.
			MSe	Cons.			Cons.		MSe	Cons.		Cons.
Game revenue	1,764	1,700	2,142		21%	26%		7,242	7,745		7%	
Revenue	1,795	1,904	2,341	2,173	30%	23%	8%	7,670	8,374	8,628	9%	-3%
Cost of sales	590	663	918	717	56%	38%	28%	2,420	2,995	2,839	24%	5%
Gross profit	1,205	1,241	1,423	1,456	18%	15%	-2%	5,250	5,379	5,789	2%	-7%
% gross margin	67%	65%	61%	67%	-6.4ppt	-4.4ppt	-6.2ppt	68%	64%	67%	-4.2ppt	-2.9ppt
Business tax	6	5	12	8				33	42	31		
S&M expense	236	241	538	337	128%	123%	60%	1,109	1,156	1,307	4%	-12%
G&A expense	645	740	742	723	15%	0%	3%	3,024	3,018	3,035	0%	-1%
Operating expenses	887	987	1,292	1,067	46%	31%	21%	4,165	4,215	4,372	1%	-4%
Operating profit	318	254	131	388	-59%	-48%	-66%	1,085	1,164	1,417	7%	-18%
% gross margin	18%	13%	6%	18%	-12.1ppt	-7.7ppt	-12.3ppt	14%	14%	16%	-0.2ppt	-2.5ppt
Total non-op	(3)	(5)	45		nm	nm		401	130		-68%	
Net profit (reported)	297	241	156	388	-48%	-36%	-60%	1,377	1,164	1,473	-15%	-21%
% net margin	17%	13%	7%	18%	-9.9ppt	-6.0ppt	-11.2ppt	18%	14%	17%	-4.1ppt	-3.2ppt
Net profit (adjusted)	310	244	155		-50%	-37%		1,076	1,164		8%	
% net margin	17%	13%	7%		-10.7ppt	-6.2ppt		14%	14%		-0.1ppt	
Net profit (normalized)	256	204	93		-64%	-55%		691	939		36%	
% net margin	14%	11%	4%		-10.3ppt	-6.8ppt		9%	11%		2.2ppt	

Source: Company data, Visible Alpha consensus, Morgan Stanley Research (E) estimates. Note: Adjusted net profit excludes impairment loss/writeback and one-time asset sale gain/loss.

Exhibit 3: G-bits: 2Q23 preview

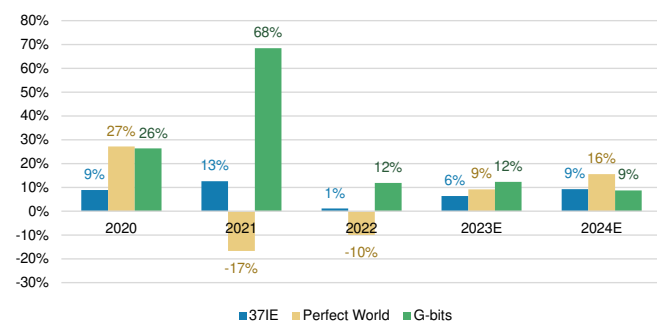
Rmb mn	2Q2022	1Q2023	2Q2023E		% YoY	% QoQ		FY2022	FY2023E	FY2023E		% YoY	% MSe vs.
			MSe						MSe	Cons.			Cons.
Revenue	1,281	1,144	1,372		7%	20%		5,168	5,804	5,781		12%	0%
Cost of sales	138	134	133		-3%	0%		582	596	577		2%	3%
Gross profit	1,144	1,010	1,239		8%	23%		4,585	5,208	5,204		14%	0%
% gross margin	89%	88%	90%		1.0ppt	2.0ppt		89%	90%	90%		1.0ppt	-0.3ppt
S&M expense	354	354	384		9%	8%		1,402	1,428	1,575		2%	-9%
G&A expense	114	90	96		-16%	7%		340	406	401		19%	1%
R&D expense	208	174	178		-14%	2%		673	810	783		20%	3%
Operating expenses	679	624	665		-2%	7%		2,435	2,673	3,324		10%	-20%
Operating profit	465	386	573		23%	48%		2,151	2,535	1,880		18%	35%
% gross margin	36%	34%	42%		5.5ppt	8.0ppt		42%	44%	33%		2.1ppt	11.2ppt
Total non-op	119	70	28		-76%	-60%		164	155			-6%	
Net profit (reported)	339	307	342		1%	12%		1,461	1,704	1,662		17%	3%
% net margin	26%	27%	25%		-1.5ppt	-1.9ppt		28%	29%	29%		1.1ppt	0.6ppt
Net profit (normalized)	335	281	341		2%	21%		1,468	1,674			14%	
% net margin	26%	25%	25%		-1.3ppt	0.3ppt		28%	29%			0.4ppt	

Source: Company data, Visible Alpha consensus, Morgan Stanley Research (E) estimates

Earnings outlook

Exhibit 4: Annual revenue growth outlook

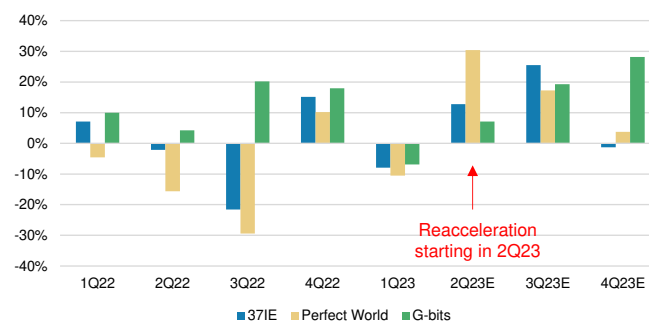
% Total revenue growth YoY



Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 5: Quarterly revenue growth outlook

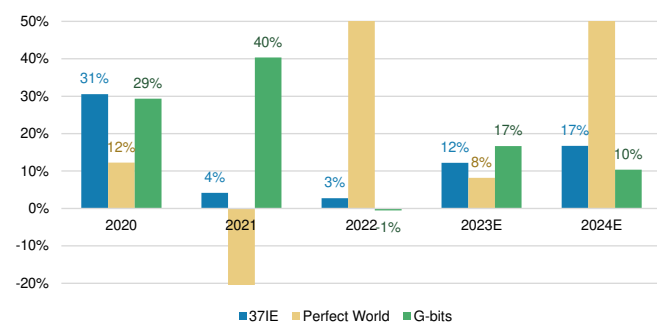
% Total revenue YoY



Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 6: Annual net profit growth outlook

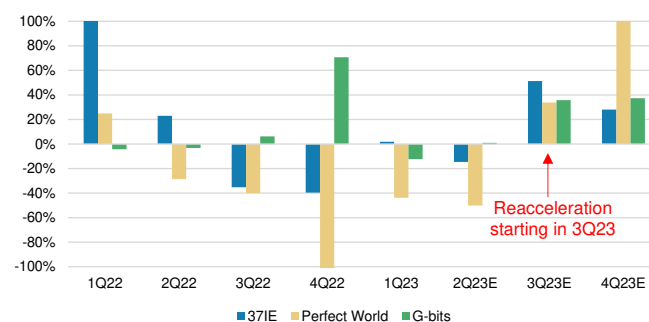
% Net profit growth YoY



Source: Company data, Morgan Stanley Research (E) estimates. Note: Adjusted net profit for Perfect World. Adjusted net profit excludes impairment loss/writeback and one-time asset sale gain/loss.

Exhibit 7: Quarterly net profit growth outlook

% Net profit YoY



Source: Company data, Morgan Stanley Research (E) estimates. Note: Adjusted net profit for Perfect World. Adjusted net profit excludes impairment loss/writeback and one-time asset sale gain/loss.

Exhibit 8:

371E: Earnings outlook summary

Rmb mn	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	2Q2023E	3Q2023E	4Q2023E		FY2022	FY2023E
Revenue	4,089	4,003	3,586	4,728	3,765	4,514	4,500	4,667		16,406	17,446
% YoY	7%	8%	-22%	15%	-8%	13%	25%	-1%		1%	6%
Gross profit	3,529	3,303	2,802	3,723	2,945	3,800	3,786	3,958		13,357	14,489
% YoY	7%	6%	-27%	7%	-17%	15%	35%	6%		-3%	8%
% gross margin	86%	83%	78%	79%	78%	84%	84%	85%		81%	83%
S&M expense	2,307	2,033	1,845	2,548	1,918	2,573	2,475	2,513		8,733	9,478
G&A expense	108	101	124	193	126	118	128	196		526	568
R&D expense	276	221	238	170	200	221	238	218		905	877
Operating expenses	2,700	2,362	2,214	2,920	2,251	2,921	2,850	2,937		10,195	10,959
Operating profit	829	941	588	804	694	878	936	1,022		3,162	3,530
% gross margin	20%	24%	16%	17%	18%	19%	21%	22%		19%	20%
Net profit (reported)	760	935	562	698	775	798	849	893		2,954	3,315
% YoY	551%	27%	-35%	-40%	2%	-15%	51%	28%		3%	12%
% net margin	19%	23%	16%	15%	21%	18%	19%	19%		18%	19%
Net profit (normalized)	762	881	567	672	670	822	873	917		2,883	3,283
% YoY	19779%	39%	-36%	-39%	-12%	-7%	54%	36%		10%	14%
% net margin	19%	22%	16%	14%	18%	18%	19%	20%		18%	19%

