

# Migme Limited (MIG)

Initiating Coverage

August 2014

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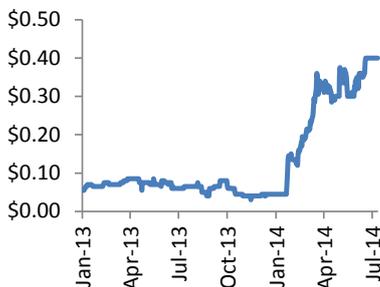
### Investment Profile

Share Price (\$) as at 11 July 2014	0.40
Issued Capital:	
Ordinary Shares (M)	251.6
Options (M)	15.0
Fully Diluted (M)	266.6
Fully Diluted Market Capitalisation (\$M)	106.6
12-Month Range (\$)	0.003/0.45

### Board and Management

Howard Dawson: Non-Executive Chairman
Steven Goh: Chief Executive Officer, Executive Director
Andy Zain: Non-Executive Director
Dmitry Levit: Non-Executive Director
John Lee: Non-Executive Director
Yen-Chang Pan: Executive Director
Yichin Lee: Non-Executive Director

### Share price performance



## CATCHING THE NEXT WAVE OF GROWTH IN SOCIAL MEDIA

While early days, our analysis of Migme's business model, growth strategy and target markets leads us to conclude that the company is well placed to benefit from the proliferation of increasingly affordable mobile phones in emerging markets. Competition will be fierce, but as was the case in China, cultural differences can level the playing field, such that internationally recognised brands do not always cross borders successfully.

### KEY POINTS

**Mig33 Acquisition Approved** – At the General Meeting held on 19 June 2014, Latin Gold (LAT) shareholders approved the 100% acquisition of Mig33 through the issue of 735m shares or circa 70% of the merged entity. The approval will constitute a material change in the nature and scale of the company's activities. Shareholders also approved the change of the company name to Migme Limited. This report focuses on Mig33's (renamed Migme) business and the merged entity.

**Merged Business** – Migme is a social entertainment platform that features a miniblog, chat, chatrooms, virtual gifts and games, is available on Android, WAP, and Web, and has in excess of 3 million monthly active users. Latin Gold, on the other hand, was a gold exploration company with two wholly owned tenements. We expect the merged entity to ultimately divest the tenements in situ, or allow the leases to lapse.

**Migme Business Model** – Not unlike its larger and more established peers, Migme seeks to attract customers to its platform by (i) offering free services such as chat/chatrooms and miniblogs; and (ii) leveraging its social networking services (SNS), user generated content (UGC) infrastructure, and portfolio of social games. In doing so, Migme is able to generate revenue by selling value added services and advertising.

**Key Revenue Drivers** – We identify three key drivers of Migme's revenues. These are (i) the target market's internet penetration rate and disposable income per capita – these determine the size of the market opportunity; (ii) the company's brand recognition, particularly with regards to enriching the customer experience through innovation; and (iii) the company's supply chain and level of vertical integration.

**Growth Potential** – Since the company's inception in 2006, Migme has evolved from a closed instant messaging platform with 70 million registered users to an open platform that has in excess of a dozen media partnership engagements with celebrities/artists and 3.2 million monthly active users (MAUs). The company's target market is the 3.5 billion people that reside in the emerging markets of Asia and Africa.

**Capital Position** – The indicative capital structure of the merged entity as at 31 December 2013 comprised (i) net assets of A\$44.1m, the vast majority of which is accounted for by Migme's goodwill of A\$41.1m and cash of A\$14.5m (includes FIH Mobile investment post approval); and (ii) 251.6m shares – this is post a 1:5 consolidation of Latin Gold's shares and includes the issue of 40m shares to FIH Mobile.

**Risks** – We identify four key risks for investors to consider as part of their appraisal process. These are (i) start-up risks; (ii) competitive intensity; (iii) operational risks; and (iv) political risks. While Migme has a level of control over start-up and operational risks, the emerging markets in which the company is targeting provide political risks outside the control of the company.

**Investment view** – This report has not undertaken a rigorous analysis of Migme's earnings and cash flow generating capabilities and thus does not include an indicative fair value estimate. However, based on the qualitative factors outlined in this report, we conclude that Migme has a number of the requisite characteristics to create value for its shareholders. The company remains in the early stages of growth. Growing its user base and being able to monetise the user base will be key to the business' success.

## OVERVIEW

- ◆ At the General Meeting held on 19 June 2014, Latin Gold shareholders voted in favour of the acquisition of 100% of Mig33 through the issue of 735m shares or circa 70% of the merged entity and a change of the company name to Migme Limited (ASX: MIG). The acquisition will constitute a material change in the nature and scale of the company's activities.
- ◆ Migme is a social entertainment platform that features a miniblog, chat, chatrooms, virtual gifts and games, is available on Android, WAP, and Web, and has in excess of 3 million monthly active users. Latin Gold, on the other hand, was a gold exploration company with two tenements that are 100% owned. These are Narracoota PLs 51/2828-2830, and Gearless Well ELA 36/808. With the acquisition approved, the merged entity will be seeking to divest the tenements.
- ◆ The company will undertake a share consolidation on a 1:5 basis and issue a total of 187m new shares will be issued to the owners of Migme with Latin Gold shareholders retaining ~26% of the merged entity. This includes the issue of 40m of shares to FIH Mobile.

