

# Tencent (700 HK)

## Solid 3Q20; Eyes on rich pipeline

Tencent delivered solid 3Q20 results, with revenue/adj. net profit +29% YoY/+32% YoY, 1%/2% above consensus. Mobile game momentum continued with 61% YoY growth. We keep bullish on its mobile game momentum with globalization and upcoming strong pipeline. We expect limited impact from regulations on Fintech and Antitrust due to its diversified rev source, and its steady growth strategy fits well in compliance. We keep our financial forecast unchanged, but lifted our SOTP-based TP to HK\$669 from HK\$624 with higher investment valuation.

- **3Q20 beat.** 3Q20 revenue was RMB125.4bn, up 29% YoY, 1%/1% above consensus/our estimate, mainly on strong mobile games. Non-GAAP net profit grew 32% YoY to RMB32.3bn, 2%/0% above consensus/our estimate. Game momentum continued (+45% YoY), partly offset by moderate FBS growth. Mgmt. stated slowdown in cloud is one-time for certain projects.
- **Game: more to come.** Game surged 45% YoY in 3Q20 (vs. +40% in 2Q20), in which mobile game +61% YoY (well above consensus of ~50% YoY), mainly driven by strong key titles and increasing overseas contribution. This growth would partly alleviate market concern on large game deceleration during post-COVID-19 normalization. Despite DNF mobile delay, we keep positive on its game momentum ahead, for 1) overseas contribution with strong PUBG Mobile; 2) deferred revenue from solid key titles; and 3) new game to bring further upside (e.g. CoD Mobile, LoL Wild Rift). Meanwhile, its newly-launched title Moonlight Blade <天涯明月刀> performed well, which was ranked Top 5 in IOS grossing ranking after launch on 16 Oct.
- **Ads to accelerate; more upside from video ads.** Ads accelerated to +16% YoY in 3Q20 (vs. +13% YoY in 2Q20), backed by wider algorithmic adoption and solid education & ecommerce ads. By segment, social ads/ media ads +21%/-1% YoY (vs. +27% /-25% YoY in 2Q20). We view the ads growth largely in-line with street estimates, and expect 4Q20E ads to accelerate, driven by popular drama series (e.g. The Legend of Xiao Chuo), recovering brand ads sentiment and video ads trend.
- **Maintain BUY.** We keep our financials unchanged, but lifted our SOTP-based TP to **HK\$669** (implying 38x FY21E P/E) to reflect higher investment valuation. We expect its strong game pipeline, 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	12.7	15.9	18.9
P/E (x)	64.1	52.9	40.8	32.4	26.8
P/B (x)	15.2	12.6	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\$669
(Previous TP	HK\$624)
Up/Downside	+16.0%
Current Price	HK\$577

### China Internet Sector

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### Stock Data

Mkt Cap (HK\$ mn)	5,281,185
Avg 3 mths t/o (HK\$ mn)	9,648.43
52w High/Low (HK\$)	633/ 318
Total Issued Shares (mn)	9,585

Source: Bloomberg

### Shareholding Structure

Naspers	30.9%
Ma Huateng	7.4%
JP Morgan	4.4%

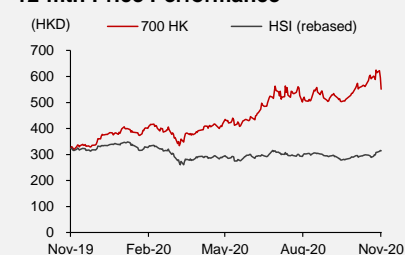
Source: HKEx

### Share Performance

	Absolute	Relative
1-mth	10.3%	1.1%
3-mth	18.5%	9.9%
6-mth	42.3%	31.1%

Source: Bloomberg

### 12-mth Price Performance



Source: Bloomberg

### Auditor: PwC

### Related Reports

1. Solid 2Q20 with strong mobile game – 13 Aug 2020
2. Eye-catching 1Q20 with strong game & social ads – 14 May 2020
3. Solid 4Q19 with game acceleration – 19 Mar 2020

**Figure 1: 3Q20 financial review**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	9.2%	29.0%	123,829	1%	124,478	1%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	11.8%	51.0%	37,570	17%	40,975	7%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	16.4%	67.5%	30,256	27%	33,234	16%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	7.1%	32.3%	31,762	2%	32,262	0%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	5.9%	26.5%	3.27	1%	3.38	-2%
<b>Margin (%)</b>													
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%			45.6%		46.0%	
Operating Margin	43.0%	31.0%	29.9%	23.1%	34.5%	34.2%	35.0%			30.3%		32.9%	
Adj. net margin	24.5%	26.5%	25.1%	20.6%	25.1%	26.2%	25.8%			25.6%		25.9%	
<b>Growth (%)</b>													
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%			27.3%		28.0%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%			7.8%		8.4%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%			29.1%		40.8%	
Adj. net Profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%			30.1%		32.2%	

Source: Company data, Bloomberg, CMBIS estimates

**Figure 2: Revenue breakdown**

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	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>9%</b>	<b>29%</b>
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	7%	38%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	8%	45%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	6%	29%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	15%	16%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	9%	21%

