EDISON

migme

Initiation of coverage

Social media for the next 3.5 billion

Software & comp services

migme's social media platform is initially targeting the rapidly growing mobile internet markets in Indonesia and India, where there are expected to be 294 million smartphone users by 2017. By taking a different approach to the more established Facebook, MIG believes its platform will have little competition from other freemium sites and will be suitable for the emerging markets. It hopes to continue to rapidly scale its user base, which has doubled to over nine million in the seven months to November 2014.

Year end	Revenue (A$m)	PBT* (A$m)	EPS* (c)	EV/Sales (x)	P/E (x)	Yield (%)
06/14	0.0	(0.4)	(0.7)	N/A	N/A	N/A
06/15e	6.1	(7.5)	(2.1)	22.3	N/A	N/A
06/16e	21.9	(1.8)	(0.5)	6.2	N/A	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Social media platform targeting emerging Asia

Singapore-based MIG runs a freemium social media platform, where basic use is free, but where virtual goods and services are paid for – a model that has worked well for both Tencent [700:HK] (629 million monthly active users [MAUs]) and YY.com [YY.US] (92 million MAUs) in China. MIG aims to attract more users by partnering with phone manufacturers, including strategic investor FIH Mobile (a subsidiary of Hon Hai Precision Co Ltd [TPE:2317], market capitalisation US$42bn to pre-install its app on low-cost smartphones in the region, and engaging celebrities and games developers.

Forecasts: Depends on driving user base

MIG's target market is potentially massive and is not limited by geographic boundaries. Our forecasts assume that the current growth trajectory continues, with monetisation rates rising to typical industry levels by 2017. Provided opex can be kept in check, there should be sufficient funding to be EBITDA positive by 2017.

Valuation: Range A$0.20 to A$1.03

MIG is still in the relatively early stages of commercialisation and it is too early to say whether its approach will be enough to enable it to develop its freemium model and take advantage of a first-mover advantage in the social media freemium market in Indonesia and other target markets. If the concept takes off and the company is able to execute, the opportunity is very significant. Consequently, this is a high-risk, potentially high-reward investment case. Our reverse DCF suggests that the current share price is factoring in a modicum of success; for example, growth in monetised users to 2.45 million by 2017 and an average spend of A$41pa. However, if the network effect takes hold, more rapid growth than this is entirely feasible. The key catalysts for pricing include rapid increase in users, high monetisation rates and increasing spend per user (YY.com growth in four years was users up 4.5x, spend up 5.5x, monetisation 13%). We have quantified the valuation range in our DCF based valuation sensitivities as from A$0.20 to A$1.03.

18 December 2014

Price	**A$0.58**
Market cap	**A$145m**

Net cash (A$m) June 2014	9.9
Shares in issue	251.6m
Free float	72%
Code	MIG.ASX / A117AB
Primary exchange	ASX
Secondary exchange	Frankfurt

Share price performance

%	1m	3m	12m
Abs	37.3	53.7	1,044
Rel (local)	45.4	63.2	1,036
52-week high/low		A$0.58	A$0.04

Business description

migme (MIG) is a social entertainment platform targeting the world's next wave of internet users – the 3.6 billion people in emerging markets. The service offers free chat, content and blogging services to acquire new users. These users buy virtual goods including gifts, games, avatar items, emoticons and stickers.

Next event

Half year results	February 2015

Analysts

Moira Daw +61 (0)2 9258 1160

Bridie Barrett +44 (0)20 3077 5700

media@edisongroup.com

Edison profile page

migme is a research client of Edison Investment Research Limited

Investment summary

Company description: Monetising social media

MIG is in the early stages of building a user base for its open social entertainment platform, initially targeting the rapidly growing mobile internet markets in Indonesia and India. The platform allows users to interact with like-minded people as well as with artists and celebrities. Basic use of the platform is free; however, some users (estimated 5-10%), spend on premium activities and virtual goods, which is how MIG generates its revenues.

The quantity and quality of celebrities and games are important incentives for signing users and vice versa. MIG's key challenge will be to convince them of the merits of using its currently smaller platform (9m MAUs) alongside or instead of the market leader Facebook (c 110m MAUs). It differentiates itself from Facebook by 1) offering content providers a share of revenues earned over its platform, and 2) its freemium approach, which it considers more suitable for Asian markets and which has worked well in China; although it is worth bearing in mind the advantage local companies have given the structural difficulties for non-Chinese media companies trying to enter China.

Financials: Early in its journey – strategic milestones

The platform was launched in May 2014 and consequently we have few data points to assess financial performance. However, it has achieved some key strategic milestones, which should help drive an acceleration in take-up rates.

- **Content agreements –** relationships with three of the big four music studios in Indonesia – Universal Music Group (UMG), Warner Music Group (WMG) and Sony Music Group (SMG) – and deals with well-known local artists.
- **Distribution agreements** – FIH Mobile, a subsidiary of Hoi Han Group, one of the world's leading smartphone handset manufacturers, invested A$8m in August 2014 for a 19.9% interest in MIG. MIG also has agreements with suppliers of about 50% of the smartphones sold in Indonesia to pre-load the migme app on all new smartphones shipped.

Forecast earnings will be driven by MIG's ability to scale its user base and increase the average revenue per paying user (ARPPU) while keeping costs in check. We initiate forecasts, which assume that by 2017 there will be 2.45 million monetising users from 30 million MAUs and that average spend per user will be A$42 pa.

Valuation: Increasing its user base key to driving value

Smartphone penetration in MIG's target markets has already surpassed that of the US and is forecast to increase by 25% by 2017. With its young demographic and high propensity to use social media, MIG's addressable market is huge. Given the network effect nature of this industry, rapid scaling is essential and consequently MAUs will be the key metric for measuring early success. The current share price implies that MAUs increase from over nine million now to 30 million by 2017, with 2.55m monetising. We have dimensioned a valuation range of A$0.20 to A$1.03, using a bear case to a blue-sky scenario assuming monetising users in 2017 ranging from 1.3 million to 11.6 million and spend per user ranging from A$41 pa to A$63 pa. Our third case (our positive case) has been determined using a mid-point.

