



March 19, 2015
Company Report
Rating: BUY
TP: HK\$ 161

H-Share price (HK\$) 135.9
Est. share price return 18.35%
Est. dividend yield 0.26%
Est. total return 18.62%

Previous Rating & TP BUY; 153
Previous Report Date Nov.13, 2014

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Key Data

52Wk H/L(HK\$)	143.3/97
Issued shares (mn)	9,373
Market cap (HK\$ mn)	1,273,791
3-mth avg daily turnover (HK\$ mn)	2,539
Major shareholder(s) (%)	
Naspers Limited	33.62
Ma Huateng	9.86

Source(s): Company, Bloomberg, ABCI Securities

FY14 Revenue breakdown (%)

VAS	80.21
Online advertising	10.53
Ecommerce transactions	6.02
Others	3.24
Total	100.00

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	3.90	5.75
3-mth	17.46	12.23
6-mth	8.55	8.47

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Tencent (700 HK)

Hitting the monetization buttons in FY15 ; reiterate **BUY**

- 4Q14 revenue was up 6% QoQ, driven by rising income from mobile game (+46% QoQ) and online ad. (8% QoQ). FY14 revenue was up 31% YoY to RMB 78,932 mn for FY14; net profit was up 54% YoY to RMB 23,810mn.
- Management still expects monetization of WeChat's ads (from WeChat Moments and Official Accounts) to grow progressively without compromising user experience. We project a mild growth in 1H15, to be followed by higher increase in 2H15
- WeBank will commence officially in Apr and focus on providing services to consumers and small enterprises. Management do not expect heavy capital input at this stage
- Medium-term catalysts include high growth in mobile advertising, commencement of WeBank business and increasing ARPU in mobile game
- Maintain **BUY** with TP revised up to HK\$ 161, reflecting 0.85x FY15E PEG

Better-than-expected FY14 results. Revenue was up 31% YoY to RMB 78,932 mn for FY14; net profit was up 54% YoY to RMB 23,810mn. Total revenues from smartphone games integrated with Mobile QQ and Weixin significantly recovered in 4Q14 and reached RMB 3,800 mn, up 46% QoQ, or 533% YoY. In 4Q14, however, fee-based VAS registered subscriptions dropped 5.6% QoQ. Management expect subscription will remain stable and ARPU will increase as more game players have turned to mid-core and hardcore genres. The ARPU range of mobile QQ and Weixin games increased to RMB 155-165 in 4Q14 from RMB 100-110 in 3Q14.

Mobile ads to grow rapidly in FY15. Tencent has begun to sell ads on WeChat Moments(a media-sharing platform for users). To ensure a quality user experience, the Group only promotes ads from its 10 largest clients. Management plan to strengthen the ecosystem in the medium term and will attract more ads clients through WeChat Moments and Official Accounts (public accounts for individuals or businesses). They expect an ecosystem combining JD, Dianping and 58.com, etc. will generate more mobile ads. Furthermore, we believe its cooperation with HBO and NBA will continue to enlarge its market shares in video ads.

Expect solid growth in O2O business and internet finance. In addition to mobile games and ads, O2O business and internet finance are growing swiftly and we believe monetization may occur in FY15. Management expect Tencent's online bank, WeBank, to commence operation in Apr. With the internet finance facilities in place, Tencent could create a powerful virtual ecosystem with plenty of O2O services that include online trip bookings, money market fund distributions, sales of wealth management products, small payment services (such as the "red packet" service) , and other social life services (restaurant ordering, taxi booking, ecommerce, online education, etc.). Noticing the upbeat growth in Visa and MasterCard (both enjoy two-digit growth in ROE in recent years), we are optimistic on the prospects of Tencent's O2O and internet finance business.

Results and Valuation

FY ended Dec 31	2012A	2013A	2014A	2015E	2016E
Turnover (RMB mn)	40,171	60,437	78,932	117,560	181,770
Chg (%.yoy)	40.97	50.45	30.60	48.94	54.62
Net Income (RMB mn)	12,732	15,502	23,810	34,374	49,991
Chg (%.YoY)	24.78	21.76	53.59	44.37	45.43
EPS (RMB)	1.37	1.66	2.55	3.61	5.18
Chg (%.YoY)	24.46	21.47	53.31	42.00	43.32
BVPS (RMB)	4.43	6.20	8.55	11.73	16.33
Chg (%.yoy)	44.72	39.94	37.85	37.16	39.21
DPS (HK\$)	0.20	0.24	0.36	0.52	0.75
P/E (x)	-	-	42.84	30.17	21.05
P/B (x)	-	-	12.75	9.30	6.68
Yield (%)	-	-	0.26	0.39	0.55
ROE (%)	36.50	31.24	34.52	35.89	37.15
ROA (%)	16.92	14.46	13.91	18.52	20.29

