

Tencent (700 HK)

Stepping into investment phase

Tencent delivered 1Q21 results, with revenue/adj. net profit +25% YoY/+22% YoY. Topline beat, while bottom line missed on associate losses. FBS performed well, offsetting VAS deceleration. We believe market has well anticipated game growth to normalize, and focus on key titles pipeline and overseas momentum. Mgmt highlighted the stepping-up investment in new opportunities (e.g. business services, high-production-value games, and short-form video), and guided FY21E earnings growth of 0-22% YoY. We trimmed its earnings by 6%/3%/2% in FY21/22/23E, but maintain our TP at HK\$753.

- **1Q21 topline beat while margin missed.** 1Q21 rev was RMB135.3bn, up 25% YoY, 1%/1% above consensus/our estimate, in which game & ads largely in-line, Fintech beat and social network soft. Non-GAAP net profit grew 22% YoY to RMB33.1bn, 5%/3% below consensus/our estimate, mainly on certain associate losses from investments (e.g. CGB; 7% hit).
- **VAS growth to normalize & ads on track.** Game +17% YoY in 1Q21 (vs. +29% YoY in 4Q20), in which mobile game +19.5% YoY (largely in line with consensus 18-20%, vs. +41% YoY in 4Q20), mainly driven by solid key titles. Tencent announced 60+ new games in pipeline recently. We believe market has well anticipated game growth to normalize for high base, and focus lies on the timeline uncertainty of DnF mobile and LoL. Social network +15% YoY, soft on moderate subs and in-game virtual item sales. Ads +23% YoY in 1Q21 (in line with consensus). By segment, social ads/ media ads +27%/+7% YoY (vs. +25%/+9% YoY in 4Q20). As recent ads headwinds priced in, we suggest to move into stronger Tencent video content in 2H21E.
- **Stepping into investment phase.** Tencent would step up investment in new opportunities (e.g. business services & enterprise software, high-production-value games, and short-form video) and pursue long-term social value. Given the whole sector in investment cycle, we think this strategy should not be surprising. Mgmt guided FY21E earnings growth below 22% YoY in 1Q21, factoring in higher content cost and dynamic investment. We expect new initiatives investment to boost longer-term growth and TAM expansion, especially in global gaming, video content.
- **Maintain BUY.** To reflect margin dilution from investment, we tweaked its earnings by 6%/3%/2% in FY21/22/23E, but maintain our SOTP-based TP at **HK\$753** (implying 34x FY22E P/E). We expect its new game pipeline, video initiatives and new initiatives investment to unlock its secular growth.

Earnings Summary

| (YE 31 Dec) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------|----------|----------|----------|----------|----------|
| Revenue (RMB mn) | 377,289 | 482,064 | 584,135 | 708,058 | 850,900 |
| YoY growth (%) | 20.7 | 27.8 | 21.2 | 21.2 | 20.2 |
| Net income (RMB mn) | 94,351 | 122,742 | 144,538 | 179,282 | 221,837 |
| Adj. EPS (RMB) | 9.7 | 12.7 | 15.1 | 18.6 | 23.0 |
| YoY growth (%) | 22.1 | 30.1 | 17.8 | 24.0 | 23.7 |
| Consensus EPS (RMB) | NA | NA | 15.8 | 19.6 | 23.8 |
| P/E (x) | 52.2 | 40.1 | 33.7 | 27.2 | 22.1 |
| P/B (x) | 11.2 | 6.9 | 6.0 | 5.0 | 4.3 |
| Yield (%) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| ROE (%) | 23.9 | 21.8 | 17.4 | 17.5 | 18.5 |
| Net gearing (%) | Net cash | Net cash | Net cash | Net cash | Net cash |

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$753**
 (Previous TP **HK\$753**)
Up/Downside **+24.5%**
Current Price **HK\$605**

China Internet Sector

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Stock Data

| | |
|--------------------------|--------------|
| Mkt Cap (HK\$ mn) | 5,805,030 |
| Avg 3 mths t/o (HK\$ mn) | 16,250.78 |
| 52w High/Low (HK\$) | 775.5/ 404.0 |
| Total Issued Shares (mn) | 9,595 |