Source: Company data, Morgan Stanley Research (E) estimates

Exhibit 9: PW: Earnings outlook summary

Rmb mn	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	2Q2023E	3Q2023E	4Q2023E		FY2022	FY2023E
Revenue	2,128	1,795	1,788	1,959	1,904	2,341	2,096	2,033		7,670	8,374
% YoY	-5%	-9%	-29%	10%	-11%	30%	17%	4%		-10%	9%
Game revenue	1,973	1,764	1,712	1,794	1,700	2,142	1,982	1,920		7,242	7,745
% YoY	23%	-2%	-25%	4%	-14%	21%	16%	7%		-2%	7%
Gross profit	1,461	1,205	1,315	1,269	1,241	1,423	1,385	1,331		5,250	5,379
% YoY	16%	15%	-23%	3%	-15%	18%	5%	5%		0%	2%
% gross margin	69%	67%	74%	65%	65%	61%	66%	65%		68%	64%
Operating expenses	1,044	887	1,044	1,191	987	1,292	967	969		4,165	4,215
Operating profit	417	318	271	78	254	131	417	362		1,085	1,164
% gross margin	20%	18%	15%	4%	13%	6%	20%	18%		14%	14%
Net profit (reported)	840	297	304	(65)	241	156	413	354		1,377	1,164
% YoY	81%	nm	-44%	-85%	-71%	-48%	36%	nm		273%	-15%
% net margin	39%	17%	17%	-3%	13%	7%	20%	17%		18%	14%
Net profit (adjusted)	434	310	308	24	244	155	412	353		1,076	1,164
% YoY	25%	nm	-40%	nm	-44%	-50%	34%	1398%		465%	8%
% net margin	20%	17%	17%	1%	13%	7%	20%	17%		14%	14%

Source: Company data, Morgan Stanley Research (E) estimates. Note: Adjusted net profit excludes impairment loss/writeback and one-time asset sale gain/loss.

Exhibit 10: G-bits: Earnings outlook summary

Rmb mn	1Q2022	2Q2022	3Q2022	4Q2022	1Q2023	2Q2023E	3Q2023E	4Q2023E		FY2022	FY2023E
Revenue	1,229	1,281	1,319	1,338	1,144	1,372	1,574	1,714		5,168	5,804
% YoY	10%	1%	20%	18%	-7%	7%	19%	28%		12%	12%
Gross profit	1,114	1,144	1,119	1,209	1,010	1,239	1,419	1,540		4,585	5,208
% YoY	20%	12%	20%	17%	-9%	8%	27%	27%		17%	14%
% gross margin	91%	89%	85%	90%	88%	90%	90%	90%		89%	90%
S&M expense	316	354	446	286	354	384	393	296		1,402	1,428
G&A expense	91	114	91	44	90	96	110	110		340	406
R&D expense	170	208	166	128	174	178	220	237		673	810
Operating expenses	582	679	709	465	624	665	732	652		2,435	2,673
Operating profit	532	465	410	744	386	573	687	888		2,151	2,535
% gross margin	43%	36%	31%	56%	34%	42%	44%	52%		42%	44%
Net profit (reported)	350	339	323	449	307	342	439	617		1,461	1,704
% YoY	-4%	-37%	6%	71%	-12%	1%	36%	37%		-1%	17%
% net margin	28%	26%	25%	34%	27%	25%	28%	36%		28%	29%
Net profit (normalized)	333	335	335	466	281	341	437	616		1,468	1,674
% YoY	-6%	-4%	13%	109%	-16%	2%	31%	32%		20%	14%
% net margin	27%	26%	25%	35%	25%	25%	28%	36%		28%	29%

Source: Company data, Morgan Stanley Research (E) estimates

Pipeline

Exhibit 11: 37IE: Game pipeline (titles in Chinese only)

Title	Launch	Self-dev.?	License?	Overseas	Genre	Title	Launch	Self-dev.?	License?	Overseas	Genre
凡人修仙传	May-23	N		Global	MMORPG	Bugtopia		N		Overseas	SLG
霸业	Jun-23	Y		Domestic	SLG	Era of Glory		N		Overseas	SLG
寻道大千	Jun-23	N		Domestic	RPG	代号巨兽		N		Overseas	SLG
扶摇一梦	3Q23e	Y	Y	Global	MMORPG	故土与新世界		N		Overseas	SLG
代号魔幻M		Y		Global	MMORPG	代号原野		N		Global	SLG
代号3D 版WTB		Y		Global	MMORPG	代号stpk		N		Overseas	SLG
代号斗罗MMO		Y		Global	MMORPG	龙与爱丽丝		Y	Y	Global	Card
曙光计划		N	Y	Global	MMORPG	最后的原始人		N		Domestic	Card
代号魔幻K 计划		N		Global	MMORPG	代号二次元ZQ		N		Domestic	Card
代号龙骑士		N		Domestic	MMORPG	铁杆三国		N	Y	Overseas	Card
洪荒异兽录		N	Y	Domestic	MMORPG	空之要塞: 启航		N		Overseas	Card
平行轨迹		N	Y	Global	MMORPG	代号星环		N		Global	Card
离火之境		N	Y	Domestic	MMORPG	织梦森林		N	Y	Global	Simulation
代号G2		Y		Overseas	SLG	金牌合伙人		N	Y	Domestic	Simulation
Puzzles & Chaos		N		Overseas	SLG	Yes Your Highness		N		Overseas	Simulation
万乘之国		N	Y	Domestic	SLG	代号琉璃		N		Overseas	Simulation
代号三国CB		N		Domestic	SLG	代号休闲		N		Overseas	Casual

Source: Company data, Morgan Stanley Research

Exhibit 12: PW: Game pipeline

Title	Chinese	Launch	License	Genre	Theme
MOBILE					
Demi-Gods and Semi-Devils 2	天龙八部2	May 2023	Y	MMORPG	Martial art
Forsaken World 2	神魔大陆2	2H23e	N	MMORPG	
Persona 5	女神异闻录	2H23e	N	RPG	
One-Punch Man: World	一拳超人: 世界	2H23e	N	RPG	ACG
Million Arthur	百万亚瑟王	2H23e	N	RPG	
Perfect New World	完美新世界	2H23e	N	MMORPG	Fantasy
Chinese Paladin	仙剑奇侠传			MMORPG	Wonderland, Martial art
Zhuxian 2	诛仙2			MMORPG	Martial art
Dreamscape 2	梦间集2			MMORPG	Cyber
Ashes of Love	香蜜沉沉烬如霜			MMORPG	Wonderland, Martial art
Code: Volcano	代号: 火山			Casual RPG	
Code: R	代号: R			MMORPG	Fiction
Project: Prism	Project: 棱镜			MMORPG	Fiction, Fantasy
Project: Bard	Project: Bard			TBC	ACG
CODE NAME: X	CODE NAME: X			TBC	ACG
Code: MA	代号: MA			CCG	ACG
Code: Archive	代号: 档案				
Ling Long IP	灵笼IP				
PC					
Zhuxian World PC	诛仙世界	2023-24e	Y		
Perfect New World PC	完美新世界 PC	2023-24e			
Have a Nice Death	Have a Nice Death	2023e			
Lumione	逐光之旅				

Source: Company data, Morgan Stanley Research

Exhibit 13: G-bits: Game pipeline

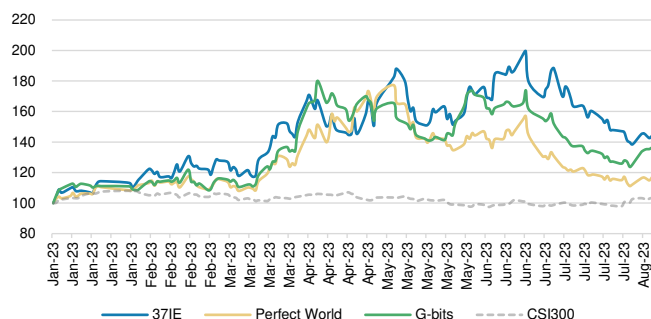
Title	Chinese	Launch	Self-dev.?	License?	Genre
Path of Immortals	这个地下城有点怪	5/30/2023	N	Y	Roguelike RPG
Outpost: Infinity Siege PC	Outpost: Infinity Siege PC	Summer 2023	Y	Y	FPS
New Mansion Age	新庄园时代	2H23E	N	Y	Simulation
Flying Dragon Warrior	飞吧龙骑士	2H23E	N	Y	Roguelike shooting
Immortal Family (M66)	不朽家族 (M66)	2H23E	Y	Y	FPS
Warrior and Gear (Code Bug)	勇者与装备 (Code Bug)	2H23E	Y	Y	Idle
Project Super Cat	超喵星计划	2H23E	Y	Y	Card, Simulation
Pi Ka Tang	皮卡堂	2H23E	N	Y	Simulation
Code: Yuandian	代号原点	1H24E (overseas)	Y	N	Idle, Card
M88	代号M88		Y	N	Idle, MMO
Beasts Evolved 2	超进化物语2		N	Y	Idle, Simulation
Beast Planet	Beast Planet		N	N	Srategy
Dawn Elite	黎明精英		N	Y	Roguelike shooting
Fengshen Fantasy World	封神幻想世界		N	Y	RPG
Project S	Project S		N	N	Roguelike strategy
Shenzhou Restaurant	神州干食舫		N	N	Simulation
Shiluo Sijing	失落四境		N	Y	RPG
Ancient Treasure	上古宝藏		N	Y	Roguelike ARPG
Hualuo Changan	花落长安		N	Y	Simulation
Family Story	家族物语		Y	N	Idle RPG
Shop Heroes Legends	商店传说		N	N	Simulation
Lvdong Guiji	律动轨迹		N	N	Musical
Shendu Chef	神都厨王号		N	N	Simulation

