



Tencent (700 HK)

Solid momentum

- Robust 1Q20 results with 26% YoY revenue growth and 29% YoY core profit growth, primarily driven by online gaming business
- We expect the strong momentum to continue in the near term, especially for international online gaming business benefiting from traffic boost amid the prolonged stay-at-home periods overseas
- Maintain **BUY** and raise TP to HK\$ 500 on further re-rating potentials on robust momentum in near term

1Q20 highlights. Tencent reported robust results in 1Q20, with 26% YoY growth in revenue and 29% YoY growth in non-GAAP net profit. Overall, the robust results were driven by the increased online traffic during the COVID-19 outbreak, which benefits its online gaming and online advertising businesses.

Strong gaming momentum to carry on. Online gaming revenue rose by 31% YoY, in which smartphone gaming revenue grew by 64% YoY, supported by key titles such as Peacekeeper Elite, PUBG Mobile, and Clash of Clans. Looking forward, although the high traffic during the extended CNY break might start to normalize, we expect the positive momentum to be perpetuated by international markets and potential launch of key titles, including DNF Mobile and League of Legends Mobile, in coming months.

Online advertising still resilient: Despite a weakened economic environment, online advertising revenue growth accelerated to 32% YoY in 1Q20 vs. 19% YoY in 4Q19, as the increase in advertising inventories and traffic has prompted a 47% YoY growth in social advertising revenue, offsetting a 10% YoY decline in media advertising.

Maintain BUY; TP raised to HK\$ 500. We maintain our **BUY** rating on the counter given the strong momentum of the online gaming business perpetuated by risen demand for online entertainment overseas amid the ongoing pandemic. We raise our SOTP-based TP to HK\$ 500. In addition, we continue to believe that current valuation has priced in the higher degree of earnings cyclicity and lower visibility after going through the earnings cycle in 2018-2019.

Results and Valuation

	2018A	2019A	2020E	2021E
Revenue (RMB mn)	312,694	377,289	459,189	581,230
Chg (% YoY)	60.8	20.7	21.7	26.6
Net profit (RMB mn)	78,719	93,310	102,944	132,489
Chg (% YoY)	10.1	18.5	10.3	28.7
Non-GAAP net profit (RMB mn)	77,469	94,351	118,694	148,239
Chg (% YoY)	19.0	21.8	25.8	24.9
EPS (RMB)	8.3	9.9	10.8	13.9
Chg (% YoY)	9.7	16.9	10.6	28.7
Non-GAAP EPS (RMB)	8.2	10.0	12.4	15.5
Chg (% YoY)	18.5	20.1	26.1	24.9
Core P/E (x)	47.2	39.3	31.1	24.9
P/B (x)	11.3	8.6	7.0	5.7
ROAE (%)	24.9	22.1	19.2	20.5
ROAA (%)	12.3	11.1	10.2	11.7
DPS(HKD)	0.97	1.13	1.25	1.61
Dividend Yield (%)	0.2	0.3	0.3	0.4

Source(s): Bloomberg, ABCI Securities estimates

Company Report

May 14, 2020

Rating: BUY

TP: HK\$500

Analyst : Steve Chow

Tel: (852) 2147 8809

stevechow@abci.com.hk

Share price (HK\$)	429.6
Est. share price return	16.1%
Est. dividend yield	0.3%
Est. total return	16.4%
Previous Rating & TP	BUY/HK\$395
Previous Report Date	Mar 19, 2020

Source(s): Bloomberg, ABCI Securities estimates

Key Data

52Wk H/L(HK\$)	437.0/312.2
Issued shares (mn)	9,553
Market cap (HK\$ mn)	4,113,522
Avg daily turnover (HK\$ mn)	3,593
Major shareholder(s)	
Naspers	31.0%
Huateng Ma	8.53%

Source(s): Bloomberg, ABCI Securities

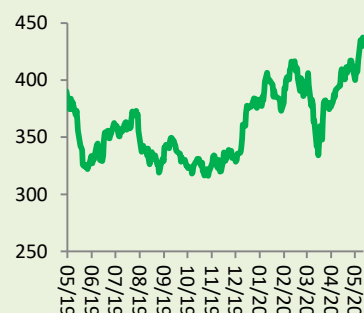
Share Performance (%)

	Absolute	Relative*
1-mth	8.8	9.8
3-mth	5.4	18.5
6-mth	36.8	44.9

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



農銀國際

ABC INTERNATIONAL

ABCI SECURITIES COMPANY LIMITED

Tencent (700 HK)
Internet Media and Consumer Commerce Sector
May 14, 2020

Contents

1Q20 highlights	3
Financial outlook	7
Valuation	12
Appendix: Industry trend	15
Risk factors	23
Financial forecast	25
Disclosures.....	27



1Q20 highlights

Tencent reported robust results in 1Q20. In 1Q20, revenue increased by 26% YoY to RMB 108.1bn, 7% above market expectation. In addition, non-GAAP net profit increased by 29% YoY to RMB 27.1bn, 9% above market expectation.

Benefiting from boost in online traffic during the COVID-19 outbreak, online gaming revenue increased by 31% YoY, driven by key titles including Peacekeeper Elite (和平精英), as well as increasing contribution from overseas titles such as PUBG Mobile and Clash of Clans. This prompted a 64% YoY growth in smartphone game revenue, offsetting the 15% YoY decline in PC game revenue.

Online advertising reported a 32% YoY revenue growth in 1Q20 vs. 19% YoY growth in 4Q19, indicating a sequential improvement. Within online advertising, social and other advertising continued to be the main growth driver with a 47% YoY growth, thanks to increased inventories (supply of advertising spaces) and impressions (traffic) from Weixin Moments and its mobile advertising network, offsetting the 10% YoY revenue decline of media advertising dragged by the weak macro environment and suspension of sports events. By industry, advertising spending in online games, internet services, and online education increased, while advertising spending on FMCG, automobile, and travel industries declined.

FinTech and business service revenue growth declined by 22% YoY in 1Q20 vs. 39% YoY in 4Q19 due to lower payment volume and delay in cloud projects during the outbreak. Nonetheless, average daily commercial transaction value in the last week of Apr recovered to the late-2019 level, according to the management.

Exhibit 1: 1Q20 highlight

(RMB m)	1Q19	1Q20	YoY	Remarks
Online game	28,513	37,298	31%	Driven by Peacekeeper Elite, PUBG Mobile, Clash of Clans, etc
Social network	20,461	25,131	23%	
Online advertising	13,377	17,713	32%	Driven by Weixin Moments and mobile advertising network
FinTech and business service	21,789	26,475	22%	Versus 39% YoY revenue growth in 4Q19 due to slowdown in payment volume and delay of cloud project
Others	1,325	1,448	9%	
Revenue	85,465	108,065	26%	7% above consensus
Gross profit	39,820	52,794	33%	
Operating profit	36,742	37,260	1%	
Net profit	27,210	28,896	6%	
Core profit (non-GAAP)	20,930	27,079	29%	9% above consensus
<u>Profitability (%):</u>	1Q19	1Q20	ppt y-o-y	
Gross margin	46.6	48.9	2.3	
Operating margin	43.0	34.5	(8.5)	
Net margin	31.8	26.7	(5.1)	
Core net margin (non-GAAP)	24.5	25.1	0.6	

Source(s): The Company, ABCI Securities



Positive momentum to continue

In 1Q20, online gaming revenue grew by 31% YoY, driven by traffic boost during the COVID-19 outbreak and accounting for 34.5% of total revenue.