Source(s): Bloomberg, ABCI Securities estimates



Maintain BUY with TP revised to HK\$ 161. We revise Tencent's FY15E EPS from RMB 3.48 to RMB 3.61 (up 3.7%) to account for the potential gains from WeChat and WeBank, the two major catalysts for the Group in FY15. We remain upbeat on Tencent's prospects based on its prowess in the mobile internet platform and promising development in its mobile ad. and internet social services businesses. Our TP is revised up to HK\$ 161 (HK\$ 153 previously), reflecting 0.85x FY15E PEG.

Risk factors: 1) Regulatory risks; 2) Disappointing monetization from WeChat or much higher volatility of revenue of WeBank; 3) Slowdown in mobile gaming sector; (4) Slowdown in PC gaming sector; (5) High stock volatility in an overheating internet sector; (6) Post-M&A risks.



Consolidated income statement (2012A-2016E)

FY Ended Dec 31 (RMB mn)	2012A	2013A	2014A	2015E	2016E
IVAS	31,995	44,985	63,310	94,494	144,499
MVAS	3,723				
Online advertising	3,382	5,034	8,308	14,124	24,010
e-Commerce transactions	4,428	9,796	4,753	5,228	7,320
Others	365	622	2,561	3,713	5,942
Revenues	40,171	60,437	78,932	117,560	181,770
Cost of revenues	(18,207)	(27,778)	(30,873)	(49,375)	(76,343)
Gross profit	25,686	32,659	48,059	68,185	105,426
SG&A	(10,759)	(15,683)	(21,952)	(29,390)	(48,750)
Other income and gains	123	2,305	2,906	1,778	2,330
Pre-tax profit	15,051	19,281	29,013	40,573	59,006
Income tax	(2,266)	(3,718)	(5,125)	(6,086)	(8,851)
Net profit	12,785	15,563	23,888	34,487	50,155
Profit attributable to:					
Minority interests	53	61	78	113	164
Equity holders of the Company	12,732	15,502	23,810	34,374	49,991
EPS (Basic)*, RMB	1.39	1.69	2.58	3.67	5.26
EPS, Diluted*, RMB	1.37	1.66	2.55	3.61	5.18
DPS*, HK\$	0.20	0.24	0.36	0.52	0.75

* Historical BVPS is adjusted for share split.

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2012A-2016E)

As of Dec 31 (RMB mn)	2012A	2013A	2014A	2015E	2016E
Fixed assets	7,403	8,693	7,918	8,306	8,112
Intangible assets	4,719	4,103	9,304	10,421	9,863
Interests in associates	7,310	1,119	2,941	2,030	2,486
Other non-current assets	19,315	39,634	75,682	65,100	71,645
Total non-current assets	38,747	53,549	95,845	85,857	92,105
Inventories	568	1,384	244	784	1,025
Accounts receivable	2,354	2,955	4,588	8,229	10,906
Prepayments, deposits and other assets	3,878	5,365	7,804	6,585	7,194
Cash and cash equivalents	13,383	20,228	42,713	62,242	114,199
Other current assets	16,326	23,754	19,972	21,863	20,918
Current Assets	36,509	53,686	75,321	99,703	154,241
Total assets	75,256	107,235	171,166	185,560	246,346
Accounts payable	4,212	6,680	8,683	10,580	16,359
Other payables and accruals	6,301	10,246	19,123	14,107	19,995
Borrowings	1,077	2,589	3,215	3,275	3,864
Current income tax liabilities	420	1,318	461	890	675
Deferred revenue	8,115	11,841	16,153	13,997	15,075
Other short-term liabilities	540	593	2,400	2,047	1,747
Total current liabilities	20,665	33,267	50,035	44,895	57,715
Borrowings	2,106	3,323	5,507	3,176	3,320
Long-term notes payable	7,517	9,141	25,028	17,085	22,067
Deferred income tax liabilities	1,312	1,441	2,942	1,753	2,348
Long-term payables	1,509	1,600	2,052	1,826	1,939
Total non-current liabilities	12,443	15,505	39,007	23,840	29,674
Total liabilities	33,108	48,772	89,042	68,735	87,389
Total equity	42,148	58,463	82,124	116,825	158,958
Non-controlling interests	851	518	2,111	5,261	1,354
Equity of the firm	41,298	57,945	80,013	111,564	157,604
BVPS*, RMB	4.43	6.20	8.55	11.73	16.33

* Historical BVPS is adjusted for share split.