Source: Bloomberg

Shareholding Structure

| | |
|------------|-------|
| Naspers | 28.9% |
| Ma Huateng | 7.4% |
| Vanguard | 2.6% |

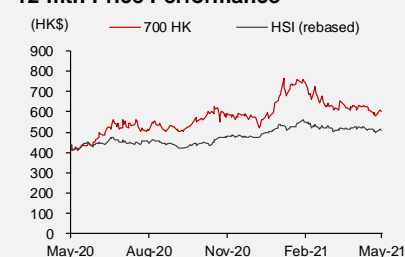
Source: Bloomberg

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -3.1% | -1.4% |
| 3-mth | -18.0% | -12.1% |
| 6-mth | 6.0% | -2.3% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

1. Alert on short-term pressure – 25 Mar 2021
2. Solid 3Q20; Eyes on rich pipeline – 13 Nov 2020
3. Solid 2Q20 with strong mobile game – 13 Aug 2020

Figure 1: 1Q21 financial review

| RMB mn | 1Q19 | 2Q19 | 3Q19 | 4Q19 | 1Q20 | 2Q20 | 3Q20 | 4Q20 | 1Q21 | QoQ | YoY | Consensus | Diff % |
|-------------------|--------|--------|--------|---------|---------|---------|---------|---------|---------|--------|-------|-----------|--------|
| Revenue | 85,465 | 88,821 | 97,236 | 105,767 | 108,065 | 114,883 | 125,447 | 133,669 | 135,303 | 1.2% | 25.2% | 133,754 | 1% |
| Operating Profit | 36,742 | 27,521 | 29,110 | 28,604 | 37,260 | 39,311 | 43,953 | 63,713 | 56,273 | -11.7% | 51.0% | 44,056 | 28% |
| Net profit | 27,210 | 24,136 | 23,004 | 21,582 | 28,896 | 33,107 | 38,542 | 59,302 | 47,767 | -19.5% | 65.3% | 34,397 | 39% |
| Adj. net profit | 20,930 | 23,525 | 24,412 | 25,484 | 27,079 | 30,153 | 32,303 | 33,207 | 33,118 | -0.3% | 22.3% | 34,732 | -5% |
| Adj. EPS | 2.19 | 2.46 | 2.62 | 2.64 | 2.82 | 3.13 | 3.31 | 3.41 | 3.42 | 0.1% | 21.2% | 3.57 | -4% |
| Margin (%) | | | | | | | | | | | | | |
| Gross Margin | 46.6% | 44.1% | 46.0% | 45.0% | 48.9% | 46.3% | 45.2% | 44.0% | 46.3% | | | 46.5% | |
| Operating Margin | 43.0% | 31.0% | 29.9% | 21.4% | 34.5% | 34.2% | 35.0% | 47.7% | 41.6% | | | 32.9% | |
| Adj. net margin | 24.5% | 26.5% | 25.1% | 19.1% | 25.1% | 26.2% | 25.8% | 24.8% | 24.5% | | | 26.0% | |
| Growth (%) | | | | | | | | | | | | | |
| Revenue (YoY) | 16.2% | 20.6% | 20.6% | 24.6% | 26.4% | 29.3% | 29.0% | 26.4% | 25.2% | | | 23.8% | |
| Revenue (QoQ) | 0.7% | 3.9% | 9.5% | 8.8% | 2.2% | 6.3% | 9.2% | 6.6% | 1.2% | | | 0.1% | |
| Operating Profit | 19.7% | 26.2% | 4.5% | 65.5% | 1.4% | 42.8% | 51.0% | 122.7% | 51.0% | | | 18.2% | |
| Adj. net profit | 14.3% | 19.3% | 23.9% | 29.2% | 29.4% | 28.2% | 32.3% | 30.3% | 22.3% | | | 28.3% | |