Overall, Tencent's two blockbuster games, Peacekeeper Elite (和平精英) and Honour of Kings (王者荣耀), have seen strong momentum in recent months, occupying the top two positions in China's best grossing mobile gaming league table every month since June 2019.

Overall, with the pandemic in China coming under control since Mar 2020, the boost in gaming traffic during the prolonged CNY break started to normalize in 2Q20. According to the management, the normalization began in Apr 2020 and traffic has largely returned a normal level in mid-May.

While the domestic market is normalizing, rising gaming traffic in overseas markets since Mar 2020 will benefit Tencent's online gaming business.

New game launch has slowed in 1Q20 domestically. This is in line its historical trend of fewer launches in 1Q (e.g. one game in 1Q19) due to the CNY holiday. The extended CNY break in 2020 amid COVID-19 outbreak provides additional reasons to defer promoting new games, in our view.

Based on Tencent's current new game pipeline, DnF Mobile (地下城与勇士) could be another potential blockbuster. To recap, DnF PC version has been Tencent's long-standing blockbuster game with a long history since 2008; the game has accumulated a large and loyal user base over the years. Overall, the expected launch date is 1H20.

Another potential blockbuster would be the upcoming launch of League of Legends (LoL) mobile version in overseas market. Similar to DnF, LoL has amassed a sizable loyal user base over the years.

For online advertising business, we believe social network advertising should continue to benefit from increased in advertising inventories and traffic which mitigates the headwinds in the media advertising amid potential budget cuts especially for international brands.

For FinTech and business services, the ongoing recovery in offline payment volume amid a gradually improving retail market should be supportive for the segment. In addition, Tencent Meeting has become the leading video conference app in China which could lead to some monetization potentials in the medium term, in our view.

Please refer to the appendix section for more discussions on the industry trend in various sub-segments including online gaming, online advertising, cloud and online payment.



Exhibit 2: Tencent's recent new mobile games launched in China

	Name	Chines name	Type	Remark
1Q19	Perfect World Mobile	完美世界手游	RPG	Licensed
2Q19	Catchya	一起来捉妖	Causal	In-house
2Q19	Peacekeeper Elite	和平精英	Action	In-house
2Q19	Happy Fish	欢乐捕鱼大战	Causal	In-house
2Q19	Ever Adventure	无尽远征	RPG	Licensed
2Q19	Legend of Blue Moon	蓝月传奇	RPG	Licensed
2Q19	Once Upon a Time	三生三世十里桃花	RPG	Licensed
2Q19	The Rhythm Of The Clouds And Dreams	云梦四时歌	RPG	Licensed
2Q19	Fairy Tail	妖精的尾巴	RPG	Licensed
2Q19	Eastward Legend: The Empyrean	剑网 3 指尖江湖	RPG	Licensed
2Q19	Raziel	拉结尔		
3Q19	KartRider Rush	跑跑卡丁车	Action	Licensed
3Q19	Game of Thrones	权力的游戏	SLG	Licensed
3Q19	Dragon Raja	龙族幻想	RPG	Licensed
3Q19	LEGO Cube	乐高无限	RPG	In-house
3Q19	Ace Force Legion	王牌战士	Action	In-house
3Q19	The Tale of Food	食物语	RPG	Licensed
4Q19	Auto Chess:Origin	多多自走棋	SLG	Licensed
4Q19	Fox Spirit Matchmaker	狐妖小红娘	RPG	In-house
4Q19	HUNTERxHUNTER	全职猎人	RPG	Licensed
4Q19	Lord Xueying Mobile	雪鹰领主	RPG	In-house
4Q19	DBM	龙珠最强之战	Action	Licensed

Source(s): The Company, ABCI Securities



Exhibit 3: Tencent's new mobile game pipeline in China

Name	Chines Name	Remark
Stone Age	石器时代	Licensed
DnF Mobile	地下城与勇士	Licensed
Lineage II Revolution	天堂 II: 革命	Licensed
Need for Speed Online Mobile	极品飞车 OL 手机版	Licensed
JX Mobile 2	剑侠情缘 2	Licensed
The Outcast	一人之下	In-house
Legend of Honour	光明勇士	Licensed
The Legend Of Qin	秦时明月手游	In-house
ReEvolve	我的起源	Licensed
Street Fighter Online	街霸 OL	In-house
Moonlight Blade Mobile	天涯明月刀手游	In-house
World of Love	恋世界	Licensed
CODM	使命召唤手游	In-house
Brawl Star	荒野乱斗	In-house
Angry Bird	愤怒的小鸟梦幻岛	Licensed
Dragon Nest Mobile 2	龙之谷 2	Licensed
My Hero Academia	我的英雄学院	Licensed
Chess Rush	魔方自走棋	In-house

Source(s): The Company, ABCI Securities

Financial outlook

We expect revenue to grow at 24% CAGR in 2019-2021E.

Online gaming: Online gaming revenue was up 10% YoY in 2019 and 31% YoY in 1Q20. We expect online gaming revenue to expand at 20% CAGR in 2019-21E. The recent coronavirus outbreak has increased consumers' time spent on online gaming, which bodes well for this segment especially in 1H20. In addition, full-year contribution of Peacekeeper Elite, which was launched in May 2019, will start in 2020. The potential launch of DnF Mobile could be another potential income driver since the franchise has accumulated a sizable user base.

Segment revenue is also supported by the consolidation of Supercell starting in Nov 2019 after Tencent raised its stakes to 51.2%. Supercell reported US\$ 1.56bn in revenue and US\$ 577mn in profit before tax (PBT) in 2019, equivalent to 2.9% and 0.5% of Tencent's revenue and PBT in 2019.

Online advertising: Despite a weak economic environment and the ongoing competition from Douyin, which has been ramping up its advertising business in recent quarters, Tencent still reported 16.3% YoY and 32% YoY growth in online advertising revenue in 2019 and 1Q20, driven by social network advertising. Looking forward, we expect a 23% revenue CAGR in 2019-21E, given the segment revenue was up 17.7% YoY in 2019.

FinTech and business service: Segment revenue was up 38.6% YoY in 2019 and 22% YoY in 1Q20. We expect segment revenue to increase at 32% CAGR in 2019-21E. The third-party payment business will be affected by a multitude of factors, with the positive ones coming from improving regulatory environment that allows interest income on customers' outstanding balance from PBOC; the negative ones mostly originate from reduced offline transactions amid the reduced consumption appetite.

Exhibit 4: Revenue forecasts (RMB mn)

	2018	2019	2020E	2021E
Value added services (VAS)	176,646	199,991	246,120	286,700
Online games	103,992	114,700	144,187	165,999
Social network	72,654	85,281	101,933	120,701
Online advertising	58,079	68,377	76,918	103,918
FinTech and business services	73,138	101,355	126,694	177,371
Others	4,831	7,566	9,458	13,241
Total revenue	312,694	377,289	459,189	581,230

Source(s): The Company, ABCI Securities estimates



Tencent's gross margin has been declining in recent quarters, mainly dragged by falling profitability of VAS business (online gaming and social network). Online advertising gross margin has been trending up as Tencent continued to innovative value-added advertising services. FinTech and business services gross margin remained largely stable in recent quarters.

