migme

Company outlook

Success to date undervalued by the market

Software & comp services

migme (MIG) is a global social media company employing a freemium model to drive user engagement. It is focused on the emerging markets of Indonesia, the Philippines and India. At 31 December 2015 monthly active users (MAUs) totalled 32m (December 2014: 10m). This report contrasts MIG's development against its peers and examines its market pricing compared with the market pricing of its peer group at similar stages of their development. We conclude that the current market pricing is out-of-step with the much higher prices that the market has paid for comparable companies at a similar stage in their life cycle.

Year end	Revenue (A$m)	PBT* (A$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	12.3	(21.0)	(7.9)	0.0	N/A	N/A
12/16e	46.0	(16.5)	(4.0)	0.0	N/A	N/A
12/17e	103.9	9.7	2.3	0.0	32.0	N/A
12/18e	171.7	37.5	8.8	0.0	8.4	N/A

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

Strong performance

Having struck key strategic relationships with content providers, local celebrities and operators, over a short time MIG has laid a strong foundation for growth. While there is still limited visibility over monetisation rates of its user base, MAUs, a key criterion for monitoring appetite for its services, are growing strongly, tracking very well compared to other major social media platforms at a similar stage of development. After China, MIG's target markets of India, Indonesia and the Philippines are the largest addressable markets in Asia. While MIG is going up against Facebook in these markets, we see plenty of scope for it to shape these markets' development with its Asia-centric freemium model.

Our forecasts show MAUs of 69m for 2016 with the addition of a further 40m MAU in 2017 (to 109m). Combined with a cap on fixed costs from H216, this will see operations turn profitable in FY17.

Valuation and pricing

Our base case DCF (WACC of 13.1%, terminal value of 2%) results in a value of A$1.93/share, of which 53.6% is represented by the terminal value. The gap between our valuation and the current share price is, in our view, at odds with the price the market has been prepared to pay for comparable businesses (such as Tencent and Momo) at a similar stage in their life cycle. Our analysis shows that applying EV/revenue multiples of comparable companies (8.9x to 14.3x) results in a share price range for MIG of A$1.42 to A$2.29. Using EV/MAU multiples results in a range of A$2.66 to A$2.90, although this analysis should be used with caution as it takes no account of different per-user monetisation rates. Applying our simple valuation rule that takes into account future profitability implies a P/E of 15x, which is more reflective of the average growth rates in the market than the high growth rates we have forecast for MIG.

15 April 2016

Price	**A$0.74**
Market cap	**A$210m**
	US$0.76/A$
Net cash (A$m) at 31 December 2015	5.5
Shares in issue	285.7m
Free float	72%
Code	MIG/117A
Primary exchange	ASX
Secondary exchange	Frankfurt

Share price performance

%	1m	3m	12m
Abs	12.5	(20.0)	2.9
Rel (local)	13.7	(23.4)	17.3
52-week high/low		A$1.30	A$0.36

Business description

migme is a social entertainment platform targeting the world's next wave of internet users, the 3.5 billion people in emerging markets. The service offers free chat, content and blogging services to acquire users. Users buy virtual goods and engage in gaming. E-commerce is planned to start in H216.

Next event

AGM	April 2016

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Business description

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, India and the Philippines (currently totalling 510m internet users and 263m social media users[1]). 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. The platform allows users to interact with likeminded people as well as with artists and celebrities. Basic use of the platform is free; however, some users spend on premium activities, including games 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 artists and games producers of the merits of using its currently smaller platform (32m MAUs) alongside or instead of the market leader Facebook (c 241m MAUs).

Valuation: At odds with comparable pricing

In our view, the current market valuation for MIG is at odds with the price that the market has paid for comparable companies at a similar stage in their life cycle. At the same early stage in their life cycle the comparable group grew revenues by an average of 41% (range 25% to 199%) compared with MIG's revenue growth rate of 975% (using Q414 compared with Q415) and 273% using FY15 compared with FY16e. In terms of monthly active users (MAUs), the comparable group increased MAUs by an average of 28% (range minus 21% to 199%) compared with a 220% increase in MIG's MAUs in FY15. Like the best in class in its comparable group, we suggest that MIG has the building blocks for success in place, including a full suite of products and a payments platform that, in our view, should enable it to convert users attracted to its platform via the freemium model into monetising users. It is operating in markets where there is competition from global players such as Facebook, but it has achieved notable early success by capturing 32m MAUs, which is ~12% of active social media users in its target markets.

Our DCF valuation of A$1.93 per share should be viewed in the context of the comparable company valuation ranges of A$1.42 to A$2.29 (using EV/revenue multiples of between 8.9x and 14.3x) and A$2.66 to A$2.90 (using EV/MAU of 11.1x to 12.1x). MIG's current price assumes an EV/revenue multiple for FY16e of 4.5x and an EV/MAU of 2.1x. Applying our simple valuation rule[2] (described on page 13) to take into account profitability and returns, the current EV/revenue multiple of 4.5x implies a P/E of 15x, which is more reflective of the average growth rates in the market than our forecast high growth rates.

Sensitivities

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. MIG 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.

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1 Wearesocial 2016 and Exhibit 6.

2 Valuation for Early-Stage Technology Companies, Jevons Global, March 2016. Research commissioned by Edison Investment Research and presented at Edison Talks Tech Conference, Auckland NZ 22 March 2016.

Business update

The focus of the report

In this report we focus on the progress that MIG has made to date and contrast this with the progression of comparable companies at the same time in their life cycle. We address the nature of social media, the different business models and their relevance to the Asian market and early stage business valuation methods that put stock market pricing in perspective. We also address recent events, in particular the Meitu acquisition and the revenue sharing partnership with Indian fantasy game operator CricBattle.

