

Tencent (700 HK)

Steady ship and aim for sustainable growth

Tencent reported 4Q22 results on 22 March: total revenue grew by 1% YoY to RMB145bn, inline with consensus/CMBI estimates. FY22 total revenue declined 1% YoY to RMB554.6bn. Non-IFRS net income grew by 19% YoY to RMB29.7bn in 4Q22, versus consensus/CMBI estimate of RMB30.8/30.2bn. The earnings growth was mainly due to enhanced operating efficiency and low-base effect. Full-year non-IFRS net income was down 7% YoY to RMB115.6bn in FY22. We raise FY23-24E non-IFRS net income forecast by 3-6% on: 1) solid recovery of high-margin ad business; 2) improved ads and FBS GPM; and 3) better operating efficiency. Our SOTP-derived target price is adjusted to HK\$455.0 (previous: HK\$450.0). Maintain BUY.

- Inline games revenue growth; ad delivered strong beat in 4Q22.** Domestic games revenue declined by 6% YoY to RMB27.9bn in 4Q22. International games revenue grew 5% YoY (or +11% if excl. currency and one-off impact) to RMB13.9bn in 4Q22, supported by the successful launches of *NIKKE* and *Darktide* in 4Q22. Online ad revenue (17% of total revenue) recorded 15% YoY growth in 4Q22, beating our expectation, mainly driven by strong performance of Video Accounts and Mini Program ads. User time spent on Video Accounts tripled YoY and reached 1.2x that of Moments in 4Q22. Tencent will further explore monetization opportunities of Video Accounts in FY23, such as live streaming tipping, in-feed ads and live streaming e-commerce.
- FBS aim for recovery and more sustainable growth.** Fintech and Business Services (FBS) revenue declined by 1% YoY in 4Q22 (33% of total revenue), as the fintech business was impacted by COVID-19 and cloud business reduced loss-making activities. The optimized cost structure supported FBS GPM to improve by 6.4ppt YoY in 4Q22. Fintech business saw solid recovery in 1Q23, with YTD daily average commercial payment volume back to double-digit YoY growth. Cloud business completed the strategic adjustment for a more sustainable model and aims for better growth outlook in FY23, per management. The management also illustrated their strategies for generative AI to amplify growth across businesses lines: 1) rolling out its self-developed foundation model; 2) leveraging AI capabilities to enhance innovation, monetization and operational efficiency.
- Strong earnings rebound potential over FY22-25.** Overall GPM expanded by 2.5ppt YoY to 42.6% in 4Q22, supported by strong growth of higher-margin ad business (+15% YoY) and enhanced GPM of FBS business (+6.4ppt YoY). S&M expenses declined by 47% YoY and was equivalent to 4.2% of total revenue in 4Q22 (4Q21: 8.1%). These drove non-IFRS net income to grow 19% YoY in 4Q22. We estimate robust non-IFRS net income CAGR of 17% over FY22-25E, which justified Tencent's current core valuation (excl. strategic investment) of 17x 23E non-IFRS.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	615,381	669,040	721,216
YoY growth (%)	16.2	(1.0)	11.0	8.7	7.8
Gross margin (%)	43.9	43.1	43.7	44.5	45.5
Adjusted net profit (RMB mn)	123,788.0	115,649.0	138,540.5	162,484.6	184,623.5
YoY growth (%)	0.9	(6.6)	19.8	17.3	13.6
EPS (Adjusted) (RMB)	12.99	12.13	14.31	16.78	19.06
Consensus EPS (RMB)	12.99	12.13	14.57	17.10	21.62
P/S (x)	5.2	5.2	4.7	4.3	4.0
P/E (x)	18.1	14.1	19.6	17.6	15.0

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$455.00
(Previous TP)	HK\$450.00
Up/Downside	31.0%
Current Price	HK\$347.20

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Stock Data

Mkt Cap (HK\$ mn)	3,311,333.2
Avg 3 mths t/o (HK\$ mn)	361.7
52w High/Low (HK\$)	415.00/190.72
Total Issued Shares (mn)	9537.3

Source: FactSet

Shareholding Structure

MIH TC	28.7%
Advance Data Services Limited	8.4%

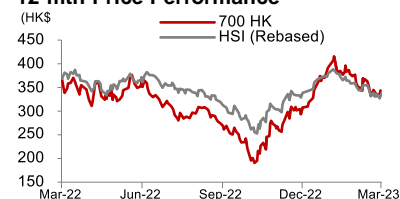
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-2.5%	1.7%
3-mth	12.9%	13.4%
6-mth	29.2%	19.7%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: Tencent: forecast revision