Sensitivities: Early-stage business in a fast-moving market

Initial signs are encouraging; however, this is an early stage business competing in a fast-moving market with an established competitor, albeit one using a different business model. It is not immune to competition from regional players, and changes in strategy by established ones could have a meaningful impact on its prospects. Approximately 75% of MIG's operating costs are fixed; therefore any swing in activity levels will have a significant impact on earnings and valuation.

Company description: Social entertainment platform

migme (MIG) was founded in Australia in 2006 by Steven Goh and Mei Lin Ng. It is headquartered in Singapore and has offices in Malaysia, Indonesia and Taiwan and representatives in South Asia. There are 158 staff covering technical, operations and sales. A shell listing on the ASX via Latin Gold (LAT.ASX) occurred in June 2014. From what was originally a closed platform used to develop a chat community, MIG relaunched in May 2014 as an open mass-market social entertainment platform. The platform has been developed in-house and offers chat, miniblog, virtual gifts and games. It attracts a user base by offering freemium services (chat, blogging etc) and monetises by encouraging users to upgrade to paid-for premium activities and virtual goods.

Initial markets are Indonesia and India, where the population is skewed to younger demographics and where mobile phone and internet usage is soaring. MIG intends to use its experience in these two markets as a blueprint for further expansion into South Asia and Africa.

MIG is still a fledging operation, albeit that its MAUs were over nine million in November and are growing by about a million users per month. MIG intends to use the experience of successful operators in China and will partner with games developers that have had success in the Chinese market. There are plans to use the Indonesian model as a blueprint for expansion into India, the Philippines and Africa.

Freemium business model

MIG's business model is more aligned to the virtual goods model used by Tencent (HK.700, market capitalisation US$128bn) and YY.com (YY.US, market capitalisation US$3.5bn) rather than the advertising based business model used by Facebook and Twitter. Broadly speaking, MIG drives its user base by partnering with mobile phone suppliers to pre-install the migme app, with key celebrities to help to attract and engage users and with games developers to provide content. All of the company's revenue is generated from migme users: half from users purchasing a range of emoticon, stickers and virtual gifts and using these to interact with other users; and the balance from users playing free games and then purchasing games upgrades and enhancements.

We explore growth drivers in more detail on pages 4 to 7. In summary, the key planks of the MIG strategy are:

- **Ensuring wide availability of the migme app** – The availability of smartphones for <US$200 is leading to fast deployment of inexpensive smartphones in Indonesia and India. This in turn should drive rapid growth in the use of social media because of the demographic skew to under-35 year olds. To encourage uptake, migme is partnering with key mobile phone manufacturers in the region to enable the migme app to be included as a free pre-loaded download.
- **The freemium model –** Management believes that the freemium model with a premium upsell is the right model for Asia, based on the success that Tencent and YY.com have had in China. The use of avatars provides users with the ability to create an identity other than their own. This has particular appeal in countries where there is a degree of repression and significant differences between the social mores applied by the older and younger generations.
- **Attracting artists and content to the platform –** Content providers use social media platforms as a way to engage with fans, market their work and potentially also make money. The proceeds from selling virtual goods are shared between MIG and the celebrity, which in turn encourages more celebrities to partner with MIG. The ability of MIG to attract celebrities and games developers is dependent on its MAU and its monetisation rates. Other businesses that increase content and add new skills/tools may also be acquired or partnered.
- **Encouraging users to spend money** – Users are enticed to spend by the popularity of the artists and the games offering. The more popular the content, the more likely they are to spend.

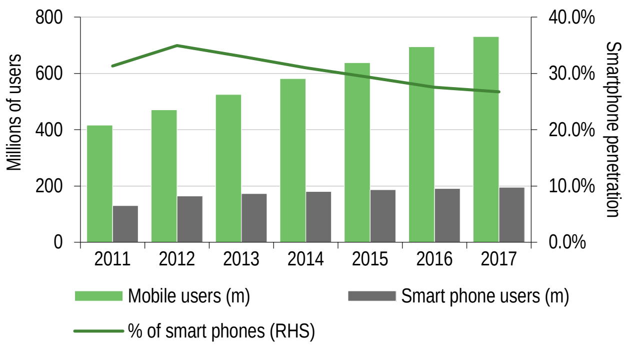
Exhibit 1: MIG – business model

Source: Edison Investment Research, company data

Geared into rapidly rising smartphone uptake

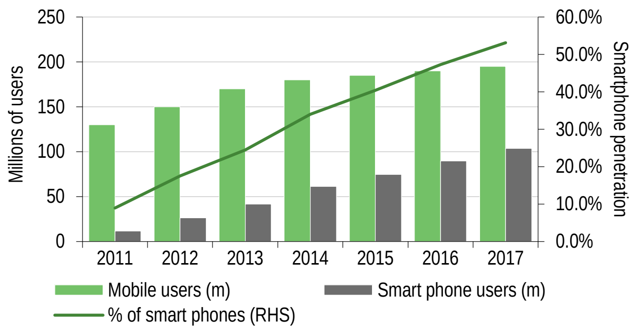
Asia has 56% of the world population and 45% of the internet users. At June 2014, Indonesia and India, MIG's initial target markets, had 72m and 243m internet users, representing a penetration rate of the population of 28.1% and 19.7% respectively. Internet connection is seen by current Indian PM Narendra Modi as a way to fuel the Indian economy and to lift millions out of poverty. Statista forecasts that the number of smartphones in 2017 will be 195.4m in India and 103.6m in Indonesia, up from 130m and 61.2m respectively in 2011.