Source: Company data, Morgan Stanley Research

Valuation

Exhibit 14: YTD share price performance

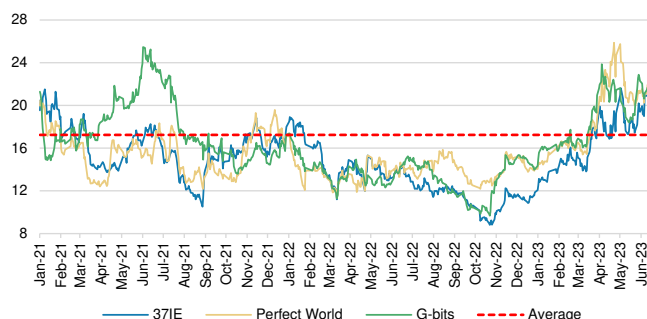
Share performance YTD (2023/1/1 indexed to 100)



Source: Refinitiv, Morgan Stanley Research

Exhibit 15: Consensus NTM forward P/E

Consensus NTM P/E (x)



Source: Refinitiv, Morgan Stanley Research

Exhibit 16:

Valuation comparables

Ticker	Company	Market Cap (USD mn)	Last px (LC)	P/E 2023E	P/E 2024E
0700.HK	Tencent	418,223	341.2	24.7	19.5
NTES.O	NetEase	69,784	108.2	17.2	14.5
002555.SZ	37IE	8,503	27.5	18.4	15.8
002624.SZ	Perfect World	4,112	15.2	25.3	14.7
603444.SS	G-bits	4,614	459.3	19.4	17.5
002602.SZ	Century Huatong	5,789	5.6	17.4	14.3
002558.SZ	Giant	4,035	14.4	18.3	16.6
300418.SZ	Kunlun	6,124	36.7	28.1	25.1
002174.SZ	Youzu	1,754	13.7	22.8	18.4
300315.SZ	Ourpalm	2,219	5.8	NA	NA
0799.HK	IGG	601	3.9	6.3	3.9
9990.HK	Archosaur	436	4.3	NA	NA
0302.HK	CMGE	617	1.8	6.0	4.2
002517.SZ	Kingnet	4,806	16.0	18.2	15.2
002605.SZ	Yaoji	2,012	35.0	15.4	12.6
1119.HK	iDreamSky	706	3.5	10.1	8.4
603258.SH	Electronic Soul	1,190	34.9	19.7	18.5
6820.HK	FriendTimes	232	0.8	7.5	6.4
Mean				17.2	14.1
	<i>Excl. Tencent and NetEase</i>			16.6	13.7
Median				18.2	15.0
	<i>Excl. Tencent and NetEase</i>			18.2	15.0

Source: Refinitiv, Morgan Stanley Research (E) estimates.

Note: MSe for Tencent, NetEase, 37IE, Perfect World and G-bits; consensus estimates for others. Prices as of August 7, 2023.

What's Changed?

37IE

We slightly lower our forecasts for revenue by 2% and net profit by 3% over 2023-25, mainly reflecting some slight delays in June-July game releases.

Our price target falls 10% to Rmb34.4, on EPS revisions and lower target 2023e P/E of 23x (was 25x), reflecting less optimistic market sentiment and potential competition concerns, but 23x is still above its historical average of 18-20x, as 37IE is entering a growth up-cycle.

Our bull case value falls 9% to Rmb47.3, derived from 28x bull-case EPS (was 30x). Our bear case value falls 6% to Rmb24.6, derived from 20x bear-case EPS (unchanged).

Exhibit 17: 37IE: Earnings estimate revisions

Years Ending December 31 Rmb mn	New			Old			% change		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Total revenue	17,446	19,056	20,660	17,818	19,466	21,105	-2%	-2%	-2%
Mobile game	16,929	18,622	20,281	17,302	19,032	20,727	-2%	-2%	-2%
Browser game	466	383	329	466	383	329	0%	0%	0%
China	10,732	11,671	12,684	10,925	11,883	12,916	-2%	-2%	-2%
Overseas	6,713	7,385	7,975	6,893	7,582	8,189	-3%	-3%	-3%
Cost of sales	2,957	3,018	3,228	3,019	3,082	3,298	-2%	-2%	-2%
Gross profit	14,489	16,038	17,431	14,799	16,383	17,808	-2%	-2%	-2%
% margin	83.1%	84.2%	84.4%	83.1%	84.2%	84.4%	0.0ppt	0.0ppt	0.0ppt
Business tax	35	95	103	36	97	106	-2%	-2%	-2%
S&M expense	9,478	10,143	10,977	9,681	10,362	11,213	-2%	-2%	-2%
G&A expense	568	596	626	568	596	626	0%	0%	0%
R&D expense	877	919	960	881	922	964	0%	0%	0%
Operating expenses	10,959	11,754	12,666	11,165	11,978	12,909	-2%	-2%	-2%
Operating profit	3,530	4,284	4,765	3,634	4,406	4,899	-3%	-3%	-3%
% margin	20.2%	22.5%	23.1%	20.4%	22.6%	23.2%	-0.2ppt	-0.2ppt	-0.1ppt
Non-operating items	258	268	289	258	269	290	0%	0%	0%
Profit before tax	3,789	4,553	5,054	3,893	4,675	5,189	-3%	-3%	-3%
% margin	21.7%	23.9%	24.5%	21.8%	24.0%	24.6%	-0.1ppt	-0.1ppt	-0.1ppt
Net profit (reported)	3,315	3,870	4,296	3,406	3,973	4,410	-3%	-3%	-3%
% margin	19.0%	20.3%	20.8%	19.1%	20.4%	20.9%	-0.1ppt	-0.1ppt	-0.1ppt
Net profit (normalized)	3,283	3,837	4,263	3,373	3,941	4,378	-3%	-3%	-3%
% margin	18.8%	20.1%	20.6%	18.9%	20.2%	20.7%	-0.1ppt	-0.1ppt	-0.1ppt
EPS (reported)	1.49	1.74	1.94	1.54	1.79	1.99	-3%	-3%	-3%
EPS (normalized)	1.48	1.73	1.92	1.52	1.78	1.97	-3%	-3%	-3%
DPS	0.60	0.79	0.97	0.61	0.81	0.99	-3%	-3%	-3%

Source: Morgan Stanley Research (E) estimates

Exhibit 18: 37IE: Valuation

P/E	
2023E (Rmb)	Bear
Target P/E (2023e)	20
Reported EPS (2023e)	1.23
Value per share	24.63
Bear case	24.60

2023E (Rmb)	
	BASE
Target P/E (2023e)	23
Reported EPS (2023e)	1.49
Value per share	34.38
Price target	34.40

2023E (Rmb)	
	Bull
Target P/E (2023e)	28
Reported EPS (2023e)	1.69
Value per share	47.26
Bull case	47.30

Source: Morgan Stanley Research (E) estimates

Perfect World

We lower our revenue by 2%, reflecting weaker 2Q growth and potential delays in new game launches. We lower our net profit by 15%/7%/6% for 2023e/2024e/2025e, reflecting slower top-line growth and 2Q23 earnings miss.

Our price target falls 22% to Rmb13.8, on EPS revision and lower target 2023 P/E of 23x (was 25x), reflecting less optimistic market sentiment and potential competition concerns, but 23x is still above its historical average of 18-20x as PW is entering a growth up-cycle.

Our bull case value falls 27% to Rmb20.4, derived from 25x bull-case EPS (was 30x). Our bear case value falls 15% to Rmb8.7, derived from 20x bear-case EPS (unchanged).