RMB bn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	615.4	669.0	721.2	611.5	662.0	-	0.6%	1.1%	-
Gross Profit	268.8	298.0	327.8	263.7	287.3	-	1.9%	3.7%	-
Adjusted net profit	138.5	162.5	184.6	134.1	152.7	-	3.3%	6.4%	-
Adjusted EPS (RMB)	14.31	16.78	19.06	13.9	15.8	-	2.9%	6.2%	-
Gross Margin	43.7%	44.5%	45.5%	43.1%	43.4%	-	0.6 ppt	1.1 ppt	-
Adjusted net margin	22.5%	24.3%	25.6%	21.9%	23.1%	-	0.6 ppt	1.2 ppt	-

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	615.4	669.0	721.2	616.4	691.3	-	-0.2%	-3.2%	-
Gross Profit	268.8	298.0	327.8	273.3	309.2	-	-1.6%	-3.6%	-
Adjusted net profit	138.5	162.5	184.6	143.7	168.6	-	-3.6%	-3.6%	-
Adjusted EPS (RMB)	14.3	16.8	19.1	14.6	17.1	-	-1.8%	-1.9%	-
Gross Margin	43.7%	44.5%	45.5%	44.3%	44.7%	-	-0.7 ppt	-0.2 ppt	-
Adjusted net margin	22.5%	24.3%	25.6%	23.3%	24.4%	-	-0.8 ppt	-0.1 ppt	-

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financial

(RMB bn)	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	Cons.	Diff%	CMBI	Diff%
SNS revenue	29.0	30.3	29.1	29.1	29.2	29.9	28.6			29.1	-1.7%
YoY %	8.6%	6.8%	4.4%	1.0%	0.6%	-1.4%	-1.7%				
Games revenue	43.0	44.9	42.8	43.6	42.5	42.9	41.8			40.1	4.1%
YoY %	12.3%	8.4%	9.5%	0.0%	-1.2%	-4.6%	-2.3%				
Online ad revenue	22.8	22.5	21.5	18.0	18.6	21.4	24.7			22.4	10.2%
YoY %	23.1%	5.4%	-12.7%	-17.6%	-18.4%	-4.7%	14.6%				
FBS revenue	41.9	43.3	48.0	42.8	42.2	44.8	47.2			48.2	-1.9%
YoY %	40.3%	30.3%	24.6%	9.6%	0.8%	3.5%	-1.5%				
Total revenue	138.3	142.4	144.2	135.5	134.0	140.1	145.0	144.5	0.3%	142.4	1.8%
YoY %	20.3%	13.5%	7.9%	0.1%	-3.1%	-1.6%	0.5%				
Gross profit margin	45.4%	44.1%	40.1%	42.1%	43.2%	44.2%	42.6%				
G&A%	16.4%	16.8%	16.9%	19.7%	19.6%	18.9%	18.8%				
S&M%	7.2%	7.3%	8.1%	5.9%	5.9%	5.1%	4.2%				
Non-IFRS net margin	24.6%	22.3%	17.3%	18.9%	21.0%	23.0%	20.5%				
Non-IFRS net profit	34.0	31.8	24.9	25.5	28.1	32.3	29.7	30.8	-3.7%	30.2	-1.7%
YoY %	12.9%	-1.7%	-25.1%	-22.9%	-17.3%	1.6%	19.4%				

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$455.0 comprises, per share:

- 1) HK\$184.0 for the online games business, based on a 20x 2023E PE, which is at discount to average PE for its global gaming peers (22x). The discount reflects Tencent's gaming business has entered a mature stage with more stable growth outlook versus peers.
- 2) HK\$29.3 for the SNS business, including the market cap of Tencent's stake in its subsidiaries, the valuation of Tencent Video (based on a 3.0x 2023E PS, at a premium to the 2.8x average PS of its peers given its content and user traffic leadership), and the valuation of other membership services (based on a 2.0x 2023E PS).
- 3) HK\$39.6 for the advertising business, based on a 18x 2023E PE, on par with the industry average.
- 4) HK\$101.9 for the fintech business, based on a 5.0x 2023E PS, at a premium to the peer average (2.6x). This mainly reflected our positive view on the recovery of China's digital payment volume in FY23/24E, and Tencent, as one of the largest digital payment platforms in China, is well positioned to benefit from the recovery
- 5) HK\$23.5 for the cloud business, based on a 5.0x 2023E PS, at a premium to the industry average (4.4x) as we expect Tencent to gradually gain market share and benefit from the growth of China SaaS market after its strategic adjustment.
- 6) HK\$62.0 for strategic investments, based on the market value of Tencent's listed investment and the book value of its unlisted investment. We applied a 30% holding company discount to the fair value of Tencent's equity investment.
- 7) HK\$14.7 for net cash.

