

Tencent (700 HK)

Solid 4Q19 with game acceleration

Tencent delivered solid 4Q19 results, with revenue/adj. net profit +22% YoY/+29% YoY, +2%/-1% compared to consensus. We are bullish on its game momentum with globalization and positive COVID-19 impact, and expect social ads to offset soft media ads. 1Q20E could be another solid quarter, and we suggest keeping eyes on upcoming DNF Mobile and LOL Mobile. We slightly adjusted its EPS by 0%/-3% in FY20/21E, and revised our TP to HK\$440. Suggest to buy on dips under market volatility.

- **Solid 4Q19.** 4Q19 revenue was RMB105.8bn, up 22% YoY, 2% above consensus, mainly on strong games, social ads and Fintech business. Non-GAAP net profit grew 29% YoY, largely in line with consensus. We view this result as positive, for its game acceleration and better-than-feared ads.
- **Game accelerated, moving to 1Q20E strong momentum.** Tencent categorized games by markets from 4Q19. Game +25% YoY in 4Q19 (vs. +11% in 3Q19), in which international games revenue more than doubled YoY, contributing 23% of online games. We expect strong game momentum to continue in 1Q20E, mainly driven by: 1) positive COVID-19 impact on games for higher MAU & time spent; 2) key titles (e.g. HoK, PUBG Mobile) performed well in both domestic market and overseas; 3) overseas contribution with Supercell's consolidation; and 4) new game titles (e.g. DNF Mobile and LOL Mobile) to bring further upside. Noted that deferred revenue +38% YoY, suggesting strong games outlook.
- **Social ads acceleration to offset soft media ads.** 4Q19 ads +19% YoY (vs. 13% YoY in 3Q19), with social ads/media ads +37% YoY/-24% YoY (vs. our estimate of +32%/-21% YoY). Despite macro headwinds and ads challenges from offline business & SME under COVID-19, we expect its social ads resilient in FY20E, driven by 4th Wechat momentum ads rollout and solid ads from game & online education advertisers. With continuously share gain, we forecast its ads to grow 18% YoY in FY20E.
- **Maintain BUY.** We slightly adjusted its EPS by 0%/-3% in FY20/21E, but revised our TP to HK\$440, by rolling over to FY21E multiple. Our new TP is equivalent to 33x/28x FY20/21E P/E. Tencent could be more defensive under COVID-19 impact, and we suggest investors to look ahead to its 1Q20E performance, with continuously mobile games acceleration and solid social ads. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue (RMB mn)	312,694	377,289	463,886	555,764	673,147
YoY growth (%)	31.5	20.7	23.0	19.8	21.1
Net income (RMB mn)	77,296	93,637	112,807	134,360	160,997
Adj. EPS (RMB)	8.1	9.8	11.8	14.0	16.7
YoY growth (%)	18.7	21.1	20.5	19.1	19.8
Consensus EPS (RMB)	NA	NA	12.1	14.7	16.7
P/E (x)	36.6	30.3	25.2	21.1	17.7
P/B (x)	8.7	7.2	5.9	4.9	4.1
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	25.4	23.9	23.8	23.5	23.2
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	HK\$440
(Previous TP	HK\$420)
Up/Downside	+28.3%
Current Price	HK\$343

China Internet Sector

Sophie Huang
 (852) 3900 0889
 sophiehuang@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	3,162,147
Avg 3 mths t/o (HK\$ mn)	5,230
52w High/Low (HK\$)	400/251
Total Issued Shares (mn)	9,555

Source: Bloomberg

Shareholding Structure

Naspers	31.0%
Ma Huateng	8.6%
JP Morgan	3.8%

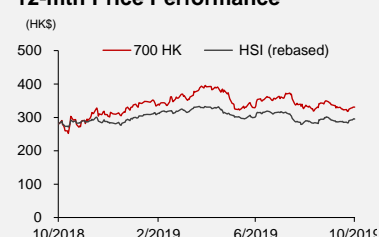
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-3.7%	-3.9%
3-mth	-8.9%	-2.9%
6-mth	-16.3%	-6.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

1. Soft 3Q19; moving to 4Q19E better outlook – 14 Nov 2019
2. 3Q19 Preview: solid game with ads headwinds – 21 Oct 2019
3. Moving into 2H19E game performance – 15 Aug 2019

