

Tencent (700 HK)

Solid 2Q20 with strong mobile game

Tencent delivered upbeat 2Q20 results, with revenue/adj. net profit +29% YoY/+28% YoY, 2%/3% above consensus. Mobile game momentum continued, with 62% YoY growth. We keep bullish on its mobile game momentum with globalization and upcoming strong pipeline. We expect limited impact from US ban on Wechat (< 2%) and mobile DNF delay. We raised its EPS by 6%/5%/5% in FY20/21/22E for stronger game, and lifted our TP to HK\$624 from HK\$500 (coupled with higher sector multiple and investment valuation). Maintain BUY.

- 2Q20 beat.** 2Q20 revenue was RMB114.9bn, up 29% YoY, 2%/2% above consensus/our estimate, mainly on strong mobile games. Non-GAAP net profit grew 28% YoY to RMB30.2bn, 3%/1% above consensus/our estimate. We are impressed by its continuous game momentum (+40% YoY), and keep confident on its growth in 2H20E. US market contributes < 2% of total revenue per mgmt., suggesting minimal impact from US ban.
- Strong game to continue.** Game surged 40% YoY in 2Q20 (vs. +31% in 1Q20), in which mobile game +62% YoY (higher than consensus of ~50% YoY), mainly driven by strong key titles (e.g. HoK, PUBG Mobile) and increasing overseas contribution. Despite mobile DNF delay, we keep positive on its game momentum in 2H20E (forecasting mobile game +45% YoY in 3Q20E), considering 1) overseas contribution and rising time spent due to global COVID-19; 2) deferred rev from solid key titles (deferred rev +68% YoY in 2Q20); and 3) new titles to bring further upside.
- Looking beyond soft 2Q20 ads.** Ads slowed down to 13% YoY in 2Q20 (below consensus of 18%-20% YoY, vs. 32% in 1Q20). By segment, social ads/ media ads +27%/-25% YoY (vs. +47% YoY/-10% YoY in 1Q20). The softer-than-expected ads was mainly due to weak brand ads demand amid challenging macro, delayed video content and game S&M normalization. However, we expect its 3Q20E ads to pick up, with popular drama series (e.g. Nothing but Thirty <三十而已>), and integrated ad platform.
- Maintain BUY.** We raised its EPS by 6%/5%/5% in FY20/21/22E, and lifted our SOTP-based TP from HK\$500 to **HK\$624**. Our new TP is equivalent to 35x FY21E P/E. Tencent could be more defensive under COVID-19 impact, and we expect its strong mobile games, new initiatives expansion and mini-programs potential to unlock its secular growth.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	312,694	377,289	480,072	591,876	723,980
YoY growth (%)	31.5	20.7	27.2	23.3	22.3
Net income (RMB mn)	77,296	93,637	121,756	153,181	185,802
Adj. EPS (RMB)	8.1	9.8	12.7	16.0	19.3
YoY growth (%)	18.7	21.1	30.0	25.8	21.3
Consensus EPS (RMB)	NA	NA	12.4	15.4	18.7
P/E (x)	57.7	47.5	36.7	29.2	24.1
P/B (x)	13.7	11.3	9.1	7.4	6.1
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	25.4	23.9	23.8	24.9	25.5
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$624
(Previous TP)	HK\$500
Up/Downside	+19.9%
Current Price	HK\$520

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,920,055
Avg 3 mths t/o (HK\$ mn)	11,310
52w High/Low (HK\$)	564/312
Total Issued Shares (mn)	9,582

Source: Bloomberg

Shareholding Structure

Naspers	30.9%
Ma Huateng	8.4%
JP Morgan	4.4%

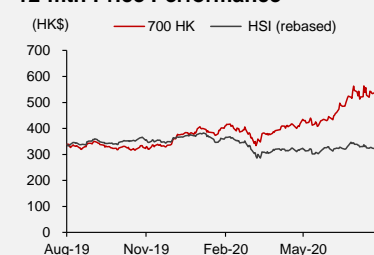
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-8.1%	-3.1%
3-mth	20.0%	19.3%
6-mth	25.3%	40.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 2Q20 financial review