Exhibit 19: PW: Earnings estimate revisions

Years Ending December 31 Rmb mn	New			Old			% change		
	2023E	2024E	2025E	2023E	2024E	2025E	2023E	2024E	2025E
Total revenue	8,374	9,673	10,717	8,576	9,904	10,978	-2%	-2%	-2%
Game	7,745	9,029	10,058	7,947	9,260	10,319	-3%	-2%	-3%
Mobile game	5,567	6,346	7,190	5,769	6,577	7,452	-4%	-4%	-4%
PC game	1,949	2,442	2,615	1,949	2,442	2,615	0%	0%	0%
Film and drama	522	536	552	522	536	552	0%	0%	0%
Cost of sales	2,995	3,175	3,423	2,968	3,206	3,458	1%	-1%	-1%
Gross profit	5,379	6,498	7,293	5,608	6,697	7,520	-4%	-3%	-3%
% margin	64.2%	67.2%	68.1%	65.4%	67.6%	68.5%	-1.2ppt	-0.4ppt	-0.4ppt
Business tax	42	48	54	43	50	55	-2%	-2%	-2%
S&M expense	1,156	1,156	1,281	1,104	1,184	1,312	5%	-2%	-2%
G&A expense	3,018	3,164	3,310	3,026	3,173	3,321	0%	0%	0%
Operating expenses	4,215	4,368	4,645	4,173	4,406	4,688	1%	-1%	-1%
Operating profit	1,164	2,130	2,649	1,435	2,291	2,832	-19%	-7%	-6%
% margin	13.9%	22.0%	24.7%	16.7%	23.1%	25.8%	-2.8ppt	-1.1ppt	-1.1ppt
Non-operating items	130	93	109	90	95	112	45%	-2%	-3%
Profit before tax	1,294	2,223	2,758	1,525	2,386	2,945	-15%	-7%	-6%
% margin	15.4%	23.0%	25.7%	17.8%	24.1%	26.8%	-2.3ppt	-1.1ppt	-1.1ppt
Net profit (reported)	1,164	2,001	2,482	1,372	2,148	2,650	-15%	-7%	-6%
% margin	13.9%	20.7%	23.2%	16.0%	21.7%	24.1%	-2.1ppt	-1.0ppt	-1.0ppt
Net profit (normalized)	939	1,776	2,257	1,147	1,923	2,425	-18%	-8%	-7%
% margin	11.2%	18.4%	21.1%	13.4%	19.4%	22.1%	-2.2ppt	-1.1ppt	-1.0ppt
EPS (reported)	0.60	1.03	1.28	0.71	1.11	1.37	-15%	-7%	-6%
EPS (normalized)	0.48	0.92	1.16	0.59	0.99	1.25	-18%	-8%	-7%
DPS	0.18	0.41	0.64	0.21	0.44	0.68	-15%	-7%	-6%

Source: Morgan Stanley Research (E) estimates

Exhibit 20: PW: Valuation

P/E	
2023E (Rmb)	Bear
Target P/E (2023e)	20
Adjusted EPS (2023e)	0.43
Value per share	8.68
Bear case	8.70

2023E (Rmb)	
	BASE
Target P/E (2023e)	23
Adjusted EPS (2023e)	0.60
Value per share	13.80
Price target	13.80

2023E (Rmb)	
	Bull
Target P/E (2023e)	25
Adjusted EPS (2023e)	0.82
Value per share	20.44
Bull case	20.40

Source: Morgan Stanley Research (E) estimates

Financial Summary

37IE

Exhibit 21: 37IE: Financial summary

INCOME STATEMENT

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Mobile game	15,632	16,929	18,622	20,281
Browser game	599	466	383	329
Others	175	50	50	50
Total revenue	16,406	17,446	19,056	20,660
Mobile game	2,854	2,792	2,876	3,101
Browser game	176	140	117	102
Others	18	25	25	25
Cost of sales	3,049	2,957	3,018	3,228
Gross profit	13,357	14,489	16,038	17,431
% margin	81.4%	83.1%	84.2%	84.4%
Business tax	32	35	95	103
S&M expense	8,733	9,478	10,143	10,977
G&A expense	526	568	596	626
R&D expense	905	877	919	960
Operating expenses	10,195	10,959	11,754	12,666
Operating profit	3,162	3,530	4,284	4,765
% margin	19.3%	20.2%	22.5%	23.1%
Non-operating items	139	258	268	289
Interest income	147	51	59	77
Interest expense	(73)	(6)	(6)	(6)
Impairment (loss)/writeback	(99)	-	-	-
Investment income	76	80	82	85
Exchange gain/(loss)	-	-	-	-
Investment disposal income	2	-	-	-
P&L on the changes in fair value	(40)	-	-	-
Others income	133	133	133	133
Non-operating income	11	-	-	-
Non-operating cost	(19)	-	-	-
Profit before tax	3,302	3,789	4,553	5,054
% margin	20.1%	21.7%	23.9%	24.5%
Income tax	392	474	683	758
% of PBT	11.9%	12.5%	15.0%	15.0%
Minority interests	(45)	-	-	-
Net profit (reported)	2,954	3,315	3,870	4,296
% margin	18.0%	19.0%	20.3%	20.8%
Net profit (normalized)	2,883	3,283	3,837	4,263
% margin	17.6%	18.8%	20.1%	20.6%
EPS (normalized)	1.30	1.48	1.73	1.92
EPS (reported)	1.33	1.49	1.74	1.94
DPS	0.45	0.60	0.79	0.97

BALANCE SHEET

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Cash	5,129	5,889	7,689	9,820
Accounts receivable	1,434	1,524	1,665	1,805
Inventories	-	-	-	-
Other current assets	4,023	4,278	4,673	5,067
Current assets	10,587	11,691	14,027	16,692
AFS financial assets	956	956	956	956
Long-term investment	622	702	784	869
PP&E	850	838	1,096	1,141
Intangible assets	1,060	1,060	1,060	1,060
Goodwill	1,589	1,589	1,589	1,589
Deferred expenses	99	99	99	99
Other non-current assets	1,332	1,332	1,332	1,332
Non-current assets	6,508	6,576	6,916	7,046
Total assets	17,095	18,267	20,943	23,738
Short-term debt	901	100	100	100
Accounts payable	2,204	2,137	2,181	2,333
Contract liabilities	260	276	301	327
Other current liabilities	977	1,039	1,135	1,231
Current liabilities	4,341	3,552	3,718	3,991
Long-term debt	323	-	-	-
Other non-current liabilities	118	118	118	118
Non-current liabilities	441	118	118	118
Total liabilities	4,783	3,670	3,836	4,109
Minority interests	129	129	129	129
Stock capital	2,218	2,218	2,218	2,218
Additional paid-in capital	2,777	2,777	2,777	2,777
Reserves	431	431	431	431
Retained earnings	6,758	9,043	11,554	14,075
Shareholders' equity	12,183	14,468	16,979	19,500
Total equity	12,312	14,596	17,107	19,629
Total liabilities and equity	17,095	18,267	20,943	23,738

CASH FLOW

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Net profit (before minority interests)	2,910	3,283	3,837	4,263
Depreciation and amortization	46,696	186	185	198
Other non-cash adjustments	(46,299)	(74)	(76)	(79)
Net change in working capital	250	(437)	(473)	(363)
Operating cash flow	3,557	2,958	3,473	4,019
Capex	(320)	(30)	(300)	(100)
Acquisition/disposal	194	-	-	-
Other investing cash flow	(3,204)	(40)	(40)	(40)
Investing cash flow	(3,330)	(70)	(340)	(140)
Net issuance/(repayment) of debt	781	(1,124)	-	-
Net issuance/(repurchase) of equity	93	-	-	-
Interest and dividend paid	(1,634)	(1,004)	(1,332)	(1,747)
Other financing cash flow	(825)	-	-	-
Financing cash flow	(1,585)	(2,128)	(1,332)	(1,747)
Net change in cash	511	759	1,800	2,131

Source: Company data, Morgan Stanley Research (E) estimates

Perfect World

Exhibit 22: PW: Financial summary

INCOME STATEMENT

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Game	7,242	7,745	9,029	10,058
Film and drama	321	522	536	552
Others	107	107	107	107
Total revenue	7,670	8,374	9,673	10,717
Game	2,119	2,530	2,698	2,935
Film and drama	262	411	423	435
Others	39	54	54	54
Cost of sales	2,420	2,995	3,175	3,423
Gross profit	5,250	5,379	6,498	7,293
% margin	68.4%	64.2%	67.2%	68.1%
Business tax	33	42	48	54
S&M expense	1,109	1,156	1,156	1,281
G&A expense	3,024	3,018	3,164	3,310
Operating expenses	4,165	4,215	4,368	4,645
Operating profit	1,085	1,164	2,130	2,649
% margin	14.1%	13.9%	22.0%	24.7%
Depreciation	60	34	41	47
Amortization of intangible assets	139	-	-	-
Amortization of deferred expenses	120	-	-	-
EBITDA	1,403	1,198	2,171	2,695
% margin	18.3%	14.3%	22.4%	25.2%
Non-operating items	401	130	93	109
Interest income	55	30	30	43
Interest expense	(88)	(140)	(140)	(140)
Impairment (loss)/writeback	(79)	-	-	-
Investment income	177	100	103	106
Exchange gain/(loss)	-	-	-	-
Investment disposal income	1	-	-	-
P&L on the changes in fair value	236	-	-	-
Others income	86	140	100	100
Non-operating income	14	-	-	-
Non-operating cost	(2)	-	-	-
Profit before tax	1,486	1,294	2,223	2,758
% margin	19.4%	15.4%	23.0%	25.7%
Income tax	86	129	222	276
% of PBT	5.8%	10.0%	10.0%	10.0%
Minority interests	22	-	-	-
Net profit (reported)	1,377	1,164	2,001	2,482
% margin	18.0%	13.9%	20.7%	23.2%
Net profit (adjusted)	1,076	1,164	2,001	2,482
% margin	14.0%	13.9%	20.7%	23.2%
Net profit (MW)	691	939	1,776	2,257
% margin	9.0%	11.2%	18.4%	21.1%
EPS (adjusted)	0.55	0.60	1.03	1.28
EPS (MW)	0.36	0.48	0.92	1.16
EPS (reported)	0.71	0.60	1.03	1.28
DPS	0.34	0.18	0.41	0.64