Investment thesis

Our investment thesis for MIG is based on an assessment of the market opportunity, the building blocks put in place, MIG's growth in MAU to date, the business model employed to build a user base and our assessment of MIG's current pricing compared with its peer group at similar stages in their life cycles. Our conclusions are:

- MIG's initial markets of Indonesia, India and the Philippines have a total of 510m internet users[3] and 263m (51.6% of internet users) are social media users. (China's figures are 680m internet users, 653m social media users.) In our view, India, with a population of 1,319m (3.7 times the populations of Indonesia and the Philippines), holds the greatest potential for MIG. We see the partnership arrangement with CricBattle (a fantasy cricket game) as strategically important in India.
- Factors that lead us to a positive view on the prospects of MIG's freemium model in the Indian market include: an urbanisation level of only 33% (China 57%), a supportive government, rapidly reducing smartphone costs, increasing broadband penetration and the success of other freemium sites in India (such as 10th ranked Shtyle.fm). MIG faces competition from Facebook (136m users[4]) in India, however, MIG believes that its freemium model as a way of attracting and building a user base could prove to be an attractive alternative. In our view, it would not be unreasonable to expect that in time India will have similar broadband connectivity and similar social media penetration to China, which could see internet usage in India increase from 375m to ~650m.
- There is evidence that the freemium model works well in China. This can be seen by the way Tencent and YY.com have grown MAUs, although Renren has been less successful. Since 2001 Tencent has grown its users by almost 20x, YY.com has increased its users by 67% in two years and Momo has doubled its user base in two years.
- There are early signs of success for MIG with an increase in MAUs in Indonesia, India and the Philippines of 220% in the last 12 months (from 10m to 32m MAUs).
- Using a comparable company peer group (all based in China) adjusted to match their respective life cycles and applying an EV/revenue multiple shows that if the same pricing metrics were applied to MIG, the share price would be between A$1.42 and A$2.29. If we use EV/MAU as a comparable measure, the MIG share price would be between A$2.67 and A$2.92. However, this measure does not adjust for different monetisation rates and we suggest can be misleading.
- Using a simple valuation rule to translate EV/revenue multiples into measures that reflect long-term potential and profitability, the P/E implied by MIG's FY16 EV/revenue multiple of 4.5x is 15x. In our view, this P/E does not reflect the growth potential of MIG. We are forecasting profitable operations for MIG in 2017 and in 2018 our forecast EPS increases by 282%.

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3 Wearesocial 2016

4 www.internetlivestats.com

Asian appetite for social media

Of the 3.4 billion global internet users in January 2016, there were 2.3 billion active social media users, of whom 1.968 billion accessed social media by way of a mobile device.[5] Of these 2.3 billion social media users, 23% (532 million) are in Asia.

With lower connectivity rates, as a share of the population, social media use in Asia is lower than in the west. However, once connected, Asian markets seem to have a much higher propensity to use social media. Exhibit 1 shows, for instance, that in the North America 67% of internet users use social media, in South-East Asia, this figure is 90%. With falling prices of handsets and cheaper data bundles being introduced, emarketer forecasts high single digit growth rates in social media usage in most of the Asian markets over the coming three years.

Exhibit 1: Internet and social media penetration per region

	Internet	Social media users, as % of population	Social media users, as % of internet users	MIG markets
South-East Asia	41.0%	37.0%	90%	Indonesia, Philippines
South Asia	27.0%	11.0%	41%	India
North America	88.0%	59.0%	67%	N/A
West Europe	83.0%	48.0%	58%	N/A
East Europe	64.0%	45.0%	70%	N/A
South America	60.0%	50.0%	83%	N/A
Middle East	53.0%	26.0%	49%	N/A
Central America	44.0%	40.0%	91%	N/A
Central Asia	40.0%	6.0%	15%	N/A
Africa	29.0%	11.0%	38%	N/A
East Asia (inc China and Japan)	54.0%	48.0%	89%	N/A
Oceania	68.0%	45.0%	66%	N/A
Global average	46.0%	31.0%	67%	N/A

Source: ITU, wearesocial 2016. Note: Internet expressed as % of population.

Market opportunity: The big four

When assessing the market opportunity for Asian social media, we look at:

- the overall size of a market, a function of population size and broadband or, mobile internet penetration rates,
- the propensity to use social media, and
- the level and type of competition.

Of the larger Asia economies (Exhibit 2), while all are potentially interesting markets, the standout countries in terms of market size potential are China, India, Indonesia and the Philippines.

China – large, good connectivity, high propensity for social media

With 1.4 billion inhabitants, China is the most populous country in the world. It is also fairly sophisticated in terms of broadband penetration, with a fairly high mobile penetration rate (1.3bn connections, of which 74% are smartphones). 47% of the population are social media users (577m), making China the largest social media market in the world by a considerable margin.

India – large market, low connectivity, low propensity for social media

While only slightly smaller than China in terms of population size (1.3 billion), due to affordability constraints,[6] it has a significantly lower broadband penetration rate (14%) and while there are 1bn

5 WeareSocial, 2016

6 India is one of five AsiaPacific countries that falls outside the Broadband Commission for Digital Development and ITU/UNESCO's targeted 5% of GNI.

mobile connections reported, only 33% are smartphones. Consequently, the share of connected users that are active on social media is the lowest of the nine countries looked at. 10.3% of the Indian population (136m) are active social media users. This is still considerable in a global context, making India one of the top 10 social media markets in the world in terms of MAUs, despite its low penetration rates. However, in order to satisfy its full potential, and to increase the level of social media use, mobile and connection prices need to fall further. Arguably (and this is certainly the view of MIG) the platforms on offer need to adhere more to an Asian model.

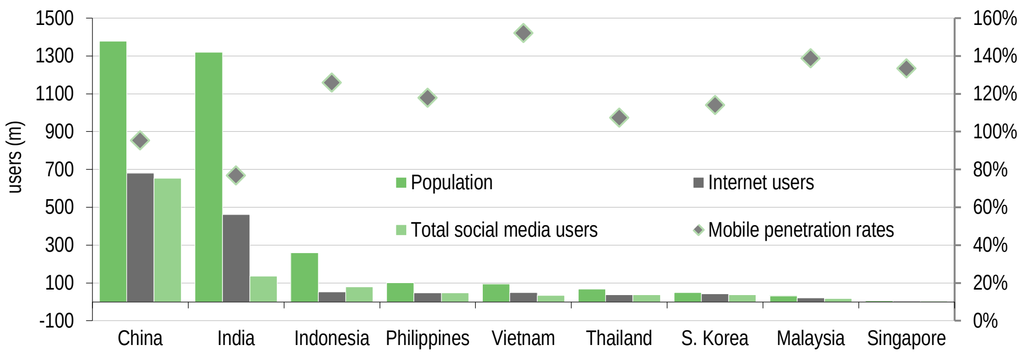
Indonesia – large market, decent connectivity and high propensity for social media

While small in population terms when compared to China and India, Indonesia is a massive market in a global context and represents a significant social media market opportunity. With a 259m population, it is close in size to the US and with 326m mobile connections, of which c 43% are smartphones, it is fairly well connected given its stage of economic development. Despite this, social media usage remains fairly low at c 25% of the population (79m), meaning there is a considerable opportunity for a company that can develop an appropriate format.

