

# Tencent (700 HK)

## Alert on short-term pressure

Tencent delivered largely in-line 4Q20 results, with revenue/adj. net profit +26% YoY/+30% YoY, 0%/2% above consensus. Ads & FBS performed well, while mobile game decelerated. We expect ads to accelerate in 1Q21E, and long-term game upside from new key titles & overseas intact. *Video Accounts* and mini program in WeChat ecosystem could further unlock its TAM. But in the short run, stock price might see pressure from game deceleration, regulation headwinds and weak market sentiment. We keep our financial forecast unchanged, but lifted our SOTP-based TP to HK\$735 from HK\$669 by rolling over to FY22E multiple.

- **4Q20 largely in-line.** 4Q20 revenue was RMB133.7bn, up 26% YoY, 0%/1% above consensus/our estimate, mainly on strong ads and FBS. Non-GAAP net profit grew 30% YoY to RMB33.2bn, 2%/0% above consensus/our estimate. We view this result as largely in-line, in which ads and FBS saw strong momentum, partly offset by moderate game growth. Regarding regulations on Fintech and Antitrust, mgmts. showed active cooperation with government to promote healthy competition landscape.
- **Game deceleration ahead.** Game +29% YoY in 4Q20 (vs. +45% in 3Q20), in which mobile game +41% YoY (slightly below consensus of +45% YoY). We are impressed by its international games performance (+43% YoY, accounting for 25% of total games). 1Q21E game might still see deceleration given high base and traffic normalization (deferred rev -3% QoQ). But in the long run, we are positive on its game momentum, backed by: 1) overseas contribution; and 2) new games to bring upside (e.g. DnF Mobile, LoL).
- **Ads to accelerate; eyes on video initiatives.** Ads accelerated to +22% YoY in 4Q20 (vs. +16% YoY in 3Q20), in which social ads/ media ads +25%/+9% YoY (vs. +21%/-1% YoY in 3Q20). We view the ads growth above street estimates, and expect 1Q21E ads to accelerate (+26% YoY), driven by popular drama series of Tencent video, recovering brand ads sentiment and video ads trend. We are bullish on *Video Accounts* potential for its deeper penetration and sizeable users, while monetization would be conservative at this stage, per mgmt.
- **Maintain BUY.** We keep our financials unchanged, but lifted our SOTP-based TP to **HK\$735** (implying 32x FY22E P/E) by rolling over to FY22E multiple. We expect its new game pipeline, video initiatives in WeChat ecosystem to unlock its secular growth.

### Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	583,051	712,876	862,549
YoY growth (%)	20.7	27.8	20.9	22.3	21.0
Net income (RMB mn)	94,351	122,742	153,836	184,888	225,296
Adj. EPS (RMB)	9.7	12.7	16.0	19.2	23.4
YoY growth (%)	22.1	30.1	25.3	20.2	21.9
Consensus EPS (RMB)	NA	NA	16.2	19.7	25.1
P/E (x)	53.8	41.3	32.6	27.2	22.4
P/B (x)	11.6	7.1	6.1	5.1	4.3
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	23.9	21.8	17.4	18.4	18.8
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

### BUY (Maintain)

Target Price	HK\$735
(Previous TP	HK\$669)
Up/Downside	+17.8%
Current Price	HK\$624

### China Internet Sector

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### Stock Data

Mkt Cap (HK\$ mn)	6,039,753
Avg 3 mths t/o (HK\$ mn)	17,606.23
52w High/Low (HK\$)	775.5/ 340.2
Total Issued Shares (mn)	9,595

Source: Bloomberg

### Shareholding Structure

Naspers	30.9%
Ma Huateng	7.4%
Vanguard	2.7%

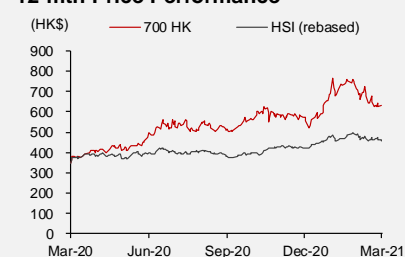
Source: Bloomberg

### Share Performance

	Absolute	Relative
1-mth	-11.2%	-6.8%
3-mth	10.7%	0.1%
6-mth	23.9%	1.7%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: PwC

### Related Reports

1. Solid 3Q20; Eyes on rich pipeline – 13 Nov 2020
2. Solid 2Q20 with strong mobile game – 13 Aug 2020
3. Eye-catching 1Q20 with strong game & social ads – 14 May 2020

