

Tencent (700 HK)

Looking beyond 2H21 ads headwinds

Tencent delivered soft 3Q21, with rev/adj. net profit +13.5%/-2% YoY, 2%/2% below consensus. By segment, games & FBS are largely in-line while ads & social network are soft. Stock price would react negatively in a near term, but we view this result as forgivable, and suggest to move into 4Q21E game momentum, boosted by eye-catching LoLM and overseas expansion. Ads recovery needs more time, given shrinking ads budget under COVID-19 uncertainty, soft macro and new regulatory environment. We expect ads pressure to linger in 4Q21E, while 2H22E would see gradual recovery with easy base. We trimmed our earnings by 1-9% in FY21-23E to reflect conservative growth, but maintain our TP at **HK\$640**.

- **3Q21 missed, but was forgivable.** 3Q21 rev was RMB142.4bn, up 13.5% YoY, 2%/1% below consensus/our estimate, in which games & FBS are largely in-line while ads & social network are soft. Non-GAAP net profit declined 2% YoY to RMB31.8bn, 2%/2% below consensus/our estimate, with margin in-line.
- **Heading into 4Q21E games momentum.** Games +8% YoY in 3Q21 (vs. +12% YoY in 2Q21), in which domestic game +5% YoY (better-than-feared) and international games +20% YoY. In 3Q21, minors accounted for 1.1% of China game grossing receipts (vs. 2.6% in 2Q21). We think the lower grossing mix from minors would partly alleviate market concern on tightening regulation impact from teenage gaming anti-addiction. We suggest to move to 4Q21E game momentum, boosted by initial success of LoLM (estimating first monthly grossing at RMB1.5bn) and upcoming game license resumption as further catalysts. We expect a strong product cycle ahead in FY22E for Tencent, with stepping-up overseas expansion.
- **Prudent ads in 4Q21E, but set low base for FY22E.** 3Q21 ads disappointed us, with +5% YoY in 3Q21 (7% below our estimate, vs. +23% YoY in 2Q21), dragged by soft macro and tightening regulations to weigh on ads budget from multiple verticals (e.g. edu, games). By segment, social ads/ media ads +7%/-4% YoY (vs. +28%/+0% YoY in 2Q21). We expect soft ads to continue in 4Q21E (with PIPL uncertainty), while 2H22E would see gradual recovery with easy base.
- **Maintain BUY.** We slightly cut our earnings by 1-9% in FY21-23E to reflect prudent financial outlook, but maintain our TP at **HK\$640** (34x FY22E P/E).

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	564,776	644,585	737,806
YoY growth (%)	20.7	27.8	17.2	14.1	14.5
Net income (RMB mn)	94,351	122,742	127,989	148,696	174,676
Adj. EPS (RMB)	9.7	12.7	13.3	15.5	18.1
YoY growth (%)	22.1	30.1	4.3	16.2	17.5
Consensus EPS (RMB)	NA	NA	14.0	17.0	20.4
P/E (x)	40.1	30.8	29.2	25.2	21.5
P/B (x)	8.6	5.3	4.7	4.1	3.6
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	23.9	21.8	17.4	16.0	16.3
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$640**
 (Previous TP **HK\$640**)
Up/Downside **41.0%**
Current Price **HK\$483.6**

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,684,892
Avg 3 mths t/o (HK\$ mn)	15,355.69
52w High/Low (HK\$)	775.50/412.20
Total Issued Shares (mn)	9,596

Source: Bloomberg

Shareholding Structure

Naspers	28.9%
Ma Huateng	7.4%
Vanguard	2.5%

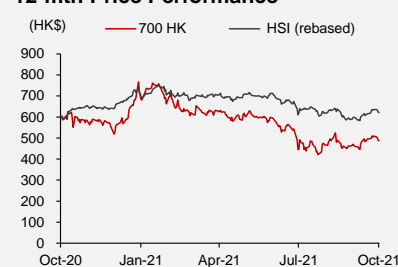
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	4.8%	-1.0%
3-mth	9.2%	6.9%
6-mth	-22.1%	-12.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 3Q21 financial review