## CORPORATE HISTORY

- ◆ Latin Gold listed on the Australian Stock Exchange in June 2001 as WestMag Ltd (ASX: WMG). Having been hamstrung by delays developing its Pilbara magnesite project, the company began looking for investment opportunities in early-stage gold projects in Australia and offshore. Success in this regard was reflected in the name change to Latin Gold (ASX: LAT) in August 2006.
- ◆ Having struggled over an extended period of time to attract the necessary funds to complete the pre-development work at its sole project (Paron Gold Project in Peru), the company announced in December 2010 that it had an agreement to divest the asset. Latin Gold stated at the time that it will use the sale proceeds to identify additional resources investment opportunities.
- ◆ In early 2011, Latin Gold entered into two advanced exploration projects in Western Australia – Narracoota (50% interest) and Loongana (50% interest). While the Loongana joint venture was subsequently terminated, Latin Gold increased its interest in the Narracoota to 100% following the termination of its joint venture in April 2014.
- ◆ In April 2013 Latin Gold announced its intent, subject to shareholder approval, to acquire an 80% interest in the brownfields Buhemba gold project in Tanzania. However, due to a subsequent deterioration in equity capital markets, the transaction was terminated in October 2013. With all options seemingly exhausted, Latin Gold announced a reverse takeover by Migme in January 2014.
- ◆ Project Goth Inc, which is the holding company for Migme, announced in April 2014 that it had secured an initial US\$2.2m investment from FIH Mobile Limited. Following completion of the merger between Latin Gold and Migme, FIH Mobile has agreed to invest an additional US\$7.4m, resulting in an aggregate 19.9% interest in the merged entity. The partnership with FIH Mobile provides a strategic partner in the industry with a potential benefit being access to pre-load Migme's application on newly manufactured phones produced by FIH Mobile.
- ◆ Migme announced in February 2014, the acquisition of alivenotdead.com, which is an Asia Pacific focused online community platform, for an undisclosed sum. The acquisition, which complies with the existing merger agreement between Migme and Latin Gold, will enable alivenotdead.com to monetise users through its 1,800-plus artists (musicians and filmmakers) using Migme's platform. Acquisitions and strategic partnerships are a key element of Migme's growth strategy.

## STRATEGIC PARTNERSHIPS

- ◆ The sale of up to 19.9% of the company to FIH Mobile Limited represented a significant milestone. The strategic merit of this partnership lies in the potential for synergies that can be created between Migme's platform and manufactured handsets. The potential benefit may be the pre-installation of Migme's software on newly manufactured FIH Mobiles.

- ◆ FIH Mobile, which is listed on the Hong Kong Stock Exchange with the ticker 2038.HK and with a market cap of US\$4.4 billion, is the world's largest vertically integrated mobile phone manufacturing service provider.
- ◆ FIH Mobile is a majority owned subsidiary of Hon Hai Precision Industry Co. Ltd (Hon Hai). Hon Hai is listed in Taiwan with the code 2317.TW and has a market cap of US\$40.5 billion. Hon Hai provides computer, communication and consumer electronics services and has a presence across Asia, Europe and the Americas.
- ◆ FIH Mobile's operations are primarily located in China. For the FY'13, FIH Mobile:
  - Had revenue of US\$4.997b and reported an operating profit of US\$129m, up from the operating loss of US\$218m in 2012;
  - Accounts for 80% of Apple's iPhone and iPad contract manufacturing business – this likely includes contributions from Hon Hai Group's other subsidiaries;
  - Recently signed a five-year profit share agreement with Blackberry, for the joint development and manufacture of a budget (US\$200) smartphone.
- ◆ While FIH Mobile manufactures an estimated 40% of global handsets, it remains to be seen how many of these units will have Migme's software pre-installed. According to The Wall Street Journal's technology site, Digits, Apple is unlikely to agree to having Migme software pre-installed, but Blackberry and Android are possibilities.

## MIGME BUSINESS PROFILE

- ◆ Latin Gold shareholders will own circa 26% of the merged entity (including the additional share issue to FIH Mobile), which has been renamed Migme Limited (ASX: MIG). The Board composition will change accordingly and will comprise six directors. Four directors will be appointed by Migme, two directors will be nominated by FIH and one Latin Gold director (Howard Dawson) will be retained
- ◆ Migme is a social networking platform with a focus on emerging markets. The company was founded in Australia in 2006 and is now based in Singapore. According to the company's website, it has "millions of users in over 200 countries, playing in tens of thousands of chatrooms, posting millions of miniblogs, sending hundreds of thousands of virtual gifts every day".
- ◆ Key features of Migme's social platform include (i) miniblog, instant messaging, and chatrooms; (ii) emoticons, stickers, virtual gifts and games; and (iii) gamification elements such as Avatars, Badges, Levels and Leaderboard. These features are available to customers on Android, WAP, and Web.
- ◆ Since the company's inception in 2006, Migme has evolved from a closed instant messaging platform with 70m registered users to an open platform that has in excess of a dozen media partnership engagements with celebrities/artists and 3.2m monthly active users (MAUs). The company's target market is the 3.5 billion people that reside in the following emerging markets:
  - South East Asia;
  - South Asia;
  - Middle East; and
  - Africa
- ◆ A closed versus open platform:
  - **A closed platform** is a software system where the carrier or service provider has control over applications, content, and media, and restricts convenient access to non-approved applications or content. Examples include Skype, Messenger, Yahoo, and WhatsApp;
  - In contrast to a closed platform, in **an open platform** consumers have unrestricted access to applications, content, and much more. While there are pros and cons of both, a key advantage to open platforms is innovation. Examples include Facebook and Tencent.