Philippines – medium sized market, well connected, high propensity to use social media

While the Philippines' population, at 101 million, pales in comparison to Asia's three most populous economies, with a high level of connectivity (broadband penetration of 47% and 119m mobile connections) and one of Asia's higher propensities to use social media (at 47%, this is in line with China), it is a significant market.

Exhibit 2: Key markets by population, broadband penetration and social media use



Source: Raw data from Internet Live Statistics, Wearesocial

Exhibit 3: Asian market data

(millions)	China	India	Indonesia	Philippines	Malaysia	Singapore	Vietnam	Thailand	Sth Korea
Population	1,379	1,319	259	101	31	6	94	68	50
GDP (PPP)/ capita (US$)	13,206	5,701	10,517	6,969	25,639	56,284	5,926	15,735	33,395
Active Internet Users	680	375	88	47	21	5	47	38	45
Active Social Media Users	653	136	79	48	18	4	35	38	38
Mobile Connections	1,314	1,012	326	119	43	8	143	73	57
Active Mobile Social Users	577	116	66	41	16	3	29	34	38
Urbanisation level	57%	33%	55%	44%	75%	100%	50%	52%	83%
Mobile penetration	95%	77%	123%	117%	142%	145%	152%	122%	113%
Social media penetration	47%	10%	30%	47%	59%	64%	37%	56%	76%
% of population owning device									
Mobile phone	99%	84%	85%	87%	96%	96%	93%	96%	98%
Smart phone	74%	33%	43%	55%	71%	88%	55%	64%	83%
Laptop/desktop	65%	16%	15%	43%	35%	71%	46%	27%	68%
Tablet	16%	5%	4%	24%	14%	42%	12%	11%	15%
TV streaming	2%	3%	1%	8%	4%	12%	2%	2%	5%
E-reader	0%	1%	1%	5%	0%	2%	0%	1%	1%
Wearable tech	0%	3%	1%	5%	1%	4%	0%	1%	2%
Social media platform usage (top 3)									
KakaoTalk/KakaoStory									
Facebook		13%	15%	26%	41%	43%	29%	32%	58%
WhatsApp		12%	14%		39%	46%	6%	11%	27%
Facebook Messenger		11%		23%	33%	26%	25%	28%	12%
Google+				17%					
WeChat	24%								
BBM			19%						
Qzone	21%								
Sina Weibo	16%								
Zalo							25%		
Mobile usage									
Messengers	39%	21%	27%	33%	56%	58%	34%	40%	47%
Watching videos	31%	17%	22%	26%	43%	42%	29%	33%	51%
Playing games	29%	13%	19%	23%	34%	33%	23%	33%	45%
Mobile banking	30%	15%	20%	21%	37%	38%	19%	30%	43%
Maps	29%	17%	22%	25%	47%	48%	28%	32%	53%

Source: www.wearesocial.com;GDP (PPP) per capital 2014 World Bank.

Social media: Contrasting business models

Two contrasting business models have emerged. Social media businesses aim to build a user base and to monetise this user base either by selling advertising space or by selling goods and experiences, both virtual and real (freemium business model).

The freemium model dominates within China

The freemium model allows users to register on a social media platform to engage in chat, interact with other users and with celebrities and to play entry-level games. Users are encouraged to experience entry-level free games and to progress to paying for premium features and to purchase virtual gifts (emoticons, stickers and the like). 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.

In China, while there are examples of successful advertising funded social media platforms (Weibo and Baidu), most platforms use a freemium model.

Tencent (HK:700) was founded in 1998 and went public in 2004. It offers users based in China a 'one-stop-shop' encompassing communication, e-commerce, games, information and entertainment.

It had 853 million MAUs in FY15, generating revenues of US$15,445m and EBIT of US$5,438m in FY15.[7]

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 July 2008, a decade later than Tencent (floated on NASDAQ in November 2012) and offers users free real-time online group activities including online games, music, education, live game broadcasting and conference calls. YY shares revenue with the artists and most games are purchased from third parties on a revenue share deal. It had 117m MAUs as of 2014. In FY15 revenues were US$910m. EBIT for FY15 has not been reported (US$196m in FY14).

Momo commenced operations three years ago and listed on NASDAQ at the end of 2014. It is a mobile-based social networking platform that monetises using the freemium model and selling virtual goods. In 2014 Momo had 69m MAUs. Revenue for FY15 was US$134m and EBIT was US$5.6m.

Renren Inc. (NYSE: RENN) floated in May 2011 and operates a leading real name social networking internet platform in China. It enables users to connect and communicate with each other, share information and user generated content, play online games, shop for deals, watch videos and enjoy a wide range of other features and services. In FY14 advertising accounted for 33% of revenue and games 45%, with the balance from internet value added services (IVAS). It had 45m MAUs in 2014, generating revenues of US$83m and an EBIT loss of US$112m.

The advertising model dominates outside China

Outside China (where Facebook is restricted), Facebook is the dominant social media platform in Asia. It has 1.59 billion users and generates most of its revenue from advertising. If we exclude China, Exhibit 4 shows that 58% of all internet users in Asia have a Facebook account.

However, there are two examples of listed social media platforms in China that employ the advertising model.

Weibo (NASDAQ:WB) is a leading social media platform for people to create, distribute and discover Chinese-language content. Weibo provides a simple way for people and organisations to publicly express themselves in real time, interact with others on a massive global platform and stay connected with the world. Almost 80% of revenue is from advertising. It has 236m MAUs as of 2015, generating revenues of US$478m and EBIT of US$35m in 2015.

Baidu (NASDAQ: BIDU) was founded in 2000 as a search engine product. Its business model is to use its internet traffic to generate 'click through' advertising revenue. It had US$9,967m of revenue and US$1,752m of EBIT in 2015.