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	142,368	3.0%	13.5%	145,413	-2%	143,672	-1%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	56,273	52,487	53,137	1.2%	20.9%	41,171	29%	40,703	31%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	47,767	42,587	39,510	-7.2%	2.5%	32,602	21%	32,794	20%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	33,118	34,039	31,751	-6.7%	-1.7%	32,354	-2%	32,290	-2%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.42	3.51	3.33	-5.2%	0.5%	3.36	-1%	3.38	-2%
Margin (%)																	
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.0%			44.6%		42.9%	
Operating Margin	43.0%	31.0%	29.9%	19.7%	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	37.3%			28.3%		28.3%	
Adj. net margin	24.5%	26.5%	25.1%	17.5%	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.3%			22.2%		22.5%	
Growth (%)																	
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%			15.9%		14.5%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%			5.2%		3.9%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	20.9%			-6.3%		-7.4%	
Adj. net profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	-1.7%			0.2%		0.0%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	QoQ	YoY
Total revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	142,368	3%	13%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	72,013	75,203	4%	8%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	43,600	43,000	44,903	4%	8%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	28,843	29,013	30,300	4%	7%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,833	22,495	-1%	5%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	43,413	44,670	3%	30%

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	564,776	644,585	737,806	576,354	684,303	804,107	-2.0%	-5.8%	-8.2%
Gross Profit	250,180	283,555	326,706	259,265	306,736	361,755	-3.5%	-7.6%	-9.7%
Operating Profit	173,573	196,668	225,855	188,963	205,212	242,374	-8.1%	-4.2%	-6.8%
Net profit	127,989	148,696	174,676	134,393	162,709	195,924	-4.8%	-8.6%	-10.8%
Adj. EPS (RMB)	13.35	15.47	18.13	14.01	16.99	20.44	-4.7%	-9.0%	-11.3%
Gross Margin	44.3%	44.0%	44.3%	45.0%	44.8%	45.0%	-0.7ppts	-0.8ppts	-0.7ppts
Operating Margin	30.7%	30.5%	30.6%	32.8%	30.0%	30.1%	-2.1ppts	+0.5ppts	+0.5ppts
Net Margin	22.7%	23.1%	23.7%	23.3%	23.8%	24.4%	-0.7ppts	-0.7ppts	-0.7ppts

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	564,776	644,585	737,806	571,794	688,047	822,912	-1.2%	-6.3%	-10.3%
Gross Profit	250,180	283,555	326,706	253,617	303,241	362,468	-1.4%	-6.5%	-9.9%
Operating Profit	173,573	196,668	225,855	175,467	209,677	244,319	-1.1%	-6.2%	-7.6%
Adj. net profit	127,989	148,696	174,676	129,773	160,822	192,541	-1.4%	-7.5%	-9.3%
EPS (RMB)	13.35	15.47	18.13	13.53	16.73	19.98	-1.4%	-7.5%	-9.3%
Gross Margin	44.3%	44.0%	44.3%	44.4%	44.1%	44.0%	-0.1ppts	-0.1ppts	+0.2ppts
Operating Margin	30.7%	30.5%	30.6%	30.7%	30.5%	29.7%	+0.0ppts	+0.0ppts	+0.9ppts
Net Margin	22.7%	23.1%	23.7%	22.7%	23.4%	23.4%	-0.0ppts	-0.3ppts	+0.3ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	377,289	482,064	564,776	644,585	737,806
VAS	199,991	264,212	290,602	320,168	355,991
Ads	68,377	82,271	91,989	112,301	132,341
E-commerce	-	-	-	-	-
Others	108,921	135,581	183,344	223,004	268,796
COGS	(209,756)	(260,532)	(314,597)	(361,030)	(411,100)
Gross profit	167,533	221,532	250,180	283,555	326,706
S&M	(21,396)	(33,758)	(39,534)	(40,609)	(47,957)
Admin.Exp.	(53,446)	(67,625)	(84,716)	(96,688)	(106,244)
Interest income	6,314	6,957	7,653	8,418	9,260
Others	19,689	57,131	39,992	41,991	44,091
Operating profit	118,694	184,237	173,573	196,668	225,855
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
Pre-tax Income	109,400	180,022	167,886	192,301	222,674
Income Tax	(13,512)	(19,897)	(26,862)	(30,768)	(35,628)
MI	(2,578)	-	-	-	-
Net profit	93,310	159,847	140,779	161,252	186,721
Adj. net profit	94,351	122,742	127,989	148,696	174,676