**Figure 1: 4Q20 financial review**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY	Consensus	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	6.6%	26.4%	133,068	0%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	45.0%	122.7%	40,119	59%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	53.9%	174.8%	32,893	80%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	2.8%	30.3%	32,645	2%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.0%	29.1%	3.52	-3%
<b>Margin (%)</b>												
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%			44.8%	
Operating Margin	43.0%	31.0%	29.9%	21.5%	34.5%	34.2%	35.0%	47.7%			30.1%	
Adj. net margin	24.5%	26.5%	25.1%	19.2%	25.1%	26.2%	25.8%	24.8%			24.5%	
<b>Growth (%)</b>												
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%			25.8%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%			6.1%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%			40.3%	
Adj. net Profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%			28.1%	

Source: Company data, Bloomberg, CMBIS estimates

**Figure 2: Revenue breakdown**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	QoQ	YoY
<b>Total revenue</b>	<b>85,465</b>	<b>88,821</b>	<b>97,236</b>	<b>105,767</b>	<b>108,065</b>	<b>114,883</b>	<b>125,447</b>	<b>133,669</b>	<b>7%</b>	<b>26%</b>
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	-4%	28%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	-6%	29%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	-2%	27%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	15%	22%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	23%	26%

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	583,051	712,876	862,549	595,321	713,118	857,978	-2.1%	0.0%	0.5%
Gross Profit	261,879	315,605	381,045	273,519	326,476	400,506	-4.3%	-3.3%	-4.9%
Operating Profit	223,441	263,291	313,698	184,673	222,608	287,326	21.0%	18.3%	9.2%
Net profit	153,836	184,888	225,296	159,184	192,518	242,204	-3.4%	-4.0%	-7.0%
Adj. EPS (RMB)	16.04	19.23	23.38	16.23	19.71	25.06	-1.2%	-2.4%	-6.7%
Gross Margin	44.9%	44.3%	44.2%	45.9%	45.8%	46.7%	-1.0ppts	-1.5ppts	-2.5ppts
Operating Margin	38.3%	36.9%	36.4%	31.0%	31.2%	33.5%	+7.3ppts	+5.7ppts	+2.9ppts
Net Margin	26.4%	25.9%	26.1%	26.7%	27.0%	28.2%	-0.4ppts	-1.1ppts	-2.1ppts

Source: CMBIS estimates, Bloomberg

**Figure 4: SOTP Valuation**

SOTP	Valuation (HK\$ bn)	HK\$/Share	Implied FY22P/E
Core business	5,828	609	26.6x
Unlisted associates	128	13	
JD	252	26	
58.com	24	2	
Meituan	473	49	
PDD	336	35	
<b>Total Valuation</b>	<b>7,040</b>	<b>735</b>	<b>32.1x</b>

