First Read

China Internet Sector

AI downstream application expert call key takeaways

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We hosted an expert call with a former AI Director at a leading short drama/AI animated short drama company, now founder of an AI content firm, with extensive video content and gaming experience. Key takeaways:

Video GenAI competition remains dynamic; world model the next frontier

The expert noted that Seedance 2.5 currently leads in overall quality and generation efficiency (eg, 30s generation, up to 50 multimodal references, and 4K output), while Kling remains differentiated in professional-grade production. **For content producers, model selection is driven by quality, efficiency, and cost.** Premium content favors leading models such as Seedance, whereas mass-production workflows are more receptive to lower-cost alternatives to optimise ROI. Although Seedance is priced higher (Rmb1.8/s vs. Alibaba Wan's Rmb0.2/s), its higher hit rate, typically requiring 1.5-2 generations vs. c.3x for peers, partially narrows the cost gap through better production efficiency. **Seedance now captures a sizable market share, but the competitive landscape remains dynamic.** Switching costs are low for creators, making model capability still the key selection factor. As a result, the key focus is whether next-generation competitors can close the gap with Seedance. According to the expert, the market is awaiting **Kling's next major release**, broadly expected to match or exceed Seedance 2.5-level capabilities. **Seedance and Kling have advantages in proprietary video content datasets**, offering an edge in future model iteration vs. peers. Model providers are also increasingly adopting tiered pricing, combining premium models with lower-cost versions to address both high-end and cost-sensitive demand. Beyond video generation, the expert sees **world models as the next major frontier**. Unlike 2D-focused video models, world models seek to understand, generate, and simulate interactive 3D environments, enabling more AI-native use cases across gaming, virtual worlds, and embodied AI. The expert believes Tencent currently leads with Hunyuan, but the field remains nascent and leadership is unsettled.

AI short drama/anime: early adoption and commercialisation

AI short drama/anime is among **the earliest downstream GenAI content applications to reach broad commercialisation**, benefiting from current video GenAI model capabilities, increasingly standardised production processes, and established monetisation channels. AI-enabled productivity gains have significantly expanded content supply, with leading studios producing thousands of titles per month and industry output reaching tens of thousands of monthly releases. **The expert views the market as gradually moving into a more competitive stage with moderating growth**, as the user base and time spent increasingly approach their limits. Profitability has normalised from early-stage levels, with ROI decreasing from c.1.2x in the initial phase to c.1.05x currently. **By platform**, AI short drama/anime traffic and monetisation remain concentrated on Hongguo/Douyin. As supply continues to increase, creators are likely to prioritise platforms with larger user bases and stronger conversion, further strengthening ByteDance's ecosystem advantage. Looking ahead, the expert views **overseas opportunities** as more attractive vs. the increasingly competitive domestic market, offering a more favorable competitive environment and appealing ROI. IAP monetisation is also more widely accepted, while distribution is more diversified across platforms, creating a more open ecosystem than in the domestic market.

Long form video/gaming: next growth engines for downstream AI applications

The expert is constructive on AI adoption in long-form video and gaming as the next major growth drivers in downstream entertainment. Compared with highly penetrated

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AI short drama/anime, adoption in long-form content and gaming remains early, with value creation extending beyond cost efficiencies to new formats and gameplay innovation, potentially driving incremental user demand. **1) Long-form video: AI's economic impact could be greater in long-form than in short-form content**, given substantially higher production costs and their larger share of project economics. Broader adoption is currently limited by model constraints, eg, character nuance and expressiveness, physical realism, and higher frame-rate and resolution requirements. As these bottlenecks improve, **adoption could accelerate from H226, with more meaningful scaling in 2027**. Longer term, AI penetration in long-form video could reach 70-80%, contingent on continued model and production-quality improvements. **2) Gaming:** Current AI adoption is primarily in interactive movie games (互动影游) and narrative-driven interactive experiences, leveraging existing video generation models. More advanced use cases, such as AI-native games and dynamic AI-generated gameplay, could require further **advances in world models**. AI is already enhancing development efficiency across areas, eg. art design, asset creation, and narrative production. In addition to productivity improvements, AI could support the emergence of **new genres and gameplay innovation, driving incremental demand and potentially broadening the gaming market**. From a competitive landscape perspective, AI is reducing barriers to content creation and enabling smaller teams and independent creators. However, **leading developers are expected to maintain advantages** in talent ecosystems, distribution, full-lifecycle operations, and IP franchise development capabilities.

Stock implications: Prefer AI leaders and downstream beneficiaries

We favor leading AI-exposed names and downstream beneficiaries within the entertainment space. We like **Tencent** (resilient core operations; re-rating catalysts from progress in the AI product cycle), **Kuaishou** (undemanding valuation; potential Kling upgrade catalyst), **NetEase** (earnings resilience from durable evergreen franchises and GPM expansion), and **China Literature** (clean downstream AI beneficiary as AI lowers barriers for literature IP visualisation and monetisation; secular growth in short drama and AI-animated drama). We will monitor AI adoption in **long-form video**, where early signs of progress are gradually emerging, incl. Mango TV's Hou Xi You Ji and iQiyi's growing release of AI mid-form content. Further scaling and improving production quality/economics could drive an industry inflection point.

Valuation Method and Risk Statement

We believe key sector risks include: 1) an evolving competitive landscape and intensifying competition; 2) fast-moving trends in technology, as well as internet users' needs and preferences; 3) uncertain monetisation; 4) the rising cost of traffic acquisition, content and brand promotions; 5) the upkeep of IT systems; 6) expansion into international markets; 7) adverse changes in market sentiment; and 8) regulatory risks. Valuation methods in the sector include SOTP analysis.