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	479,547	590,378	706,456	0.1%	0.3%	2.5%
Gross Profit	219,788	265,296	319,996	220,922	270,465	321,830	-0.5%	-1.9%	-0.6%
Operating Profit	156,328	189,132	226,220	150,415	179,006	215,787	3.9%	5.7%	4.8%
Net profit	121,756	153,181	185,802	122,507	154,672	187,157	-0.6%	-1.0%	-0.7%
Adj. EPS (RMB)	12.70	15.97	19.33	12.75	15.94	18.91	-0.4%	0.2%	2.2%
Gross Margin	45.8%	44.8%	44.2%	46.1%	45.8%	45.6%	-0.3ppts	-1.0ppts	-1.4ppts
Operating Margin	32.6%	32.0%	31.2%	31.4%	30.3%	30.5%	+1.2ppts	+1.6ppts	+0.7ppts
Net Margin	25.4%	25.9%	25.7%	25.5%	26.2%	26.5%	-0.2ppts	-0.3ppts	-0.8ppts

Source: CMBIS estimates, Bloomberg

**Figure 4: SOTP Valuation**

SOTP	Valuation (HK\$ bn)	HK\$/Share	Implied FY21 P/E
Core business	5,352	559	32x
Unlisted associates	120	13	
JD	235	25	
58.com	22	2	
Meituan	424	44	
PDD	253	26	
<b>Total Valuation</b>	<b>6,406</b>	<b>669</b>	<b>38x</b>

Source: CMBIS estimates, Bloomberg, CMBIS estimates

## Financial Summary

### Income statement

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Revenue</b>	<b>312,694</b>	<b>377,289</b>	<b>480,072</b>	<b>591,876</b>	<b>723,980</b>
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
<b>COGS</b>	<b>(170,574)</b>	<b>(209,756)</b>	<b>(260,285)</b>	<b>(326,581)</b>	<b>(403,984)</b>
<b>Gross profit</b>	<b>142,120</b>	<b>167,533</b>	<b>219,788</b>	<b>265,296</b>	<b>319,996</b>
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
<b>Operating profit</b>	<b>97,648</b>	<b>118,694</b>	<b>156,328</b>	<b>189,132</b>	<b>226,220</b>
Financial cost	(4,669)	(7,613)	(6,736)	(6,736)	(6,736)
Associates	(1,265)	(2,578)	-	-	-
<b>Pre-tax Income</b>	<b>94,466</b>	<b>109,400</b>	<b>153,061</b>	<b>186,420</b>	<b>223,991</b>
Income Tax	(14,482)	(13,512)	(25,912)	(31,691)	(38,079)
MI	(1,265)	(2,578)	-	-	-
<b>Net profit</b>	<b>78,719</b>	<b>93,310</b>	<b>126,642</b>	<b>154,112</b>	<b>185,171</b>
<b>Adj. net profit</b>	<b>77,296</b>	<b>93,637</b>	<b>121,756</b>	<b>153,181</b>	<b>185,802</b>

### Cash flow summary

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Net income</b>	<b>78,719</b>	<b>93,310</b>	<b>126,642</b>	<b>154,112</b>	<b>185,171</b>
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
<b>Operating CF</b>	<b>106,443</b>	<b>141,420</b>	<b>203,607</b>	<b>238,263</b>	<b>283,865</b>
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)
<b>Investing CF</b>	<b>(151,913)</b>	<b>(90,552)</b>	<b>(103,898)</b>	<b>(117,796)</b>	<b>(137,580)</b>
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)
<b>Financing CF</b>	<b>35,380</b>	<b>29,888</b>	<b>(13,953)</b>	<b>(20,320)</b>	<b>(26,409)</b>
<b>Net change in cash</b>	<b>(10,090)</b>	<b>80,756</b>	<b>85,755</b>	<b>100,147</b>	<b>119,875</b>
Cash (beg of yr)	105,697	97,814	178,570	264,326	364,473
FX	2,207	0	0	0	0
<b>Cash (end of yr)</b>	<b>97,814</b>	<b>178,570</b>	<b>264,326</b>	<b>364,473</b>	<b>484,348</b>

### Balance sheet

YE 31 Dec (RMB mn)	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Non-current assets</b>	<b>506,441</b>	<b>543,193</b>	<b>594,463</b>	<b>663,118</b>	<b>745,766</b>
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
<b>Current assets</b>	<b>217,080</b>	<b>293,262</b>	<b>395,601</b>	<b>513,571</b>	<b>654,506</b>
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
<b>Current liabilities</b>	<b>202,435</b>	<b>183,187</b>	<b>223,939</b>	<b>283,128</b>	<b>358,307</b>
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
<b>Non-current liabilities</b>	<b>164,879</b>	<b>219,404</b>	<b>227,392</b>	<b>232,280</b>	<b>237,488</b>
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
<b>Total net assets</b>	<b>356,207</b>	<b>433,865</b>	<b>538,733</b>	<b>661,281</b>	<b>804,478</b>
<b>Shareholders' equity</b>	<b>323,510</b>	<b>394,039</b>	<b>489,281</b>	<b>600,581</b>	<b>730,633</b>

### Key ratios

YE 31 Dec	FY18A	FY19A	FY20E	FY21E	FY22E
<b>Sales mix (%)</b>					
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
<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	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
<b>P&amp;L ratios (%)</b>					
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
<b>Returns (%)</b>					
ROE	25.4	23.9	23.8	24.9	25.5
ROA	11.7	10.7	11.2	12.3	13.0
<b>Per share</b>					
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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