## TRANSACTION MECHANICS

- ◆ Migme’s business model is built on the success of established peers such as Tencent (HK: 298), Weibo (NASDAQ: WB) and YY.com (NASDAQ.YY). A key distinguishing feature of these businesses, in comparison to other social platforms such as Facebook, is that they derive the bulk (circa 90%) of their revenue from the sale of virtual gifts and games, rather than through advertising. The company uses a proven merchant model for payments.
- ◆ Not unlike its larger and more established peers, Migme seeks to attract customers to its platform by (i) offering free services such as chat/chatrooms and miniblogs; and (ii) leveraging its social networking services (SNS), user generated content (UGC) infrastructure, and portfolio of social games. In doing so, Migme is able to generate revenue by selling:
  - Value added services such as (i) avatars; (ii) virtual goods, such as digital clothing for avatars and other freemiums; (iii) social games; and (iv) other premium services; and
  - The sale of advertising space on the parts of the company’s website that generate significant daily impressions. Key mediums in this regard are the use of log-in and system-prompted advertising that is displayed for several seconds.
- ◆ According to Weibo’s recent Prospectus, “social media in China has enormous monetisation potential given its differentiated ability to reach a broad audience and target specific user behaviours/interests. Social media can offer a full spectrum of advertising and marketing solutions to address the needs of businesses ranging from large brand advertisers to SMEs and individuals”
- ◆ While Migme’s business model continues to evolve, the company’s primary source of revenue will be from value added services. In order for this to occur, Migme will need to partner with (i) celebrities and content providers to engage the market; (ii) handset manufacturers to increase market share; (iii) retailers to distribute its consumables; and (iv) mobile networks to collect billings.
- ◆ It is worth noting that Migme recently began taking steps to optimise its customer proposition. We note (i) the acquisition of alivenotdead.com, which provides it with celebrity content; and (ii) the sale of a strategic stake in Migme to FIH Mobile, which provides it with a valuable means of increasing market awareness/market share
- ◆ The cost of doing business for Migme will reflect the extent to which these partnerships are secured, and on what terms. While revenue share agreements are likely to be the key means by which these commercial agreements are fulfilled, other payment options include (i) direct payments to merchants; and (ii) offering key relationships equity in Migme.

## KEY REVENUE DRIVERS

- ◆ We identify three key drivers of Migme’s revenues. These are (i) the target market’s internet penetration rate and disposable income per capita – these determine the size of the market opportunity; (ii) the company’s brand recognition, particularly with regards to enriching the customer experience through innovation; and (iii) the company’s supply chain and level of vertical integration.
  - **The size of the market opportunity:** While the disruptive forces of technology have, to a large extent, played out in developed markets such as the US, there are arguably still contestable first mover advantages in many emerging markets. Indonesia is one such market that is large, emerging, and underpenetrated by online services providers.
  - **Brand recognition:** In our view, this is ultimately determined by (i) understanding the needs of the market; and (ii) providing innovative ways to enrich the user’s experience of the product or service. By virtue of being an online social network, success in this regard can become self-perpetuating, particularly in large underpenetrated markets.
  - **Supply chain:** If you build it (the customer base), they (the media partnerships) will follow. As is the case with Migme, the company used free services (chat and miniblogs) to procure initial engagements and then deepened these engagements through value added services. This makes a value-added supply chain (verticals) easier to assemble.

- ◆ With regards to the supply chain, it is worth noting the strategic importance of the recent investment in Migme by FIH Mobile, which is one of the largest mobile handset manufacturers in the world. While the US\$9.6m of funds will greatly enhance Migme's ability to fund its near-term growth initiatives, the key benefit is expected to be the pre-installation of its software on select mobile phones.

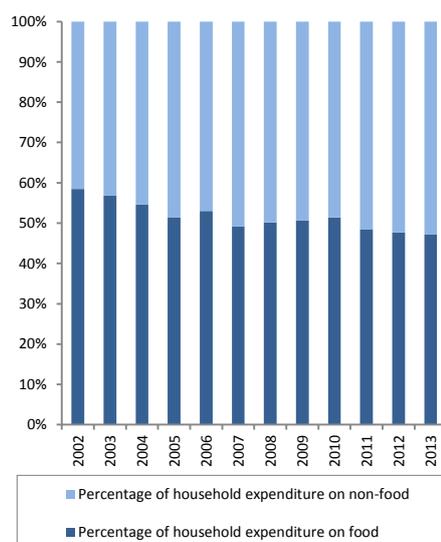
## THE MARKET OPPORTUNITY

- ◆ Migme is seeking to capitalise on growing demand for social media in emerging markets. As outlined in the following section of this report, demand for social media in emerging markets is being driven by (i) urbanisation, which is underpinning growth in per capita wealth, and (ii) the proliferation in budget smartphones, due in part to competition amongst handset manufacturers.
- ◆ The company's core markets at this stage are Indonesia and India, with these two markets currently making up the bulk of the company's revenue. In our view, this seems logical given the medium-term potential of these two markets based on their respective population, per capita wealth profile, and rapid adoption of social media, which remains relatively underpenetrated by world standards.

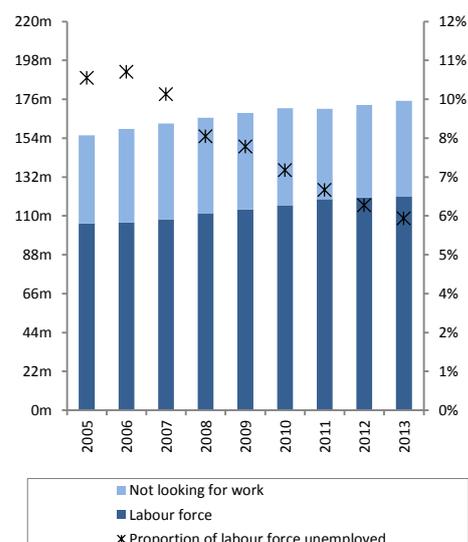
### MARKET OPPORTUNITY IN INDONESIA

- ◆ Indonesia is one of two key markets the company currently operates in. As the following overview illustrates, the country has a large population with a growing workforce, a declining rate of unemployment, an increasing proportion of household expenditure on non-food items, and skyrocketing growth in the rate of smartphone penetration.