Source(s): Company, ABCI Securities estimates



Consolidated cash flow statement (2012A-2016E)

FY ended Dec 31 (RMB mn)	2012A	2013A	2014A	2015E	2016E
Profit for the year	12,785	15,563	23,888	34,487	50,155
Adjustments for:					
Income tax expense	2,266	3,718	5,125	6,086	8,851
Dividend income	(407)	(509)	(458)	(484)	(471)
Depreciation of fixed assets and investment properties	1,880	2,484	2,182	2,333	2,258
Amortization of intangible assets	733	1,106	919	1,013	966
Interest income	(836)	(1,314)	(1,676)	(1,275)	(1,422)
Equity-settled share-based compensation expenses	905	1,168	2,055	3,268	4,893
Changes in working capital:					
Accounts receivable	(267)	(606)	(1,633)	(3,641)	(2,677)
Inventories	(301)	(815)	1,140	(540)	(241)
Prepayments, deposits and other receivables	(2,255)	(940)	(2,439)	1,220	(610)
Accounts payable	1,689	2,036	2,003	1,897	5,779
Other adjusted items	5,461	5,601	11,480	(2,950)	8,222
Net Cash generated from operating activities	21,654	27,492	42,586	41,413	75,703
Income tax paid	(2,225)	(3,118)	(4,298)	(5,104)	(7,423)
Net cash flow generated from operating activities	19,429	24,374	32,711	36,309	68,280
Cash flow from investing activities					
Payments for business combinations, net of cash acquired	(435)	4	(215)	(106)	(161)
Purchase fixed assets, construction in progress & investment properties	(3,657)	(4,788)	(2,956)	(3,872)	(3,414)
Payments for interests in associates	(3,668)	(4,456)	(4,062)	(4,259)	(4,161)
Purchase/prepayment of intangible assets	(869)	(1,200)	(1,035)	(1,117)	(1,076)
Receipt from maturity of term deposits with initial term of over 3 months	18,532	15,950	17,241	16,595	16,918
Interest received	626	536	581	558	570
Dividends received	440	551	495	523	509
Other adjusted items	(27,239)	(25,731)	(38,438)	(26,223)	(26,387)
Net cash flow used in investing activities	(16,270)	(19,134)	(28,388)	(17,900)	(17,200)
Cash flow from financing activities					
Proceeds from short-term borrowings	983	2,320	1,651	1,986	1,819
Proceed from long-term borrowings	2,215	2,846	4,555	3,701	4,128
Net proceed from issuance of long-term notes	3,768	1,847	2,807	2,327	2,567
Proceeds from issuance of ordinary shares	238	308	273	291	282
Dividends paid to the Company's shareholders	(1,108)	(1,468)	(1,288)	(1,378)	(1,333)
Other adjusted items	(8,483)	(4,145)	10,351	(5,661)	(6,420)
Net cash flow (used in)/generated from financing activities	(2,386)	1,708	18,350	1,265	1,043
Net increase in cash and cash equivalents	773	6,948	22,673	19,674	52,123
Cash and cash equivalents at beginning of the year	12,612	13,383	20,228	42,713	62,242
Exchange losses on cash and cash equivalents	(2)	(103)	(188)	(146)	(167)
Cash and cash equivalents at end of the year	13,383	20,228	42,713	62,242	114,199

Source(s): Company, ABCI Securities estimates

Financial ratio table (2012A-2016E)

FY Ended Dec 31	2012A	2013A	2014A	2015E	2016E
Gross Profit Margin, %	54.68	54.04	60.89	58.00	58.00
Operating Margin, %	38.53	31.76	38.69	35.04	32.84
Net Margin, %	31.69	25.65	30.17	29.24	27.50
ROE, %	36.50	31.24	34.52	35.88	37.14
ROA, %	16.92	14.46	13.91	18.52	20.29
Total Liability/Total Asset, %	43.99	45.48	52.02	37.04	35.47

Source(s): Company, ABCI Securities estimates

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Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2010-2014

Time horizon of share price target: 12-month

Definition of share price risk

Rating	Definition
Very high	$2.6 \leq$ 180 day volatility/180 day benchmark index volatility
High	$1.5 \leq$ 180 day volatility/180 day benchmark index volatility < 2.6
Medium	$1.0 \leq$ 180 day volatility/180 day benchmark index volatility < 1.5
Low	180 day volatility/180 day benchmark index volatility < 1.0

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

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