Exhibit 5: Gross margin trend

	1Q19	2Q19	3Q19	4Q19	1Q20
VAS (Online game and social network)	57.6%	52.6%	51.8%	50.1%	59.0%
Online advertising	41.9%	48.6%	48.8%	54.3%	49.2%
Fintech and business service	28.5%	24.0%	27.7%	28.1%	27.9%
Others	-13.7%	24.6%	-8.2%	16.2%	-10.4%
Overall gross margins	46.6%	44.1%	43.7%	43.6%	48.9%

Source(s): The Company, ABCI Securities

In addition, the changing business mix that shifts from higher-margin VAS to lower-margin online advertising and FinTech/business services also contributed to the decline. For example, VAS accounted for 63.2% of gross profit in 2019, down from 72.3% in 2018.

Looking forward, we expect gross margin to fall from 44.4% in 2019 to 43.1% in 2021E given the ongoing changes in business mix shifting towards lower-margin online advertising and FinTech/business services segments.

In terms of operating cost, we expect ongoing improvement to mitigate partially the negative impacts of gross margin erosion. Overall, we expect SG&A cost-to-revenue ratio to drop from 19.8% in 2019 to 16.5% in 2021E

Selling and marketing expenses: Overall, we expect selling and marketing cost-to-revenue ratio to drop from 5.7% in 2019 to 4.9% in 2021E, driven by higher economies of scale

General and admin expenses: We expect general and admin cost-to-revenue ratio to drop from 14.2% in 2019 to 11.6% in 2021E, driven by higher economies of scale.



Exhibit 6: SG&A cost trend (RMB mn)

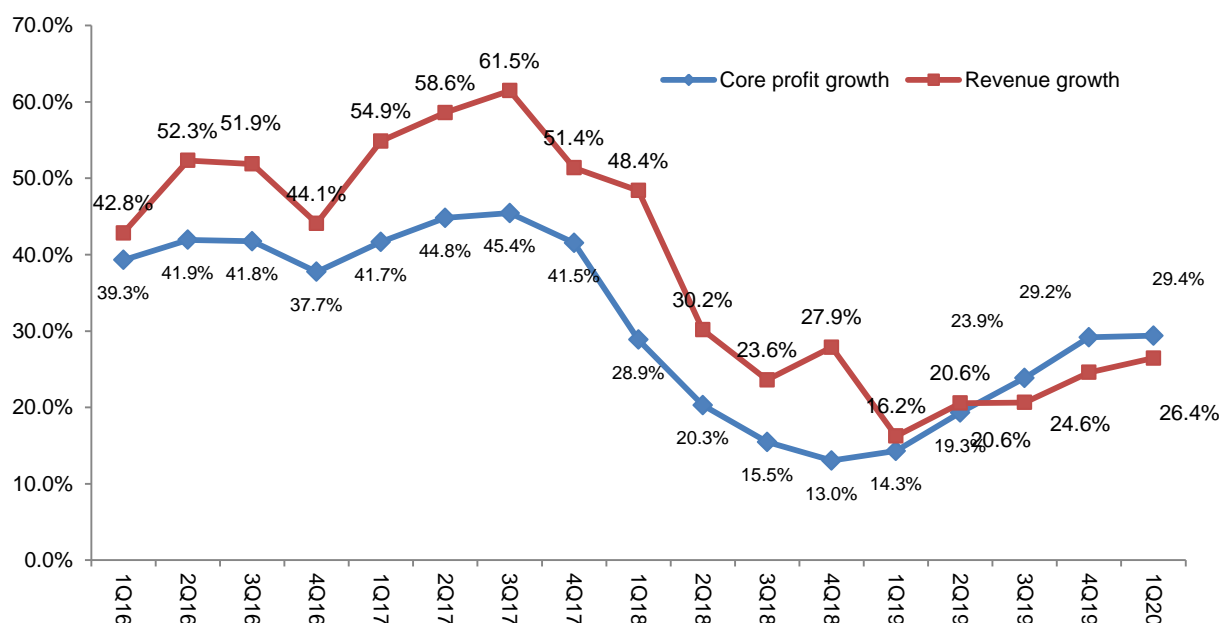
	2018	2019	2020E	2021E
Selling & marketing expenses	(24,233)	(21,396)	(25,191)	(28,375)
General & admin expenses	(41,522)	(53,446)	(60,687)	(67,391)
Total SG&A	(65,755)	(74,842)	(85,878)	(95,766)
% of revenue				
Selling & marketing expenses	7.7%	5.7%	5.5%	4.9%
General & admin expenses	13.3%	14.2%	13.2%	11.6%
Total SG&A	21.0%	19.8%	18.7%	16.5%

Source(s): The Company, ABCI Securities estimates

Based on the gross margin and cost trends, we expect core net margin (excl. impacts of share-based compensation and other non-operating items) to remain largely stable going forward. This would result in a 24% CAGR in core net profit for 2019-21E.

Overall, Tencent's core profit growth has slowed significantly since 2Q18 due to tightened regulatory environment in mobile gaming and increasing competition for user time from emerging online entertainment. The situation has improved since 3Q19 because of the stabilizing regulatory environment on mobile gaming, contribution from new mobile games, and an easier comparison base.

Exhibit 7: Revenue and profit growth trend



Source(s): The Company, ABCI Securities



Earnings sensitivity

In terms of earning sensitivity, we estimate that a 100bp improvement in core net margin would increase its 2020E and 2021E core net profits by 3.9% and 3.9% respectively.

Exhibit 8: Earnings sensitivity

Changes in core net margin (bps)	Changes in 2020E core net profit	Changes in 2021E core net profit
100	3.9%	3.9%
75	2.9%	2.9%
50	1.9%	2.0%
25	1.0%	1.0%
-	0.0%	0.0%
(25)	-1.0%	-1.0%
(50)	-1.9%	-2.0%
(75)	-2.9%	-2.9%
(100)	-3.9%	-3.9%

Source(s): ABCI Securities estimates

Exhibit 9: Forecast changes

(RMB m)	2020E		Diff	Comment
	old	new		
Revenues	447,828	459,189	3%	Higher growth from online games and online advertising
Net income	95,303	102,944	8%	
Core profit	111,053	118,694	7%	

Source(s): ABCI Securities estimates

Exhibit 10: Forecast changes

(RMB m)	2021E		Diff	Comment
	old	new		
Revenues	538,708	581,230	8%	Higher growth from online games and online advertising
Net income	117,025	132,489	13%	
Core profit	132,775	148,239	12%	

Source(s): ABCI Securities estimates



Exhibit 11: Quarterly financials (RMB mn)

