



**March 25, 2014  
Company Report  
Rating: BUY  
TP: HK\$ 690\***

H-Share price (HK\$)	587
Est. share price return	17.55%
Est. dividend yield	0.39%
Est. total return	17.94%

Previous Rating & TP	BUY; HK\$ 610
Previous Report Date	Jan 29, 2014

**Analyst: Mark Chen**  
Tel: (852) 2147 8819  
Email: markchen@abci.com.hk

\*TP is calculated based on the no. of shares before the proposed 1-to-5 share split

**Key Data**

52Wk H/L(HK\$)	646/237
Issued shares (mn)	1,864
Market cap (HK\$ mn)	1,094,168
3-mth avg daily turnover (HK\$ mn)	3,287.8
Major shareholder(s) (%):	
Naspers Limited	34.02
Ma Huateng	10.25

Source(s): Company, Bloomberg, ABCI Securities

**FY13 Revenue breakdown (%)**

VAS	74.4
Online advertising	8.3
Ecommerce transactions	16.2
Others	1.0
Total	100.0

Source(s): Company, ABCI Securities

**Share performance (%)**

	Absolute	Relative*
1-mth	0.17	2.80
3-mth	25.11	30.86
6-mth	43.52	49.05

\*Relative to HSI

Source(s): Bloomberg, ABCI Securities

**1-Year stock performance (HK\$)**



Source(s): Bloomberg

**Tencent (700 HK)**  
Clear business strategies to prompt future growth

- Tencent offered a clear mobile internet strategy with distinct operating models. We believe the implementation will enhance its mobile internet businesses
- Proposal of a 5-to-1 share split (effective on May15) will broaden shareholders' base and may provide a positive trigger to share price in the short term
- We believe the clear strategy would help alleviate investors' concerns on its businesses and support valuation. Maintain **BUY** with revised TP at HK\$ 690, reflecting 0.95x FY14E PEG

**Ecommerce becomes a significant driver.** The Group's FY13 net profit was in line with our expectations. Diluted EPS was RMB 8.30, about 1.3% lower than our forecast. The Group saw growth in almost all business lines in 4Q13: Revenue in VAS was up 2.5% QoQ, online ad. was up 7.7% QoQ, ecommerce was up 40.9% QoQ, and other revenues were up 43.7% QoQ. Its FY13 ecommerce achieved a significantly higher growth (+121% YoY) than we expected (+100% YoY). Overall, ecommerce accounted for 32% of the increased revenue, which is impressive considering the segment is still in its early development stage.

**A clear mobile internet strategy with promising operating models.** Tencent's management offered a detailed monetization plan for its mobile internet business. The Group will enhance its present platforms to attract traffic while expanding into new areas through internal resources or external strategic partnerships / participants. To ensure success of the operating models, Tencent will continue its input in internal mobile internet platforms, purchase well-designed apps, and tighten cooperation with its strategic partners.

**Online payment is a potential profit trigger.** The strong demand for online financial services may become a profit trigger in the near future. The Group has discussed with regulators on the matter and the regulator would continue to support Tencent's innovation — a positive signal for Tencent's online payment business.

**5-to-1 share split.** The Group proposed a 5-to-1 share split to facilitate ownership and trading of small investors, with the lots of 100 shares remaining unchanged. We believe the share split, if executed, would help expand shareholders' base.

**Maintain BUY with TP of HK\$ 690.** We revise up Tencent's net profit in FY14E/FY15E by 1.8%/3.8% to reflect the higher growth forecasts in ecommerce and online ad. segments. Considering the Group's leading position, high ROE and fast-growing ecommerce business, we believe its current valuation is still attractive. Maintain **BUY** with TP at HK\$ 690, reflecting 0.95x/0.58x FY14E/FY15E PEG.

**Risk factors:** 1) Regulatory risks concerning online financial products and payment; 2) Disappointing monetization from WeChat and increasing marketing costs; 3) Intensifying competition among domestic ecommerce companies; (4) Slowdown in PC gaming sector; (5) High stock volatility in an overheating internet sector; (6) Post M&A risks.

