

Tencent (700 HK)

3Q19 Preview: solid game with ads headwinds

Tencent will announce its 3Q19 result on 13 Nov. Despite already-low market expectation, we expect its 3Q19E topline to be soft again, mainly on weak ads and Fintech business. Margin might see upside for its disciplined cost control and slower M&A. Our TP of **HK\$420** is unchanged. Maintain BUY.

- **3Q19E preview: soft topline, but with margin upside.** We forecast a 20% YoY revenue growth to RMB96bn in 3Q19E (3% below consensus), and expect adj. net profit up 26% YoY to RMB25bn (1% above consensus). Soft topline was mainly due to ads pressure and Fintech deceleration, while margin upside derives from effective cost control. Stock price might see short term pressure on its soft ads outlook and unsurprising results. However, in the long run, we keep positive on its game momentum and new business expansion.
- **Mobile games to maintain strong momentum.** We forecast 3Q19E games revenue to grow 11% YoY (vs. 8% YoY in 2Q19), in which mobile/PC games +28%/-10% YoY. Mobile games growth was mainly driven by solid *HoK*, Peacekeeper Elite contribution, and new game launches (e.g. Crazy Racing). We see high visibility for its mobile game to accelerate in 4Q19E, for rising contribution from Peacekeeper Elite and new games. PC games will still see pressure in the short run.
- **Still cautious on ads outlook.** We forecast 3Q19E ads revenue to grow 13% YoY (vs. 16% YoY in 2Q19), in which social ads/ media ads +27%/-22% YoY. We expect challenging ads trend to continue in 2H19E, mainly on: 1) continued macro headwinds; 2) increasing ads inventory from top newsfeed and short video; and 3) soft video ads momentum.
- **Maintain BUY.** We keep our full-year financial forecast unchanged, and maintain our TP of HK\$420, which is equivalent to 38x/31x FY19/20E P/E. We think market might well anticipate its solid earning in 3Q19E, ads outlook and more color on games pipeline would be key focus.

Earnings Summary

(YE 31 Dec)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue (RMB mn)	237,760	312,694	380,642	474,648	586,376
YoY growth (%)	56.5	31.5	21.7	24.7	23.5
Net income (RMB mn)	65,126	75,044	92,905	112,677	138,976
Adj. EPS (RMB)	6.9	7.9	9.7	11.8	14.5
YoY growth (%)	43.1	14.6	23.7	21.2	23.1
P/E (x)	43.6	38.1	30.8	25.4	20.6
P/B (x)	10.3	8.1	6.3	5.0	4.0
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	31.8	26.7	27.0	26.1	25.7
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, CMBIS estimates

BUY (Maintain)

Target Price	HK\$420
(Previous TP	HK\$420)
Up/Downside	+26.9%
Current Price	HK\$331

China Internet Sector

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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

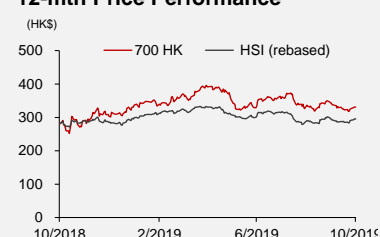
Naspers	31.0%
Ma Huateng	8.6%
JP Morgan	3.8%
Source: HKEx	