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	85,465	88,821	96,830	105,767	108,065	114,883	6.3%	29.3%	112,439	2%	112,322	2%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	5.5%	42.8%	34,962	12%	34,774	13%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	14.6%	37.2%	27,291	21%	29,540	12%
Adj. net profit	20,930	23,525	24,898	25,484	27,079	30,153	11.4%	28.2%	29,172	3%	29,735	1%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	11.1%	27.2%	3.01	4%	3.10	1%
Margin (%)												
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%			46.0%		44.0%	
Operating Margin	43.0%	31.0%	30.1%	25.4%	34.5%	34.2%			31.1%		31.0%	
Adj. net margin	24.5%	26.5%	25.7%	22.7%	25.1%	26.2%			25.9%		26.5%	
Growth (%)												
Revenue (YoY)	16.2%	20.6%	20.1%	24.6%	26.4%	29.3%			26.6%		26.5%	
Revenue (QoQ)	0.7%	3.9%	9.0%	9.2%	2.2%	6.3%			4.0%		3.9%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%			27.0%		26.4%	
Adj. net Profit	14.3%	19.3%	26.3%	29.2%	29.4%	28.2%			24.0%		26.4%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	QoQ	YoY
Total revenue	85,465	88,821	96,830	105,767	108,065	114,883	6%	29%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	4%	35%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	3%	40%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	6%	29%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	5%	13%
Others	23,114	24,332	28,241	33,234	27,923	31,329	12%	29%

Source: Company data

Figure 3: CMBIS estimates vs consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	480,072	591,876	723,980	475,247	584,084	701,346	1.0%	1.3%	3.2%
Gross Profit	219,788	265,296	319,996	217,284	263,742	306,265	1.2%	0.6%	4.5%
Operating Profit	156,328	189,132	226,220	145,587	176,070	210,966	7.4%	7.4%	7.2%
Net profit	121,756	153,181	185,802	121,224	151,718	183,346	0.4%	1.0%	1.3%
Adj. EPS (RMB)	12.70	15.97	19.33	12.40	15.39	18.70	2.4%	3.8%	3.3%
Gross Margin	45.8%	44.8%	44.2%	45.7%	45.2%	43.7%	+0.1ppts	-0.3ppts	+0.5ppts
Operating Margin	32.6%	32.0%	31.2%	30.6%	30.1%	30.1%	+1.9ppts	+1.8ppts	+1.2ppts
Net Margin	25.4%	25.9%	25.7%	25.5%	26.0%	26.1%	-0.1ppts	-0.1ppts	-0.5ppts

Source: CMBIS estimates, Bloomberg

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E	FY20E	FY21E	FY22E
Revenue	480,072	591,876	723,980	470,520	577,506	703,947	2.0%	2.5%	2.8%
Gross Profit	219,788	265,296	319,996	211,104	254,922	306,173	4.1%	4.1%	4.5%
Operating Profit	156,328	189,132	226,220	148,669	181,379	215,959	5.2%	4.3%	4.8%
Net profit	121,756	153,181	185,802	115,112	146,309	176,681	5.8%	4.7%	5.2%
Adj. EPS (RMB)	12.70	15.97	19.33	12.01	15.26	18.38	5.8%	4.7%	5.2%
Gross Margin	45.8%	44.8%	44.2%	44.8%	43.5%	42.7%	+1.0ppts	+1.3ppts	+1.5ppts
Operating Margin	32.6%	32.0%	31.2%	32.1%	31.2%	30.3%	+0.5ppts	+0.8ppts	+1.0ppts
Net Margin	25.4%	25.9%	25.7%	24.3%	24.2%	23.9%	+1.0ppts	+1.7ppts	+1.7ppts

Source: Company data, CMBIS estimates

Figure 5: SOTP Valuation

SOTP	Valuation (HK\$ bn)	HK\$/Share	Implied FY21 P/E
Core business	5,352	559	32x
Unlisted associates	120	13	
JD	128	13	
58.com	20	2	
Meituan	218	23	
PDD	137	14	
Total Valuation	5,976	624	35x

Source: CMBIS estimates, Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	312,694	377,289	480,072	591,876	723,980
VAS	176,646	199,991	255,487	297,918	351,609
Ads	58,079	68,377	83,022	103,915	125,300
E-commerce	-	-	-	-	-
Others	77,969	108,921	141,564	190,043	247,071
COGS	(170,574)	(209,756)	(260,285)	(326,581)	(403,984)
Gross profit	142,120	167,533	219,788	265,296	319,996
S&M	(24,233)	(21,396)	(26,898)	(30,486)	(36,358)
Admin.Exp.	(41,522)	(53,446)	(65,435)	(77,438)	(92,354)
Interest income	4,569	6,314	7,036	7,740	8,514
Others	16,714	19,689	21,837	24,021	26,423
Operating profit	97,648	118,694	156,328	189,132	226,220
Financial cost	(4,669)	(7,613)	(6,736)	(6,736)	(6,736)
Associates	(1,265)	(2,578)	-	-	-
Pre-tax Income	94,466	109,400	153,061	186,420	223,991
Income Tax	(14,482)	(13,512)	(25,912)	(31,691)	(38,079)
MI	(1,265)	(2,578)	-	-	-
Net profit	78,719	93,310	126,642	154,112	185,171
Adj. net profit	77,296	93,637	121,756	153,181	185,802