Exhibit 2: India – mobile handsets 2011-17



Source: Statista Portal (smartphones 2011)

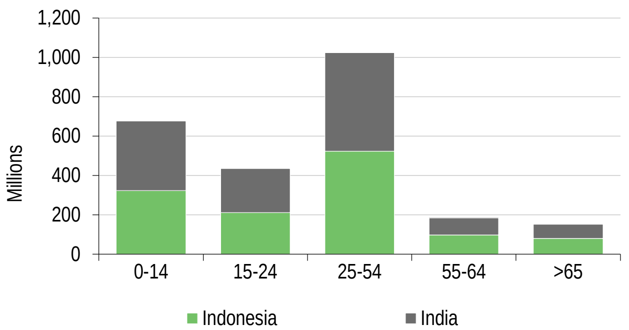
Exhibit 3: Indonesia – mobile handsets 2011-17



Source: Statista Portal (smartphones 2011)

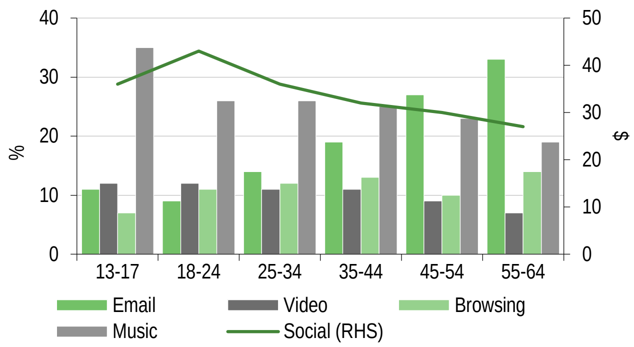
Smartphone usage in both India and Indonesia is helped by a relatively young population, which in turn has a much higher propensity to use social media than its western counterpart. Global Digital Stats 2014 published by 'We are Social' reported that the fastest markets in the Asia-Pacific region were India (up from 5% in March 2013 to 7% in January 2014) and Indonesia (increased from 19% to 25% in the same time period). In 2013, 43% of 18-24 year olds' time spent on mobiles was devoted to social media.

Exhibit 4: Population of India and Indonesia by age



Source: Statista

Exhibit 5: Global usage of mobile by age



Source: Statista

MIG is partnering with key mobile phone manufacturers to ensure its platform is visible to new smartphone users. Before its debut on the ASX, FIH Mobile took a 19.9% stake in the company. FIH Mobile is a subsidiary of Taiwanese Hon Hai Precision Co Ltd (trading as Foxconn Technology Group), which produces 40m to 60m handsets per month. Foxconn is the world's third largest information technology company by revenue and is the world's largest electronics contract manufacturer, making phones for Apple, Blackberry, Nokia, Sony and Xiaomi. The investment by Foxconn is its first investment in the social entertainment space as it seeks to create value to compensate for shrinking hardware margins. Other deals with mobile phone providers in Indonesia are currently being negotiated to include the migme app as a free download on new smartphones sold (covering about 50% of annual shipments in Indonesia). In October 2014 Smartfren, a mobile phone distributor in Indonesia, preinstalled migme on an initial shipment of 700,000 devices. A October 2014 partnership with DOKU in Indonesia will allow migme customers to buy prepaid credits at everyday payment locations.

Social media competition – Facebook's advertising model is dominant

Facebook has a very different model from migme with revenue generated from advertisers rather from the users, as is the case with the migme freemium model. Facebook is the dominant social media platform in MIG's target markets, and while there are other social media platforms used in India and Indonesia (eg Orkut in India), they have never progressed beyond a few million users. As at 31 December 2012, in India there were 62.7m Facebook accounts (c 26% of all internet users) and in Indonesia there were 51.1m Facebook accounts (72% of all internet users). The statistics for India should be read in the context that markedly low internet penetration there is a feature of the underdeveloped infrastructure. Improvements in internet access are a key plank of PM Modi's strategy to use technology to improve national living standards.

Despite their relative sizes, and Facebook's established position, management believes that artists (and consequently their fans) will be attracted to its platform, as it does not demand any upfront fees from the artists to interact with their fan base. We understand that Facebook charges artists for use of the platform, based on the size of following, not on the size of income from that fan base. This contrasts starkly with MIG's more artist-friendly revenue share approach, an approach that is also used by closest comparator YY.com.

From the user's perspective, management believes that offering virtual identities will be more attractive to culturally sensitive users. Furthermore, Asian users are very celebrity and games focused, and with its emphasis on these areas of the platform, MIG believes its offer will prove attractive.

Exhibit 6: Asian internet and Facebook penetration

	Population 2014 estimate	Internet users Year 2000	Internet users 30 June 2014	Users % Asia	Facebook 31 December 2012	Internet % pop	Facebook % internet
China*	1,355,692,576	22,500,000	642,261,240	46.30%	633,300	47.4%	0.1%
India	1,236,344,631	5,000,000	243,000,000	17.50%	62,713,680	19.7%	25.8%
Japan	127,103,388	47,080,000	109,626,672	7.90%	17,196,080	86.2%	15.7%
Indonesia	253,609,643	2,000,000	71,190,000	5.10%	51,096,860	28.1%	71.8%
Korea, South	49,039,986	19,040,000	45,314,248	3.30%	10,012,400	92.4%	22.1%
Philippines	107,668,231	2,000,000	44,200,540	3.20%	29,890,900	41.1%	67.6%
Vietnam	93,421,835	200,000	41,012,186	3.00%	10,669,880	43.9%	26.0%
Pakistan	196,174,380	133,900	29,128,970	2.10%	7,984,880	14.8%	27.4%
Malaysia	30,073,353	3,700,000	20,140,125	1.50%	13,589,520	67.0%	67.5%
Thailand	67,741,401	2,300,000	20,100,000	1.50%	17,721,480	29.7%	88.2%
Taiwan	23,359,928	6,260,000	18,687,942	1.30%	13,240,660	80.0%	70.9%

Source: Asia internet statistics

A social media strategy is crucial in the music industry

There is growing recognition that social media is rapidly developing into a cornerstone of an artist's music career. Album and single song sales continue to fall and even successful artists can no longer rely on record sales and plus the occasional live appearance to generate historic earnings levels. Year to date in 2014 only one album has sold over 1m units compared with five albums that went platinum in 2013. The number of singles to sell more than 1m units has fallen to 60 from 83 last year. Social media has become the outlet of choice for artists to have a two-way conversation and to build a presence in social media, which has the potential to lead to concert/event ticket sales and merchandise purchases. Artists use social media to provide feedback on their material or their shows as well as using it as a medium to interact with fans by asking them for an opinion; for example, 'We are playing a gig tonight in Jakata. What songs do you want us to play?' There is nothing to stop artists signing up to multiple social media platforms. However, artists who spread themselves too thin do so at the expense of creating strong interaction and engagement on those platforms. Therefore selecting a handful of platforms that provide a spread of different categories of fans is a favoured approach.

In its core markets migme has talent management specialists and key local connections to reach out to and manage an artist's social media strategy. MIG has signed deals with three of the major record labels, Universal, Sony and Warner, which cover approximately 70% of the local music industry. It believes that such music partnerships will lower the churn rate, bring new users onto the platform and create premium interactions between the artist and the user, which should increase the number of monetising users and ARPPU.

