

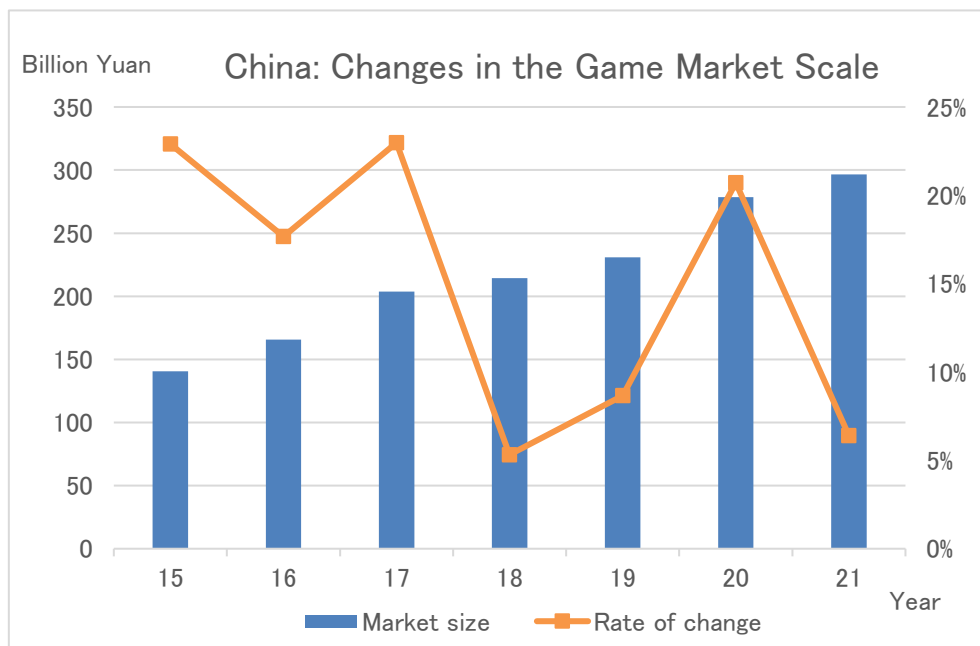
China: Game industry

<Industry overview> Slowing signs in world's largest market

With the spread of the Internet and smartphones, China's gaming market has expanded rapidly over the past few years to become the largest market in the world. According to a US market research firm, the size of China's gaming market was 13.8 billion US dollars in 2013, but expanded to 24.6 billion US dollars in 2016, surpassing the United States, emerging as the world's top and has continued to maintain its leading position.

However, according to a research firm, the US may again overtake China to take the world's top position in 2022 as the Chinese government has strictly controlled the publishing of games and has implemented various measures such as limiting the playing time of minors (details will be described later).

According to data compiled by industry groups such as China Game Publishers Association Publications Committee (GPC), the size of the Chinese game market (sales basis) in 2021 was 296.51 billion yuan, an increase of 6.4% from the previous year. Although the uptrend was maintained, growth slowed from the prior year's 20.7%. In China, the review of online game distribution was suspended temporarily for eight months from August 2021 to March 2022, which led to a slowdown in overall industry growth.



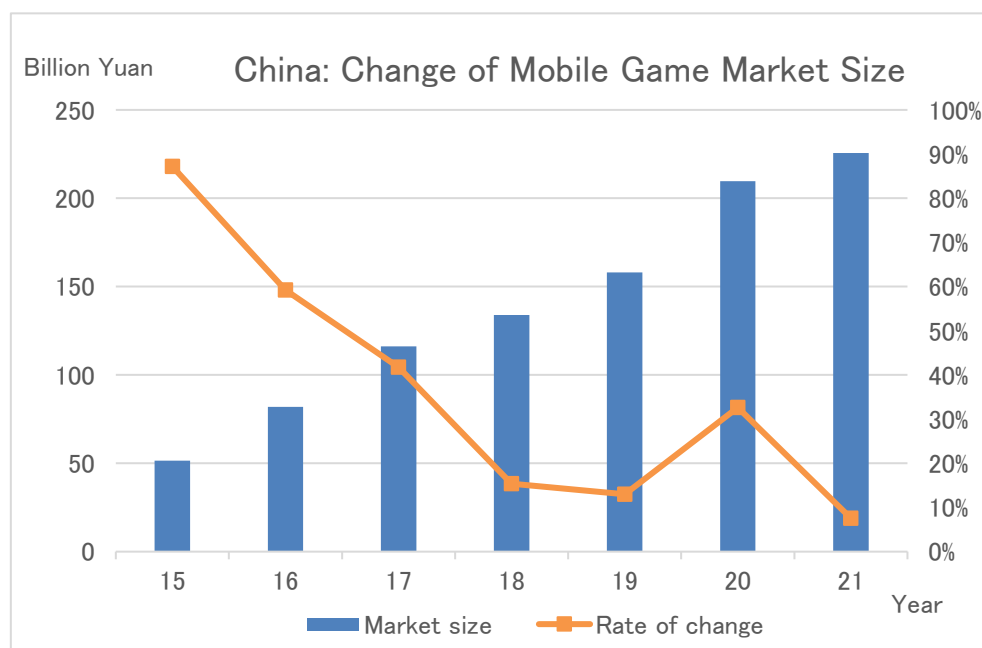
(Data compiled by Ashu Research based on data from China Game Publishers Association Publications Committee: GPC)