	1Q18	2Q18	3Q18	4Q18	1Q19	2Q19	3Q19	4Q19	1Q20
Value added services (VAS)	46,877	42,069	44,049	43,651	48,974	48,080	50,629	52,308	62,429
Online games	28,778	25,202	25,813	24,199	28,513	27,307	28,604	30,286	37,298
Social network	18,099	16,867	18,236	19,452	20,461	20,773	22,025	22,022	25,131
Online advertising	10,689	14,110	16,247	17,033	13,377	16,409	18,366	20,225	17,713
FinTech and business services	15,182	16,666	19,693	21,597	21,789	22,888	26,758	29,920	26,475
Others	780	830	606	2,615	1,325	1,444	1,483	3,314	1,448
Revenue	73,528	73,675	80,595	84,896	85,465	88,821	97,236	105,767	108,065
Cost of revenue	-36,486	-39,229	-45,115	-49,744	-45,645	-49,695	-54,757	-59,659	-55,271
Gross profit	37,042	34,446	35,480	35,152	39,820	39,126	42,479	46,108	52,794
Interest income	1,065	1,072	1,082	1,350	1,408	1,652	1,674	1,580	1,636
Other gains/(losses), net	7,585	2,506	8,762	-2,139	11,089	4,038	932	3,630	4,037
Selling & marketing expenses	-5,570	-6,360	-6,573	-5,730	-4,244	-4,718	-5,722	-6,712	-7,049
General & admin expenses	-9,430	-9,857	-10,890	-11,345	-11,331	-12,577	-13,536	-16,002	-14,158
Profit from operations	30,692	21,807	27,861	17,288	36,742	27,521	25,827	28,604	37,260
Net finance cost	-654	-1,151	-1,492	-1,372	-1,117	-1,982	-1,747	-2,767	-1,684
Shares of profit of associates/JV	-319	1,526	264	16	-2,957	2,370	234	-1,328	-281
PBT	29,719	22,182	26,633	15,932	32,668	27,909	24,314	24,509	35,295
Income tax expenses	-5,746	-3,602	-3,228	-1,906	-4,812	-3,225	-3,338	-2,137	-5,892
Minority interest	-683	-713	-72	203	-646	-548	-594	-790	-507
Net income	23,290	17,867	23,333	14,229	27,210	24,136	20,382	21,582	28,896
Non-GAAP net profit	18,313	19,716	19,710	19,730	20,930	23,525	24,412	25,484	27,079
YoY									
Revenue growth (%)	48.4%	30.2%	23.6%	27.9%	16.2%	20.6%	20.6%	24.6%	26.4%
EBIT growth (%)	59.3%	-3.3%	22.5%	-32.8%	19.7%	26.2%	-7.3%	65.5%	1.4%
Net profit growth (%)	60.9%	-2.0%	29.6%	-31.6%	16.8%	35.1%	-12.6%	51.7%	6.2%
Core profit growth (%)	28.9%	20.3%	15.5%	13.0%	14.3%	19.3%	23.9%	29.2%	29.4%
Margin									
Gross profit margin (%)	50.4%	46.8%	44.0%	41.4%	46.6%	44.1%	43.7%	43.6%	48.9%
Operating margin (%)	41.7%	29.6%	34.6%	20.4%	43.0%	31.0%	26.6%	27.0%	34.5%
Net margin (%)	31.7%	24.3%	29.0%	16.8%	31.8%	27.2%	21.0%	20.4%	26.7%
Core net margin (%)	24.9%	26.8%	24.5%	23.2%	24.5%	26.5%	25.1%	24.1%	25.1%

Source: The Company, ABCI Securities



Valuation

We maintain **BUY** on Tencent given the strong momentum of online gaming/entertainment business benefiting from increased traffic amid the COVID-19 outbreak - we expect the boost to extend in the near term especially in the overseas market.

We derive Tencent's fair valuation range based on the SOTP approach.

In valuing Tencent's core business, we apply 24x-29x (vs. 21x-25x previously) targeted 2021E P/E ratio.

We value Tencent's investment based on their latest book value (at end-March 2020, which has reflected the weakened economic environment amid COVID-19 outbreak) with a 0-30% holding discount.

The SOTP approach results in a fair valuation range of HK\$ 450- 550. We set our TP at HK\$ 500, approximating the mid-point of our fair valuation range.

Exhibit 12: SOTP valuation

	Valuation – Mid-point (HKD per share)	Valuation – high end	Valuation – low end	Remarks
Core business	453	495	411	24x -29x 2021E core PE
Investments	47	55	39	End-March 2020 book value with 0%-30% holding discount
Total	500	550	450	

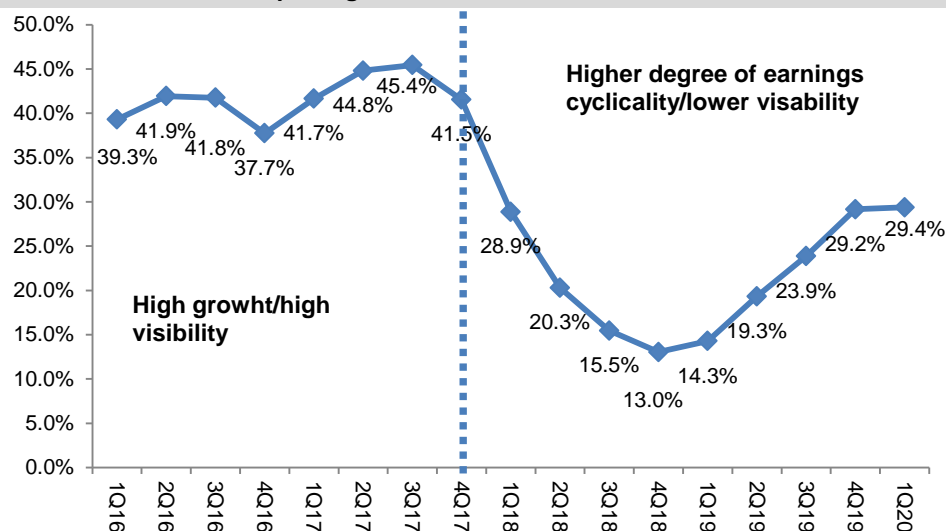
Source(s): ABCI Securities estimates

While Tencent's earnings trend have stabilized recently, the moderated earnings growth since early 2018 have allowed investors to become more aware of the Group's earnings cycles and the potential downside risks in downturn. This is in contrast with the period during 2016-2017 when investors perceived Tencent as a growth stock based on its robust earnings trend during the period.

As a result, we believe current valuation has priced in the higher degree of earnings cyclicalities and lower earnings visibility compared to the past.

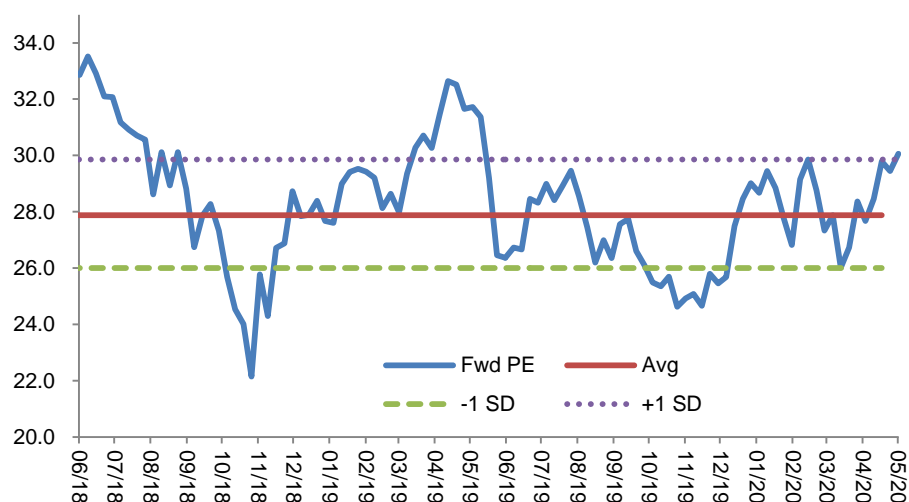


Exhibit 13: Tencent's core profit growth trend



Source(s): The Company, ABCI Securities

Exhibit 14: P/E band



Source(s): Bloomberg, ABCI Securities

Exhibit 15: TP changes (HK\$ per share)

Segment	Old	New	Methodology-old	Methodology-new
Core business	352	453	23x 2021E core P/E	26.5x 2021E core P/E
Investments	43	47	Book value with a 15% holding discount	Book value with a 15% holding discount
Overall	395	500		

Source(s): ABCI Securities estimates



Peer valuation analysis

Among the HK-listed internet platforms, including Tencent, Alibaba (9988 HK/BABA US), and Meituan (3690 HK), Tencent is trading at a higher P/E than Alibaba. In our view, this could be justified by higher defensiveness of the former amid the recent pandemic that increases users' time spent on online platforms. On the other hand, Alibaba's ecommerce business is impacted by supply chain disruptions.