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	78,719	93,310	126,642	154,112	185,171
D&A	34,248	13,539	16,888	20,942	25,470
Change in WC	4,687	11,746	22,156	25,166	29,036
Income tax paid	(58)	(2,942)	8,742	4,074	4,503
Others	(11,153)	25,767	29,178	33,968	39,684
Operating CF	106,443	141,420	203,607	238,263	283,865
Capex	(22,151)	(32,369)	(42,070)	(51,868)	(61,859)
Associates	(39,699)	(43,669)	(48,036)	(52,839)	(63,407)
Others	(90,063)	(14,514)	(13,792)	(13,088)	(12,314)
Investing CF	(151,913)	(90,552)	(103,898)	(117,796)	(137,580)
Equity raised	525	0	0	0	0
Change of Debts	37,842	40,800	0	0	0
Others	(2,987)	(10,912)	(13,953)	(20,320)	(26,409)
Financing CF	35,380	29,888	(13,953)	(20,320)	(26,409)
Net change in cash	(10,090)	80,756	85,755	100,147	119,875
Cash (beg of yr)	105,697	97,814	178,570	264,326	364,473
FX	2,207	0	0	0	0
Cash (end of yr)	97,814	178,570	264,326	364,473	484,348

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	506,441	543,193	594,463	663,118	745,766
Fixed asset	47,076	67,188	93,702	129,980	171,720
Associates	219,215	213,614	213,614	213,614	213,614
Intangible assets	56,650	50,237	39,533	28,829	18,125
Others	183,500	212,154	247,614	290,695	342,308
Current assets	217,080	293,262	395,601	513,571	654,506
Cash	97,814	178,373	264,326	364,473	484,348
Deposit over 3 months	62,918	46,911	46,911	46,911	46,911
Account receivable	28,427	34,299	43,643	53,807	65,817
Others	27,921	33,679	40,721	48,380	57,430
Current liabilities	202,435	183,187	223,939	283,128	358,307
Borrowings	26,834	22,695	22,695	22,695	22,695
Account payable	73,735	90,672	112,515	141,173	174,633
Tax payable	11,259	10,771	19,513	23,588	28,091
Other	90,607	59,048	69,216	95,672	132,888
Non-current liabilities	164,879	219,404	227,392	232,280	237,488
Borrowings	87,437	104,257	104,257	104,257	104,257
Deferred taxation	10,964	10,230	19,618	23,993	28,828
Others	66,478	104,918	103,517	104,030	104,402
MI	32,697	39,825	49,451	60,700	73,845
Total net assets	356,207	433,865	538,733	661,281	804,478
Shareholders' equity	323,510	394,039	489,281	600,581	730,633

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
VAS	56.5	53.0	53.2	50.3	48.6
Ads	18.6	18.1	17.3	17.6	17.3
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	24.9	28.9	29.5	32.1	34.1
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	31.5	20.7	27.2	23.3	22.3
Gross profit	21.5	17.9	31.2	20.7	20.6
EBIT	8.1	21.6	31.7	21.0	19.6
Net profit	18.7	21.1	30.0	25.8	21.3
P&L ratios (%)					
Operating margin	31.2	31.5	32.6	32.0	31.2
Pre-tax margin	30.2	29.0	31.9	31.5	30.9
Adj. net margin	24.7	24.8	25.4	25.9	25.7
Effective tax rate	-4.6	-3.6	-5.4	-5.4	-5.3
Returns (%)					
ROE	25.4	23.9	23.8	24.9	25.5
ROA	11.7	10.7	11.2	12.3	13.0
Per share					
EPS (RMB)	8.1	9.8	12.7	16.0	19.3
DPS (RMB)	1.1	1.4	2.0	2.5	3.2
BVPS (RMB)	34.0	41.2	51.1	62.6	76.2

Source: Company data, CMBIS estimates

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