To extend its functionality and reach, MIG recently acquired alivenotdead, a HK-based artist management company, and LoveByte, a couples-sharing mobile app, each for A$0.5m in shares.

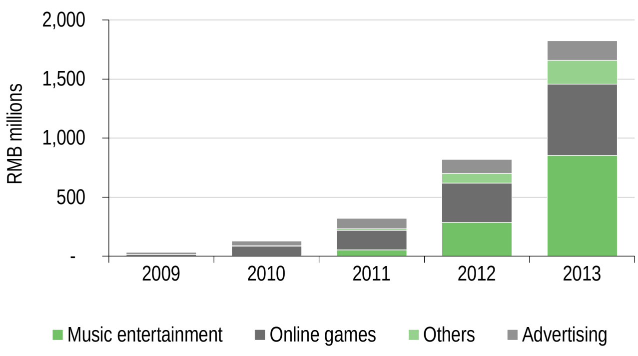
Case studies (YY.com and Tencent) – freemium models

Tencent (HK:700, market capitalisation US$128bn) and YY.com (NASDAQ YY.US, market capitalisation US$3.5bn) are examples of successes in the mainland Chinese market and MIG's freemium business model is closely aligned with these groups.

YY.com is a Hong Kong based company operating a social entertainment platform in China. YY.com's core product, YY Client, was launched in 2008 and offers users free real-time online group activities including online games, music, education, live game broadcasting and conference calls. The description of the business model included in YY.com's 2013 Annual Report is almost identical to MIG's business model: "online music and entertainment platform using a virtual items-based revenue model whereby users can listen to music, access other forms of entertainment for free and have the option of purchasing in-channel virtual items… we currently operate all of our online games on YY using the virtual items-base revenue model whereby players can play games for free but have the option of purchasing in-game virtual items and in-games accessories." Like MIG, YY shares revenue with the artists and most games are purchased from third parties on a revenue share deal. It is worth highlighting that the success or failure of one game can have a significant impact on sales. In 2010, one game, DDTank (launched in 2009), was responsible for 63% of online games revenue. Game popularity tends to decline over time, with DDTank's revenue share falling to 46.5% in 2011, 15.7% in 2012 and 8.2% in 2013.

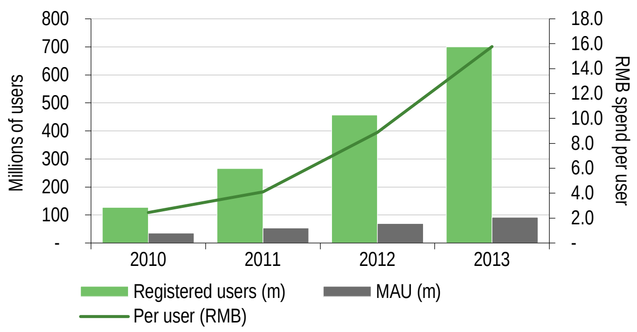
YY reported MAUs of 105 million at Q314, of which 1.2 million are paying users. These customers generated ARPPU of RMB453 in the quarter on music and entertainment products, equivalent to A$294 on an annualised basis. If we also include the revenues from games sales, then annualised ARPU is closer to A$425. On total net revenues of US$163m in Q314 gross margins were 52% and EBIT margins were 31%. YY reports revenues net of revenue share, where the control of the game rests with the third party, therefore while financial metrics cannot be directly compared to MIG, they provide a useful reference to what this kind of business model could deliver at scale.

Exhibit 7: YY.com's divisional revenues



Source: YY.com annual reports

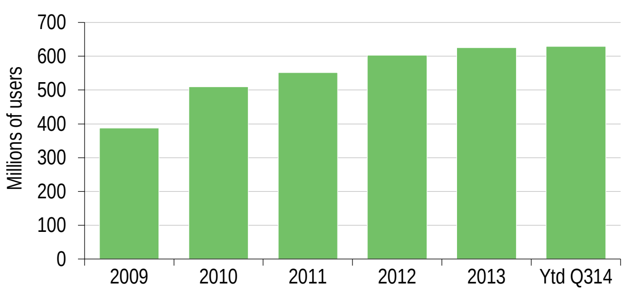
Exhibit 8: YY.com's user profiles



Source: YY.com annual reports

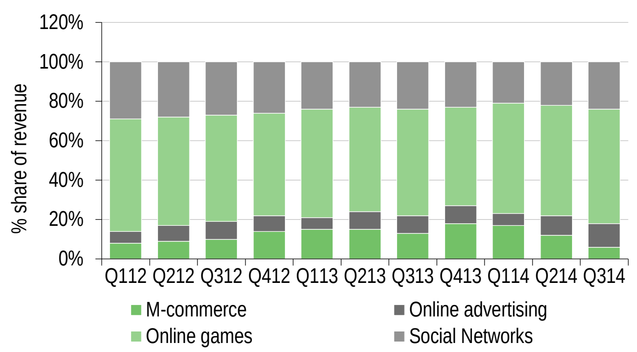
Tencent was founded in 1998 and is now one of China's largest internet service portals. It has a market capitalisation of US$128bn (37 times larger than YY.com). Although its businesses include telecommunications and e-commerce (Exhibit 10), its social media platform accounts for the bulk of group revenues (82% in Q214).

Exhibit 9: Tencent's MAUs



Source: Tencent Annual Reports and quarterly statements

Exhibit 10: Tencent's quarterly divisional revenues



Source: Tencent Annual Reports and quarterly statements

Although Tencent and YY.com have clearly had considerable success, it is worth bearing in mind the structural advantage local Chinese companies have in the media market in China; non-Chinese companies face considerable regulatory restrictions on ownership and operation of Chinese media companies. Facebook has virtually no market presence and there are no successful examples of overseas ownership of Chinese media assets. As such while these companies are useful peers to demonstrate the kind of margins that can be reached should MIG scale to similar levels, the companies are operating in structurally very different markets.