<Mobile games> Growth pace slowing

Like the overall gaming market, the mobile gaming market slowed its pace of growth in 2021. According to data from GPC and others, the size of China's mobile game market (sales basis) grew 7.6% from the prior year to 225.54 billion yuan in 2021, a significant slowdown from the 32.6% rate in the prior year. As a percentage of the total gaming market, it accounted for 76.1%, slightly up from 75.2% a year earlier.

As mentioned above, various restrictions by the Chinese government have led to a slowdown in market growth. In addition, there was a slowing in reaction to the rapid expansion of the market with “Stay-at-home demand” at the beginning of the Covid-19 outbreak in the prior year (2020).

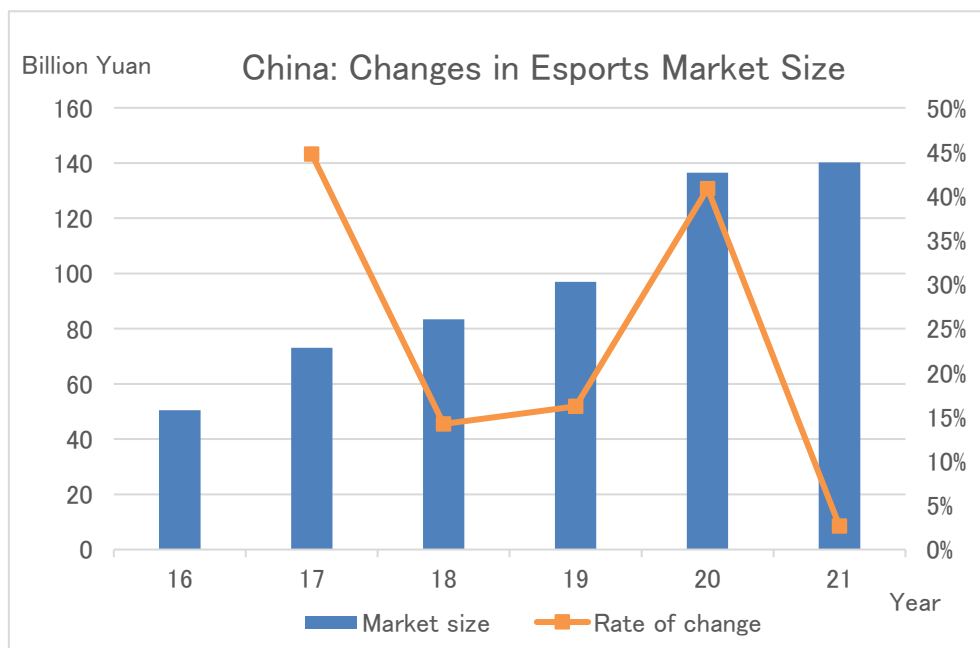
Furthermore, some are saying the market is approaching saturation, with the spread of smartphones pausing and the growth of mobile gaming users slowing. According to data from GPC and others, the number of mobile gaming users in China reached 656 million at the end of 2021, but the growth rate from the previous year was almost flat at 0.2%. This was a further slowdown from the 4.8% increase in the prior year.



(Data compiled by Ashu Research based on data from China Game Publishers Association Publications Committee: GPC)

<e-sports> Growth slows due to Covid pandemic

In addition, the e-sports market is increasing its presence in the gaming related sector. According to data from GPC and others, the market size (sales basis) reached 140.18 billion yuan in 2021, up 2.7% from the prior year. Although the growth rate slowed from 44.2% in the prior year as the number of related events held declined in the wake of the Covid pandemic, GPC projects the growth to accelerate again after 2022. About 90% of sales in the e-sports market are related to events (event admission fee, sponsor fee, advertising fee, etc.), and the remaining 10% are online video streaming fees. As for game video streaming platforms, Tencent affiliates “Fighting Fish (DouYu)” and “Huya” together account for more than 70% of the market share.



(Data compiled by Ashu Research based on data from China Game Publishers Association Publications Committee: GPC)

<Policy environment> Authorities strengthen supervision

The current policy environment for the Chinese gaming market is becoming increasingly severe. In China, when publishing new online games that include the sale of paid items, a permit number called an “edition number” is required. This “edition number” granting review has often been frozen for periods of time since 2018. Most recently, as noted above, the review was suspended temporarily for eight months from August 2021 to March 2022.

The review suspension is due to the fact that the Chinese authorities are becoming more sensitive to the game contents. According to local media, the authorities intend that game content should prevent “game addiction” among minors and reflect “correct values” and “correct understanding of Chinese history and culture” without political color.