Figure 1: 4Q19 financial review

RMB mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	QoQ	YoY	Consensus	Diff %
Revenue	73,528	73,675	80,595	84,896	85,465	88,821	96,830	105,767	7.1%	22.1%	103,690	2%
Operating Profit	30,692	21,807	27,861	17,288	36,742	27,521	29,110	28,604	-1.7%	65.5%	28,471	0%
Net profit	23,290	17,867	23,333	14,229	27,210	24,136	23,004	21,582	-6.2%	51.7%	22,767	-5%
Adj. net profit	18,313	19,716	19,710	19,730	20,930	23,525	24,898	25,484	2.4%	29.2%	25,803	-1%
EPS	1.91	2.06	2.06	2.07	2.19	2.46	2.62	2.64	0.9%	28.0%	2.76	-4%
Margin (%)												
Gross Margin	50.4%	46.8%	44.0%	41.4%	46.6%	44.1%	46.0%	45.0%			43.3%	
Operating Margin	41.7%	29.6%	34.6%	20.4%	43.0%	31.0%	30.1%	27.6%			27.5%	
Adj. net margin	24.9%	26.8%	24.5%	23.2%	24.5%	26.5%	25.7%	24.6%			24.9%	
Growth (%)												
Revenue (YoY)	48.4%	30.2%	23.6%	27.9%	16.2%	20.6%	20.1%	24.6%			22.1%	
Revenue (QoQ)	10.7%	0.2%	9.4%	5.3%	0.7%	3.9%	9.0%	9.2%			7.1%	
Operating Profit	59.3%	-3.3%	22.5%	-32.8%	19.7%	26.2%	4.5%	65.5%			64.7%	
Adj. net Profit	28.9%	20.3%	15.5%	13.0%	14.3%	19.3%	26.3%	29.2%			30.8%	

Source: Company data, Bloomberg

Figure 2: Revenue breakdown

RMB mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	QoQ	YoY
Total revenue	73,528	73,675	80,595	84,896	85,465	88,821	96,830	105,767	9%	25%
VAS	46,877	42,069	44,049	43,651	48,974	48,080	50,629	52,308	3%	20%
- Online games	28,778	25,202	25,813	24,199	28,513	27,307	28,604	30,286	6%	25%
- Social network	18,099	16,867	18,236	19,452	20,461	20,773	22,025	22,022	0%	13%
Online advertising	10,689	14,110	16,247	17,033	13,377	16,409	18,366	20,225	10%	19%
Others	15,962	17,496	20,299	24,212	23,114	24,332	28,241	33,234	18%	37%

Source: Company data

Figure 3: CMBI estimates vs consensus

RMB mn, Mar-YE	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	463,886	555,764	673,147	465,904	565,274	679,611	-0.4%	-1.7%	-1.0%
Gross Profit	207,876	241,739	287,298	206,186	248,772	289,132	0.8%	-2.8%	-0.6%
Operating Profit	148,943	173,400	203,924	137,951	165,712	239,168	8.0%	4.6%	-14.7%
Net profit	112,807	134,360	160,997	116,840	143,228	173,227	-3.5%	-6.2%	-7.1%
Adj. EPS (RMB)	11.77	14.01	16.75	12.15	14.66	16.67	-3.1%	-4.4%	0.5%
Gross Margin	44.8%	43.5%	42.7%	44.3%	44.0%	42.5%	+0.6ppts	-0.5ppts	+0.1ppts
Operating Margin	32.1%	31.2%	30.3%	29.6%	29.3%	35.2%	+2.5ppts	+1.9ppts	-4.9ppts
Net Margin	24.3%	24.2%	23.9%	25.1%	25.3%	25.5%	-0.8ppts	-1.2ppts	-1.6ppts

Source: CMBIS estimates, Bloomberg

Figure 4: Earnings revision

RMB mn, Dec-YE	New		Old		Diff (%)	
	FY20E	FY21E	FY20E	FY21E	FY20E	FY21E
Revenue	463,886	555,764	474,648	586,376	-2.3%	-5.2%
Gross Profit	207,876	241,739	207,826	250,742	0.0%	-3.6%
Operating Profit	148,943	173,400	156,856	191,884	-5.0%	-9.6%
Net profit	112,807	134,360	112,677	138,976	0.1%	-3.3%
EPS (RMB)	11.77	14.01	11.77	14.49	0.0%	-3.3%
Gross Margin	44.8%	43.5%	43.8%	42.8%	+1.0ppts	+0.7ppts
Operating Margin	32.1%	31.2%	33.0%	32.7%	-0.9ppts	-1.5ppts
Net Margin	24.3%	24.2%	23.7%	23.7%	+0.6ppts	+0.5ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Revenue	312,694	377,289	463,886	555,764	673,147
VAS	176,646	199,991	236,820	262,875	302,787
Ads	58,079	68,377	80,535	96,713	112,279
E-commerce	-	-	-	-	-
Others	77,969	108,921	146,531	196,176	258,081
COGS	(170,574)	(209,756)	(256,010)	(314,025)	(385,849)
Gross profit	142,120	167,533	207,876	241,739	287,298
S&M	(24,233)	(21,396)	(24,634)	(28,626)	(33,805)
Admin.Exp.	(41,522)	(53,446)	(64,298)	(72,714)	(85,870)
Interest income	4,569	6,314	7,200	7,920	8,712
Others	16,714	19,689	22,800	25,080	27,588
Operating profit	97,648	118,694	148,943	173,400	203,924
Financial cost	(4,669)	(7,613)	(11,068)	(11,068)	(11,068)
Associates	(1,265)	(2,578)	-	-	-
Pre-tax Income	94,466	109,400	140,375	165,232	196,104
Income Tax	(14,482)	(13,512)	(23,864)	(28,089)	(33,338)
MI	(1,265)	(2,578)	-	-	-
Net profit	78,719	93,310	116,511	137,143	162,766
Adj. net profit	77,296	93,637	112,807	134,360	160,997

Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Net income	78,719	93,310	116,511	137,143	162,766
D&A	34,248	13,539	17,160	21,330	25,678
Change in WC	4,687	11,549	14,501	19,263	22,199
Income tax paid	(58)	(2,942)	7,298	2,979	3,700
Others	(11,153)	25,767	28,386	33,147	38,384
Operating CF	106,443	141,223	183,857	213,862	252,728
Capex	(22,151)	(32,369)	(42,678)	(51,131)	(60,382)
Associates	(39,699)	(43,669)	(48,036)	(52,839)	(63,407)
Others	(90,063)	(14,514)	(13,628)	(12,908)	(12,116)
Investing CF	(151,913)	(90,552)	(104,342)	(116,879)	(135,906)
Equity raised	525	0	0	0	0
Change of Debts	37,842	40,800	0	0	0
Others	(2,987)	(10,912)	(13,953)	(18,694)	(23,502)
Financing CF	35,380	29,888	(13,953)	(18,694)	(23,502)
Net change in cash	(10,090)	80,559	65,562	78,290	93,321
Cash (beg of yr)	105,697	97,814	178,373	243,935	322,224
FX	2,207	0	0	0	0
Cash (end of yr)	97,814	178,373	243,935	322,224	415,545

Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
Non-current assets	506,441	543,193	593,444	652,770	724,202
Fixed asset	47,076	67,188	98,765	134,190	174,519
Associates	219,215	213,614	213,614	213,614	213,614
Intangible assets	56,650	50,237	38,989	27,741	16,493
Others	183,500	212,154	242,076	277,224	319,576
Current assets	217,080	293,262	372,629	465,566	577,600
Cash	97,814	178,373	243,935	322,224	415,545
Deposit over 3 months	62,918	46,911	46,911	46,911	46,911
Account receivable	28,427	34,299	42,172	50,525	61,196
Others	27,921	33,679	39,612	45,906	53,948
Current liabilities	202,435	183,187	211,451	251,640	305,230
Borrowings	26,834	22,695	22,695	22,695	22,695
Account payable	73,735	90,672	110,667	135,745	166,793
Tax payable	11,259	10,771	18,069	21,048	24,748
Other	90,607	59,048	60,020	72,152	90,994
Non-current liabilities	164,879	219,404	225,404	229,039	233,335
Borrowings	87,437	104,257	104,257	104,257	104,257
Deferred taxation	10,964	10,230	18,067	21,266	25,239
Others	66,478	104,918	103,080	103,517	103,839
MI	32,697	39,825	48,578	58,532	70,059
Total net assets	356,207	433,865	529,218	637,656	763,236
Shareholders' equity	323,510	394,039	480,640	579,124	693,177

Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
Sales mix (%)					
VAS	56.5	53.0	51.1	47.3	45.0
Ads	18.6	18.1	17.4	17.4	16.7
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	24.9	28.9	31.6	35.3	38.3
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	31.5	20.7	23.0	19.8	21.1
Gross profit	21.5	17.9	24.1	16.3	18.8
EBIT	8.1	21.6	25.5	16.4	17.6
Net profit	18.7	21.1	20.5	19.1	19.8
P&L ratios (%)					
Operating margin	31.2	31.5	32.1	31.2	30.3
Pre-tax margin	30.2	29.0	30.3	29.7	29.1
Adj. net margin	24.7	24.8	24.3	24.2	23.9
Effective tax rate	-4.6	-3.6	-5.1	-5.1	-5.0
Returns (%)					
ROE	25.4	23.9	23.8	23.5	23.2
ROA	11.7	10.7	11.2	11.7	12.0
Per share					
EPS (RMB)	8.1	9.8	11.8	14.0	16.7
DPS (RMB)	1.1	1.4	1.8	2.3	2.9
BVPS (RMB)	34.0	41.2	50.2	60.4	72.3

Source: Company data, CMBIS estimates

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CMB International Securities Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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