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	93,310	159,847	140,779	161,252	186,721
D&A	13,539	17,923	20,431	23,188	25,852
Change in WC	8,972	12,843	15,172	15,583	15,835
Income tax paid	(2,735)	166	4,247	2,382	2,964
Others	35,504	3,340	47,712	51,216	55,128
Operating CF	148,590	194,119	228,342	253,621	286,500
Capex	(32,369)	(33,960)	(39,787)	(44,274)	(49,410)
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)	(105,802)	(120,091)	(137,067)
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(24,125)	(29,393)
Financing CF	1,672	13,647	(25,648)	(24,125)	(29,393)
Net change in cash	34,092	25,811	96,893	109,405	120,040
Cash (beg of yr)	97,814	132,991	152,798	249,691	359,096
FX	1,085	(6,004)	0	0	0
Cash (end of yr)	132,991	152,798	249,691	359,096	479,136

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	700,018	1,015,778	1,089,307	1,171,216	1,263,134
Fixed asset	77,215	93,802	119,545	147,018	176,963
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	517,842	585,051	659,798
Current assets	253,968	317,647	429,608	553,553	690,576
Cash	132,991	152,798	249,691	359,096	479,136
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	52,699	60,146	68,844
Others	38,227	51,381	58,732	65,824	74,109
Current liabilities	240,156	269,079	343,547	422,022	516,988
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	113,543	130,301	148,372
Tax payable	10,978	14,283	18,530	20,913	23,876
Other	125,793	146,524	197,232	256,566	330,497
Non-current liabilities	225,006	286,303	292,133	295,485	289,384
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	21,683	24,836	28,759
Others	107,908	158,097	158,305	158,504	148,480
MI	56,118	74,059	84,072	95,877	109,211
Total net assets	488,824	778,043	883,235	1,007,262	1,147,338
Shareholders' equity	432,706	703,984	799,164	911,384	1,038,127

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
VAS	53.0	54.8	51.5	49.7	48.2
Ads	18.1	17.1	16.3	17.4	17.9
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.9	28.1	32.5	34.6	36.4
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	20.7	27.8	17.2	14.1	14.5
Gross profit	17.9	32.2	12.9	13.3	15.2
EBIT	21.6	55.2	-5.8	13.3	14.8
Net profit	22.1	30.1	4.3	16.2	17.5
P&L ratios (%)					
Operating margin	31.5	38.2	30.7	30.5	30.6
Pre-tax margin	29.0	37.3	29.7	29.8	30.2
Adj. net margin	25.0	25.5	22.7	23.1	23.7
Effective tax rate	(12.4)	(11.1)	(16.0)	(16.0)	(16.0)
Returns (%)					
ROE	23.9	21.8	17.4	16.0	16.3
ROA	10.7	9.9	9.2	8.4	8.6
Per share					
EPS (RMB)	9.7	12.7	13.3	15.5	18.1
DPS (RMB)	1.4	2.5	2.3	2.8	3.5
BVPS (RMB)	45.2	73.3	82.8	95.0	108.0

Source: Company data, CMBIS estimates

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