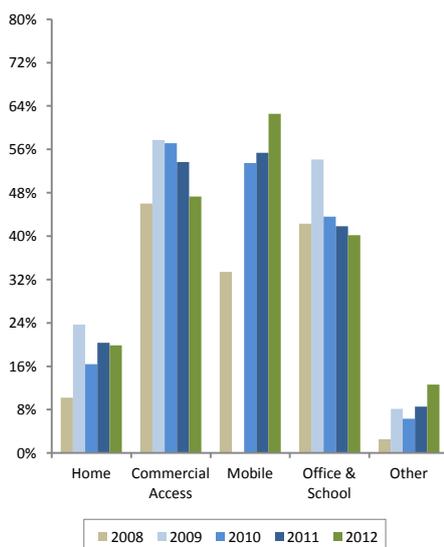
Household Expenditure



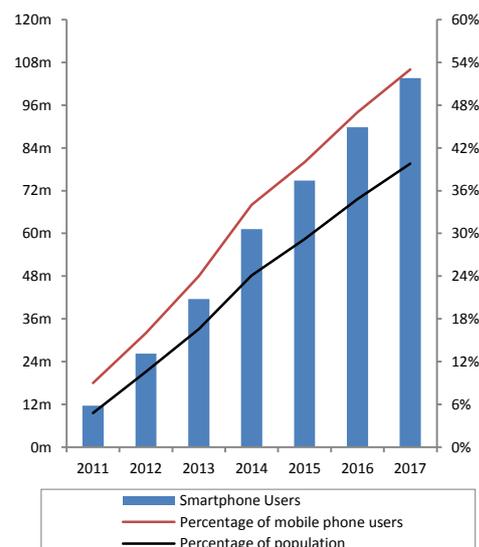
Workforce (limited to persons over 15)



Internet Use

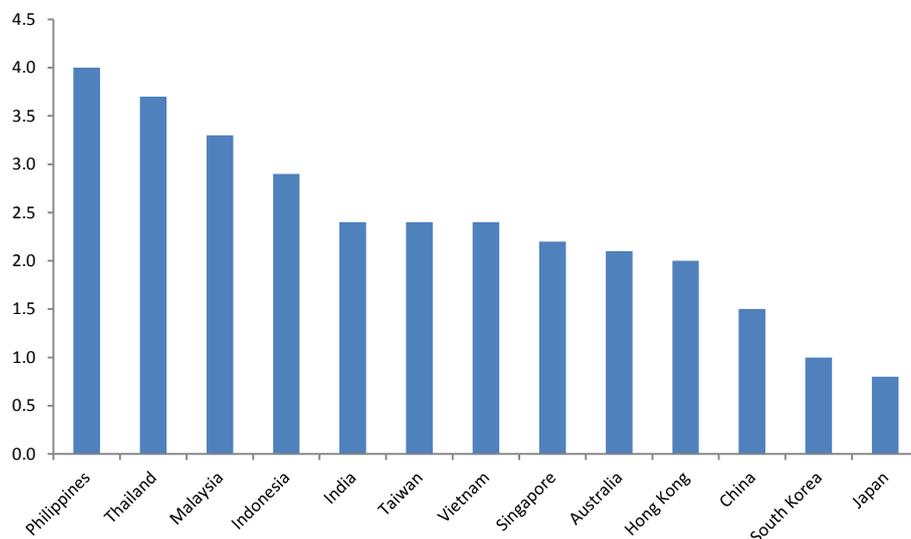


Smartphone Users in Indonesia



- ◆ While not a comprehensive overview of the market opportunity in Indonesia, other interesting snippets include (i) only 22% of the population have web access at home and only 9% have a PC, with 65% accessing the web via cafes; (ii) Blackberry is the country's most popular smartphone with a 50% market share; and (iii) 96% of Indonesia's smartphone users use social media.
- ◆ Another interesting point on Indonesia is its preference for local brands. According to [www.socialbakers.com](http://www.socialbakers.com), Facebook's ten most popular brands include Batik Indonesia (apparel) Blackberry, Samsung, Yamaha Motor Indonesia, Intel, Surfer Girl (a Bali-based company), Clear (cosmetics), and OLX Indonesia (online classified). Migme is yet to feature in the top 100.

Average Hours per Day on Social Media



Source: [wearesocial.net](http://wearesocial.net)

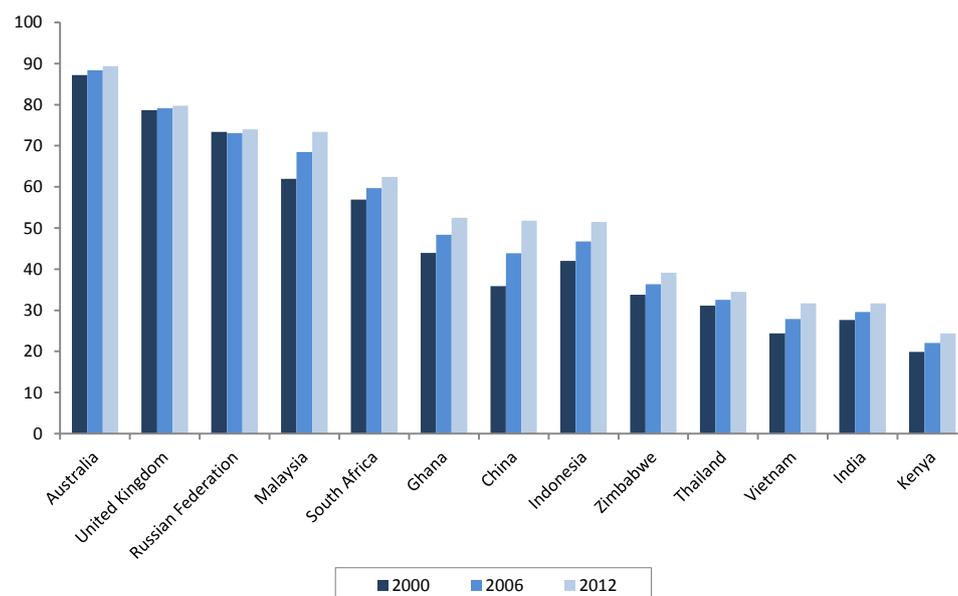
- ◆ While on the topic of Indonesia's inherent preference for local brands, it is interesting to note that social networking website Path's largest user base is from Indonesia - 4m of the 6m users. This is small in the scheme of things, but highlights an interesting point. The possible reasons for Path gaining traction in Indonesia include (more personal, private, and authentic, and less commercial):
  - The cap it imposes on the number of connections a profile can have at 150, thereby keeping it more selective and personal. One of Path's stated values is Authenticity, where it believes "the genuine self is the best self . . . you can be you, with no spotlight, stage, or expectation of perfection"