**Results and Valuation**

FY ended Dec 31	2011A	2012A	2013A	2014E	2015E
Turnover (RMB mn)	28,496	43,894	60,437	86,031	121,206
Chg (%.yoy)	45.05	54.03	37.69	42.35	40.89
Net Income (RMB mn)	10,203	12,732	15,502	22,943	34,840
Chg (%.YoY)	26.69	24.78	21.76	48.00	51.85
EPS (RMB)	5.49	6.83	<b>8.30</b>	12.17	18.30
Chg (%.YoY)	26.85	24.46	21.45	46.60	50.42
BVPS (RMB)	15.32	22.16	31.02	40.35	55.88
Chg (%.yoy)	29.22	44.72	39.96	30.07	38.49
DPS	0.75	1.00	1.20	1.77	2.65
P/E (x)	-	-	54.83	37.40	24.86
P/B (x)	-	-	14.67	11.28	8.14
Yield (%)	-	-	0.26	0.39	0.58
ROE (%)	40.63	36.50	31.24	34.23	38.19
ROA (%)	17.96	16.92	14.46	19.21	21.94

Source(s): Bloomberg, ABCI Securities estimates

## Business outlook for Tencent (0700 HK)

### Tencent's operating models:

1. Continuous effort in existing social/games/media & entertainment platforms;
2. Expand to new areas: Ecommerce, O2O services, online finance, education, health care;  
Approaching the new areas by: 1) own expertise (if available); 2) open platform strategy to attract strategic partners with relevant expertise; 3) build structures and attract participants to sign in and use Tencent's products/services, such as its online ad. platform Guangdiantong (广点通). This will help enlarge the user base of the ecommerce system.

### Three main input baskets in FY14E:

1. Incremental spending in mobile internet, including Weixin/WeChat and mobile QQ, as the Group would need the traffic to support its other mobile apps;
2. New input in WeXin/WeChat payment service (QR code), Taxi booking (嘀嗒打车), WeChat marketing, video ad., etc.;
3. Allocating resources to support strategic partners, including JD.com.

**Online payment business:** PBOC suspended Tencent's online credit card and QR code payment services earlier on. Depressed by recent regulatory concerns, however, the Group believes the business is still promising because of the following reasons:

1. There are clear users' and merchants' demand for online payment services. Innovations are called for;
2. Even though relevant services by Tencent have been suspended, innovation in this area is still encouraged according to the Group's discussion with the regulators;
3. As per the specific tools of the services, further discussion will be needed between the Group and the regulators who urge that Tencent to take into account of the regulatory considerations in launching relevant products and services. As long as the demand is there, Tencent will find ways to resolve the issues. The Group is still bullish on the long-term prospect of the online payment market.

**Mobile games business:** While the platform still in its early development stage, Tencent expects the DAUs to continue to grow among different types of users.

**Online Ad.:** The revenue growth reflected the quick development of video ad. and Guangdiantong (广点通), but growth in traditional ad. tools is slowing.

### Ecommerce strategy and competition:

1. Strengthen cooperation with JD.com in ecommerce of physical goods selling; Tencent will use traffic and ad. to help JD.com build up its scale and B2C merchant base;
2. Tencent will also liaise with individual retailers who want to sell goods/services on the internet (esp. mobile internet), including those who do not want to be a part of a big marketplace; Tencent will attract both offline and online retailers;
3. Competition is stiffening, esp. in the mobile internet market where cross-industry development is increasing. Tencent will continue to strengthen its platforms in different industries.

**Capex:** No definite guideline was given, but FY14 capex should not exceed that of FY11 (~11% of revenue). For FY12/FY13, the capex was at ~ 6% of revenue and management stated the Group does not expect a significant increase in FY14E.