Figure 4: Tencent: SOTP valuation

	2023E net profit (RMBmn)	2023E revenue (RMBmn)	2023E PE (x)	2023E PS (x)	Market cap (RMBmn)	Valuation to Tencent (RMBmn)	As % of total valuation	Per share valuation (HK\$)
Online games	74,835		20x			1,496,707	40.4	184.0
Social network services (SNS)		122,666				238,137	6.4	29.3
Tencent Music (TME)					84,254	46,424	1.3	5.7
China Literature					31,259	18,499	0.5	2.3
Huya					5,467	2,592	0.1	0.3
Online video – subscription		27,300		3.0x		81,900	2.2	10.1
Others		44,361		2.0x		88,722	2.4	10.9
Online advertising	17,891		18x			322,044	8.7	39.6
Fintech		165,760		5.0x		828,801	22.4	101.9
Cloud (business services)		38,267		5.0x		191,337	5.2	23.5
Net cash						119,633	3.2	14.7
Valuation of core business						3,196,659		
RMB/HK\$						0.85		
Valuation of core business (HK\$mn)						3,747,548		
Valuation per share – core business (HK\$)						392.9		
Valuation per share – investment (HK\$)						62.0	13.6	
Valuation per share – Tencent (HK\$)						455.0		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

Companies	Ticker	Price	EPS growth (YoY %)		PE (x)	
		(Local)	FY23E	FY24E	FY23E	FY24E
Online games						
NetEase	NTES US	86.1	(2)	11	17	16
Activision Blizzard	ATVI US	79.8	27	6	21	20
Electronic Arts	EA US	114.9	(14)	7	19	18
Take Two Interactive	TTWO US	118.6	(28)	42	33	23
IGG	799 HK	2.5	na	142	39	16
iDreamSky	1119 HK	3.9	na	136	25	10
Nexon	3659 JP	2,951.0	(0)	17	23	20
Nintendo	7974 JP	5,054.0	(7)	(10)	15	16
Bandai Namco	7832 JP	8,371.0	25	3	19	18
Perfect World	002624 CH	15.9	16	16	17	14
37 Interactive	002555 CH	25.3	16	12	16	14
Average PE					22	17
Online advertising						
Focus Media	002027 CH	6.8	60	23	20	16
Baidu	BIDU US	151.8	22	17	16	14
Meta	Meta US	202.2	10	23	17	14
Google	GOOG US	105.8	9	19	19	16
Average PE					18	15

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 21 March

Figure 6: Peer comparison: online video, fintech, and cloud sectors

Companies	Ticker	Price	Revenue growth (YoY %)		PS (x)	
		(Local)	FY23E	FY24E	FY23E	FY24E
Online video						
iQiyi	IQ US	7.0	9.1	8.4	1.4	1.3
Mango Excellent Media	300413 CH	36.5	16.3	12.8	4.2	3.7
Average PS					2.8	2.5
Cloud						
Microsoft	MSFT US	273.8	11.5	11.9	8.7	7.8
Google	GOOG US	105.8	17.0	9.0	4.9	4.5
Salesforce	CRM US	188.7	11.7	11.1	5.5	4.9
Kingsoft Cloud	KC US	5.3	10.7	7.6	1.0	1.0
Amazon	AMZN US	100.6	9.0	12.5	1.9	1.6
Average PS					4.4	4.0
Fintech						
PayPal	PYPL US	76.7	6.6	9.8	3.0	2.7
Square	SQ US	77.5	14.4	13.6	2.3	2.1
Average PS					2.6	2.4

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 21 March

Our calculation for the valuation of Tencent's strategic investments is based on the current market value of Tencent's listed investment and the book value of its unlisted investment. We applied a 30% holding company discount to the fair value of Tencent's equity investment.