- The limited privacy options for users – on or off. Unlike Facebook, which has had its fair share of bad publicity due to perceived privacy breaches, Path users can opt to either share nothing with their connections or everything with their connections. This materially reduces the potential for unintended distribution of content.
- ◆ And finally, it is also worth noting that, according to global information and measurement company Nielsen, the percentage of Indonesian mobile subscribers that spend less than 50,000 rupiah (Rp) per month (A\$4.71) increased from 18% in 2005 to 58% in 2011. This reflects (i) mobile tariff reductions, and (ii) the surge in tweens (10-14 years of age) having a mobile phone connection.

## MARKET OPPORTUNITY IN INDIA

- ◆ Similar to Indonesia and other markets where the urbanisation of a large population is boosting per capita wealth and subsequent demand for consumer goods and services, India has many of the hallmarks of an emerging social media hotspot. We note India's (i) relatively high population density in rural areas and low mobile phone penetration rate; and (ii) acceptance of social media.
- ◆ While due in part to the country's large population, a relatively high proportion of India's residents remain rural based, with urbanisation seemingly happening at a slower rate than in other regions. As outlined in the chart below, the World Bank reports that 31.7% of India's population in 2012 resided in urban areas, compared to wearesocial.net' estimated global average of 52% in 2014.

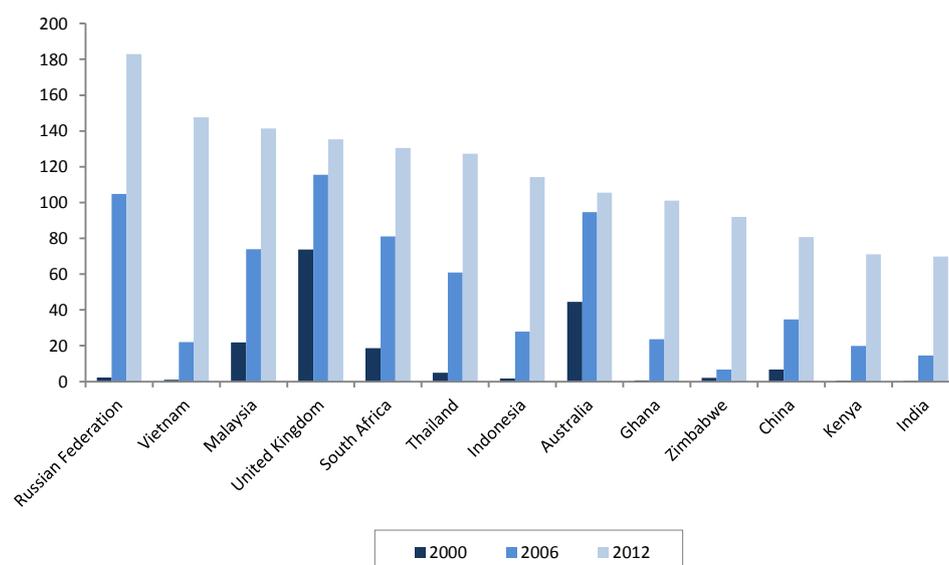
Urban Population as a Percentage of Total Population



Source: World Bank

- ◆ As illustrated in the chart below, growth in cellular subscriptions has been most pronounced in emerging markets, with Russia being the standout. While growth in Russia and developed countries like the United Kingdom and Australia appears to have peaked, growth in emerging regions such as India, Africa, and to a lesser extent Asia, looks set to continue.

Mobile/Cellular Subscriptions per 100 People.



Source: World Bank

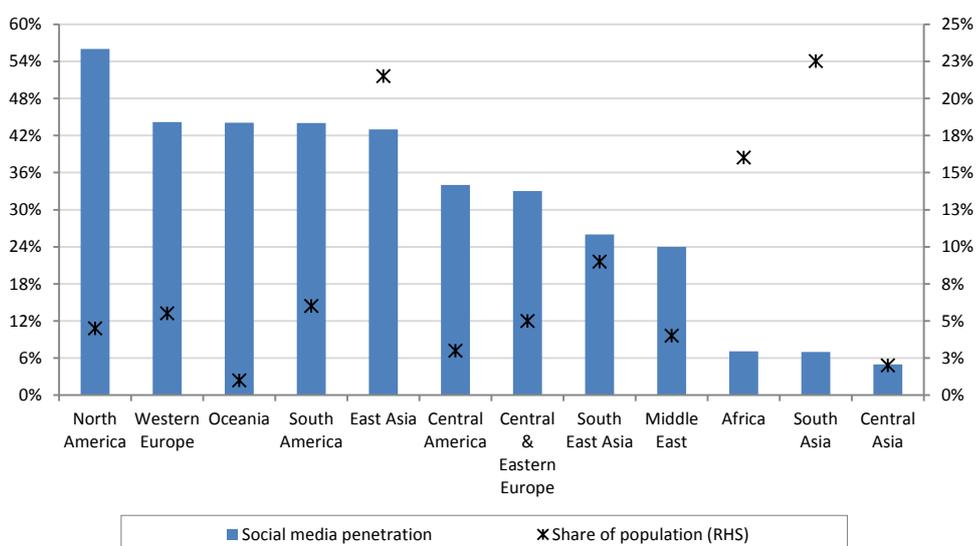
- ◆ Despite India having a relatively low mobile penetration rate, particularly smartphones, it is worth noting that, as at January 2014, the country still had (i) 213m internet users, of which 100m are active Facebook users; and (ii) 893.8m active mobile subscriptions, of which 95% are operated on a pre-paid basis. India's social media penetration is 17%, and smartphone penetration is 13%.
- ◆ India's potential as a social media hotspot is arguably best illustrated by the country's recent general election. In contrast to the 2009 election, when only one politician (Shashi Tharoor) had a Twitter account with 6,000 followers, after the seventh of nine rounds of polling, there were 49 million Indian election-related conversations on Twitter, compared to 20 million for all of 2013.
- ◆ While social media is currently considered to be the 'dipstick of the elite' given that access to it, at this stage, is largely limited to affluent urban dwellers (mostly the young and well educated), India nonetheless has the largest number of users of Facebook and Twitter, outside of the US. Facebook now has 100 million users in India, while that of Twitter has doubled since January 2014