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

| RMB mn | 1Q19 | 2Q19 | 3Q19 | 4Q19 | 1Q20 | 2Q20 | 3Q20 | 4Q20 | 1Q21 | QoQ | YoY |
|----------------------|---------------|---------------|---------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------|------------|
| Total revenue | 85,465 | 88,821 | 97,236 | 105,767 | 108,065 | 114,883 | 125,447 | 133,669 | 135,303 | 1% | 25% |
| VAS | 48,974 | 48,080 | 50,629 | 52,308 | 62,429 | 65,002 | 69,802 | 66,979 | 72,443 | 8% | 16% |
| - Online games | 28,513 | 27,307 | 28,604 | 30,286 | 37,298 | 38,288 | 41,422 | 39,100 | 43,600 | 12% | 17% |
| - Social network | 20,461 | 20,773 | 22,025 | 22,022 | 25,131 | 26,714 | 28,380 | 27,879 | 28,843 | 3% | 15% |
| Online advertising | 13,377 | 16,409 | 18,366 | 20,225 | 17,713 | 18,552 | 21,351 | 24,655 | 21,820 | -11% | 23% |
| Others | 23,114 | 24,332 | 28,241 | 33,234 | 27,923 | 31,329 | 34,294 | 42,035 | 41,040 | -2% | 47% |

Source: Company data

Figure 3: CMBIS estimates vs. consensus

| RMB mn, Dec-YE | CMBIS | | | Consensus | | | Diff (%) | | |
|------------------|---------|---------|---------|-----------|---------|---------|----------|----------|----------|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Revenue | 584,135 | 708,058 | 850,900 | 590,532 | 710,828 | 835,096 | -1.1% | -0.4% | 1.9% |
| Gross Profit | 260,466 | 314,064 | 374,531 | 269,063 | 324,360 | 382,205 | -3.2% | -3.2% | -2.0% |
| Operating Profit | 210,791 | 250,538 | 299,341 | 185,115 | 226,022 | 270,101 | 13.9% | 10.8% | 10.8% |
| Net profit | 144,538 | 179,282 | 221,837 | 154,529 | 190,616 | 229,372 | -6.5% | -5.9% | -3.3% |
| Adj. EPS (RMB) | 15.07 | 18.65 | 23.02 | 15.81 | 19.62 | 23.81 | -4.7% | -4.9% | -3.3% |
| Gross Margin | 44.6% | 44.4% | 44.0% | 45.6% | 45.6% | 45.8% | -1.0ppts | -1.3ppts | -1.8ppts |
| Operating Margin | 36.1% | 35.4% | 35.2% | 31.3% | 31.8% | 32.3% | +4.7ppts | +3.6ppts | +2.8ppts |
| Net Margin | 24.7% | 25.3% | 26.1% | 26.2% | 26.8% | 27.5% | -1.4ppts | -1.5ppts | -1.4ppts |

Source: CMBIS estimates, Bloomberg

Figure 4: Earnings revision

| RMB mn, Dec-YE | New | | | Old | | | Diff (%) | | |
|------------------|---------|---------|---------|---------|---------|---------|----------|----------|----------|
| | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E | FY21E | FY22E | FY23E |
| Revenue | 584,135 | 708,058 | 850,900 | 583,051 | 712,876 | 862,549 | 0.2% | -0.7% | -1.4% |
| Gross Profit | 260,466 | 314,064 | 374,531 | 261,879 | 315,605 | 381,045 | -0.5% | -0.5% | -1.7% |
| Operating Profit | 210,791 | 250,538 | 299,341 | 223,441 | 263,291 | 313,698 | -5.7% | -4.8% | -4.6% |
| Adj. net profit | 144,538 | 179,282 | 221,837 | 153,836 | 184,888 | 225,296 | -6.0% | -3.0% | -1.5% |
| EPS (RMB) | 15.07 | 18.65 | 23.02 | 16.04 | 19.23 | 23.38 | -6.0% | -3.0% | -1.5% |
| Gross Margin | 44.6% | 44.4% | 44.0% | 44.9% | 44.3% | 44.2% | -0.3ppts | +0.1ppts | -0.2ppts |
| Operating Margin | 36.1% | 35.4% | 35.2% | 38.3% | 36.9% | 36.4% | -2.2ppts | -1.5ppts | -1.2ppts |
| Net Margin | 24.7% | 25.3% | 26.1% | 26.4% | 25.9% | 26.1% | -1.6ppts | -0.6ppts | -0.0ppts |