7 Converted from RMB prices at 31 December 2015 of US$1.00/RMB 6.66.

Exhibit 4: Asia internet users and Facebook members			
(Millions)	Internet users	Facebook (Nov 2015	% Facebook users
India	375.0	136.0	36.3%
China	674.0	1.9	0.3%
Indonesia	78.0	78.0	100.0%
Pakistan	29.1	23.0	79.0%
Bangladesh	53.9	28.0	51.9%
Philippines	47.1	47.0	99.7%
Myanmar	7.1	7.1	100.0%
Vietnam	47.3	35.0	74.0%
Thailand	38.0	38.0	100.0%
Nepal	5.7	5.7	100.0%
Sri Lanka	5.7	3.4	59.8%
Cambodia	5.0	3.3	66.0%
Malaysia	20.6	18.0	87.4%
South Korea	45.3	16.0	35.3%
Laos	1.0	1.0	97.4%
Mongolia	1.3	1.3	100.0%
Singapore	4.7	3.6	77.4%
Bhutan	0.3	0.2	78.4%
Brunei	0.3	0.3	84.7%
Total	1,439.4	446.7	31.0%
Total excluding China	765.4	444.8	58.1%

Source: www.internetlivestats.com; Asia internet statistics. Note: eMarketer estimates users in Indonesia at 67.7m (not 78m) and in the Philippines e-Marketer estimates users at 37.2m.

Key building blocks in place

migme is targeting the largest non-Chinese speaking markets in South Asia and South-East Asia: Indonesia, India and the Philippines. In these markets, Facebook is currently the dominant platform. However, as we have shown, in these markets the addressable market remains significant and social media usage, particularly in India, is relatively low compared to China.

By using a freemium model, rather than an advertising one, MIG believes it can rapidly build market share and drive social media usage in these so far underdeveloped markets. Tencent (HK:700, market capitalisation US$194bn) and YY.com (NASDAQ YY.US, market capitalisation US$3.5bn)[8] and Momo (NASDAQ MOMO, market capitalisation US$3.2bn) are examples of successes in the mainland Chinese market and MIG's freemium business model is closely aligned with these groups.

In our view, building trusted relationships in Asia by developing discrete online social communities where the members trust each other, are prepared to transact with each other and are willing to share views and information, enhances the utility of social media and builds the user base.

Users are likely to be attracted by one of more of the following:

- the ease of access to the social media app. The app could be made available by the social media provider arranging for the app to be pre-loaded onto new smartphones;
- the available content and in particular the appeal of the games offered;
- the extent and quality of the user base;
- the appeal of the artists and celebrities that use the site and the opportunity to communicate directly with artists and celebrities; and
- the option to use avatars and to create an identity other than their own. This has particular appeal in countries where there is a degree of repression and where there are significant differences between the social mores applied by the older and younger generations.

[8] Prices as at 8 April 2016 (Bloomberg)

Since the migme open platform launch in 2014, we believe that MIG has put in place the key building blocks for growing and monetising the user base. In the last 12 months, the number of monthly active users (MAUs) has increased threefold and the quarterly revenue has increased by a factor of 10. In our view, MIG is poised for significant growth in users and monetisation rates similar to those seen on other Asian social media platforms (eg Tencent). The key building blocks established by MIG include:

- 32m registered users generating increasing amounts of revenue (A$5.4m in Q415).
- Establishing markets in three key South-East and East Asian countries (plus Nepal, a small market that has been used as a test market for entry to India).
- Signing content deals with key record labels.
- Signing more than 600 artists, who are attracted to the migme platform because of the revenue sharing model (the share of revenue in the early years is expected by MIG to be more than the long-term average of around 50% but management expects to move towards 50% as the platform matures).
- Establishing a games platform launched in Q116. MIG does not develop games in-house – games are developed by third parties who have revenue sharing arrangements with MIG.
- Adding social activities such as online dating.
- Putting in place payment platforms to enable users who do not have conventional credit cards or bank accounts to pay for goods and services on the migme platform (for example Doku in Indonesia).
- Entering into a joint venture with Meitu, a privately owned company based in Xiamen, China, to "explore joint marketing and product development opportunities". MIG's CEO, Stephen Goh, believes that the combination of the Meitu product and the migme platform could provide users with an experience similar to Instagram and Snapchat.[9]
- A strategic revenue sharing partnership with CricBattle, a leading fantasy sports platform offering an apparently unique draft-based fantasy cricket game. CricBattle also offers a fantasy soccer game.
- Raising sufficient capital to fund the company until it becomes profitable (our forecasts show that operations will be profitable in FY17 and are likely to reach break-even in the latter part of FY15). Since the listing, MIG has raised A$26.7m after capital raising costs. Capital raises done throughout FY16 have been sold at significantly more than the A$0.20 per share IPO price. The A$10m capital raise in Q315 was priced at A$1.00 per share and the placement to Meitu on 3 March 2016 was made at A$0.60 per share.

MIG's MAU growth in perspective

The chart below puts MIG's early growth rate in MAUs in perspective. We have tracked the MAU progress of other social media platforms at a similar stage in their development (from c 15-20m MAUs) against MIG's progress and our forecasts for its MAU growth.

Benchmarking the point at which the 'network effect' (the inflection point at which growth feeds growth in users) on social media platforms kicks in is relatively subjective. However, looking at the early years (from the point at which they reached 20m MAUs) for larger peers in Exhibit 5, MIG's MAU growth is tracking well.

In the first two years of scaling beyond 20m MAUs, Facebook, Twitter and LinkedIn for instance all added c 10m MAUs a quarter. For Facebook there is a distinct sign that the network effect kicked in approximately two years later at c 100m MAUs. Over the last four quarters, MIG has added 22m subscribers, an encouraging trend. Hence, we are forecasting a user growth trajectory only lagging behind Facebook, but broadly in line with Tencent in its early years.