### THE BROADER MARKET OPPORTUNITY

- ◆ As outlined above, Indonesia and India, in our view, represents the key near-term market opportunities for Migme given they currently operate in these areas. That said, it is worth noting that the company's growth aspirations are not limited to these countries. The company has stated on numerous occasions that it is targeting the 3.5 billion people that reside in the following emerging markets:
  - South East Asia;
  - South Asia;
  - Middle East; and
  - Africa.
- ◆ Looking at these regions within a global context, we note that the lowest per capita internet use, social media use, and mobile subscriptions is in South Asia (includes India) and Africa. From a social networking perspective, we believe the key appeal for Migme is the fact that South Asia and Africa:
  - Account for 23% and 16% of the world's population, respectively; and
  - Have mobile penetration rates of 72% and 67%, respectively.

- ◆ While internet penetration is 12% and 18% for South Asia and Africa, respectively, each region's internet user base is larger than that of South East Asia. And given the recent proliferation in budget smartphones, it seems logical to expect internet and thus social media penetration rates to respond the most in regions where there is the greatest disconnect between mobile phone and internet use.
- ◆ With regards to social media in Africa, a 2012 report by Deloitte noted that Africa is very different to the ROW in that it is being used as a cost-effective communication platform rather than as an entertainment tool. While there are obstacles, such as price of mobile phones and price of data, platform providers are addressing this by offering free access to their applications.

Social Media Penetration



Source: wearesocial.net

## PEERS

While there is no shortage of social media companies in operation globally, for the purposes of this report, we have outlined below the industry leaders that have the most relevance to Migme. Of particular interest are Tencent and Weibo, which have both originated from China and provide good examples of how the needs of social media users are evolving.

## WEIBO

- ◆ Weibo is a Chinese mobile microblogging platform that listed on the NASDAQ (WB.NASDAQ) in April 2014 and has a market capitalisation of US\$4bn. Weibo's key feature is its asymmetric messaging platform, which enables any user to follow any other user, thus resulting in an original feed becoming a live viral conversation stream. In December 2013, Weibo:
  - Had 129.1m monthly active users (MAUs) and 61.4m daily active users (DAUs), up from 96.7m and 45.1m, respectively, in December 2012;
  - Reported that 2.8bn feeds were shared on its platform. This comprised (i) 2.2bn feeds with pictures, 81.7m feeds with short videos, and (iii) 21.5m feeds with songs; and
  - Reported that 70% of its MAUs accessed the company's platform from a mobile device at least once during the month.
- ◆ In addition to its users, Weibo's ecosystem includes its customers and platform partners, both of which are attracted to Weibo because of its large user base and the viral potential of each promoted feed. In return, Weibo generates revenue from (i) its customers advertising spend (circa 75% of Weibo's revenues); and (ii) commissions generated on content provided by its platform partners.

- ◆ With regards to Weibo's non-advertising related revenues (platform partners), the company collects these sales direct from the user (i.e. from the sale of game tokens or VIP memberships). Where the sale pertains to third party content, Weibo remits a predetermined percentage of the proceeds to the content provider (i.e. game developers).

## TENCENT

- ◆ Tencent is listed on the Hong Kong Stock Exchange with a market capitalisation of US\$140bn. The company comprises a set of social platforms that offer users content, games, and payment services. It derives circa 90% of its revenues from premium interactions, with the balance coming from advertising. Revenues are billed and collected through three channels. These are:
  - **Mobile and fixed line operators** – due to the relatively low penetration rate of credit cards in China, this represents a key channel for Tencent. Accordingly, the telecommunications provider charges Tencent a withholding fee (12-15%) for providing the remittance;
  - **Pre-paid cards** – Tencent's pre-paid cards are used to purchase the company's fee-based services. The pre-paid cards are distributed via select retail outlets and contractual arrangements with other third parties, some of which provide a vertically integrated service; and
  - **The company's proprietary e-sales system** – Tencent has developed an e-sales platform to dispense user credit through select internet cafes and other retailers across China. Under the reseller agreement, retailers purchase the user credit in bulk at wholesale prices.

### Difference between Weibo and Tencent

- ◆ Social media platforms, such as Weibo, combine microblogging and social networking features and are public in nature. On such social media platforms, feeds can be viewed by any follower and are not limited to a particular audience. They are also characterized by a relative emphasis on interests, meaning that users tend to follow users that they are interested in or that share the same interests.
- ◆ On the other hand, social networks and messengers, such as Tencent Qzone, connect users by allowing friends and families to communicate and interact within a primarily private network. Thus, the asymmetric follow model of Weibo enables a less private and broader range of social relationships and engagements to develop between people, organizations and objects of interest.