BALANCE SHEET

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Cash and cash equivalents	2,987	3,029	4,323	5,660
Accounts receivable	982	1,072	1,239	1,372
Inventories	1,562	1,706	1,970	2,183
Other current assets	847	925	1,068	1,184
Current assets	6,378	6,732	8,601	10,399
AFS financial assets	1,767	1,767	1,767	1,767
Long-term investment	2,614	2,714	2,817	2,923
PP&E	340	406	465	519
Intangible assets	153	153	153	153
Goodwill	272	272	272	272
Deferred expenses	249	249	249	249
Other non-current assets	3,864	3,864	3,864	3,864
Non-current assets	9,258	9,424	9,586	9,746
Total assets	15,636	16,155	18,187	20,144
Short-term debt	351	200	200	200
Accounts payable	353	437	463	499
Advance payment	1,839	2,008	2,319	2,570
Other current liabilities	1,574	1,719	1,985	2,200
Current liabilities	4,117	4,363	4,968	5,469
Long-term debt	-	-	-	-
Other non-current liabilities	2,043	2,043	2,043	2,043
Non-current liabilities	2,043	2,043	2,043	2,043
Total liabilities	6,160	6,406	7,010	7,511
Minority interests	317	317	317	317
Stock capital	2,012	2,012	2,012	2,012
Additional paid-in capital	1,690	1,690	1,690	1,690
Reserves	54	54	54	54
Retained earnings	5,403	5,676	7,103	8,560
Shareholders' equity	9,159	9,432	10,859	12,316
Total equity	9,476	9,749	11,176	12,633
Total liabilities and equity	15,636	16,155	18,187	20,144

CASH FLOW

Years Ending December 31 Rmb mn	2022	2023E	2024E	2025E
Net profit (before minority interests)	1,400	939	1,776	2,257
Depreciation and amortization	319	34	41	47
Other non-cash adjustments	(306)	40	37	34
Net change in working capital	(257)	86	30	39
Operating cash flow	1,155	1,099	1,884	2,377
Capex	(277)	(100)	(100)	(100)
Acquisition/disposal	223	-	-	-
Other investing cash flow	1,416	-	-	-
Investing cash flow	1,362	(100)	(100)	(100)
Net issuance/(repayment) of debt	(256)	(151)	-	-
Net issuance/(repurchase) of equity	6	-	-	-
Interest and dividend paid	(2,321)	(806)	(489)	(940)
Other financing cash flow	(451)	-	-	-
Financing cash flow	(3,022)	(957)	(489)	(940)
Net change in cash	(450)	42	1,294	1,336

Source: Company data, Morgan Stanley Research (E) estimates. Note: Adjusted net profit excludes impairment loss/writeback and one-time asset sale gain/loss.

G-bits

Exhibit 23: G-bits: Financial summary

INCOME STATEMENT

Years Ending December 31	2021	2022	2023E	2024E	2025E
Rmb mn					
Self-operated	2,039	2,533	2,887	3,176	3,478
Third party-operated	336	314	298	283	269
Co-operated	2,181	2,278	2,574	2,806	3,044
Total revenue	4,619	5,168	5,804	6,311	6,838
Self-operated	200	204	224	244	264
Third party-operated	8	7	7	7	6
Co-operated	468	343	328	355	383
Cost of sales	698	582	596	644	693
Gross profit	3,921	4,585	5,208	5,667	6,146
% margin	84.9%	88.7%	89.7%	89.8%	89.9%
Business tax	30	21	29	32	34
S&M expense	1,274	1,402	1,428	1,546	1,669
G&A expense	284	340	406	435	449
R&D expense	609	673	810	849	881
Operating expenses	2,196	2,435	2,673	2,863	3,033
Operating profit	1,724	2,151	2,535	2,805	3,113
% margin	37.3%	41.6%	43.7%	44.4%	45.5%
Depreciation	63	63	32	30	29
Amortization of intangible assets	2	2	2	2	2
Amortization of deferred expenses	46	31	31	31	31
EBITDA	1,836	2,247	2,599	2,868	3,175
% margin	39.7%	43.5%	44.8%	45.4%	46.4%
Non-operating items	400	164	155	163	172
Interest income	13	45	26	33	41
Interest expense	(36)	172	-	-	-
Impairment (loss)/writeback	(19)	(175)	-	-	-
Investment income	405	106	80	82	83
Exchange gain/(loss)	-	-	-	-	-
Investment disposal income	0	(0)	-	-	-
P&L on the changes in fair value	(6)	(27)	-	-	-
Others income	50	49	49	49	49
Non-operating income	3	4	-	-	-
Non-operating cost	(10)	(10)	-	-	-
Profit before tax	2,125	2,315	2,690	2,968	3,285
% margin	46.0%	44.8%	46.3%	47.0%	48.0%
Income tax	372	355	403	445	493
% of PBT	17.5%	15.4%	15.0%	15.0%	15.0%
Minority interests	284	499	582	642	711
Net profit (reported)	1,468	1,461	1,704	1,881	2,082
% margin	31.8%	28.3%	29.4%	29.8%	30.4%
Net profit (normalized)	1,226	1,468	1,674	1,851	2,051
% margin	26.5%	28.4%	28.8%	29.3%	30.0%
EPS (normalized)	17.06	20.43	23.29	25.75	28.55
EPS (reported)	20.43	20.33	23.72	26.17	28.97
DPS	16.00	17.00	18.97	20.94	23.17

BALANCE SHEET

Years Ending December 31	2021	2022	2023E	2024E	2025E
Rmb mn					
Cash	2,903	2,629	3,324	4,081	4,925
Accounts receivable	294	265	297	323	350
Inventories	-	-	-	-	-
Other current assets	1,157	686	770	837	907
Current assets	4,354	3,579	4,391	5,241	6,182
AFS financial assets	505	656	656	656	656
Long-term investment	1,188	1,187	1,267	1,349	1,432
PP&E	719	630	605	581	558
Intangible assets	2	72	72	72	72
Goodwill	4	4	4	4	4
Deferred expenses	7	6	6	6	6
Other non-current assets	323	356	356	356	356
Non-current assets	2,749	2,912	2,966	3,024	3,084
Total assets	7,103	6,490	7,358	8,265	9,266
Short-term debt	-	-	-	-	-
Accounts payable	281	282	289	312	336
Advance payment	-	0	0	0	0
Other current liabilities	1,545	1,408	1,582	1,720	1,864
Current liabilities	1,826	1,691	1,871	2,032	2,199
Long-term debt	-	-	-	-	-
Other non-current liabilities	218	90	90	90	90
Non-current liabilities	218	90	90	90	90
Total liabilities	2,044	1,781	1,961	2,122	2,290
Minority interests	479	731	966	1,225	1,511
Stock capital	72	72	72	72	72
Additional paid-in capital	1,314	1,334	1,334	1,334	1,334
Reserves	22	96	96	96	96
Retained earnings	3,172	2,477	2,929	3,416	3,963
Shareholders' equity	4,580	3,979	4,431	4,918	5,465
Total equity	5,060	4,710	5,397	6,143	6,976
Total liabilities and equity	7,103	6,490	7,358	8,265	9,266

CASH FLOW

Years Ending December 31	2021	2022	2023E	2024E	2025E
Rmb mn					
Net profit (before minority interests)	1,753	1,959	2,256	2,492	2,762
Depreciation and amortization	113	100	65	63	62
Other non-cash adjustments	38	54	(80)	(82)	(83)
Net change in working capital	515	(361)	32	37	40
Operating cash flow	2,418	1,752	2,273	2,512	2,781
Capex	(19)	(44)	(6)	(6)	(6)
Acquisition/disposal	0	0	-	-	-
Other investing cash flow	(449)	230	(2)	(2)	(2)
Investing cash flow	(468)	186	(8)	(8)	(8)
Net issuance/(repayment) of debt	(35)	-	-	-	-
Net issuance/(repurchase) of equity	0	1	-	-	-
Interest and dividend paid	(1,115)	(2,398)	(1,222)	(1,363)	(1,505)
Other financing cash flow	(2)	(6)	(347)	(383)	(424)
Financing cash flow	(1,153)	(2,404)	(1,569)	(1,746)	(1,928)
Net change in cash	760	(275)	696	757	844

Source: Company data, Morgan Stanley Research (E) estimates

Risk Reward – 37 Interactive Entertainment (002555.SZ)

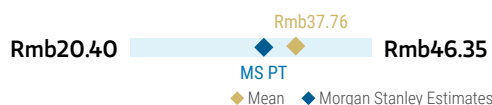
Fundamental and thematic tailwinds aligned