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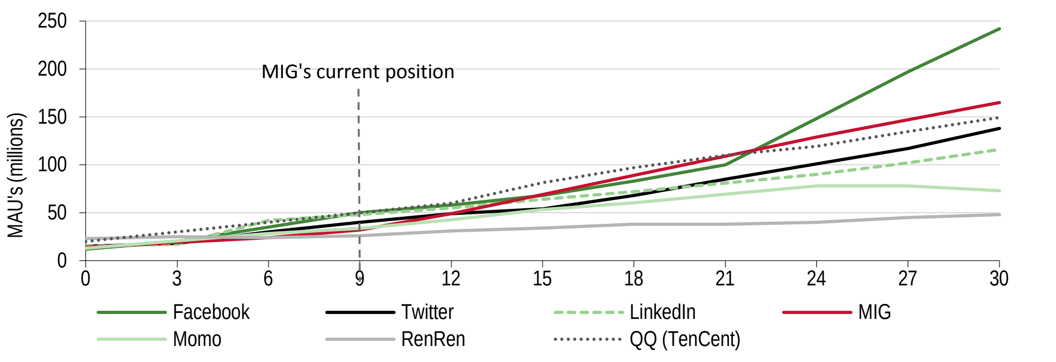
[9] MIG announcement 3 March 2016.

Our forecasts show profitable operations from FY17. However, we caution that the amount of profit will depend on the number of monetising users, the amount spent per monetising user and the gross profit margins from the core social network business as well as the success or otherwise of the social e-commerce venture. The FY15 results showed a negative gross profit margin because the revenue sharing arrangements are skewed to the artists and the market development costs are much higher than they would be in a steady state environment.

Exhibit 5: Social media platforms' growth in MAU (on a monthly basis)



Source: Company data. Note: X-axis is number of months. In each case zero is taken as the point at which there were c 15-20 million users.

Valuation of early stage social media companies

Valuation considerations

Early signs of success are expected to include growth rates in MAU, spend per user, the churn rate and profit per MAU.

Social media companies usually spend the first few years of their existence building their user base and are loss making during this phase. There are few precedents available, there is limited operating history, building the business is very dependent on the tastes and preferences of users and in some cases the business models are still to be proven or at best are embryonic. The data typically available to be used for valuation purposes include MAU growth, revenue, monetisation rates and customer acquisition costs.

Comparable company analysis is frequently used to provide a guide to valuation, but in our view this is fraught with difficulties because of the different life cycles of the component companies, the market capitalisations, which can range from tens of millions to billions, and the comparability of the business models adopted. In our examination of peer group companies we have used a qualitative overlay to assess the comparability of the business models and we have adjusted the comparative data so that MIG is compared with the performance and pricing of other companies at a similar stage in their life cycle. These companies constitute our comparable business peer group.

While a business is going through the product innovation or establishment phase there is an emphasis on revenue driven metrics. The reason for this is that members or users and recurring sales demonstrate interest from customers. During this phase and particularly in disruptive technology companies, including social media companies, it is likely that the costs of producing and establishing a market for the product will mean a negative bottom line. In the case of MIG, in 2015 the gross profit margin was negative because MIG had invested in building the platform, attracting artists and users.

We now discuss a number of different valuation methodologies including customer value analysis (where we do not have sufficient data to apply), returns and comparative company market valuations adjusted for life cycle, the 'simple valuation rule' where we assess the reasonableness of the EV/revenue multiple by linking it to profitability and a DCF.

Customer value analysis

One method of valuing an early stage revenue-generating, loss-making company is to use customer value analysis. This is the cost of customer acquisition measured alongside the lifetime value of each customer. This value needs to be linked to shareholder value. Customers should be treated as assets that increase cash flows, reduce cash flow volatility and thereby increase shareholder value. Customers have a value that is the net present value (NPV) of the aggregated net cash flows generated from base potential, growth potential, networking potential and learning potential. In our comparative value analysis below, we have used EV/MAU as one of our benchmarks for valuation.

Comparable quantitative and qualitative company market valuation analysis

Our analysis uses four social media companies that employ the freemium business model and operate in China (Tencent, YY.com, Momo and Renren) and two social media companies that have a 100% advertising model (Weibo and Baidu). It should be noted that Weibo and Baidu, referenced in our comparable company table, are not directly comparable with MIG because they use the advertising model. They have been included for completeness to show the pricing of the advertising model compared with the freemium model. The peer group on which our comparable company analysis has been done are the four social media companies using the freemium business model.

We compare this peer group with MIG at similar stages in their life cycle to back test market pricing in terms of EV/revenue multiples and EV per MAU. We have undertaken a qualitative analysis to compare the business models and the size of the companies (using MAU as the determinant of size) to find the most comparable companies.

Exhibit 6: Comparable companies (FY15)

US$m	Tencent	YY	Renren	Momo	Baidu	Weibo	MIG
Revenue	15,422	593	83	134	9,952	478	12
EBIT	5,430	196	-112	6	1,750	35	-16
MAU	853	117	45	69		236	32
EBIT %	35%	33%	N/A	4%	18%	7%	N/A
Revenue change	30%	97%	-47%	199%	54%	43%	530%
EBIT change	25%	100%	N/A	N/A	46%	N/A	
New MAU added	38	25	17	36	N/A	60	22
Market cap (US$m)	22,039	3,490	911	3,220	63,610	4,480	210

Source: Company data. Note: Renren YY.com and Momo use FY14 data.

We examine the comparative company business models and compare the key features with the MIG business model to obtain the best match. The qualitative features used were MAU growth ('Yes' if more than 50%), the inclusion of a freemium offer to drive MAU, monetisation through selling virtual gifts, the inclusion of e-commerce, a games platform offering, a fantasy game offer, telecommunication services, the provision of a payments platform and whether the business was profitable in year 2. We then determined the comparison period for each peer by going back to the first year of trading (Year 1) followed by the subsequent year (Year 2) to calculate the respective EV/revenue and EV/MAU multiples. This approach allows us to capture the period when these companies were at a broadly similar, early development stage to MIG. Our EV calculation uses the share price at the end of each period.

Our proprietary scoring system is designed to match the comparable company 'Yes' responses with the MIG 'Yes' responses to see how many matches there out of a perfect score of 7 points. Tencent's business model scored 5 points out of a possible total of 7 points.