Management

The management team is headed by MIG founder CEO Steven Goh, who has had a long association with technology ventures. Steven established one of the first successful online stockbroking businesses in Australia. This business listed on the ASX as Sanford Securities Ltd and was sold in 2003, in an on-market transaction, to IWL Ltd. Steven then went on to found Bell Direct, which is a high-profile online stockbroker that is part of listed entity Bell Financial Group Ltd (BFG.ASX). VP Marketing Mei Lin NG Wnuk is a co-founder and has expertise in internet related marketing. At Kingsoft Entertainment Mei Lin was responsible for the marketing of the Candy Crush game, which became the most popular game on Facebook with 46 million MAU. Other key management include Gene Yu (VP corporate and business development) and Patrick Wong (CFO). Detailed biographies are on the back page of this report.

Strengths, weaknesses, opportunities, threats

Exhibit 11: MIG – SWOT analysis

Strengths	Opportunities
■ FIH (Hon Hai) shareholding of 19.9% adds credibility/preload possibilities ■ 50% of Indonesian smartphone shipments have the migme app pre-loaded ■ Content deals covering 70% Indonesian music ■ Rapid growth in MAUs year to date ■ First mover advantage in Indonesia ■ Funding in place to fund to profitability – A$9.7m cash at 30 September 2014	■ Continue to add content to platform ■ Advertising revenue as MAU grows ■ Expansion into new geographies
Weaknesses	**Threats**
■ Small games portfolio ■ Key man risk (Steven Goh) ■ Monetisation unproven within migme app ■ Exposure to 'killer' games ■ Dependent on third parties for content ■ Relatively small number of users (>9m vs hundreds of millions of users of successful platforms in other markets)	■ Competition from large international players, eg Facebook ■ Competition from local players ■ Technology changes ■ Privacy issues ■ Managing growth ■ System failure

Source: Edison Investment Research

Summary investment case

MIG's investment case is based on the premise that there is room for more than one social media platform in the emerging markets of Indonesia and India. There is precedent in China, where in large regions two or three exist in parallel. The large and fast-growing mobile markets in Indonesia and India have a high propensity to use social media, and there may be room for a new entrant. MIG's platform look is distinct from Facebook, and its business model, which is geared more towards celebrity, games and blogging, could prove appealing to an Asian audience. With its revenue share business model for artists, it offers them a low risk approach to developing new revenue streams, and initial artist take up is very encouraging. Its addressable market within Indonesia and India is large (294m smartphone users by 2017) and could increase further should MIG expand into other countries in South Asia, South-East Asia and Africa. The increase in MAUs from over 5m in June 2014 to over 9m million in November 2014, and management's expectation that MAUs will grow by about one million per month in the short to medium term, provides evidence of the strength of the market and the appeal of the migme product. The content deals with music artists and record companies plus the sale of smartphones with pre-loaded free migme apps (covering about 50% of the smartphones shipped in Indonesia) should underpin near term user growth. That said, this is a very early stage business, pitted against a strong and established competitor in a fast-changing market. If it succeeds, the rewards could be significant, but the risks are considerable. We consider the key sensitivities to our forecast and valuation below.

Sensitivities

Managing rapid growth – The migme social entertainment platform has been operating for seven months and in this relatively short time the number of MAUs has increased from over five million in June 2014 to over nine million in November 2014. We have adopted management's targets of the addition of approximately one million new users each month for the short to medium term. Managing growth remains a challenge for an early stage company, however CEO Steven Goh has a track record in establishing successful fast-growing technology businesses.

Challenge of monetisation – Monetisation rates are currently relatively low because it usually takes, on average, 3 - 6 six months for users to start spending. If we assume that in the September quarter there was an average of 6m users and that 5% of these monetised, then the ARPPU was A$0.33 per month or ~A$4 pa per user. Management believes that ARPPU in China is ~A$6 per month and as high as A$20 per month in Japan. In MIG's target markets of Indonesia and India we expect ARPPU to be a little less than in China because of the lower socioeconomic environment.

Operational gearing effects – MIG is a high fixed-cost business and thus any downturn in the number of MAUs or in monetisation levels will flow straight to the bottom line. The flipside is that the platform is very scalable and planned expansion to new markets can be managed with the addition of some in-country local marketing personnel with little or no increase in corporate costs.

Games success importance – MIG is not immune to changes in technology or to competition. The internet continues to change due to rapid technological evolution and shifts in customer preferences as well as the introduction of new products and services. The impact of a successful game like Candy Crush is such that just one game can become a 'game changer' and spell success for the site at the expense of other sites that do not have a competitive games portfolio. This could happen to migme early in its life in any of its markets.

Competition – MIG is an early stage company that hopes to capitalise on its first mover advantage in a number of emerging markets in Asia and Africa. Currently competition is fairly limited; western companies such as Facebook and Twitter have a presence in many of these markets, and while MIG has a comprehensive strategy to gain market share, these are well funded businesses that may respond in kind if MIG is considered a threat. To date Tencent, the largest company of this kind, appears to have made little committed attempt to move outside China. This cannot be ruled out in the future.

Network effect business model – Social media companies are network effect businesses in that success breeds success: the larger the user base, the more attractive it becomes to artists and other users. For successful companies there could be a winner takes all situation, leaving little room in the market for the runners up.

Early stage business – MIG is at a very early stage of development. Momentum is currently strong, but from a very small base. If it can succeed in exploiting its first mover advantage in these emerging markets, strong growth should continue, and, if the network effect comes into play, could even accelerate. However, execution risks are high and success is not a given.

Currency – MIG reports in Australian dollars and operates in Singapore dollars, Indonesian rupiah and Indian rupees. This exposes MIG to currency translation risks.

Valuation

MIG is in the early stages of commercialisation of a social entertainment product in the fast-moving space of internet value-added services. Relevant comparatives are substantially more developed and measure users in hundreds of millions compared with MIG's over nine million users. As such, comparative company analysis is included to provide some external reference data, but given the early stage of the business, we view a DCF as the most appropriate valuation method.

DCF-based valuation range

We recognise the difficulty in determining the likelihood of success in a business that in its present form is less than six months old and where the success of an online game includes an element of luck. It is possible for just one game to generate more than 50% of total revenues, as was the case for YY.com with the DDTank game in 2010. Such success is impossible to forecast, and for this reason as well as the fledgling nature of the business, we present three valuation scenarios – a bear case, a positive case and a blue-sky case (here we assume a faster ramp-up from a low user base, and a faster increase in spend) – which results in a valuation range of A$0.20 to A$1.03.