Meituan is trading at significant higher P/E than Tencent and Alibaba; however, P/E might not be the best valuation metric for Meituan as the company is still in the early stage of profitability. Instead, P/Sales is a more suitable measure.

Exhibit 16: Peer valuation

		Market cap (Lcy)	Price (Lcy)	P/sales			P/E		
				<u>2019E</u>	<u>2020E</u>	<u>2021E</u>	<u>2019E</u>	<u>2020E</u>	<u>2021E</u>
HK-listed major online platforms									
700 HK Equity	TENCENT	4,104,055	429.6	10.0	8.1	6.6	40.3	33.0	26.5
9988 HK Equity	ALIBABA	4,212,948	196.3	7.7	5.8	4.7	29.4	24.8	19.8
3690 HK Equity	MEITUAN	688,138	118.1	5.6	4.0	3.9	203.7	44.1	44.6
				8.8	7.0	5.7	34.9	28.9	23.1
US-listed major online platforms									
FB US Equity	FACEBOOK	598,597	210.1	8.5	7.8	6.2	32.4	25.4	19.6
GOOGL US Equity	ALPHABET	938,927	1,375.2	5.8	6.8	5.6	27.3	27.0	21.3
AMZN US Equity	AMAZON.COM	1,175,590	2,357.0	4.2	3.4	2.9	101.4	76.4	46.1
				7.2	6.4	5.4	74.6	31.4	27.1

Source(s): Bloomberg, ABCI Securities estimates



Appendix: Industry trend

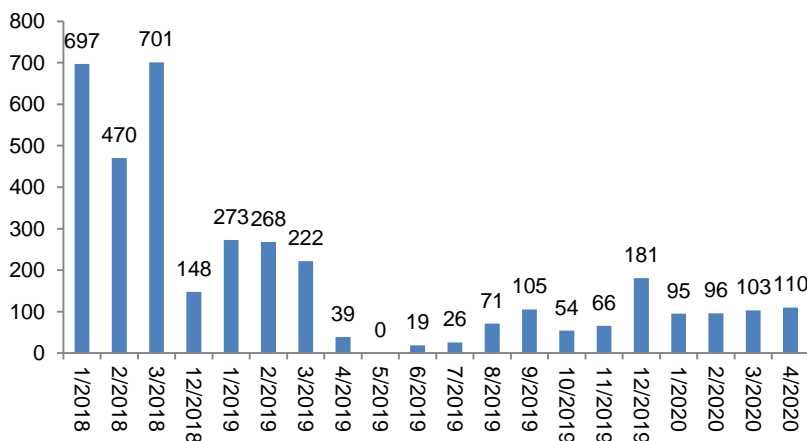
Online gaming: Positive momentum

The number of new mobile game approvals has been recovering in recent months, averaging 110 per month in 2019. The figure is similar for the first four months in 2020, although it is still significantly lower than average of 622 approvals per month in 1Q18, prior to the regulatory tightening.

For Tencent, 44 new games have been approved since 2019, including its recent blockbuster hit Peacekeeper Elite (和平精英), an extreme survival game “replacing” its earlier PUBG Mobile that highly popular but non-monetizing due to the regulatory restriction. Overall, Peacekeeper Elite (和平精英) was able to inherit PUBG Mobile’s popularity since launched.

In our view, the tightened approval process since 2018 has benefited larger players, including Tencent and NetEast, which have more financial resources to manage a longer product development cycle. In addition, fewer new games can imply a longer product life cycle for existing mobile games, which is favorable to these large players.

Exhibit 17: Number of mobile game approvals



Source(s): SAPPRFT, ABCI Securities

Tencent’s two blockbuster games, Peacekeeper Elite (和平精英) and Honour of Kings (王者荣耀), have been occupying the top two positions in China’s best grossing mobile gaming league table every month since June 2019.

According to JiGuang, Honour of Kings (王者荣耀) achieved 69mn Daily Average User (DAU) in Dec 2019, up 28.3% YoY. In addition, DAU of Peacekeeper Elite (和平精英) increased from 26mn in June 2019 to 33.5mn DAU in Dec 2019.

In addition, other mobile gaming including QQ Speed (QQ飞车), CrossFire (穿越火线), etc. also achieved good rankings in recent months.



Exhibit 18: Best-selling mobile games in China's iOS platform (1/2019-7/2019)

	01/19	02/19	03/19	04/19	05/19	06/19	07/19
1	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)	Honour of Kings (王者荣耀)
2	Fantasy Westward Journey (梦幻西游)	Fantasy Westward Journey (梦幻西游)	Perfect World (完美世界)	Perfect World (完美世界)	Perfect World (完美世界)	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)
3	Westward Journey Online (大话西游)	QQ Speed (QQ 飞车)	Fantasy Westward Journey (梦幻西游)	Fantasy Westward Journey (梦幻西游)	Peacekeeper Elite (和平精英)	Fantasy Westward Journey (梦幻西游)	CrazyRacing KartRider (跑跑卡丁车官方竞速版)
4	QQ Speed (QQ 飞车)	Onmyoji (阴阳师)	Westward Journey Online (大话西游)	Westward Journey Online (大话西游)	Fantasy Westward Journey (梦幻西游)	Perfect World (完美世界)	Fantasy Westward Journey (梦幻西游)
5	LifeAfter (明日之后)	Lord of the City (一刀传世)	LifeAfter (明日之后)	All Within The Boundaries (率土之滨)	Arknights (明日方舟)	Arknights (明日方舟)	Perfect World (完美世界)
6	King Of Chaos (乱世王者)	Fate/Grand Order	QQ Speed (QQ 飞车)	QQ Speed (QQ 飞车)	Onmyoji (阴阳师)	Onmyoji (阴阳师)	Dragon Raja (龙族幻想)
7	QQ Dancer (QQ 炫舞)	QQ Dancer (QQ 炫舞)	All Within The Boundaries (率土之滨)	Onmyoji (阴阳师)	Westward Journey Online (大话西游)	QQ Speed (QQ 飞车)	Arknights (明日方舟)
8	Red Alert OL (红警 OL)	LifeAfter (明日之后)	Onmyoji (阴阳师)	Let's Hunt Monsters (一起来捉妖)	Let's Hunt Monsters (一起来捉妖)	Westward Journey Online (大话西游)	Westward Journey Online (大话西游)
9	Onmyoji (阴阳师)	Westward Journey Online (大话西游)	Kingdom Craft (乱世王者)	Anipop (开心消消乐)	QQ Speed (QQ 飞车)	Fairy Tail: Magic Guide (妖精的尾巴: 魔导少年)	Authorization of Mu (精灵盛典)
10	Ghost (倩女幽魂)	King Of Chaos (乱世王者)	Lord of the City (一刀传世)	Red Alert OL (红警 OL)	Kingdom Craft (乱世王者)	All Within The Boundaries (率土之滨)	QQ Dancer (QQ 炫舞)

Source(s): App Annie (Tencent's games are highlighted), ABCI Securities



Exhibit 19: Best-selling mobile games in China's iOS platform (7/2019-3/2020)