PRICE TARGET Rmb34.40

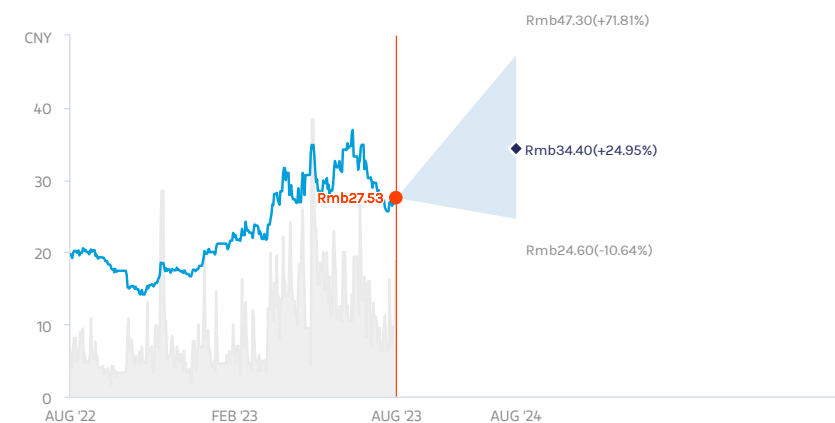
Base case, derived from a target 2023 P/E of 23x, higher its historical trading average of ~18-20x. We believe 23x is justified given its earnings growth is entering an up-cycle, amid AI-driven positive sentiment.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



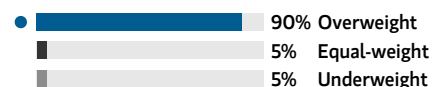
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

OVERWEIGHT THESIS

- Fundamental recovery is taking place. We expect a revenue inflection in 2Q23 and net profit inflection in 3Q, thanks to a rich game pipeline starting in May-June.
- We think an improving growth outlook, with rich game catalysts, should drive multiples towards the upper bound of the historical range.
- Also, positive themes around AI should boost investor sentiment further and spur continued re-rating in the near term, despite low visibility into AI's impacts.
- Thus, we see potential re-rating to ~23x 2023e P/E, above its historical average of ~18-20x, but below the 2H20 peak of ~35x (A-share bull market).

Consensus Rating Distribution



● MS Rating

Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Market Share: *Positive*

Secular Growth: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE Rmb47.30

28x 2023e bull case (reported) EPS

Domestic mobile games:

- Revenue growth: 8% in 2023e, 12% in 2024e
- Cost of sales: 14.5% in 2023e, 13.0% in 2024e

Overseas mobile games:

- Revenue growth: 17% in 2023e, 15% in 2024e
- Cost of sales: 17.0% in 2023e, 16.6% in 2024e

BASE CASE Rmb34.40

23x 2023e base case (reported) EPS

Domestic mobile games:

- Revenue growth: 6% in 2023e, 10% in 2024e
- Cost of sales: 15.5% in 2023e, 14.0% in 2024e

Overseas mobile games:

- Revenue growth: 12% in 2023e, 10% in 2024e
- Cost of sales: 18.0% in 2023e, 17.6% in 2024e

BEAR CASE Rmb24.60

20x 2023e bear case (reported) EPS

Domestic mobile games:

- Revenue growth: 4% in 2023e, 7% in 2024e
- Cost of sales: 16.5% in 2023e, 15.0% in 2024e

Overseas mobile games:

- Revenue growth: 5% in 2023e, 5% in 2024e
- Cost of sales: 19.0% in 2023e, 18.6% in 2024e

Risk Reward – 37 Interactive Entertainment (002555.SZ)

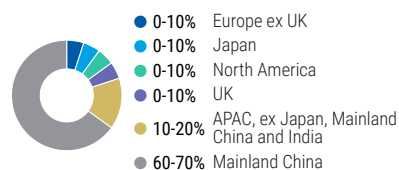
KEY EARNINGS INPUTS

Drivers	2022	2023e	2024e	2025e
Mobile game revenue (Rmb, mn)	15,632	16,929	18,622	20,281
Mobile game gross margin (%)	81.7	83.5	84.6	84.7
S&M expense as % of revenue (%)	53.2	54.3	53.2	53.1
R&D expense (Rmb, mn)	905	877	919	960

INVESTMENT DRIVERS

- New game releases
- Strong sustainability from existing titles
- More efficient marketing investment

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

MS ALPHA MODELS

4/5 MOST 3 Month Horizon

Source: Refinitiv, FactSet, Morgan Stanley Research; 1 is the highest favored Quintile and 5 is the least favored Quintile

RISKS TO PT/RATING

RISKS TO UPSIDE

- Stronger-than-expected grossing from new titles
- Stronger-than-expected sustainability from overseas titles
- More efficient marketing efforts

RISKS TO DOWNSIDE

- Weaker-than-expected grossing from new and existing titles
- Increased spending on marketing, with lower ROI
- License approval risks

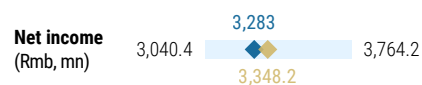
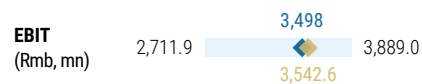
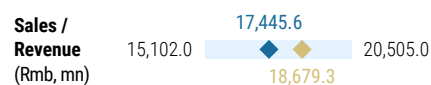
OWNERSHIP POSITIONING

Inst. Owners, % Active 89.6%

Source: Refinitiv, Morgan Stanley Research

MS ESTIMATES VS. CONSENSUS

FY Dec 2023e



◆ Mean ◆ Morgan Stanley Estimates
Source: Refinitiv, Morgan Stanley Research

Risk Reward – Perfect World Co Ltd (002624.SZ)

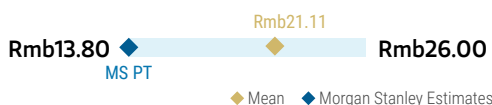
Growth up-cycle ahead, but uncertainties remain

PRICE TARGET Rmb13.80

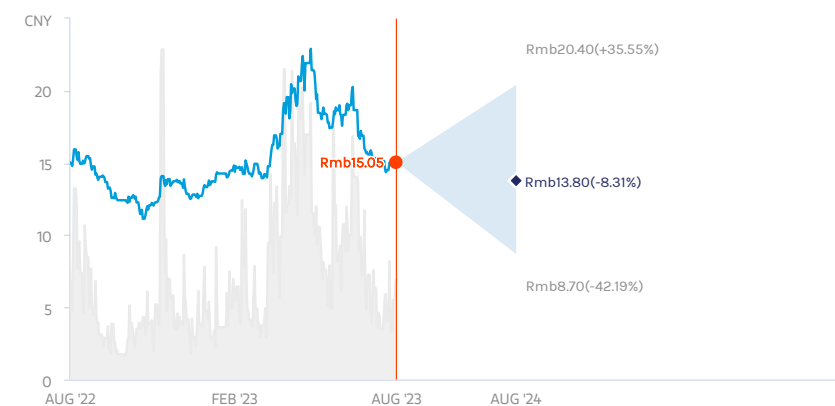
We value Perfect World at 23x 2023e adjusted EPS, above its historical average of ~18-20x since 2018. We believe 23x is justified given PW is entering an earnings upcycle, amid AI-driven positive sentiment.

Consensus Price Target Distribution

Source: Refinitiv, Morgan Stanley Research



RISK REWARD CHART



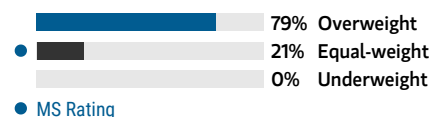
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

EQUAL-WEIGHT THESIS

- We like Perfect World's strong production and capability to foster IP in the field of martial-arts MMORPG. We also see upside potential from its second growth engine - innovative titles.
- Two major overhangs are bottoming as the regulatory environment looks more promising and pipeline grossing has stabilized.
- Growth should be entering an up-cycle, but timing of license approval and release schedule remains uncertain.
- Valuation looks fair.

Consensus Rating Distribution



Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Self-help: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE

Rmb20.40

25x 2023e bull-case adjusted EPS

Mobile game revenue growth 14% in 2023e, 16% in 2024e.

Self-developed PC game revenue growth 22% in 2023e, 42% in 2024e.

BASE CASE

Rmb13.80

23x 2023e base-case adjusted EPS

Mobile game revenue growth 10% in 2023e, 14% in 2024e.

Self-developed PC game revenue growth 2% in 2023e, 40% in 2024e.

BEAR CASE

Rmb8.70

20x 2023e bear-case adjusted EPS

Mobile game revenue growth 6% in 2023e, 12% in 2024e.

Self-developed PC game revenue growth -5% in 2023e, 38% in 2024e.

Risk Reward – Perfect World Co Ltd (002624.SZ)

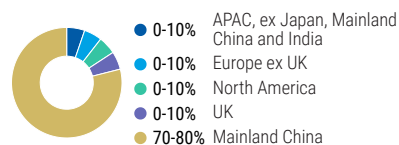
KEY EARNINGS INPUTS

Drivers	2022	2023e	2024e	2025e
Mobile game revenue (Rmb, mn)	5,061	5,567	6,346	7,190
PC game revenue (Rmb, mn)	1,903	1,949	2,442	2,615
Mobile game gross margin (%)	73.9	70.5	72.0	72.5
S&M expense as % of revenue (%)	14.5	13.8	12.0	12.0
R&D expense (Rmb, mn)	2,290	2,277	2,408	2,531

INVESTMENT DRIVERS

- Announcement of new game pipeline.
- Improvement in overseas expansion.