Figure 7: Tencent: valuation of strategic investment

Name	Ticker	Tencent's stake %	Mkt cap (US\$mn)	Value to Tencent (HK\$bn)
PDD Holdings Inc	PDD US	15.5	99,798	120,578
Sea Ltd	SE US	20.2	44,860	70,682
Kuaishou Technology	1024 HK	20.6	30,884	49,720
Meituan	3690 HK	3.6	103,688	29,277
Snap Inc	SNAP US	17.5	17,996	24,606
KE Holdings Inc	BEKE US	11.3	23,529	20,739
China International Capital Co	3908 HK	11.4	20,682	18,326
Spotify Technology SA	SPOT US	8.6	24,914	16,732
JD.com Inc	9618 HK	2.7	62,917	13,054
NU Holdings Ltd/Cayman Islands	NU US	7.9	20,716	12,781
Futu Holdings Ltd	FUTU US	21.6	7,055	11,892
Bilibili Inc	9626 HK	13.4	9,782	10,232
Tongcheng Travel Holdings Ltd	780 HK	21.4	4,775	7,963
Vipshop Holdings Ltd	VIPS US	11.5	8,531	7,665
Krafton Inc	259960 KS	13.5	6,621	6,967
Kanzhun Ltd	BZ US	9.9	8,434	6,493
Warner Music Group Corp	WMG US	4.9	15,772	6,053
Netmarble Corp	251270 KS	17.5	4,267	5,831
Yixin Group Ltd	2858 HK	53.9	856	3,598
ZhongAn Online P&C Insurance C	6060 HK	8.1	4,663	2,943
Waterdrop Inc	WDH US	26.5	1,188	2,456
Paradox Interactive AB	PDX SS	9.1	2,635	1,873
Kadokawa Corp	9468 JP	6.9	2,875	1,538
Maoyan Entertainment	1896 HK	13.7	1,351	1,448
Ubisoft Entertainment SA	UBI FP	5.5	2,995	1,275
DHC Software Co Ltd	002065 CH	4.9	3,199	1,223
Oxford Nanopore Technologies P	ONT LN	7.7	2,030	1,211
Linklogis Inc	9959 HK	15.6	961	1,171
Tuya Inc	2391 HK	11.7	1,106	1,007
Other listed entities as a whole			52,982	11,117
Listed investment (Current value)				470,454
Unlisted investment (Book Value)				373,858
Total investment value				844,312
Holdco discount				30%
Valuation of strategic investment				591,018
Valuation of strategic investment per share				62.0

Source: Bloomberg, Company data, CMBIGM estimates

Note: data as of the market close on 21 March

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	482,064	560,118	554,552	615,381	669,040	721,216
Cost of goods sold	(260,532)	(314,174)	(315,806)	(346,579)	(371,029)	(393,406)
Gross profit	221,532	245,944	238,746	268,802	298,011	327,810
Operating expenses	(37,295)	25,676	(3,040)	(84,896)	(93,946)	(99,456)
Selling expense	(33,758)	(40,594)	(29,229)	(32,615)	(35,459)	(36,782)
Admin expense	(67,625)	(89,847)	(106,696)	(116,307)	(123,772)	(129,819)
Others	64,088	156,117	132,885	64,026	65,285	67,145
Operating profit	184,237	271,620	235,706	183,905	204,065	228,354
Share of (losses)/profits of associates/JV	3,672	(16,444)	(16,129)	(3,384)	(3,384)	(3,384)
Interest income	6,957	6,650	8,592	11,494	11,177	11,414
Interest expense	(7,887)	(7,114)	(9,352)	(9,525)	(9,617)	(2,326)
Pre-tax profit	180,022	248,062	210,225	170,996	191,064	222,644
Income tax	(19,897)	(20,252)	(21,516)	(23,085)	(25,794)	(29,062)
After tax profit	160,125	227,810	188,709	147,912	165,270	193,581
Minority interest	(278)	(2,988)	(466)	(365)	(408)	(460)
Net profit	159,847	224,822	188,243	147,547	164,862	193,122
Adjusted net profit	122,742	123,788	115,649	138,540	162,485	184,623
Gross dividends	12,653	12,704	20,256	18,258	20,401	22,987
BALANCE SHEET						
YE 31 Dec (RMB mn)						
Current assets	317,647	484,812	544,322	683,190	805,554	977,953
Cash & equivalents	152,798	167,966	344,346	419,218	543,965	645,068
Account receivables	44,981	49,331	45,287	48,747	51,407	53,754
Inventories	814	1,063	1,782	1,879	1,941	2,050
Prepayment	40,321	65,390	36,131	73,146	42,095	78,406
ST bank deposits	68,487	83,813	102,194	124,157	150,307	181,331
Financial assets at FVTPL	6,593	10,573	11,102	11,657	12,240	12,852
Other current assets	3,653	106,676	3,481	4,386	3,600	4,492
Non-current assets	1,015,778	1,127,552	1,166,667	1,232,379	1,277,581	1,340,372
PP&E	59,843	61,914	74,137	85,047	94,551	102,944
Deferred income tax	21,348	26,068	19,437	31,059	23,840	35,341
Investment in JVs & assos	305,258	323,188	338,245	353,790	369,811	386,298
Intangibles	159,437	171,376	194,746	216,214	237,125	257,256
Financial assets at FVTPL	165,944	192,184	192,184	192,184	192,184	192,184
Other non-current assets	303,948	352,822	347,918	354,086	360,071	366,349
Total assets	1,333,425	1,612,364	1,710,989	1,915,569	2,083,135	2,318,325
Current liabilities	269,079	403,098	300,720	353,415	354,507	403,035
Short-term borrowings	14,242	19,003	16,918	18,567	19,877	21,075
Account payables	94,030	109,470	96,007	127,237	109,366	138,998
Tax payable	12,134	12,506	14,126	15,192	15,939	16,562
Other current liabilities	144,851	256,673	168,223	186,972	203,880	220,953
Lease liabilities	3,822	5,446	5,446	5,446	5,446	5,446
Non-current liabilities	286,303	332,573	360,868	377,383	392,599	408,836
Long-term borrowings	112,145	136,936	139,423	140,182	140,411	140,480
Bond payables	122,057	145,590	156,509	162,378	165,423	166,974
Deferred income	6,678	4,526	12,632	13,863	14,841	15,736
Other non-current liabilities	45,423	45,521	52,304	60,960	71,924	85,646
Total liabilities	555,382	735,671	661,588	730,798	747,106	811,871
Retained earnings	538,464	669,911	842,153	977,158	1,128,007	1,297,973
Other reserves	165,520	136,388	136,388	136,388	136,388	136,388
Total shareholders equity	703,984	806,299	978,541	1,113,546	1,264,395	1,434,361
Minority interest	74,059	70,394	70,860	71,225	71,633	72,093
Total equity and liabilities	1,333,425	1,612,364	1,710,989	1,915,569	2,083,135	2,318,325