Exhibit 7: Qualitative overlay for comparable companies

	Market cap year 1 US$m	MAU year 1	Rel. size MAU (x) migme	MAU growth year 2	Size* MAU	Growth MAU >50% yr2/1yr1	Freem-ium offer	Virtu al	E-comm (exc virtual)	Advert> 30% rev years 1&2?	Game	Fan-tasy games	Telco	Pay-ment Plat-form	Profit-able Year 2	Main location	Score
Freemium model																	
Tencent	804	134.0	4	51%	0	Yes	Yes	Yes	No	No	Yes	No	Yes	Yes	No	China	5
YY	209	69.7	2	32%	1	No	Yes	Yes	No	No	Yes	No	No	No	No	China	3
Renren	1,574	38.0	1	(47%)	0	No	Yes	Yes	No	Yes	Yes	No	No	No	No	China	3
Momo	1,012	33.7	1	106%	1	Yes	Yes	Yes	No	No	Yes	No	No	No	Yes	China	4
Advertising model																	
Baidu	1,080	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	Yes	N/A	N/A	N/A	N/A	No	China	0
Weibo	2,325	96.7	3	34%	0	No	No	No	No	Yes	No	No	No	No	No	China	0
migme	145	32.0	1	220%	1	Yes	Yes	Yes	Yes	No	Yes	Yes	No	Yes	No	SE/E Asia	7

Source: Company data, Edison Investment Research. Note: Renren offers a finance platform. Momo earns subscription revenue. US$/A$ exchange rate used for MIG was US$1.00 to A$0.76 and the US$ to RMB$ rate used for Tencent was US$1.00/RMB8.23. As at 11 April 2015. *Size refers to the MAU of the comparable companies compared with MIG's MAU. Above 70 MAU = 0 below=1.

The EV/revenue multiples and US dollar market capitalisation per MAU and the qualitative score adjusted for relative MAU size show that Tencent and Momo score the most points and are, in our view, the most comparable companies because of their business models and comprehensive product range. Momo also fits the size criteria with 33.7m MAU and revenue of US$45m in Year 1. One significant point of difference is that both Tencent and Momo operate in China so they do not compete with global players such as Facebook, whereas in MIG's markets of Indonesia, India and Philippines Facebook is the dominant social media site.

Exhibit 8: Comparable companies – multiple analysis

	First year of trading	First year rev (US$)	Year 1 EV/rev (x)	Year 2 EV/rev (x)	Year 1 EV/MAU	Year 2 EV/MAU	Qual score	Size	Total
Freemium model									
Tencent	2004	138	5.8	8.9	6.0	7.8	5	0	5
YY	2012	132	1.6	9.8	3.0	32.2	3	1	4
Renren	2011	112	7.8	19.2	23.0	15.8	3	0	3
Momo	2014	45	13.2	14.3	8.5	NP	4	1	5
Advertising model									
Baidu	2005	38	3.1	3.3	N/A	N/A	0	N/A	N/A
Weibo	2014	334	5.7	6.0	10.8	12.2	0	0	0
migme	2015	12	18.0	4.5	4.8	2.1	7	0	7

Source: Company data, Bloomberg, Edison Investment Research. Note: Tencent RMB converted at US$1.00/8.1RMB

MIG is currently trading on a FY16e EV/revenue multiple of 4.5x and an EV/MAU of 2.1x, based on our forecasts of a 273% lift in revenue in FY16 and an increase in MAU from 32m to 69m. Our FY16 forecasts are premised on the following assumptions:

- Quarterly MAU increases of an average 9.25m (this compares with 8m MAUs added in the December 2015 quarter).
- Increasing spend per MAU based on quarter on quarter increases in December 2015 of 45% and 69% in September 2015. Revenues in the December 2014 quarter were A$0.565m and in the December 2015 quarter were almost 10x this amount at A$5.393m.[10]
- Platform development including a fully-fledged launch of the games platform in Q116.
- The addition of e-commerce activity.
- The inclusion of sports fantasy games (initially cricket in India).

[10] MIG 4C quarterly reports lodged with ASX.

The table below uses the Year 2 EV/revenue and EV/MAU multiples for the peer group from Exhibit 8 and applies this to the respective revenues and MAUs of MIG. For example, the Year 2 EV/revenue of Tencent is 8.9x and if applied to MIG's FY16e (Year 2) revenue of US$34.9m (A$45.9m) would give EV of A$408.5m. This would imply the equity value of A$1.42/share compared with MIG's current share price of A$0.74.

Exhibit 9: MIG pricing using comparative company EV/revenue and EV/AU multiples (Year 2)

	MIG	Tencent	Momo	YY.com	Renren
	2016e	2005	2015	2012	2012
Operating metrics					
Revenue growth	273.0%	25.0%	199.0%	159.1%	43.0%
Revenue (US$m)	34.9	176.8	134.0	131.6	159.5
MAU (m)	69.0	201.9	70.0	69.0	56.0
Multiples					
EV/revenue multiple (x)	4.5	8.9	14.3	9.8	19.2
EV/MAU multiple (x)	3.0	11.1	12.1	42.0	15.5
MIG's EV using peer group multiples					
EV (A$m) applying peer EV/revenue (x) to MIG	213.6	408.5	657.7	449.8	881.3
EV (A$m) applying EV/MAU to MIG	213.6	765.9	834.9	2,898.0	1,073.2.
MIG's share price using peer group multiples					
MIG share price using peer group EV/revenue	$0.74	$1.42	$2.29	$1.56	$3.07
MIG share price using peer group EV/MAU	$0.74	$2.66	$2.90	$10.08	$3.74

Source: Edison Investment Research, Bloomberg. Note: For prices at 11 April 2016. EV/MAU expressed in A$ is A$2.1m (US$3.0m). The EV of MIG is calculated as 285.7m shares x A$0.74 share price plus net debt at end for FY16 of A$2.2m = A$213.6m.

The application of comparative multiples analysis taking into account our qualitative overlay, which has identified Tencent and Momo as the companies that have a business model that is closely allied to MIG's business model, results in a valuation range for MIG of A$1.41 to A$2.29 per share if we use EV/revenue multiples. If we use EV/MAU, the valuation range is A$2.67 to A$2.92 per share for MIG. However, we believe that some caution should be exercised because MAU does not take into account monetisation rates or spend per user or changes in the time value of money. For example, the amount spent per user by Tencent in 2005 (defined as year 2 in the comparative table) was US$0.88, compared with Momo (2015) at US$0.94, YY.com (2012) at US$3.27 and Renren (2012) at US$0.90.

In determining these valuation ranges, we have not adjusted for investor sentiment, which to some extent will be driven by the supply of opportunities and the capital available. In our view, there is now some evidence of a cooling in market sentiment and more of a focus on the path to profitability.