GLOBAL REVENUE EXPOSURE



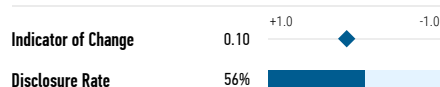
Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

MS ALPHA MODELS

4/5
MOST
3 Month
Horizon

Source: Refinitiv, FactSet, Morgan Stanley Research; 1 is the highest favored Quintile and 5 is the least favored Quintile

SUSTAINABILITY & ESG



RISKS TO PT/RATING

RISKS TO UPSIDE

- Better-than-expected grossing from Tower of Fantasy and other new titles.
- Earlier-than-expected game title releases.
- Lower-than-expected mobile channel commission and S&M expense.

RISKS TO DOWNSIDE

- Worse-than-expected grossing from Tower of Fantasy and other titles.
- Postponement of game title releases.
- Higher-than-expected marketing expense.

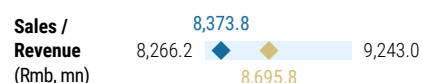
OWNERSHIP POSITIONING

Inst. Owners, % Active: 94.5%

Source: Refinitiv, Morgan Stanley Research

MS ESTIMATES VS. CONSENSUS

FY Dec 2023e



Source: Refinitiv, Morgan Stanley Research
◆ Mean ◆ Morgan Stanley Estimates

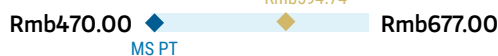
Risk Reward – G-bits Network Technology (603444.SS)

More optimistic outlook, but valuation is full

PRICE TARGET Rmb470.00

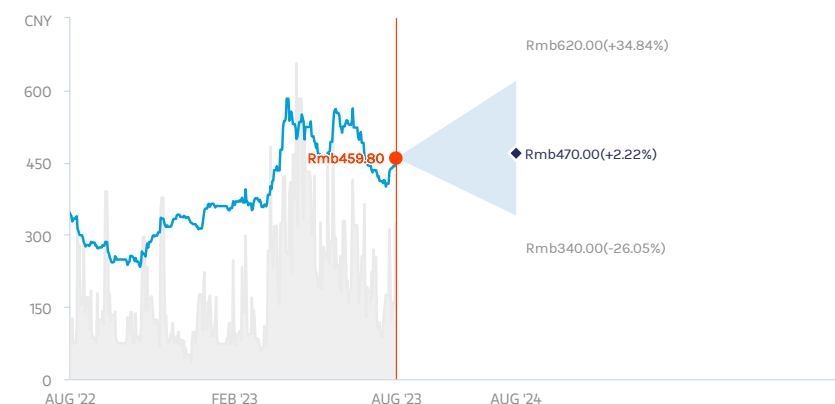
Base case, derived from a target 2023 P/E of 20x, slightly above its five-year historical average of ~18x. We believe 20x is justified because earnings are entering an up-cycle, with AI-driven positive sentiment. But 20x is lower than the target of 23x we assign 37IE and Perfect World, due to its weaker game catalyst and slower progress on AI developments.

Consensus Price Target Distribution



Source: Refinitiv, Morgan Stanley Research

RISK REWARD CHART



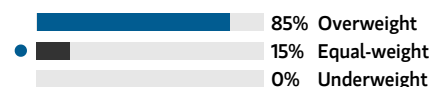
Key: — Historical Stock Performance ● Current Stock Price ◆ Price Target

Source: Refinitiv, Morgan Stanley Research

EQUAL-WEIGHT THESIS

- G-bits has proven itself in production expertise, evident from the excellent sustainability that its iconic titles bring.
- However, constrained capacity is the key concern around its upside potential over the longer term.
- We stay EW in view of less visible growth versus peers, and full valuation.

Consensus Rating Distribution



● MS Rating

Source: Refinitiv, Morgan Stanley Research

Risk Reward Themes

Market Share: *Positive*
Secular Growth: *Positive*

View descriptions of Risk Rewards Themes [here](#)

BULL CASE	Rmb620.00	BASE CASE	Rmb470.00	BEAR CASE	Rmb340.00
25x 2023e bull case (reported) EPS		20x 2023e base case (reported) EPS		15x 2023e bear-case (reported) EPS	
Self-operated revenue growth: 17%/13% in 2023 and 2024.		Self-operated revenue growth: 14%/10% in 2023 and 2024.		Self-operated revenue growth: 11%/7% in 2023 and 2024.	
Co-operated revenue growth: 16%/12% in 2023 and 2024.		Co-operated revenue growth: 13%/9% in 2023 and 2024.		Co-operated revenue growth: 10%/6% in 2023 and 2024.	

Risk Reward – G-bits Network Technology (603444.SS)

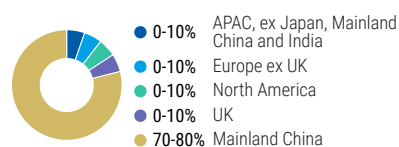
KEY EARNINGS INPUTS

Drivers	2022	2023e	2024e	2025e
Co-operated gross margin (%)	84.9	87.2	87.3	87.4
S&M expense as % of revenue (%)	27.1	24.6	24.5	24.4
R&D expense (Rmb, mn)	673	810	849	881

INVESTMENT DRIVERS

- New game releases
- Production capacity ramp-up
- Overseas expansion

GLOBAL REVENUE EXPOSURE



Source: Morgan Stanley Research Estimate
View explanation of regional hierarchies [here](#)

MS ALPHA MODELS

4/5 MOST 3 Month Horizon

Source: Refinitiv, FactSet, Morgan Stanley Research; 1 is the highest favored Quintile and 5 is the least favored Quintile

RISKS TO PT/RATING

RISKS TO UPSIDE

- Stronger-than-expected grossing and sustainability from new titles
- Faster-than-expected overseas expansion
- Faster-than-expected capacity ramp-up

RISKS TO DOWNSIDE

- Weaker-than-expected grossing from new titles
- Weakening sustainability from existing titles
- License approval risks

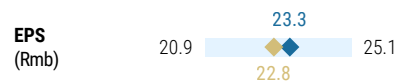
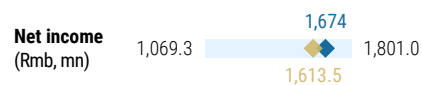
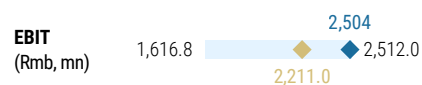
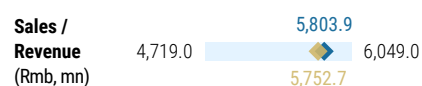
OWNERSHIP POSITIONING

Inst. Owners, % Active **94.3%**

Source: Refinitiv, Morgan Stanley Research

MS ESTIMATES VS. CONSENSUS

FY Dec 2023e



◆ Mean ◆ Morgan Stanley Estimates

Source: Refinitiv, Morgan Stanley Research

Risk Reward Reference links

1. View explanation of Options Probabilities methodology - [Options_Probabilities_Exhibit_Link.pdf](#)
2. View descriptions of Risk Rewards Themes - [RR_Themes_Exhibit_Link.pdf](#)
3. View explanation of regional hierarchies - [Microsoft PowerPoint - Exhibit Links.pptx](#)
4. View explanation of 'Indicator of Change' methodology - [ESG_Indicator_of_Change_External_Link.pdf](#)
5. View explanation of Theme/Exposure methodology - [ESG_Sustainable_Solutions_External_Link.pdf](#)
6. View explanation of HERS methodology - [ESG_HERS_External_Link.pdf](#)

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(as of July 31, 2023)

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For disclosure purposes only (in accordance with FINRA requirements), we include the category headings of Buy, Hold, and Sell alongside our ratings of Overweight, Equal-weight, Not-Rated and Underweight. Morgan Stanley does not assign ratings of Buy, Hold or Sell to the stocks we cover. Overweight, Equal-weight, Not-Rated and Underweight are not the equivalent of buy, hold, and sell but represent recommended relative weightings (see definitions below). To satisfy regulatory requirements, we correspond Overweight, our most positive stock rating, with a buy recommendation; we correspond Equal-weight and Not-Rated to hold and Underweight to sell recommendations, respectively.

Stock Rating Category	Coverage Universe		Investment Banking Clients (IBC)			Other Material Investment Services Clients (MISC)	
	Count	% of Total	Count	% of Total IBC	% of Rating Category	Count	% of Total Other MISC
Overweight/Buy	1347	37%	276	43%	20%	609	39%
Equal-weight/Hold	1659	46%	294	46%	18%	717	46%
Not-Rated/Hold	3	0%	0	0%	0%	1	0%
Underweight/Sell	604	17%	69	11%	11%	227	15%
Total	3,613		639			1554	

Data include common stock and ADRs currently assigned ratings. Investment Banking Clients are companies from whom Morgan Stanley received investment banking compensation in the last 12 months. Due to rounding off of decimals, the percentages provided in the "% of total" column may not add up to exactly 100 percent.

Analyst Stock Ratings

Overweight (O). The stock's total return is expected to exceed the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Equal-weight (E). The stock's total return is expected to be in line with the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Not-Rated (NR). Currently the analyst does not have adequate conviction about the stock's total return relative to the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Underweight (U). The stock's total return is expected to be below the average total return of the analyst's industry (or industry team's) coverage universe, on a risk-adjusted basis, over the next 12-18 months.