## YY.COM

- ◆ YY is a Chinese video-based social network that listed on the NASDAQ in November 2012 with the ticker YY. Unlike other major Chinese-based social platforms that are to some extent clones of their US peers, YY's success to date (circa 310m-plus users) is based on a customer offering that is unique and innovative.
- ◆ YY was established in 2005 as a gaming portal for China's gamers under the name Duowan.com. In 2008, the company launched YY, initially as a voice-based gaming communications service, which enabled gamers to voice chat online and text chat in real-time while simultaneously participating in online games.
- ◆ More recently, YY expanded its customer offering beyond gaming into a much larger social communication platform. The key mechanism for this wider offering is its video streaming capabilities, which enable users to participate in group voice and/or video sessions – essentially a virtual stadium or auditorium. We note:
  - Popular uses of YY's video streaming include (i) karaoke sessions, where one person will sing while others watch and text chat amongst each other, and (ii) virtual classrooms (education) and virtual corporate meetings (business);
  - YY generates revenue from (i) commission on virtual goods purchased on games – circa 45% of revenue, (ii) commission on virtual goods purchased by users to give to performers circa 35% of revenue, and (iii) advertising – circa 20% of revenue.

- Content providers such as singers, teachers, game developers and other people using the service can earn money on YY from cashing in virtual goods - audience members buy virtual roses from YY to give to performers they like or rate.

### Comparing China and America's Major Social Networks

- ◆ While the lines are beginning to blur, Weibo is essentially China's version of Twitter, albeit with elements of Tumblr (microblogging) and Instagram (digital image sharing). In contrast, Tencent's flagship mobile messaging product WeChat is China's version of Facebook, albeit with tighter privacy controls. While both compete for marketing budgets, functionality differs. We note:
  - Just like Twitter, a key feature of Weibo is its ability to disseminate information from a grassroots level in real time; and
  - In contrast, and just like Facebook, WeChat (Weixin) is a mobile messaging platform that enables 'friends' to communicate with each other in a private realm.

### TWITTER

- ◆ Twitter is an online social networking and microblogging service that was founded in 2006, listed on the New York Stock Exchange (TWTR.NYSE) in 2013, and has a market capitalisation of US\$19bn. The company chose the word twitter based on its meaning – to utter a succession of small, tremulous sounds or chatter, as a bird.
- ◆ Twitter's platform enables users to send and read short 140-character (similar to Weibo) text messages, called "tweets". Registered users can read and post tweets, while unregistered users can only read them. As per Twitter's prospectus, the company aimed to "become an indispensable daily companion to live human experiences".
- ◆ In late 2013, Twitter had in excess of 215m monthly active users and more than 100m daily active users across the globe, with these users in aggregate creating approximately 500m tweets per day. Mobile devices are the key medium through which users access Twitter, accounting for (i) 75% of MAU activity, and (ii) 65% of advertising revenues.
- ◆ Twitter generates revenue primarily from the sale of advertising services and, to a lesser extent, from entering into data licensing arrangements. The company's advertising services comprise three products. These are (i) Promoted Tweets, (ii) Promoted Accounts, and (iii) Promoted Trends.
- ◆ Of the three advertising services, Promoted Tweets and Promoted Accounts are performance based, whereby the platform partners pay a predetermined amount for each user that engages with its promoted tweet(s) or follows a promoted account. Promoted Trends are featured by geography and offered on a fixed-fee-per-day basis.

### FACEBOOK

- ◆ Facebook is a social networking service that was founded in 2004, listed on the NASDAQ in 2012 with the ticker FB, and has a market capitalisation of US\$155bn. People use Facebook to stay connected with their friends/family, to discover what is going on in the world around them, and to share and express what matters to them with others. Facebook's ecosystem comprises:
  - **Users:** While by no means up to date, to highlight the magnitude of Facebook's popularity, we note in December 2011 the social network comprised 845m MAUs, of which 425m accessed the platform via a mobile device, and 483m DAUs, with more than 100bn friend connections.
  - **Developers:** Facebook uses its Facebook Platform to enable content developers to integrate their product with Facebook. This provides (i) users with a personalised and engaging experience, (ii) developers with the opportunity to sell their content to users, and (iii) Facebook with an engaged user base and commission revenues.
  - **Advertisers:** The sheer magnitude of Facebook's user base and the personalised information therein represents an attractive marketing medium for businesses. According to Facebook, the company offers advertisers a unique combination of reach, social context, and engagement to enhance the value of their advertisements.

- ◆ Facebook derives revenue from three main sources. These are (i) advertising fees that are generated by displaying advertisements on Facebook's social network; (ii) agency fees that are generated when users purchase content from content developers using Facebook's payments infrastructure; and (iii) other fees, predominantly from mobile providers.
- ◆ While Facebook derives the bulk of its revenue from advertising, it is worth noting that the click-through-rate (CTR) for advertisements on its platform has been materially lower than other major websites. According to BusinessWeek.com, banner advertisements on Facebook have generally received one-fifth the number of clicks compared to industry average.

#### Competitive Rivalry

- ◆ In our view, the key success factors critical to establishing a competitive position within the social networking market include (i) the size of the user base; (ii) the cohesiveness and interactivity of the target market; (iii) brand recognition; (iv) technology; (v) understanding of and tailoring to user needs; and (vi) pricing. To this end, first mover advantage and innovation are two key requirements.
- ◆ While Migme is seeking to replicate the success of Tencent in China by securing first-mover advantage in emerging markets such as South East Asia, it remains to be seen whether it will be successful. According to an article published by Forbes in May 2014, Tencent is strategically targeting large and growing markets. Since 2012, WeChat has:
  - Leveraged partnerships with famous Bollywood stars to establish an initial footprint in India;
  - Recruited star footballer Lionel Messi to help market the application in Europe and South America;
  - Upgraded its application to support languages such as Indonesian, Spanish, Hindi, and Russian;
  - Completed a number of bolt-on acquisitions and invested in products that give it a complimentary springboard into new markets.
- ◆ That said, per capita projections for Migme's target markets suggest that there will be sufficient demand for a multitude of social networks that cater to the changing needs of the respective user groups, be they mainstream or niche. As such, while the likelihood of Migme becoming the next Tencent is possibly a stretch, becoming a profitable business with good growth prospects is not.