Source: CMBIS estimates, Bloomberg, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Revenue</b>	<b>377,289</b>	<b>482,064</b>	<b>583,051</b>	<b>712,876</b>	<b>862,549</b>
VAS	199,991	264,212	295,390	348,219	406,507
Ads	68,377	82,271	102,650	123,748	146,508
E-commerce	-	-	-	-	-
Others	108,921	135,581	185,011	240,910	309,534
<b>COGS</b>	<b>(209,756)</b>	<b>(260,532)</b>	<b>(321,172)</b>	<b>(397,271)</b>	<b>(481,504)</b>
<b>Gross profit</b>	<b>167,533</b>	<b>221,532</b>	<b>261,879</b>	<b>315,605</b>	<b>381,045</b>
S&M	(21,396)	(33,758)	(32,651)	(38,923)	(45,918)
Admin.Exp.	(53,446)	(67,625)	(76,284)	(90,938)	(106,730)
Interest income	6,314	6,957	7,653	8,418	9,260
Others	19,689	57,131	62,844	69,129	76,041
<b>Operating profit</b>	<b>118,694</b>	<b>184,237</b>	<b>223,441</b>	<b>263,291</b>	<b>313,698</b>
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
<b>Pre-tax Income</b>	<b>109,400</b>	<b>180,022</b>	<b>219,814</b>	<b>260,174</b>	<b>311,868</b>
Income Tax	(13,512)	(19,897)	(37,368)	(44,230)	(53,018)
MI	(2,578)	-	-	-	-
<b>Net profit</b>	<b>93,310</b>	<b>159,847</b>	<b>182,129</b>	<b>215,570</b>	<b>258,401</b>
<b>Adj. net profit</b>	<b>94,351</b>	<b>122,742</b>	<b>153,836</b>	<b>184,888</b>	<b>225,296</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Net income</b>	<b>93,310</b>	<b>159,847</b>	<b>182,129</b>	<b>215,570</b>	<b>258,401</b>
D&A	13,539	17,923	20,431	23,433	26,907
Change in WC	8,972	12,843	30,495	26,922	29,291
Income tax paid	(2,735)	166	10,655	4,184	5,359
Others	35,504	3,340	72,314	81,786	92,421
<b>Operating CF</b>	<b>148,590</b>	<b>194,119</b>	<b>316,023</b>	<b>351,895</b>	<b>412,380</b>
Capex	(32,369)	(33,960)	(41,074)	(48,965)	(57,764)
Associates	(43,669)	(48,036)	(52,839)	(63,407)	(76,089)
Others	(40,132)	(99,959)	(13,175)	(12,410)	(11,568)
<b>Investing CF</b>	<b>(116,170)</b>	<b>(181,955)</b>	<b>(107,089)</b>	<b>(124,782)</b>	<b>(145,421)</b>
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(31,211)	(39,294)
<b>Financing CF</b>	<b>1,672</b>	<b>13,647</b>	<b>(25,648)</b>	<b>(31,211)</b>	<b>(39,294)</b>
<b>Net change in cash</b>	<b>34,092</b>	<b>25,811</b>	<b>183,287</b>	<b>195,903</b>	<b>227,665</b>
Cash (beg of yr)	97,814	132,991	152,798	336,085	531,987
FX	1,085	(6,004)	0	0	0
<b>Cash (end of yr)</b>	<b>132,991</b>	<b>152,798</b>	<b>336,085</b>	<b>531,987</b>	<b>759,652</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Non-current assets</b>	<b>700,018</b>	<b>1,015,778</b>	<b>1,134,713</b>	<b>1,269,569</b>	<b>1,429,481</b>
Fixed asset	77,215	93,802	120,832	152,750	189,994
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	561,960	677,671	813,114
<b>Current assets</b>	<b>253,968</b>	<b>317,647</b>	<b>519,331</b>	<b>738,886</b>	<b>993,817</b>
Cash	132,991	152,798	336,085	531,987	759,652
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	54,404	66,518	80,484
Others	38,227	51,381	60,356	71,893	85,195
<b>Current liabilities</b>	<b>240,156</b>	<b>269,079</b>	<b>432,092</b>	<b>613,839</b>	<b>836,339</b>
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	115,916	143,381	173,782
Tax payable	10,978	14,283	24,938	29,122	34,481
Other	125,793	146,524	276,996	427,093	613,834
<b>Non-current liabilities</b>	<b>225,006</b>	<b>286,303</b>	<b>300,193</b>	<b>305,998</b>	<b>303,093</b>
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	30,164	35,702	42,796
Others	107,908	158,097	157,884	158,150	148,152
MI	56,118	74,059	87,739	103,621	122,206
Total net assets	488,824	778,043	921,760	1,088,618	1,283,866
<b>Shareholders' equity</b>	<b>432,706</b>	<b>703,984</b>	<b>834,021</b>	<b>984,996</b>	<b>1,161,660</b>

### Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
<b>Sales mix (%)</b>					
VAS	53.0	54.8	50.7	48.8	47.1
Ads	18.1	17.1	17.6	17.4	17.0
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.9	28.1	31.7	33.8	35.9
<b>Total</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>
<b>Growth rate (%)</b>					
Revenue	20.7	27.8	20.9	22.3	21.0
Gross profit	17.9	32.2	18.2	20.5	20.7
EBIT	21.6	55.2	21.3	17.8	19.1
Net profit	22.1	30.1	25.3	20.2	21.9
<b>P&amp;L ratios (%)</b>					
Operating margin	31.5	38.2	38.3	36.9	36.4
Pre-tax margin	29.0	37.3	37.7	36.5	36.2
Adj. net margin	25.0	25.5	26.4	25.9	26.1
Effective tax rate	(3.6)	(4.1)	(6.4)	(6.2)	(6.1)
<b>Returns (%)</b>					
ROE	23.9	21.8	17.4	18.4	18.8
ROA	10.7	9.9	9.2	9.3	9.2
<b>Per share</b>					
EPS (RMB)	9.7	12.7	16.0	19.2	23.4
DPS (RMB)	1.4	2.5	3.0	3.8	4.8
BVPS (RMB)	45.2	73.3	86.4	102.7	120.8

Source: Company data, CMBIS estimates

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