Consolidated income statement (2011A-2015E)

FY Ended Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
IVAS	23,043	31,995	44,985	58,458	74,322
MVAS	3,271	3,723			
Online advertising	1,992	3,382	5,034	7,048	10,219
e-Commerce transactions	0	4,428	9,796	19,592	35,266
Others	190	365	622	933	1,400
<b>Revenues</b>	<b>28,496</b>	<b>43,894</b>	<b>60,437</b>	<b>86,031</b>	<b>121,206</b>
Cost of revenues	(9,928)	(18,207)	(27,778)	(395,40)	(50,906)
<b>Gross profit</b>	<b>18,568</b>	<b>25,686</b>	<b>32,659</b>	<b>46,491</b>	<b>70,299</b>
SG&A	(7,204)	(10,759)	(15,683)	(23,345)	(30,301)
Other income and gains	(735)	(123)	(2,305)	(1,055)	(1,161)
<b>Pre-tax profit</b>	<b>12,099</b>	<b>15,051</b>	<b>19,281</b>	<b>24,200</b>	<b>41,159</b>
Income tax	(1,874)	(2,266)	(3,718)	(3,630)	(6,174)
<b>Net profit</b>	<b>10,225</b>	<b>12,785</b>	<b>15,563</b>	<b>23,039</b>	<b>34,985</b>
<b>Profit attributable to:</b>					
Minority interests	22	53	61	95	145
<b>Equity holders of the Company</b>	<b>10,203</b>	<b>12,732</b>	<b>15,502</b>	<b>22,943</b>	<b>34,840</b>
<b>EPS (Basic), RMB</b>	<b>5.61</b>	<b>6.97</b>	<b>8.46</b>	<b>12.28</b>	<b>18.47</b>
<b>EPS, Diluted, RMB</b>	<b>5.49</b>	<b>6.83</b>	<b>8.30</b>	<b>12.17</b>	<b>18.30</b>
<b>DPS, RMB</b>	<b>0.75</b>	<b>1.00</b>	<b>1.20</b>	<b>1.77</b>	<b>2.65</b>

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2011A-2015E)

As of Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
Fixed assets	5,885	7,403	8,693	13,481	19,186
Intangible assets	3,780	4,719	4,103	4,952	5,791
Interests in associates	4,433	7,310	12,170	9,740	10,955
Other non-current assets	7,203	19,315	28,583	27,080	27,045
<b>Total non-current assets</b>	<b>21,301</b>	<b>38,747</b>	<b>53,549</b>	<b>55,253</b>	<b>62,977</b>
Inventories		568	1,384	2,939	5,290
Accounts receivable	2,021	2,354	2,955	5,162	8,484
Prepayments, deposits and other assets	2,212	3,878	5,365	4,621	4,993
Cash and cash equivalents	12,612	13,383	20,228	31,430	55,124
Other current assets	18,659	16,326	23,754	20,040	21,897
<b>Current Assets</b>	<b>35,503</b>	<b>36,509</b>	<b>53,686</b>	<b>64,192</b>	<b>95,789</b>
<b>Total assets</b>	<b>56,804</b>	<b>75,256</b>	<b>107,235</b>	<b>119,445</b>	<b>158,766</b>
Accounts payable	2,244	4,212	6,680	8,603	10,909
Other payables and accruals	5,014	6,301	10,246	11,184	14,545
Borrowings	7,999	1,077	2,589	2,025	2,679
Current income tax liabilities	709	420	1,318	869	1,093
Deferred revenue	5,016	8,115	11,841	9,978	10,909
Other short-term liabilities	200	540	593	567	580
<b>Total current liabilities</b>	<b>21,183</b>	<b>20,665</b>	<b>33,267</b>	<b>33,225</b>	<b>40,715</b>
Borrowings		2,106	3,323	3,229	2,653
Long-term notes payable	3,733	7,517	9,141	3,286	5,435
Deferred income tax liabilities	940	1,312	1,441	1,376	1,409
Long-term payables	1,860	1,509	1,600	1,554	1,577
<b>Total non-current liabilities</b>	<b>6,533</b>	<b>12,443</b>	<b>15,505</b>	<b>9,445</b>	<b>11,074</b>
<b>Total liabilities</b>	<b>27,716</b>	<b>33,108</b>	<b>48,772</b>	<b>42,670</b>	<b>51,789</b>
<b>Total equity</b>	<b>29,088</b>	<b>42,148</b>	<b>58,463</b>	<b>76,774</b>	<b>106,977</b>
Non-controlling interests	625	851	518	684	601
<b>Equity of the firm</b>	<b>28,464</b>	<b>41,298</b>	<b>57,945</b>	<b>76,090</b>	<b>106,376</b>
BVPS, RMB	15.32	22.16	31.02	40.35	55.88