Source: Company data, CMBIS estimates

Figure 5: SOTP Valuation

| SOTP | Valuation (HK\$ bn) | HK\$/Share | Implied FY22P/E |
|------------------------|----------------------------|-------------------|------------------------|
| Core business | 6,024 | 629 | 28.6x |
| Unlisted associates | 128 | 13 | |
| JD | 224 | 23 | |
| 58.com | 24 | 2 | |
| Meituan | 473 | 49 | |
| PDD | 336 | 35 | |
| Total Valuation | 7,208 | 753 | 33.9x |

Source: CMBIS estimates, Bloomberg, CMBIS estimates

Financial Summary

Income statement

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|-------------------------|------------------|------------------|------------------|------------------|------------------|
| Revenue | 377,289 | 482,064 | 584,135 | 708,058 | 850,900 |
| VAS | 199,991 | 264,212 | 303,283 | 351,845 | 405,176 |
| Ads | 68,377 | 82,271 | 100,016 | 120,612 | 142,843 |
| E-commerce | - | - | - | - | - |
| Others | 108,921 | 135,581 | 180,837 | 235,602 | 302,880 |
| COGS | (209,756) | (260,532) | (323,669) | (393,995) | (476,368) |
| Gross profit | 167,533 | 221,532 | 260,466 | 314,064 | 374,531 |
| S&M | (21,396) | (33,758) | (40,889) | (44,608) | (45,298) |
| Admin.Exp. | (53,446) | (67,625) | (76,426) | (90,323) | (105,288) |
| Interest income | 6,314 | 6,957 | 7,653 | 8,418 | 9,260 |
| Others | 19,689 | 57,131 | 59,988 | 62,987 | 66,136 |
| Operating profit | 118,694 | 184,237 | 210,791 | 250,538 | 299,341 |
| Financial cost | (7,613) | (7,887) | (7,887) | (7,887) | (6,983) |
| Associates | (2,578) | - | - | - | - |
| Pre-tax Income | 109,400 | 180,022 | 205,104 | 246,171 | 296,160 |
| Income Tax | (13,512) | (19,897) | (34,868) | (41,849) | (50,347) |
| MI | (2,578) | - | - | - | - |
| Net profit | 93,310 | 159,847 | 169,941 | 203,967 | 245,386 |
| Adj. net profit | 94,351 | 122,742 | 144,538 | 179,282 | 221,837 |

Cash flow summary

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------|------------------|------------------|------------------|------------------|------------------|
| Net income | 93,310 | 159,847 | 169,941 | 203,967 | 245,386 |
| D&A | 13,539 | 17,923 | 20,431 | 23,448 | 26,853 |
| Change in WC | 8,972 | 12,843 | 16,929 | 19,566 | 22,203 |
| Income tax paid | (2,735) | 166 | 9,130 | 4,257 | 5,183 |
| Others | 35,504 | 3,340 | 69,468 | 75,479 | 82,144 |
| Operating CF | 148,590 | 194,119 | 285,899 | 326,718 | 381,769 |
| Capex | (32,369) | (33,960) | (41,151) | (48,634) | (56,984) |
| Associates | (43,669) | (48,036) | (52,839) | (63,407) | (76,089) |
| Others | (40,132) | (99,959) | (13,175) | (12,410) | (11,568) |
| Investing CF | (116,170) | (181,955) | (107,165) | (124,451) | (144,641) |
| Equity raised | 0 | 0 | 0 | 0 | 0 |
| Change of Debts | 40,800 | 0 | 0 | 0 | 0 |
| Others | (39,128) | 13,647 | (25,648) | (29,122) | (37,179) |
| Financing CF | 1,672 | 13,647 | (25,648) | (29,122) | (37,179) |
| Net change in cash | 34,092 | 25,811 | 153,086 | 173,145 | 199,950 |
| Cash (beg of yr) | 97,814 | 132,991 | 152,798 | 305,884 | 479,029 |
| FX | 1,085 | (6,004) | 0 | 0 | 0 |
| Cash (end of yr) | 132,991 | 152,798 | 305,884 | 479,029 | 678,979 |