We estimate that the current share price is consistent with the following key variables for 2017: MAU of 30m, a monetisation rate of 8.5% and a monthly spend of A$3.50per person.

We assume a WACC of 13.0% and a terminal growth rate of 2% from 2022. Our analysis assumes that the Indonesian and Indian markets are developed. If MIG is successful in these markets, it is likely to try to expand into other developing markets in South Asia, South-East Asia and Africa. This possibility has not been included in our forecasts and represents potential upside.

Exhibit 12: DCF – key assumptions per case

		2015	2016	2017	2022	DCF
Implied in share price						
No of users at period end (m)	[m]	14	22	30	100	$0.45
% of users monetising	[%]	3.0%	6.7%	8.5%	8.5%	
% of smartphone users	[%]	5.5%	8.0%	10.2%	N/P	
$ spent month/user (A$)	[A$]	2.19	3.03	3.43	5.37	
Revenue	[A$'000]	4,081	16,296	35,672	101,890	
EBITDA	[A$'000]	(8,460)	(4,557)	3,511	27,611	
Net Cash/(Debt)	[A$'000]	1,345	- 2,008	2,359	80,696	
Blue Sky						
No of users at period end	[m]	25	85	155	225	$1.03
% of users monetising	[%]	2.0%	5.7%	7.5%	7.5%	
% of smartphone users	[%]	9.8%	30.7%	52.6%	N/P	
$ spent month/user (A$)	[A$]	2.30	3.80	5.22	8.59	
Revenue	[A$'000]	3,051	52,867	121,142	143,847	
EBITDA	[A$'000]	(8,975)	13,729	46,246	48,590	
Net Cash/(Debt)	[A$'000]	729	15,247	54,347	185,901	
Positive						
No of users at period end	[m]	18	34	50	120	$0.71
% of users monetising	[%]	4.0%	7.7%	9.5%	9.5%	
% of smartphone users	[%]	7.1%	12.3%	17.0%	N/P	
$ spent month/user (A$)	[A$]	2.21	3.18	3.75	5.93	
Revenue	[A$'000]	5,477	25,459	52,189	125,830	
EBITDA	[A$'000]	(7,762)	25	11,770	39,582	
Net Cash/(Debt)	[A$'000]	2,181	3,556	14,428	126,308	
Bear						
No of users at period end	[m]	12	16	20	90	$0.20
% of users monetising	[%]	1.0%	4.8%	6.5%	6.5%	
% of smartphone users	[%]	4.7%	5.8%	6.8%	N/P	
$ spent month/user (A$)	[A$]	2.19	3.03	3.43	5.37	
Revenue	[A$'000]	1,467	9,837	24,607	77,916	
EBITDA	[A$'000]	(9,767)	(7,786)	(2,022)	15,624	
Net Cash/(Debt)	[A$'000]	(219)	(7,181)	(7,747)	36,462	

Source: Edison Investment Research

Included in Exhibit 13 below, we benchmark the growth rates included in our valuation range calculations to YY's experience for the first three to four years of its life. YY.com began with a higher user base (>30m compared with 14x for MIG at the end of year one), therefore the rate of increase achieved by YY.com in the first year is less than we would expect for MIG. YY.com achieves PBT margins of 31% compared with our forecasts for MIG of a PBT margin in 2017 of 23%. YY.Com had a NPAT margin of 26% in 2013.

Exhibit 13: MIG – DCF valuation cases – revenue growth assumptions

	Year 1	Year 2	Year 3
Implied share price MIG			
Inc no users	57%	36%	23%
Inc no MAU	257%	72%	50%
Increase in number of users monetising	38%	13%	10%
Blue Sky			
Inc no users	240%	82%	35%
Inc no MAU	889%	140%	75%
Increase in number of users monetising	65%	37%	20%
Positive			
Inc no users	89%	47%	25%
Inc no MAU	266%	82%	65%
Increase in number of users monetising	44%	18%	12%
Bear			
Inc no users	33%	25%	10%
Inc no MAU	562%	70%	30%
Increase in number of users monetising	38%	13%	5%
YY.com			
Inc no users	109%	72%	53%
Inc no MAU	51%	31%	32%
Increase in number of users monetising	68%	117%	78%

Source: Edison Investment Research

Comparative companies

Exhibit 14: Peer comparison

Company name	Share price Currency	Share price	Market cap (US $ m)	EV/ sales (CY)	EV/ sales (NY)	EV/ EBITDA (CY)	EV/ EBITDA (NY)	P/E (CY)	P/E (NY)	EPS growth	EBIT margin	PEG
migme	A$	0.58	145	22.3x	6.2x	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Tencent Holdings Ltd	HKD	105.30	128,200	9.8x	8.0x	22.5.x	17.8x	32.2x	25.1x	51%	37.2%	0.61
Facebook Inc	US$	74.69	166,106	12.5x	9.1x	19.1x	15.4x	44.3x	39.2x	172%	56.9%	0.23
Twitter Inc	US$	35.13	22,290	14.7x	8.9x	76.2x	37.x	369.8x	106.1x	N/A	7.0%	N/A
LinkedIn Corp	US$	215.57	23,352	9.6x	7.1x	36.6x	25.6x	111.2x	77.6x	708%	17.0%	0.11
Yelp Inc	US$	50.04	3,129	7.3x	5.1x	38.9x	22.7x	74.4x	49.8x	N/A	2.5%	N/A
YY Inc*	US$	60.79	3,540	5.3x	3.6x	16.9x	11.8x	21.8x	15.6x	102%	30.2%	0.15
Zynga Inc	US$	2.32	1,780	0.3x	0.3x	4.9x	2.5x	N/A	100.9x	N/A	N/A	N/A
Gree Inc	JPY	731.00	1,461	1.2x	1.1x	4.7x	5.2x	11.1x	12.6x	N/A	22.8%	N/A
Renren Inc	US$	2.49	656	N/A	N/A	2.2x	2.9x	43.7x	N/A	N/A	N/A	0.15
Average				7.4x	5.4x	24.6x	15.6x	88.6x	53.3x	25%	24.8%	0.25

Source: Bloomberg. Note: Priced at 17 December 2014, CY = current year, NY = next year.