Source(s): Company, ABCI Securities estimates

**Consolidated cash flow statement (2011A-2015E)**

<b>FY ended Dec 31 (RMB mn)</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>
<b>Profit for the year</b>	<b>10,225</b>	<b>12,785</b>	<b>15,563</b>	<b>23,039</b>	<b>34,985</b>
Adjustments for:					
Income tax expense	1,874	2,266	3,718	3,630	6,174
Dividend income	–	(407)	(407)	(407)	(407)
Depreciation of fixed assets and investment properties	1,208	1,880	1,544	1,712	1,628
Amortization of intangible assets	726	733	729	731	730
Interest income	(469)	(836)	(1,314)	(873)	(1,008)
Equity-settled share-based compensation expenses	733	905	1,400	1,883	2,730
<b>Changes in working capital:</b>					
Accounts receivable	(251)	(267)	(601)	(2,207)	(3,323)
Inventories	–	(301)	(816)	(1,555)	(2,351)
Prepayments, deposits and other receivables	(2,630)	(2,255)	(1,487)	744	(372)
Accounts payable	828	1,689	2,468	1,923	2,305
Other adjusted items	2,951	5,461	6,871	4,239	6,474
<b>Net Cash generated from operating activities</b>	<b>15,194</b>	<b>21,654</b>	<b>27,668</b>	<b>32,859</b>	<b>47,567</b>
Income tax paid	(1,836)	(2,225)	(3,294)	(3,564)	(6,061)
<b>Net cash flow generated from operating activities</b>	<b>13,358</b>	<b>19,429</b>	<b>24,374</b>	<b>29,295</b>	<b>41,506</b>
<b>Cash flow from investing activities</b>					
Payments for business combinations, net of cash acquired	(1,444)	(435)	(940)	(687)	(813)
Purchase fixed assets, construction in progress & investment properties	(4,060)	(3,657)	(7,180)	(5,419)	(6,299)
Payments for interests in associates	(3,529)	(3,668)	(3,598)	(3,633)	(3,616)
Purchase/prepayment of intangible assets	(788)	(869)	(829)	(849)	(839)
Receipt from maturity of term deposits with initial term of over 3 months	5,989	18,532	12,261	15,396	13,828
Interest received	415	626	520	573	547
Dividends received	20	440	230	335	282
Other adjusted items	(11,958)	(27,239)	(19,598)	(23,419)	(21,509)
<b>Net cash flow used in investing activities</b>	<b>(15,355)</b>	<b>(16,270)</b>	<b>(19,134)</b>	<b>(17,702)</b>	<b>(18,418)</b>
<b>Cash flow from financing activities</b>					
Proceeds from short-term borrowings	6,683	983	3,833	2,408	3,120
Proceed from long-term borrowings	0	2,215	1,822	2,019	1,920
Net proceed from issuance of long-term notes	3,761	3,768	3,764	3,766	3,765
Proceeds from issuance of ordinary shares	160	238	199	219	209
Dividends paid to the Company's shareholders	(838)	(1,108)	(973)	(1,040)	(1,007)
Other adjusted items	(5,392)	(8,483)	(6,937)	(7,710)	(7,324)
<b>Net cash flow (used in)/generated from financing activities</b>	<b>4,373</b>	<b>(2,386)</b>	<b>1,708</b>	<b>(339)</b>	<b>685</b>
<b>Net increase in cash and cash equivalents</b>	<b>2,376</b>	<b>773</b>	<b>6,948</b>	<b>11,254</b>	<b>23,772</b>
<b>Cash and cash equivalents at beginning of the year</b>	<b>10,408</b>	<b>12,612</b>	<b>13,383</b>	<b>20,228</b>	<b>31,430</b>
<b>Exchange losses on cash and cash equivalents</b>	<b>(172)</b>	<b>(2)</b>	<b>(103)</b>	<b>(53)</b>	<b>(78)</b>
<b>Cash and cash equivalents at end of the year</b>	<b>12,612</b>	<b>13,383</b>	<b>20,228</b>	<b>31,430</b>	<b>55,124</b>