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

Moving into 2H19E game performance
 – 15 Aug 2019

Figure 1: 3Q19E financial preview

RMB mn	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19E	QoQ	YoY	Consensus	Diff %
Revenue	73,528	73,675	80,595	84,896	85,465	88,821	96,830	9.0%	20.1%	99,706	-3%
Operating Profit	30,692	21,807	27,861	17,288	36,742	27,521	29,110	5.8%	4.5%	29,567	-2%
Net profit	23,290	17,867	23,333	14,229	27,210	24,136	23,004	-4.7%	-1.4%	23,553	-2%
Adj. net profit	18,313	19,716	19,710	19,730	20,930	23,525	24,898	5.8%	26.3%	24,533	1%
EPS	1.91	2.06	2.06	2.07	2.19	2.46	2.62	6.5%	27.1%	2.60	1%
Margin (%)											
Gross Margin	50.4%	46.8%	44.0%	41.4%	46.6%	44.1%	46.0%			43.9%	
Operating Margin	41.7%	29.6%	34.6%	20.4%	43.0%	31.0%	30.1%			29.7%	
Adj. net margin	24.9%	26.8%	24.5%	23.2%	24.5%	26.5%	25.7%			24.6%	
Growth (%)											
Revenue (YoY)	48.4%	30.2%	23.6%	27.9%	16.2%	20.6%	20.1%			23.7%	
Revenue (QoQ)	10.7%	0.2%	9.4%	5.3%	0.7%	3.9%	9.0%			12.3%	
Operating Profit	59.3%	-3.3%	22.5%	-32.8%	19.7%	26.2%	4.5%			6.1%	
Adj. net Profit	28.9%	20.3%	15.5%	13.0%	14.3%	19.3%	26.3%			24.5%	

Source: Company data, CMBIS estimates, Bloomberg

Figure 2: CMBI estimates vs consensus

RMB mn, Mar-YE	CMBI			Consensus			Diff (%)		
	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E	FY19E	FY20E	FY21E
Revenue	380,642	474,648	586,376	381,992	474,298	580,276	-0.4%	0.1%	1.1%
Gross Profit	172,704	207,826	250,742	169,452	207,252	249,424	1.9%	0.3%	0.5%
Operating Profit	129,283	156,856	191,884	121,582	140,253	170,499	6.3%	11.8%	12.5%
Net profit	92,905	112,677	138,976	95,627	116,675	140,859	-2.8%	-3.4%	-1.3%
Adj. EPS (RMB)	9.71	11.77	14.49	9.99	12.12	14.56	-2.8%	-2.9%	-0.5%
Gross Margin	45.4%	43.8%	42.8%	44.4%	43.7%	43.0%	+1.0ppts	+0.1ppts	-0.2ppts
Operating Margin	34.0%	33.0%	32.7%	31.8%	29.6%	29.4%	+2.1ppts	+3.5ppts	+3.3ppts
Net Margin	24.4%	23.7%	23.7%	25.0%	24.6%	24.3%	-0.6ppts	-0.9ppts	-0.6ppts

Source: CMBIS estimates, Bloomberg

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Revenue	237,760	312,694	380,642	474,648	586,376
VAS	153,983	176,646	203,331	231,483	261,624
Ads	40,439	58,079	69,681	87,101	106,263
E-commerce	-	-	-	-	-
Others	43,338	77,969	107,630	156,064	218,489
COGS	(120,835)	(170,574)	(207,938)	(266,822)	(335,634)
Gross profit	116,925	142,120	172,704	207,826	250,742
S&M	(17,652)	(24,233)	(23,638)	(28,002)	(32,864)
Admin.Exp.	(33,051)	(41,522)	(50,170)	(59,432)	(69,751)
Interest income	3,940	4,569	5,510	6,612	7,934
Others	20,140	16,714	24,877	29,852	35,823
Operating profit	90,302	97,648	129,283	156,856	191,884
Financial cost	(2,908)	(4,669)	(7,063)	(7,063)	(7,063)
Associates	821	1,487	(187)	(374)	(449)
Pre-tax Income	88,215	94,466	122,033	149,419	184,373
Income Tax	(15,744)	(14,482)	(19,157)	(23,456)	(28,943)
MI	(961)	(1,265)	(1,494)	(1,829)	(2,257)
Net profit	71,510	78,719	101,382	124,134	153,173
Adj. net profit	65,126	75,044	92,905	112,677	138,976