Financials

Performance to date – short trading history

The open platform was launched in May 2014 but it was not until August 2014 that the platform was fully operational; as such there is little trading history. However, since that start of the year, MAUs have increased by over one million a month. Monetisation rates are currently relatively low because it usually takes, on average, three to six months for users to start spending

The cash flow analysis for Q115 shows total revenue of A$306,000 with the monthly run rate at the end of the period at ~A$160,000. Staff were still being added during the quarter so the average monthly outgoings shown in the quarterly statement of~ A$0.5m are significantly understated.

Forecasts

Forecasts are dependent on user growth, the conversion of users from registered to active to paying and then increasing the amount spent per user. User take up is dependent on competition, the use of the pre-loaded migme app on new low-cost mobile phones and the attraction of artists, celebrities and games, which will increase and monetise the user base.

Key assumptions

Management believes that the company has sufficient funds to finance losses for two years before becoming profitable in H217.

Our forecasts assume that the current run rate of net MAUs broadly continues in the near term. We forecast year end users for FY15 (to June) of 15m growing to 25m by the end of FY16. By 2016, we forecast 5% of users will monetise and will on average spend A$40/person pa.

We forecast a gross margin of 50%. COGS include the cost of running the platform (c 20% revenues), and the revenue share paid to artists (30% revenues generated by the artists and by user inspired interaction). Both of these costs are largely variable in nature. Deals with content providers are done on a case-by-case basis, with revenue share between 30% and 90% depending on the success of the celebrity engagement or the success of the game. Platform costs relate to the cost of running the platform (eg licence costs) and should grow with users.

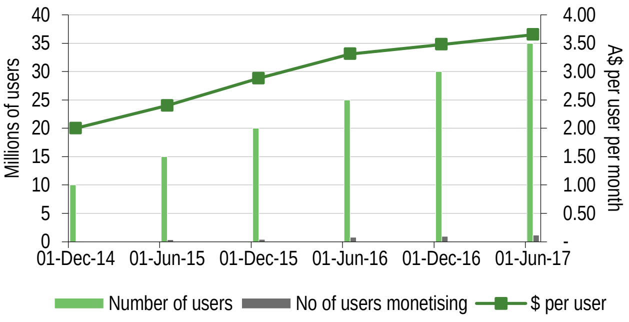
Roughly half of operating costs is accounted for by the 158 employees (with a fairly low average annual salary of A$35,000). The remainder relates mainly to infrastructure costs (servers and equipment) and facility rental. Most of these costs are of a semi fixed nature. Some of the work done by the 40-strong technical team is development work but the company's policy is to write costs off as incurred rather than capitalising. The platform is scalable and can accommodate 100 million users for the same cost as ten million users. We forecasts operating costs to grow at 10% pa.

Exhibit 15: MIG labour cost structure

	Number	Monthly (A$';000)
Development	40	200
Operating	60	120
General & admin	20	120
Sales & marketing	30	130
Acquired companies	8	30
Total monthly staff costs	158	600

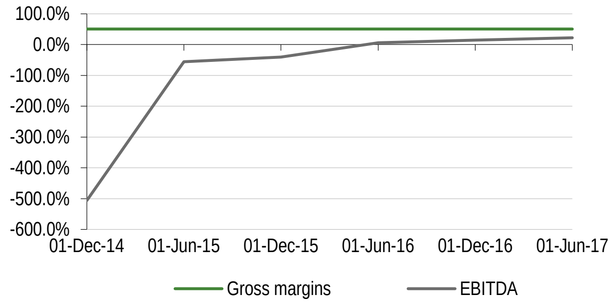
Source: migme data

Exhibit 16: MAU, monetising uses, $ spend per user



Source: Edison Investment Research

Exhibit 17: Gross margin, EBITDA margin



Source: Edison Investment Research

Cash flow and balance sheet

We understand that the current monthly cash burn is c A$830,000, which is offset by revenue of c A$160,000 per month. However, with the current rate of user build and the recently added content we assume monthly revenue will average A$500,000 per month by the end of FY15.

Our forecasts and the implied share price case indicate that there is sufficient cash to fund operations until they reach profitability at the beginning of calendar year 2017. There are no plans to pay dividends while the company is loss making.