Source(s): Company, ABCI Securities estimates

**Financial ratio table (2011A-2015E)**

<b>FY Ended Dec 31</b>	<b>2011A</b>	<b>2012A</b>	<b>2013A</b>	<b>2014E</b>	<b>2015E</b>
Gross Profit Margin, %	58.52	55.00	54.00	58.00	58.00
Operating Margin, %	43.00	35.27	31.76	28.32	34.10
Net Margin, %	35.81	29.01	25.65	26.67	28.74
ROE, %	40.63	36.50	31.24	34.23	38.19
ROA, %	17.96	16.92	14.46	19.21	21.94
Total Liability/Total Asset, %	48.79	43.99	45.48	35.72	32.62

Source(s): Company, ABCI Securities estimates

## Disclosures

### Analyst Certification

I, Chen Yibiao, Mark, being the person primarily responsible for the content of this research report, in whole or in part, hereby certify that all of the views expressed in this report accurately reflect my personal view about the subject company or companies and its or their securities. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this report. I and/or my associates have no financial interests in relation to the listed company (ies) covered in this report, and I and/or my associates do not serve as officer(s) of the listed company (ies) covered in this report.

### Disclosures of Interests

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

### 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 2009-2013

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.

### Disclaimers

This report is for our clients only and is for distribution only under such circumstances as may be permitted by applicable law. It has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient. It is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. No representation or warranty, either expresses or implied, is provided in relation to the accuracy, completeness or reliability of the information contained herein. This report should not be regarded by recipients as a substitute for the exercise of their own judgment. Any opinions expressed in this report are subject to change without notice and may differ or be contrary to opinions expressed by other business areas as a result of using different assumptions and criteria. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. The analyst(s) responsible for the preparation of this report may interact with trading desk personnel, sales personnel and other constituencies for the purpose of gathering, synthesizing and interpreting market information. ABCI Securities Company Limited is under no obligation to update or keep current the information contained herein. ABCI Securities Company Limited relies on information barriers to control the flow of information contained in one or more areas within ABCI Securities Company Limited, into other areas, units, groups or affiliates of ABCI Securities Company Limited. The compensation of the analyst who prepared this report is



determined exclusively by research management and senior management (not including investment banking). Analyst compensation is not based on investment banking revenues, however, compensation may relate to the revenues of ABCI Securities Company Limited as a whole, of which investment banking, sales and trading are a part. The securities described herein may not be eligible for sale in all jurisdictions or to certain categories of investors. The price and value of the investments referred to in this research and the income from them may fluctuate. Past performance is not necessarily indicative of future results. Foreign currency rates of exchange may adversely affect the value, price or income of any security or related instrument mentioned in this report. For investment advice, trade execution or other enquiries, clients should contact their local sales representative. Neither ABCI Securities Company Limited nor any of its affiliates, directors, employees or agents accepts any liability for any loss or damage arising out of the use of all or any part of this report. Additional information will be made available upon request.

ABCI Securities Company Limited and/or its affiliates may pursue financial interests to the companies mentioned in the report.

ABCI Securities Company Limited and/or its affiliates, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

---

Copyright 2014 ABCI Securities Company Limited

No part of this material may be (i) copied, photocopied or duplicated in any form by any means or (ii) redistributed without the prior written consent of ABCI Securities Company Limited.

**Office address: ABCI Securities Company Limited, 13/F Fairmont House,  
8 Cotton Tree Drive, Central, Hong Kong.**

**Tel: (852) 2868 2183**