Balance sheet

| YE 31 Dec (RMB mn) | FY19A | FY20A | FY21E | FY22E | FY23E |
|--------------------------------|----------------|------------------|------------------|------------------|------------------|
| Non-current assets | 700,018 | 1,015,778 | 1,120,282 | 1,243,072 | 1,387,867 |
| Fixed asset | 77,215 | 93,802 | 120,908 | 152,481 | 188,999 |
| Associates | 221,894 | 305,258 | 305,258 | 305,258 | 305,258 |
| Intangible assets | 128,860 | 159,437 | 146,663 | 133,889 | 121,115 |
| Others | 272,049 | 457,281 | 547,453 | 651,443 | 772,495 |
| Current assets | 253,968 | 317,647 | 489,329 | 685,050 | 911,022 |
| Cash | 132,991 | 152,798 | 305,884 | 479,029 | 678,979 |
| Deposit over 3 months | 46,911 | 68,487 | 68,487 | 68,487 | 68,487 |
| Account receivable | 35,839 | 44,981 | 54,505 | 66,068 | 79,397 |
| Others | 38,227 | 51,381 | 60,452 | 71,465 | 84,159 |
| Current liabilities | 240,156 | 269,079 | 400,558 | 554,889 | 743,250 |
| Borrowings | 22,695 | 14,242 | 14,242 | 14,242 | 14,242 |
| Account payable | 80,690 | 94,030 | 116,817 | 142,199 | 171,929 |
| Tax payable | 10,978 | 14,283 | 23,413 | 27,670 | 32,853 |
| Other | 125,793 | 146,524 | 246,087 | 370,778 | 524,227 |
| Non-current liabilities | 225,006 | 286,303 | 298,648 | 304,537 | 301,391 |
| Borrowings | 104,257 | 112,145 | 112,145 | 112,145 | 112,145 |
| Deferred taxation | 12,841 | 16,061 | 28,145 | 33,781 | 40,641 |
| Others | 107,908 | 158,097 | 158,357 | 158,611 | 148,605 |
| MI | 56,118 | 74,059 | 86,658 | 101,725 | 119,387 |
| Total net assets | 488,824 | 778,043 | 910,405 | 1,068,696 | 1,254,248 |
| Shareholders' equity | 432,706 | 703,984 | 823,747 | 966,971 | 1,134,861 |

Key ratios

| YE 31 Dec | FY19A | FY20A | FY21E | FY22E | FY23E |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| Sales mix (%) | | | | | |
| VAS | 53.0 | 54.8 | 51.9 | 49.7 | 47.6 |
| Ads | 18.1 | 17.1 | 17.1 | 17.0 | 16.8 |
| E-commerce | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Others | 28.9 | 28.1 | 31.0 | 33.3 | 35.6 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Growth rate (%) | | | | | |
| Revenue | 20.7 | 27.8 | 21.2 | 21.2 | 20.2 |
| Gross profit | 17.9 | 32.2 | 17.6 | 20.6 | 19.3 |
| EBIT | 21.6 | 55.2 | 14.4 | 18.9 | 19.5 |
| Net profit | 22.1 | 30.1 | 17.8 | 24.0 | 23.7 |
| P&L ratios (%) | | | | | |
| Operating margin | 31.5 | 38.2 | 36.1 | 35.4 | 35.2 |
| Pre-tax margin | 29.0 | 37.3 | 35.1 | 34.8 | 34.8 |
| Adj. net margin | 25.0 | 25.5 | 24.7 | 25.3 | 26.1 |
| Effective tax rate | (3.6) | (4.1) | (6.0) | (5.9) | (5.9) |
| Returns (%) | | | | | |
| ROE | 23.9 | 21.8 | 17.4 | 17.5 | 18.5 |
| ROA | 10.7 | 9.9 | 9.2 | 9.0 | 9.3 |
| Per share | | | | | |
| EPS (RMB) | 9.7 | 12.7 | 15.1 | 18.6 | 23.0 |
| DPS (RMB) | 1.4 | 2.5 | 2.8 | 3.6 | 4.6 |
| BVPS (RMB) | 45.2 | 73.3 | 85.4 | 100.8 | 118.1 |

Source: Company data, CMBIS estimates

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| | |
|-----------------------|---|
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