	08/19	09/19	10/19	11/19	12/19	01/20	02/20	3/20
1	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)	Peacekeeper Elite (和平精英)	Game For Peace (和平精英)
2	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)	Peacekeeper Elite (和平精英)	Honour of Kings (王者榮耀)	Honour of Kings (王者榮耀)
3	Fantasy Westward Journey (梦幻西游)	Fantasy Westward Journey (梦幻西游)	Westward Journey Online (大话西游)	Fantasy Westward Journey 3D	Fantasy Westward Journey (梦幻西游)	AFK Arena	AFK Arena	Sangokushi Strategy (三国志·战略版)
4	CrazyRacing KartRider (跑跑卡丁车官方竞速版)	CrazyRacing KartRider (跑跑卡丁车官方竞速版)	Sangokushi Strategy (三国志·战略版)	Sangokushi Strategy (三国志·战略版)	Sangokushi Strategy (三国志·战略版)	Fantasy Westward Journey (梦幻西游)	Sangokushi Strategy (三国志·战略版)	AFK Arena
5	Dragon Raja (龙族幻想)	Authorization of Mu (精灵盛典)	Authorization of Mu (精灵盛典)	Onmyoji (阴阳师)	Fantasy Westward Journey 3D	Sangokushi Strategy (三国志·战略版)	Fantasy Westward Journey (梦幻西游)	Fantasy Westward Journey (梦幻西游)
6	Authorization of Mu (精灵盛典)	Fate/Grand Order	CrazyRacing KartRider (跑跑卡丁车官方竞速版)	Westward Journey Online (大话西游)	Onmyoji (阴阳师)	CrossFire (穿越火线)	QQ Speed (QQ飞车)	New Swordsman (新笑傲江湖)
7	Return of the Condor Heroes 2 (神雕侠侣2)	Onmyoji (阴阳师)	Westward Journey Online (大话西游)	All Within The Boundaries (率土之滨)	New Swordsman (新笑傲江湖)	Onmyoji (阴阳师)	New Swordsman (新笑傲江湖)	All Within The Boundaries (率土之滨)
8	Westward Journey Online (大话西游)	Dragon Raja (龙族幻想)	Honkai Impact 3 (崩坏3)	Perfect World (完美世界)	Junior Three Kingdoms 2 (少年三国志2)	QQ Speed (QQ飞车)	CrossFire (穿越火线)	Shenwu 4 (神武4)
9	Onmyoji (阴阳师)	Westward Journey Online (大话西游)	Onmyoji (阴阳师)	Shining Nikki (閃耀暖暖)	All Within The Boundaries (率土之滨)	Naruto Mobile (火影忍者)	Shenwu 4 (神武4)	Onmyoji (阴阳师)
10	Shining Nikki (閃耀暖暖)	Perfect World (完美世界)	All Within The Boundaries (率土之滨)	Arknights (明日方舟)	Punishing: Gray Raven (战双帕弥什)	New Swordsman (新笑傲江湖)	Onmyoji (阴阳师)	Westward Journey Online (大话西游)

Source(s): App Annie (Tencent's games are highlighted), ABCI Securities



Exhibit 20: 2019 financial comparison (Tencent vs. NetEase)

	Tencent	NetEase
Financials (RMB m)		
Revenue	377,289	59,241
Gross profit	167,533	31,555
Net profit**	93,310	13,275
Core net profit	94,351	15,662
Revenue mix (%)		
Online gaming	30%	78%
Social network	23%	0%
Online advertising	18%	0%
FinTech and business services	27%	0%
Others	2%	22%*
Growth (YoY)		
Revenue	20.7%	15.8%
Gross profit	17.9%	15.4%
Net profit	18.5%	60.1%
Core net profit	21.8%	45.5%
Margins		
Gross margin	44.4%	53.3%
Net margin	24.7%	22.4%
Core net margin	25.0%	26.4%

Source(s): Companies, ABCI Securities

*Including online music, e-commerce, others

** Profit from continuous operating for NetEase



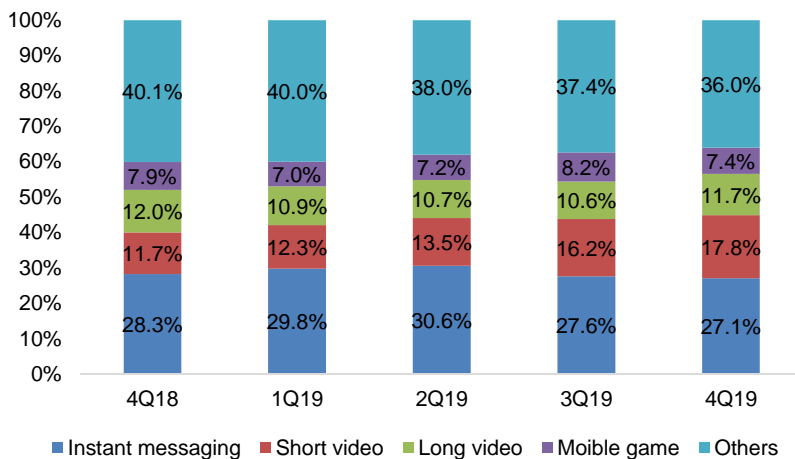
Online advertising: Intensified competition

Compared with the ongoing gaming business, we are less bullish on the online advertising segment. Although more users have gone online amid the pandemic, ; structurally, we are seeing an ongoing shift of users spending more time on short videos, an area where Douyin (抖音) has a leading market position.

According to JiGuang, users' time spent on instant messaging, where Tencent has a leading market position via its WeChat app, has dropped from 40.1% in 4Q18 to 36.0% in 4Q19. In addition, users' time spent on long videos (Tencent Video is the second largest player with 114m DAUs in Dec 2019 vs. 124m for iQiyi) also dropped slightly from 12.0% in 4Q18 to 11.7% in 4Q19. On the other hand, users' time spent on short videos has increased from 11.7% in 4Q18 to 17.8% in 4Q19.

As users' time spent continued to shift to short videos, advertisers are more inclined to place advertisements on leading short video platforms such as Douyin.

Exhibit 21: Share of users' time spent among mobile applications

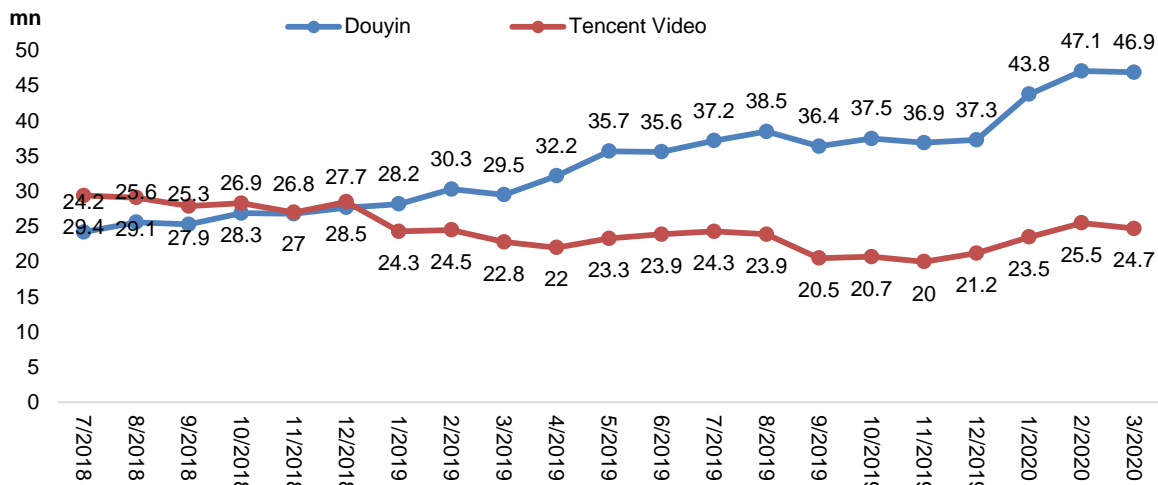


Source(s): JiGuang, ABCI Securities

Douyin's MAUs exceed that of Tencent Video since 4Q18 and the gap continues to widen. According to Trustdata, Douyin's MAUs reached 46.9m in Mar 2020 vs. 24.7mn for Tencent Video. In our view, this divergent trend would inevitably affect their respective online advertising businesses.