Unless otherwise specified, the time frame for price targets included in Morgan Stanley Research is 12 to 18 months.

Analyst Industry Views

Attractive (A): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be attractive vs. the relevant broad market benchmark, as indicated below.

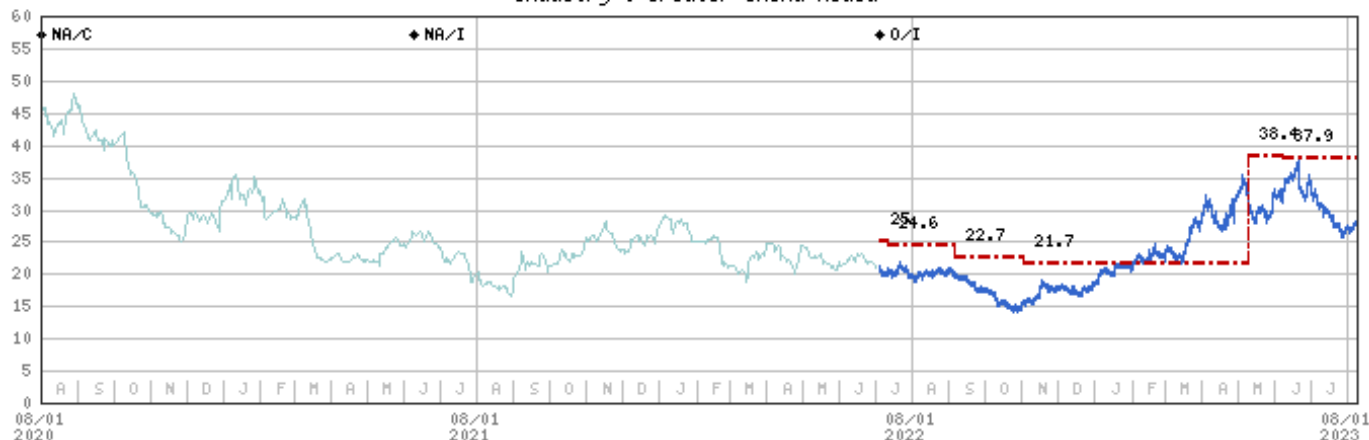
In-Line (I): The analyst expects the performance of his or her industry coverage universe over the next 12-18 months to be in line with the relevant broad market benchmark, as indicated below.

Cautious (C): The analyst views the performance of his or her industry coverage universe over the next 12-18 months with caution vs. the relevant broad market benchmark, as indicated below.

Benchmarks for each region are as follows: North America - S&P 500; Latin America - relevant MSCI country index or MSCI Latin America Index; Europe - MSCI Europe; Japan - TOPIX; Asia - relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Stock Price, Price Target and Rating History (See Rating Definitions)

37 Interactive Entertainment (002555.SZ) - As of 8/7/23 in CNY
Industry : Greater China Media



Stock Rating History: 1/4/19 : NA/NR; 2/22/19 : NA/C; 6/10/21 : NA/I; 7/4/22 : O/I

Price Target History: 7/4/22 : 25; 7/11/22 : 24.6; 9/5/22 : 22.7; 11/2/22 : 21.7; 5/10/23 : 38.4; 6/7/23 : 37.9

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)

Stock Price (Not Covered by Current Analyst) — Stock Price (Covered by Current Analyst) —

Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View

Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)

Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.

Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

G-bits Network Technology (603444.SS) - As of 8/7/23 in CNY
Industry : Greater China Media

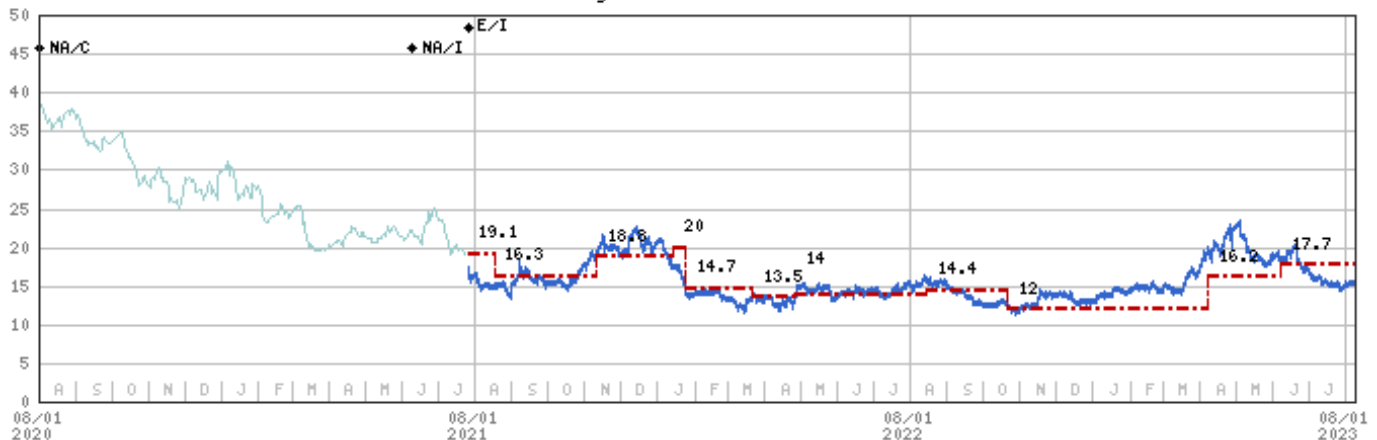


Stock Rating History: 1/4/19 : NA/NR; 2/22/19 : NA/C; 6/10/21 : NA/I; 7/4/22 : E/I
Price Target History: 7/4/22 : 370; 8/16/22 : 320; 10/27/22 : 280; 3/31/23 : 410; 6/7/23 : 470

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.
Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

Perfect World Co Ltd (002624.SZ) - As of 8/7/23 in CNY
Industry : Greater China Media



Stock Rating History: 1/4/19 : NA/NR; 2/22/19 : NA/C; 6/10/21 : NA/I; 7/26/21 : E/I
Price Target History: 7/26/21 : 19.1; 8/17/21 : 16.3; 11/10/21 : 18.8; 1/14/22 : 20; 1/24/22 : 14.7; 3/21/22 : 13.5; 4/26/22 : 14; 8/15/22 : 14.4; 10/21/22 : 12; 4/7/23 : 16.2; 6/7/23 : 17.7

Source: Morgan Stanley Research Date Format : MM/DD/YY Price Target --- No Price Target Assigned (NA)
Stock Price (Not Covered by Current Analyst) --- Stock Price (Covered by Current Analyst) ---
Stock and Industry Ratings (abbreviations below) appear as ♦ Stock Rating/Industry View
Stock Ratings: Overweight (O) Equal-weight (E) Underweight (U) Not-Rated (NR) No Rating Available (NA)
Industry View: Attractive (A) In-line (I) Cautious (C) No Rating (NR)

Effective January 13, 2014, the stocks covered by Morgan Stanley Asia Pacific will be rated relative to the analyst's industry (or industry team's) coverage.
Effective January 13, 2014, the industry view benchmarks for Morgan Stanley Asia Pacific are as follows: relevant MSCI country index or MSCI sub-regional index or MSCI AC Asia Pacific ex Japan Index.

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INDUSTRY COVERAGE: Greater China Media

COMPANY (TICKER)	RATING (AS OF)	PRICE* (08/08/2023)
Alex Poon		
Tencent Music Entertainment Group (TME.N)	O (12/01/2022)	US\$6.30
Rebecca Xu		
37 Interactive Entertainment (002555.SZ)	O (07/04/2022)	Rmb27.53
Alibaba Pictures Group Ltd (1060.HK)	E (03/28/2022)	HK\$0.53
Alpha Group (002292.SZ)	U (05/10/2022)	Rmb10.19
Beijing Enlight Media (300251.SZ)	E (09/04/2020)	Rmb8.92
China Film Co. Ltd. (600977.SS)	E (04/09/2020)	Rmb15.85

China Literature Ltd (0772.HK)	E (03/12/2020)	HK\$33.10
Focus Media Information Technology (002027.SZ)	O (03/14/2023)	Rmb7.52
G-bits Network Technology (603444.SS)	E (07/04/2022)	Rmb459.80
Guangdong South New Media Co.Ltd (300770.SZ)	E (09/14/2021)	Rmb42.72
Huayi Brothers Media Corporation (300027.SZ)	U (09/10/2021)	Rmb3.20
Linmon Media Ltd (9857.HK)	E (10/12/2022)	HK\$10.44
Mango Excellent Media Co Ltd (300413.SZ)	E (03/21/2022)	Rmb34.32
Maoyan Entertainment (1896.HK)	O (05/10/2022)	HK\$10.32
Perfect World Co Ltd (002624.SZ)	E (07/26/2021)	Rmb15.05
Songcheng Performance Development Co Ltd (300144.SZ)	E (07/26/2021)	Rmb13.03
Wanda Film Holding Co Ltd (002739.SZ)	E (12/09/2021)	Rmb14.76
Zhejiang Huace Film and TV (300133.SZ)	E (01/25/2021)	Rmb6.90

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