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	180,022	248,062	210,225	170,996	191,064	222,644
Depreciation & amortization	50,774	56,818	60,230	69,766	78,414	86,446
Tax paid	(19,897)	(20,252)	(21,516)	(23,085)	(25,794)	(29,062)
Change in working capital	27,423	(2,844)	33,122	9,408	27,365	7,938
Others	(44,203)	(106,598)	0	0	0	(7,367)
Net cash from operations	194,119	175,186	282,061	227,085	271,050	280,599
Investing						
Capital expenditure	(33,906)	(34,931)	(33,892)	(36,858)	(39,270)	(41,486)
Acquisition of subsidiaries/ investments	(108,665)	(117,642)	(21,688)	(56,758)	(40,733)	(66,795)
Net proceeds from disposal of short-term investments	15,376	0	0	0	0	0
Others	(54,760)	(25,976)	(61,929)	(65,286)	(69,559)	(73,484)
Net cash from investing	(181,955)	(178,549)	(117,510)	(158,902)	(149,563)	(181,765)
Financing						
Net borrowings	44,490	45,239	19,724	17,999	16,294	17,164
Proceeds from share issues	1,716	0	0	0	0	0
Others	(32,559)	(23,619)	(7,894)	(11,311)	(13,035)	(14,894)
Net cash from financing	13,647	21,620	11,829	6,689	3,259	2,270
Net change in cash						
Cash at the beginning of the year	132,991	152,798	167,966	344,346	419,218	543,965
Exchange difference	(6,004)	(3,089)	0	0	0	0
Cash at the end of the year	152,798	167,966	344,346	419,218	543,965	645,068
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	27.8%	16.2%	(1.0%)	11.0%	8.7%	7.8%
Gross profit	32.2%	11.0%	(2.9%)	12.6%	10.9%	10.0%
Operating profit	55.2%	47.4%	(13.2%)	(22.0%)	11.0%	11.9%
Net profit	71.3%	40.6%	(16.3%)	(21.6%)	11.7%	17.1%
Adj. net profit	30.1%	0.9%	(6.6%)	19.8%	17.3%	13.6%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	46.0%	43.9%	43.1%	43.7%	44.5%	45.5%
Operating margin	38.2%	48.5%	42.5%	29.9%	30.5%	31.7%
Adj. net profit margin	25.5%	22.1%	20.9%	22.5%	24.3%	25.6%
Return on equity (ROE)	28.1%	29.8%	21.1%	14.1%	13.9%	14.3%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	0.1	0.2	(0.0)	(0.1)	(0.2)	(0.2)
Current ratio (x)	1.2	1.2	1.8	1.9	2.3	2.4
Receivable turnover days	34.1	32.1	29.8	28.9	28.0	27.2
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	23.2	18.1	14.1	19.6	17.6	15.0
P/E (diluted)	23.6	18.4	14.3	20.0	17.9	15.3
P/B	5.3	5.0	2.7	2.6	2.3	2.0

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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