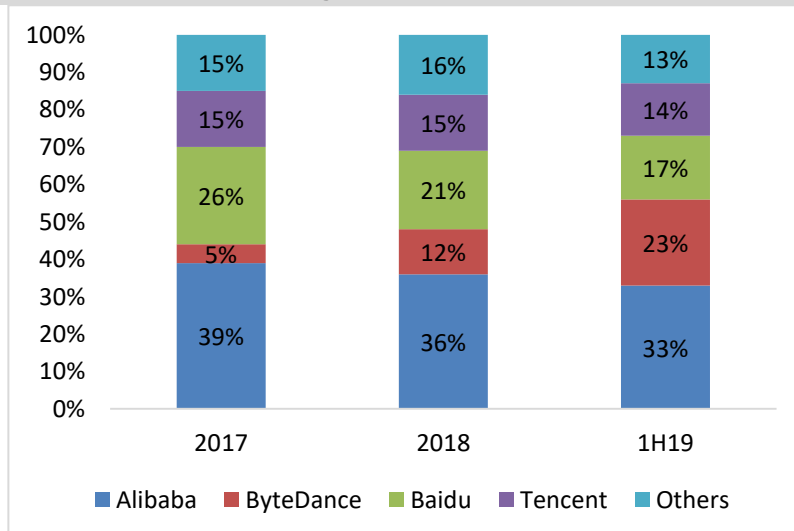
Exhibit 22: Monthly Average Users (MAU) comparison



Source(s): Trustdata, ABCI Securities

Overall, rising MAU and time spent of Douyin have helped its parent group, ByteDance, to grow its online advertising business in recent years. According to R3, ByteDance's online advertising market increased markedly from 5% in 2017 to 23% in 1H19, and became the second largest player in China's online advertising market in 1H19 with 113% YoY revenue growth during the period. Tencent, on the other hand, has maintained a stable market share in recent years, ranking fourth with a 14% market share in 1H19.

Exhibit 23: Online advertising market share trend



Source(s): R3, ABCI Securities



Online payment: Competitive landscape to stabilize

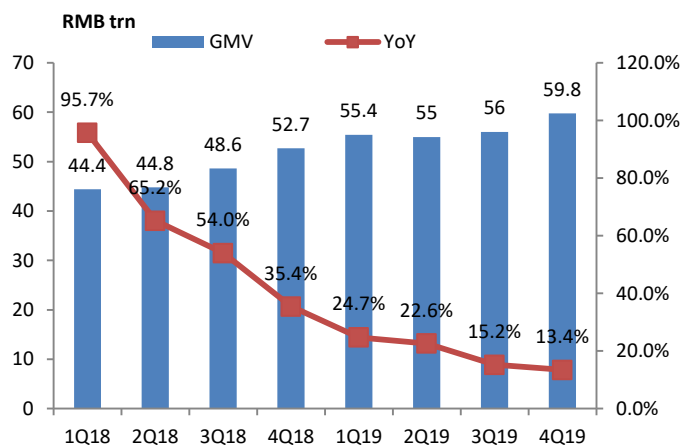
On the third-party payment market, we expect the current competitive landscape to remain stable as price competition has eased in recent quarters, which should bode well for profitability.

The third-party mobile payment market size reached RMB 60tr in 4Q19, with growth normalizing to the mid-teens levels after years of development. Tencent had a 39% market share in 4Q19, vs. Alibaba's 55%.

On the regulatory front, various local media have recently reported that PBOC had allowed third-party payment platforms to enjoy a 0.35% annual interest (10% of the interest income will be transferred into a protection fund for the non-bank payments industry) from PBOC on their customer balance, effective for three years between Aug 2019 and July 2022. This indicates a policy reversal of its previous "no interest" policy on third-party payment platforms.

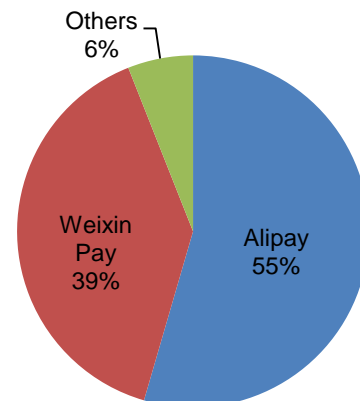
On the flip side, the weakened consumer market would inevitably impact third-party payment volume in the near term, as the majority of payment volume is related to offline merchants such as restaurants, retail stores, and more.

Exhibit 24: Third-party mobile payment market size



Source(s): iResearch, ABCI Securities

Exhibit 25: Third-party mobile payment market share (4Q19)



Source(s): iResearch, ABCI Securities



Cloud: Riding on corporates' digital transformation

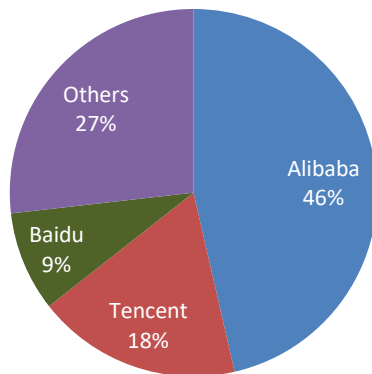
Tencent is China's second largest cloud service provider with an 18% market share in 4Q19, lower than Alibaba's 46% but higher than Baidu's 9%, according to Canalys.

Overall, cloud infrastructure market in China increased 63.7% in 2019 to exceed US\$ 10.7bn, according to Canalys.

In our view, China's cloud market is driven by increasing need from corporates to embark on digital transformation projects and building platforms and application to develop new services. In particular, the recent COVID-19 outbreak might have speeded up corporates' digital transformation, which bodes well for the industry.

We believe Alibaba has a competitive edge in terms of developing deep understanding via the A.I. system. Based on the large number of local merchants from its operation of online platform accumulated in the past decades, Alibaba is more able to assess the need of SMEs in China. In comparison, Tencent, may need more time to develop similar capabilities as its core business is consumer-focused with less connection to SMEs in China.

Exhibit 26: China's cloud market –market share (4Q19)



Source(s): Canalys, ABCI Securities



Risk factors

Market competition

We believe the rise of emerging forms of online entertainment such as short video apps could steal shares from online gaming in the online entertainment market.

We expect competition to intensify if major overseas online platforms, such as Google and Facebook, are allowed to enter the China market. In our view, competition would be particularly fierce in the online advertising realm, which in turn could potentially impact Tencent's online advertising revenue accounting for 18% of total revenue in 2019.