Simple valuation model[11]

In our view, user metrics and revenue multiples used in isolation can be problematic because they are not anchored to profit margins or to earnings multiples. We have applied a simple valuation rule taken from a research paper commissioned by Edison Investment Research for the Edison Talks Tech Conference held in Auckland, New Zealand on 21 March 2016. This simple valuation rule takes into account profit margins and earnings multiples and is defined as:

Current price to sales = stable margin × price earnings ratio × sales uplift/price uplift[12]

The price the market will pay at a given time is dependent on the cyclicality of markets. When the market favours growth, then the emphasis is on revenue multiples with seemingly little regard for profitability. However, as this enthusiasm cools the market will turn its attention to profitability and return on funds employed.

[11] Valuation for early-stage companies. Dr Kingsley Jones, Jevons Global, March 2016

[12] Valuation for early stage technology companies, Dr Kingsley Jones, Jevons Global, March 2016

The market is currently pricing MIG at 4.5x FY16 revenue. We apply the simple valuation rule explained above and make the following assumptions:

- Sales uplift (defined as the expected growth in sales over the investor's investment horizon) divided by price (to the investor) uplift (defined as the investor's expectations of return over the investor's investment horizon) is assumed to be 1. We have neutralised the impact of this assumption by setting the ratio to 1; however, in a growth company such as MIG it is possible that sales uplift could be greater than price uplift, which would mean a reduction in the implied P/E.
- A long-run profit margin for the industry of 30%, which we have based on the average NPAT/sales margin achieved by Tencent over the last five years (29.8%). We have selected Tencent as the benchmark because it has been operating since 1999 and has been a public company since 2004 and is therefore the most mature of the peer group. Tencent operates in China (as do all the other companies in the peer group) where it does not face competition from global players such as Facebook.

This means the current MIG FY16e EV/revenue multiple of 4.5x assumes a P/E ratio of 15x, which is about the market multiple (calculated as EV/revenue multiple of 4.5x divided by stable profit margin of 30% = P/E of 15x). This P/E ratio does not reflect the expected future growth we have incorporated in our forecasts. However, in our view, because the peer group has been operating in the social media space for significantly longer than MIG, some discount should be applied to the group. The trailing 12-month P/E ratios for the comparative company group using the freemium model are Tencent 43.9x, Momo 207.3x, Renren is loss making therefore has no P/E ratio and YY.com 23.3x.

DCF valuation: A$1.93

Our DCF valuation, which is based on our forecasts, results in a DCF of A$1.93 using a WACC of 13% and a terminal value of 2%. The terminal value accounts for 53.6% of the base case DCF and assumes a 6.9x EBIT multiple.

We have calculated a reverse DCF, which suggests that the current share price is pricing in MAU of ~91 million by FY18 (this is the equivalent of adding 4.9m users a quarter, against growth of 8m actually achieved in Q415) compared with our DCF assumption of 147 million MAU by FY18.

We have also undertaken sensitivity analysis as follows:

- MAU growth – Scenario 1 assumes that the number of MAUs increases to 43% of market share by FY18. This increases MAUs from 147 million in our base case forecast to 189 million in our Sensitivity 1 analysis below. The result is a DCF of A$2.89, which is an additional A$0.96 to our base case DCF of A$1.93. By the same token, a decrease of 10% market share will decrease our DCF valuation by $0.96 to $0.97.
- MAU spend – MIG does not provide data on the number of monetising users or the average revenue per paying user (ARPPU). See Exhibit 10 for our base assumptions. Sensitivity 2 assumes that MAUs increase their FY18 spend by A$0.30 to A$1.47. The result is an increase of A$3.60 to our base case DCF to a total of A$5.53. Similarly, a decrease of 25% spend per user would result in negative valuation.
- E-commerce users – We have assumed in our base case that 2% of MAUs engage in social e-commerce. Our Sensitivity 3 assumes usage doubles to 4%, which adds A$0.39 to our base case DCF, resulting in a total DCF of A$2.32. If the usage halves, the DCF would decline by A$0.39 to A$1.54.

Exhibit 10: DCF – impact of sensitivity analysis (A$ per share)

Case	Case description	Change in DCF	Upper end of DCF	Lower end of DCF
Base case	Base case DCF – A$1.93/share			
Sensitivity 1	MAU increase/decrease by 10% of market share (189m/102m MAU)	0.96	2.89	0.97
Sensitivity 2	MAU increase/decrease in spend ±30c (or ±25%) in FY18	3.60	5.53	N/M
Sensitivity 3	E-commerce doubles/halves market share (4% or 1% market share)	0.39	2.32	1.54

Source: Edison Investment Research

Valuation summary

The results of our valuation work are as follows:

- EV/revenue multiple analysis results in a share price range for MIG of A$1.41 to A$2.29 if we use the most comparable of our peer group companies (Tencent and Momo).
- EV/MAU results analysis results in a share price range for MIG of A$2.67 to A$2.92.
- The simple valuation rule, taking into account profitability and returns at the current EV/revenue multiple of 4.5x, implies a P/E of 15x. This is more reflective of the average growth rates in the market than our forecast high growth rates.
- Our DCF using our base case forecasts results in a valuation of A$1.93.
- Our reverse DCF assumes that the current share price of A$0.74 is pricing in ~91m users by 2018, compared with users as at 31 December 2015 of 32m. The increase required is equivalent to 4.9m additional users per quarter. This compares with the last quarter of FY15 when MIG added 8m users.

The table below summarises the difference between the current share price and these valuations:

Exhibit 11: Valuation summary

		From	To	From	To
	A$	A$	A$	Var (%)	Var (%)
MIG current share price	0.74				
EV/revenue		1.42	2.29	91%	209%
EV/MAU		2.66	2.90	261%	295%
DCF		1.93		161%	

Source: Edison Investment Research

Recent events

The joint venture with privately owned Chinese company Meitu, a leading photo and video mobile app developer, is, in our view, evidence of the importance of MIG's relationship with Foxconn (a 19.9% shareholder in MIG via FIH Mobile – a subsidiary of Hon Hai Precision Co Ltd [TPE:2317]).

Meitu subscribed to 11.65m shares in MIG at A$0.60 per share (A$6.99m) and the companies are to work together on sharing content, marketing initiatives in MIG's key markets and product development opportunities. Meitu has 900m users of whom 100m are outside China.