Exhibit 18: Financial summary

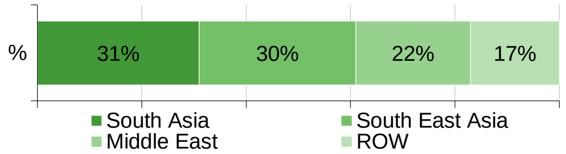
A$000s	2014	2015e	2016e	2017e	2018e	2019e	2020e	2021e	2022e
30 June	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS									
Revenue	6	6,084	21,855	45,839	64,659	79,802	86,998	96,352	109,799
Cost of Sales	0	(3,042)	(10,927)	(22,920)	(32,330)	(39,901)	(43,499)	(48,176)	(54,899)
Gross Profit	6	3,042	10,927	22,920	32,330	39,901	43,499	48,176	54,899
EBITDA	(434)	(7,458)	(1,778)	8,595	16,537	22,489	24,302	27,012	31,566
Operating Profit (before amort. and except.)	(434)	(7,458)	(1,778)	8,595	16,536	22,489	24,302	27,012	31,566
Intangible Amortisation	0	0	0	0	0	0	0	0	0
Exceptionals	(274)	0	0	0	0	0	0	0	0
Other	0	0	0	0	0	0	0	0	0
Operating Profit	(708)	(7,458)	(1,778)	8,595	16,536	22,489	24,302	27,012	31,566
Net Interest	0	0	0	0	0	0	0	0	0
Profit Before Tax (norm)	(434)	(7,458)	(1,778)	8,595	16,536	22,489	24,302	27,012	31,566
Profit Before Tax (FRS 3)	(708)	(7,458)	(1,778)	8,595	16,536	22,489	24,302	27,012	31,566
Tax	0	2,237	533	(2,578)	(4,961)	(6,747)	(7,291)	(8,104)	(9,470)
Profit After Tax (norm)	(434)	(5,221)	(1,244)	6,016	11,575	15,742	17,011	18,908	22,096
Profit After Tax (FRS 3)	(708)	(5,221)	(1,244)	6,016	11,575	15,742	17,011	18,908	22,096
Average Number of Shares Outstanding (m)	64.6	251.6	252.4	252.4	252.4	252.4	252.4	252.4	252.4
EPS - normalised (c)	(0.7)	(2.1)	(0.5)	2.4	4.6	6.2	6.7	7.5	8.8
EPS - normalised and fully diluted (c)	(0.3)	(2.3)	(0.5)	2.4	4.6	6.2	6.7	7.5	8.8
EPS - (IFRS) (c)	(1.1)	(2.1)	(0.5)	2.4	4.6	6.2	6.7	7.5	8.8
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	100.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0	50.0
EBITDA Margin (%)	-7422.3	-122.6	-8.1	18.7	25.6	28.2	27.9	28.0	28.7
Operating Margin (before GW and except.) (%)	-7423.9	-122.6	-8.1	18.7	25.6	28.2	27.9	28.0	28.7
BALANCE SHEET									
Fixed Assets	681	2,918	3,735	3,735	3,735	3,735	3,734	3,734	3,734
Intangible Assets	0	0	0	0	0	0	0	0	0
Tangible Assets	150	2	2	2	2	1	1	1	1
Investments	531	2,916	3,733	3,733	3,733	3,733	3,733	3,733	3,733
Current Assets	9,861	2,953	3,506	13,497	28,192	46,445	64,649	85,108	96,143
Stocks	0	0	0	0	0	0	0	0	0
Debtors	7	409	1,469	3,081	4,346	5,364	5,848	6,477	6,811
Cash	9,854	2,544	2,037	10,416	23,846	41,081	58,801	78,631	89,332
Other	0	0	0	0	0	0	0	0	0
Current Liabilities	(458)	(1,008)	(3,622)	(7,598)	(10,717)	(13,227)	(14,420)	(15,970)	(16,795)
Creditors	(458)	(1,008)	(3,622)	(7,598)	(10,717)	(13,227)	(14,420)	(15,970)	(16,795)
Short term borrowings	0	0	0	0	0	0	0	0	0
Long Term Liabilities	0	0	0	0	0	0	0	0	0
Long term borrowings	0	0	0	0	0	0	0	0	0
Other long term liabilities	0	0	0	0	0	0	0	0	0
Net Assets	10,084	4,863	3,619	9,635	21,210	36,953	53,964	72,872	83,082
CASH FLOW									
Operating Cash Flow	(305)	(7,310)	(224)	10,958	18,391	23,981	25,011	27,933	32,890
Net Interest	4	0	0	0	0	0	0	0	0
Tax	0	0	(284)	(2,578)	(4,961)	(6,747)	(7,291)	(8,104)	(9,470)
Capex inc R&D	(2)	(0)	(0)	(0)	(0)	(0)	(0)	(0)	(0)
Acquisitions/disposals	0	0	0	0	0	0	0	0	0
Financing	7,975	0	0	0	0	0	0	0	0
Dividends	0	0	0	0	0	0	0	0	0
Net Cash Flow	7,672	(7,310)	(508)	8,379	13,430	17,234	17,721	19,830	23,421
Opening net debt/(cash)	(2,182)	(9,854)	(2,544)	(2,037)	(10,416)	(23,846)	(41,081)	(58,801)	(78,631)
HP finance leases initiated	0	0	0	0	0	0	0	0	0
Other	0				0	0	0	0	0
Closing net debt/(cash)	(9,854)	(2,544)	(2,037)	(10,416)	(23,846)	(41,081)	(58,801)	(78,631)	(102,052)

Source: migme accounts, Edison Investment Research

Contact details

Level 26 – 01/02
111 North Bridge Road
Peninsula Plaza
Singapore 179098
+65 6221 5660
www.mig.me

Revenue by geography



CAGR metrics		Profitability metrics		Balance sheet metrics		Sensitivities evaluation	
EPS 2013 to 2015	N/A	ROCE 14e	N/A	Gearing 14e	N/A	Litigation/regulatory	○
EPS 2011 to 2015	N/A	Avg ROCE 11-15e	N/A	Interest cover 14e	N/A	Pensions	○
EBITDA 2013 to 2015	N/A	ROE 14e	N/A	CA/CL 14e	N/A	Currency	●
EBITDA 2011 to 2015	N/A	Gross margin 14e	N/A	Stock days 14e	N/a	Stock overhang	◖
Sales 2013 to 2015	N/A	Operating margin 14e	N/A	Debtor days 14e	N/A	Interest rates	○
Sales 2011 to 2015	N/A	Gr mgn / Op mgn 14e	N/A	Creditor days 14e	N/A	Oil/commodity prices	○

Management team

CEO: Steven Goh

Steven is the co-founder of migme Limited. He pioneered online stock broking in Australia and founded Sanford Securities Ltd in 1998. He was also instrumental in the formation of Bell Direct, a high-profile online stock broking business in Australia. He is an avid technologist and has a commerce degree and MBA from University of Western Australia.

CFO: Patrick Wong

Patrick has over 15 years' experience with venture capital backed companies in Singapore and in Silicon Valley. His previous role was CFO of Landmark Enterprises, a mid-sized multinational training company based out of the US. During his tenure with the company it raised US$20m and increased revenue by 80% to US$90m in 2012.

VP Marketing: Mei Lin Ng Wnuk

Mei Lin is a co-founder of migme Limited with over 15 years of professional marketing and public relations experience in financial services, consumer internet (social) and gaming. Previously director of marketing at Kingsoft Entertainment PLC the makers of the successful game Candy Crush.

VP Corporate and Business Development: Gene Yu

Gene majored in computer science and had a distinguished career in the US Special Forces before joining Credit Suisse in Hong Kong and later Palantir Technologies in Singapore serving larger Asia and the Middle East.

Principal shareholders	(%)
Big Build Enterprises Limited	19.9%
Heracles Investment Group Limited	7.95%
Smart Tailor Trading Limited	4.90%
High Income International Limited	4.90%
DMP-105 Limited	4.47%
Escomindo Pte Limited	4.27%
T Durden Pte Limited	4.09%

Companies named in this report

Tencent (HK:700), YY.com (YY.US) , Facebook (FB:US), Twitter (TWTR:US), LinkedIn (LNKD:US), Yelp (YELP:US), Zynga (ZNGA:US), Gree (GREZF:US), Renren (RENN:US)