In China, as “game addiction,” in which children become too addicted to games, has become a social problem, the government announced in November 2019 that it cap the amount of play time and charges for minors. In addition, from September 2021, a new regulation was implemented limiting online gaming by minors under the age of 18 to Fridays, Saturdays, Sundays, and legal holidays from 8 to 9 pm. All gaming companies were notified that they may not provide services to minors at any other time.

Tencent, the largest company, had introduced its own regulations for minors in phases ahead of this, so the impact of the regulation was initially thought to be limited. However, in a situation where authorities are tightening regulations, the impact is gradually becoming apparent. Tencent’s Q1 (Jan-Mar) 2022 financial results in mainland China showed a 1% YoY decline in gaming revenue. Affected by regulations results fell into negative growth. The company explained that the underage restrictions have directly and indirectly affected the number of active and paying users.

In response to this domestic policy environment, major industry companies are accelerating efforts to strengthen their overseas operations. Of these, NetEase Games announced in May 2022 a policy to expand investment in overseas markets. At present, 10% to 20% of R&D expenditures are allocated to overseas markets, but they plan to increase the ratio to 40% to 50% in the future. The company is establishing a game studio in Japan in early 2022.

<Industry map> Tencent’s overwhelming presence

Tencent has an overwhelming presence in the Chinese gaming market. The company is one of the top gaming companies in the world, operating online and mobile gaming distribution platforms, in-house development, and proxy publishing, all at a high level. The company is also active in capital participation and business alliances with foreign companies, and in 2016 took control of Supercell, a Finnish company in the same industry. Since then, the company has continued to invest in the gaming business, investing in a total of 27 gaming-related companies in the first half of 2021, according to local media. It is calculated that investments are made at the pace of “One company a week” on average.

In addition to online games, in December 2019, as a Chinese distributor of Nintendo, started selling the home game console “Nintendo Switch” in China. According to Tencent, as of January 2021, cumulative sales of “Nintendo Switch” in China exceeded 1 million units. This record surpasses the combined sales performance of Microsoft’s “Xbox One” and Sony’s “PlayStation 4,” and it is said to be the best-selling home video game console in China.

NetEase, the second-largest domestic gaming company, also has a global presence. According to a US research firm, Tencent and NetEase ranked first and second in the world revenue rankings of app publishers (2021), respectively, following the previous year. This surpassed Activision Blizzard and Bandai Namco Holdings in the US, among others.

On the other hand, it is difficult for foreign companies to enter the Chinese gaming market. This is

because there are restrictions on foreign investment and strict content review, so partnerships with local Chinese companies are essential. For example, for home video game consoles, as mentioned above, Nintendo formed a partnership with Tencent, and US Microsoft and Sony Interactive Entertainment setting up a joint venture with the Shanghai City government-affiliated Oriental Pearl Group to launch “Xbox” and “PlayStation” in China, for sales respectively.

China: Major Game Companies

Company name	Main features and trends	Sales (2021)
Tencent	China's largest Internet service provider. Online games are a main pillar of revenue. Armed with a customer base (slightly under 1.3 billion people) built with the “WeChat” messaging app for smartphones, it also provides online advertising, payment services, and cloud services.	560.12 billion yuan (133.3 billion yuan)
NetEase	It is a major online service provider with a portal site as its mainstay. In online gaming, it holds the second largest market share after Tencent. In addition, it operates a variety of businesses, including online education, music streaming, e-commerce, and portal sites.	87.61 billion yuan (62.8 billion yuan)
37 Interactive Entertainment	Headquartered in Anhui province Wuhu. Formerly an auto parts manufacturer, it entered the gaming market in 2011. Since then its main focus has shifted. It has multiple game distribution platforms such as “37Games” and “37Mobile.”	16.22 billion yuan
Zhejiang Century Huatong Group	It started as an auto parts manufacturer but entered the online gaming business in 2014 through the acquisition of Wuxi 7cool Network Technology. In 2019, it made a long-established game development company Shanda Games a subsidiary.	13.93 billion yuan (11.6 billion yuan)
Perfect World	A gaming company based in Beijing. The company's strength lies in its development capabilities, handling a wide range of products including online games, mobile games, and home game consoles. The company's name at the time of its founding was “Perfect world Network Technology,” but changed to the same name as the hit in 2011.	8.52 billion yuan (7.4 billion yuan)

NetDragon Websoft Holdings	A medium-sized online game development company. The company's masterpiece, "Magical Realm," has been called a mega-hit that shook the Chinese MMORPG industry. In the past few years, it has been promoting diversification of its business. It is focusing on the online education business.	7.04 billion yuan (3.6 billion yuan)
Giant network	Online gaming, online finance, and online medical care are the three pillars. Shanghai City based. Listed on the New York Stock Exchange in 2007, but went private in 2014. Once again in 2016, it was listed on the Shenzhen A-share market.	2.13 billion yuan (2.1 billion yuan)

* Sales figures in parentheses are for the gaming division only, all figures without parentheses are for the game business.

(Data compiled by Ashu Research based on each company's website and financial materials)

(Ashu Research: August 2022)