### CAPITAL STRUCTURE

- ◆ As at 11 July 2014, Migme Limited, had 251.6m fully paid ordinary shares and 15m unlisted options on issue with a fully diluted market capitalisation of \$106.6m.
- ◆ The capital structure of the merged entity includes (i) net assets of A\$44.1m, the vast majority of which will be accounted for Migme's goodwill of A\$41.1m and cash of A\$14m; and (ii) 251,631,941 shares on issue— this includes a 1:5 consolidation of Latin Gold's shares and the 40m new shares to be issued to FIH Mobile. The company will also issue 15m options post approval to board members and management.

### INVESTMENT CASE

- ◆ This report has not undertaken a rigorous analysis of Migme's earnings and cash flow generating capabilities and thus does not include an indicative fair value estimate. However, based on the qualitative factors outlined in this report, we conclude that Migme has a number of the requisite characteristics to create value for its shareholders. We note:
  - **Growth strategy:** Migme's growth strategy is simple to understand and appears readily attainable. In particular, we note the company's initial focus on establishing a competitive position in Indonesia and India, which are large and growing markets with some unique qualities.

- **Brand equity:** While Migme’s customer proposition is not unique, it appears to have been customised with South East Asia in mind. It is early days, but based on the trajectory of its MAUs thus far, the brand is resonating with users, and looks set to continue to grow given recent product upgrades and media partnership engagements.
- **Supply chain:** The recent strategic investment in Migme by FIH Mobile is indicative of the company’s intention to align the interests of the key components within the supply chain. While a bit like the chicken or the egg conundrum in not knowing what comes first (users or content), the other key inputs are content providers and advertisers.
- **Funding:** Migme noted in its recent ASX releases that it (i) has sufficient funds (cash) to enact its near-term growth initiatives, and (ii) is intended that “no new equity will be raised, either pursuant to a prospectus or otherwise. While debt capital markets have not been mentioned to date, the point is that the business appears well funded.

## RISKS

- ◆ We identify four key risks for investors to consider as part of their appraisal process. These are (i) start-up risks; (ii) competitive intensity; (iii) operational risks; and (iv) political risks. While Migme has a level of control over start-up and operational risks, its stated strategy of targeting emerging markets means that it has limited control over political risks.
  - **Start-up risks:** While this risk is diminished somewhat by Migme seeking to apply a blend of proven business models (Tencent and Weibo) to emerging markets where competitive rivalries are less established, the company remains, for all intents and purposes, a start-up. As such, the usual investment appraisal caveats should apply.
  - **Competition rivalry:** The success or otherwise of Migme is predicated on its ability to attract a large base of active users. While focussing on emerging markets increases its probability of success given the likelihood that first mover advantages will be less established, the reality is that Migme operates in a globally competitive market.
  - **Operational risks:** By virtue of being a technology business, Migme is susceptible to system failures, security breaches, and infringement claims from third parties. Failure to manage these risks could have an adverse impact on the company’s ability to establish a large base of active users, and thus its capacity to generate revenues.
  - **Political risks:** By seeking to operate in emerging markets, Migme is exposing itself to regions that have relatively high levels of political risk. Given that the occurrence of these risks are difficult to foresee and yet can have a materially adverse impact on any given operating environment, they need to be factored into the investment case.

## BOARD AND MANAGEMENT

- ◆ The composition of the Executive Board is set to change. The Board of the merged entity will comprise six directors. Four directors will be appointed by Migme, two directors will be appointed from FIH Mobile and one Latin Gold director (Howard Dawson) will be retained.
  - **Howard Dawson (Non-Executive Chairman):** Mr. Dawson, who was appointed to the Board of Latin Gold in December 2003 and is Chairman of the Audit Committee, was a geologist for 11 years before starting a 20-year career in the securities industry. He is Chairman of Discovery Capital Limited and will hold 1.4m shares in the merged entity.
  - **Steven Goh (Co-founder, CEO, Executive Director):** Mr. Goh is recognised as an authority on contemporary IT issues and serves on several advisory panels within the Asian region. In the late 1990s, he developed and subsequently sold Sanford Securities, which was Australia’s first online stockbroker. Mr. Goh will hold 29.2m shares in the merged entity.

- **Andy Zain (Non-Executive Director):** Mr. Zain has in excess of 15 years of experience in building internet and mobile businesses in South East Asia, and launched the first content provider and ringtone service in Indonesia. Mr. Zain will hold 2.7m shares in the merged entity.
- **Dmitry Levit (Non-Executive Director):** Mr. Levit is a partner of Digital Media Partners, which is a venture capital firm within the technology sector. He has extensive experience in the IT sector and was a BDO for Yahoo in South East Asia. Mr. Levit will hold 11.2m shares in the merged entity.
- **John Lee (Non-Executive Director):** Mr Lee has had multiple senior executive roles in games companies listed on the NASDAQ and the KSE. He has also had consulting roles with McKinsey & Company and Deloitte & Touche in their technology services divisions. Mr Lee will hold 4m shares in the merged entity.
- **Yen-Chang (Charles) Pan (Executive Director):** Mr. Pan has 18 years of business experience and is currently the special assistant to the Chairman and CID of FIH Mobile. Prior to joining FIH Mobile, Mr. Pan was the GM of France Telecom’s subsidiary, Orange Capital. Mr. Pan will hold no shares in the merged entity.
- **Yichin Lee (Non-Executive Director):** Mr. Lee has over 20 years of strategy management experience. He is currently a managing partner of FCC Partners and the Senior Adviser and Taiwan Chief Representative of Booz and Co, and was formerly CEO of NASDAQ-listed GigaMedia. Mr. Lee will hold no shares in the merged entity.

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