MIG has entered fantasy sports betting by partnering with CricBattle, a provider of draft-based fantasy games for cricket and soccer. The cricket game is of immediate interest ahead of the 2016 Indian Premium League cricket season commencing in April 2016. The partnership arrangement includes revenue sharing from purchased migme credits and revenue generated from sponsorships, advertisements and product sales.

We have not altered our forecasts for these additional revenue earning possibilities. We view the Meitu and CricBattle opportunities as improving our confidence levels in our forecasts and hence in our view that the current price of MIG does not fully reflect its value.

Financials

Profit forecasts

Our forecasts assume that FY17 will result in EBITDA of A$9.9m generated from 109 million MAU, including A$4.9m from e-commerce and A$7.1m from core social network business before share-based payments. We have assumed share-based payments of A$2m. The core business is forecast to achieve an EBITDA margin of 9.6% in FY17 increasing to 21.6% in FY18 due to the addition of 38 million MAU and the impact of more revenue driven from the same infrastructure. The business split in FY18 is expected to be 78% from core social media and 22% from social e-commerce.

We understand that operating costs will peak in H116 and then are likely to remain largely fixed. Payment gateway fees, revenue sharing with artists and gaming licence costs will remain variable and we expect that these costs will reduce over time (measured as a percentage of sales).

Exhibit 12: MIG – path to profitability

	2015	2016e	2017e	2018e
MAU (m)	32	69	109	147
Revenue (A$m)	12.3	46.0	103.9	171.7
EBITDA (A$m) (norm)	(21.0)	(16.3)	9.9	37.2
NPAT (A$m) (norm)	(20.7)	(11.5)	6.8	26.2
Growth rates				
Revenue		274%	126%	65%
EBITDA		NM	NM	274%
NPAT		NM	NM	286%

Source: MIG data, Edison Investment Research

Balance sheet

At 31 December 2015 MIG had net cash of A$5.5m. The placement to Meitu increased net cash by A$6.99m. Our forecasts assume that net operating cash flows will be negative (A$14.6m) in FY16 and that net debt will be A$2.2m. There are 19.4m options on issue exercisable at between A$0.20 and A$1.20 (at an average price of A$0.53) between 31 July 2017 and 30 November 2019. Over this period, A$10.3m of possible funds could be raised from the exercise of options.

We have not included the payment of dividends in our forecasts. We have included the conversion of all outstanding options at the exercise price, which in all cases is less than our DCF. The convertible note of A$3.1m is assumed to be converted to equity in FY17 in accordance with the terms of issue.

Exhibit 13: Financial summary

A$000s	2014	2015	2016e	2017e	2018e
Year end 31 December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	1,953	12,300	45,962	103,925	171,734
Cost of Sales	(605)	(13,043)	(40,398)	(71,001)	(110,730)
Gross Profit	1,347	(744)	5,564	32,924	61,004
EBITDA	(28,597)	(21,021)	(16,320)	9,940	37,173
Operating Profit (before amort. and except.)	(16,017)	(20,930)	(16,363)	9,900	37,135
Intangible Amortisation	0	0	0	0	0
Exceptionals	0	0	0	0	0
Other	0	0	0	0	0
Operating Profit	(16,017)	(20,930)	(16,363)	9,900	37,135
Net Interest	0	(20)	(87)	(201)	336
Profit Before Tax (norm)	(16,017)	(20,950)	(16,450)	9,699	37,471
Profit Before Tax (FRS 3)	(28,597)	(21,313)	(16,450)	9,699	37,471
Tax	(32)	(3)	4,935	(2,910)	(11,241)
Profit After Tax (norm)	(16,048)	(20,680)	(11,515)	6,789	26,230
Profit After Tax (FRS 3)	(28,629)	(21,043)	(11,515)	6,789	26,230
Average Number of Shares Outstanding (m)	251.6	262.7	285.7	296.3	299.9
EPS – normalised (c)	(6.38)	(7.87)	(4.03)	2.29	8.75
EPS – normalised and fully diluted (c)	(5.95)	(7.33)	(3.77)	2.20	8.51
EPS – (IFRS) (c)	(11.38)	(8.01)	(4.03)	2.29	8.75
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	69.0	-6.0	12.1	31.7	35.5
EBITDA Margin (%)	-1464.3	-170.9	-35.5	9.6	21.6
Operating Margin (before GW and except.) (%)	-820.2	-170.2	-35.6	9.5	21.6
BALANCE SHEET					
Fixed Assets	646	1,077	5,971	5,933	5,898
Intangible Assets	0	326	326	326	326
Tangible Assets	502	583	542	504	469
Investments	145	168	5,103	5,103	5,103
Current Assets	6,539	9,419	1,655	11,489	43,505
Stocks	0	100	0	0	0
Debtors	0	0	0	0	0
Cash	5,926	8,658	994	10,829	42,844
Other	613	661	661	661	661
Current Liabilities	(1,593)	(2,931)	(4,586)	(6,093)	(9,386)
Creditors	(1,352)	(1,694)	(3,348)	(5,884)	(9,177)
Short term borrowings	0	0	0	0	0
Other current liabilities	(241)	(1,238)	(1,238)	(209)	(209)
Long Term Liabilities	0	(3,178)	(3,178)	0	0
Long term borrowings	0	(3,178)	(3,178)	0	0
Other long term liabilities	0	0	0	0	0
Net Assets	5,593	4,387	(138)	11,329	40,017
CASH FLOW					
Operating Cash Flow	(11,074)	(17,065)	(14,565)	11,448	40,465
Net Interest	0	0	(87)	(201)	336
Tax	(143)	(10)	0	(2,910)	(11,241)
Capex inc R&D	(506)	(328)	(2)	(2)	(2)
Acquisitions/disposals	9,344	411	0	0	0
Financing	11	16,146	6,990	1,500	2,458
Dividends	0	0	0	0	0
Net Cash Flow	(2,368)	(846)	(7,665)	9,835	32,015
Opening net debt/(cash)	(2,182)	(5,926)	(5,480)	2,184	(10,829)
HP finance leases initiated	0	0	0	0	0
Other/ Conv note converted to equity	(1,376)	400		3,178	0
Closing net debt/(cash)	(5,926)	(5,480)	2,184	(10,829)	(42,844)

Source: migme accounts, Edison Investment Research. Note: COGS does not include marketing costs and revenue includes ‘other income’. Our forecasts assume that options are converted at their expiry date.