Cash flow summary

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Net income	71,510	78,719	101,382	124,134	153,173
D&A	23,611	9,470	12,257	14,186	16,282
Change in WC	23,322	9,134	6,694	1,576	3,302
Income tax paid	2,071	(698)	2,585	2,378	3,035
Others	(14,374)	19,597	30,156	37,083	45,390
Operating CF	106,140	116,221	153,074	179,357	221,182
Capex	(12,126)	(23,941)	(24,868)	(29,220)	(34,293)
Associates	(39,879)	(43,867)	(48,254)	(53,079)	(58,387)
Others	(44,387)	18,215	19,156	20,258	21,580
Investing CF	(96,392)	(49,593)	(53,966)	(62,041)	(71,100)
Equity raised	171	-	-	-	-
Change of Debts	29,012	-	-	-	-
Others	(2,585)	(9,933)	(11,869)	(16,490)	(23,138)
Financing CF	26,598	(9,933)	(11,869)	(16,490)	(23,138)
Net change in cash	36,346	56,695	87,239	100,826	126,944
Cash (beg of yr)	71,902	105,697	162,392	249,631	350,457
FX	(2,551)	-	-	-	-
Cash (end of yr)	105,697	162,392	249,631	350,457	477,401

Balance sheet

YE 31 Dec (RMB mn)	FY17A	FY18A	FY19E	FY20E	FY21E
Non-current assets	376,226	429,430	487,401	556,691	643,587
Fixed asset	31,871	50,306	66,998	86,111	108,202
Associates	113,779	113,779	113,779	113,779	113,779
Intangible assets	40,266	35,778	28,524	20,364	12,204
Others	190,310	229,566	278,101	336,437	409,402
Current assets	178,446	246,402	338,225	448,981	587,282
Cash	105,697	162,392	249,631	350,457	477,401
Deposit over 3 months	36,724	36,724	36,724	36,724	36,724
Account receivable	16,549	21,765	26,494	33,037	40,814
Others	19,476	25,521	25,375	28,763	32,343
Current liabilities	151,740	166,792	227,963	289,542	367,795
Borrowings	15,696	15,696	15,696	15,696	15,696
Account payable	84,270	100,857	164,243	225,979	303,777
Tax payable	9,642	8,944	11,529	13,907	16,942
Other	42,132	41,296	36,495	33,960	31,380
Non-current liabilities	125,839	155,819	145,557	144,730	147,018
Borrowings	82,094	82,094	82,094	82,094	82,094
Deferred taxation	5,975	5,496	7,270	8,902	10,984
Others	37,770	68,229	56,192	53,734	53,940
MI	21,019	26,794	34,295	43,344	54,317
Total net assets	277,093	353,220	452,106	571,400	716,056
Shareholders' equity	256,074	326,426	417,811	528,056	661,740

Key ratios

YE 31 Dec	FY17A	FY18A	FY19E	FY20E	FY21E
Sales mix (%)					
VAS	64.8	56.5	53.4	48.8	44.6
Ads	17.0	18.6	18.3	18.4	18.1
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	18.2	24.9	28.3	32.9	37.3
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	56.5	31.5	21.7	24.7	23.5
Gross profit	38.4	21.5	21.5	20.3	20.7
EBIT	60.9	8.1	32.4	21.3	22.3
Net profit	43.4	15.2	23.8	21.3	23.3
P&L ratios (%)					
Operating margin	37.1	30.2	32.1	31.5	31.4
Pre-tax margin	30.1	25.2	26.6	26.2	26.1
Adj. net margin	27.4	24.0	24.4	23.7	23.7
Effective tax rate	17.8	15.3	15.7	15.7	15.7
Returns (%)					
ROE	31.8	26.7	27.0	26.1	25.7
ROA	15.9	14.0	14.8	14.9	15.0
Per share					
EPS (RMB)	6.9	7.9	9.7	11.8	14.5
DPS (RMB)	0.9	0.8	1.0	1.2	1.4
BVPS (RMB)	29.2	37.0	47.3	59.7	74.7

Source: Company data, CMBIS estimates

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