Tightening regulation on online gaming

Regulators have suspended granting approvals on new games (including monetization of existing games) between Apr 2018 and Nov 2018. Mobile gaming revenue could be impacted should the regulatory tighten new game approval again in the future.

Tightening regulation on internet finance

As the Group is exposed to the internet finance market via its payment business, further regulatory measures may affect business performance

Slowing of ecommerce consumption

As the Group is exposed to consumer spending on online entertainment, any significant slowdown of consumption in China would impact financial performance. In the long run, we believe domestic market growth would converge with income growth, which is usually in line with GDP growth.

Ecosystem may need to improve further in the face of competition

Popularity of short-video sharing platforms such as Douyin (抖音) has been increasing rapidly. According to Trustdata, Douyin's MAUs reached 43.8m in Jan 2020 vs. 23.5mn for Tencent Video. This shows that Tencent's ecosystem has room to improve.

Non-GAAP financials

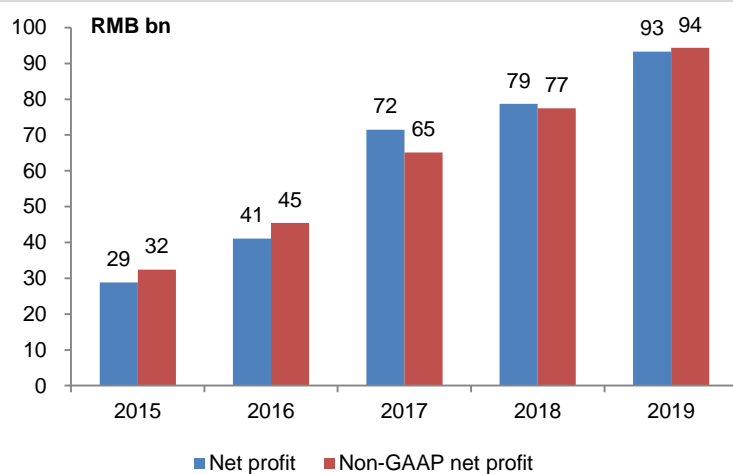
The Group has disclosed the non-GAAP financial metric, such as the non-GAAP net profit, to supplement its GAAP financial measures. Historically, there were differences between its GAAP net profit and non-GAAP net profit due to inclusion of items such as share-based compensation, impairment, fair valuation changes of investment, and disposal gains of asset in the former.

Among these items, share-based compensation expense is related to various factors including price movement of ordinary shares, expected volatility, risk-free interest rate, etc. Its share-based compensation expenses have been trending up over the past few years, rising from RMB4.9bn in 2016 to RMB 12.3bn in 2019.

While investors tend to exclude these items when performing analysis given their non-cash nature, we believe these non-GAAP financial measures should only serve as reference.



Exhibit 27: Net profit vs. Non-GAAP core net profit (RMB m)



Source(s): The Company, ABCI Securities



Financial forecast

Consolidated income statement (2018A-2021E)

FY Ended Dec 31 (RMB mn)	2018A	2019A	2020E	2021E
Online gaming	103,992	114,710	144,187	165,999
Social network	72,654	85,281	101,933	120,701
Online advertising	58,079	68,377	76,918	103,918
FinTech and business service	73,138	101,355	126,694	177,371
Others	4,831	7,566	9,458	13,241
Total revenue	312,694	377,289	459,189	581,230
Cost of sales	(170,574)	(209,756)	(253,057)	(330,973)
Gross profit	142,120	167,533	206,132	250,257
Interest income	4,569	6,314	7,050	8,050
Other gains/losses	16,714	19,689	7,250	7,550
Selling & marketing expenses	(24,233)	(21,396)	(25,191)	(28,375)
General & admin expenses	(41,522)	(53,446)	(60,687)	(67,391)
Operating Profits	97,648	118,694	134,554	170,091
Finance cost	(4,669)	(7,613)	(8,100)	(8,350)
Share of profit of investments in associates	1,487	(1,681)	(500)	(500)
Profit before tax	94,466	109,400	125,954	161,241
Tax	(14,482)	(13,512)	(22,673)	(28,319)
Profit after tax	79,984	95,888	103,281	132,923
Minority interests	1,265	2,578	337	434
Net profit	78,719	93,310	102,944	132,489
Share based compensation	11,025	12,309	12,500	12,800
Gain/losses from investee companies	(33,073)	(20,720)	(4,000)	(4,100)
Amortization and impairment	21,265	10,547	7,250	7,050
Other non-core items	(467)	(1,095)	-	-
Non-GAAP net profit (core profit)	77,469	94,351	118,694	148,239
Growth				
Total revenue (%)	60.8	20.7	21.7	26.6
Gross Profits (%)	21.5	17.9	23.0	21.4
Operating Profits (%)	8.1	21.6	13.4	26.4
Net Profits (%)	10.1	18.5	10.3	28.7
Non-GAAP net profit (%)	19.0	21.8	25.8	24.9
Operating performance				
Gross margin (%)	45.5	44.4	44.9	43.1
Operating margin (%)	31.2	31.5	29.3	29.3
Net margin (%)	25.2	24.7	22.4	22.8
Non-GAAP net margin (%)	24.8	25.0	25.8	25.5
ROAE (%)	24.9	22.1	19.2	20.5
ROAA (%)	12.3	11.1	10.2	11.7

Source(s): The Company, ABCI Securities estimates

Notes: Individual items may not sum to total due to rounding differences

Individual items may varies from reported figures due to rounding differences/definition differences



Consolidated balance sheet (2018A-2021E)

As of Dec 31 (RMB mn)	2018A	2019A	2020E	2021E
Fixed assets	47,801	78,070	99,070	120,070
Intangible assets	56,650	128,860	131,360	133,860
Investment in associates and JV	227,790	221,894	261,894	301,894
Financial assets	136,914	210,543	220,543	230,543
Term deposit	-	19,000	19,000	19,000
Other non-current assets	37,286	41,651	41,651	41,651
Total non-current assets	506,441	700,018	773,518	847,018
Cash & equivalents	97,814	132,991	166,475	233,159
Restricted cash	2,590	2,180	2,180	2,180
Term deposit	62,918	46,911	46,911	46,911
Account receivables	28,427	35,839	35,540	46,578
Deposit, prepayments and other assets	18,493	27,840	27,840	27,840
Inventories	324	718	718	718
Other current assets	6,514	7,489	7,489	7,489
Total current assets	217,080	253,968	287,152	364,875
Total assets	723,521	953,986	1,060,670	1,211,893
Accounts payable	73,735	80,690	91,847	120,127
Other payables & accruals	33,312	45,174	45,174	45,174
Borrowings and notes	40,554	33,229	33,229	33,229
Deferred revenue	42,375	64,228	64,228	64,228
Other current liabilities	12,459	16,835	16,835	16,835
Total current liabilities	202,435	240,156	251,313	279,593
Loans and bonds payables	138,735	187,584	187,584	187,584
Deferred revenue	7,077	7,334	7,334	7,334
Other non-current liabilities	19,067	30,088	30,088	30,088
Total non-current liabilities	164,879	225,006	225,006	225,006
Total liabilities	367,314	465,162	476,319	504,599
Net current assets	14,645	13,812	35,839	85,282
Equity attributable to shareholders	323,510	432,706	527,896	650,405
Non-controlling interests	32,697	56,118	56,455	56,889
Total equity	356,207	488,824	584,351	707,294

Source(s): The Company, ABCI Securities estimates

Notes: Individual items may not sum to total due to rounding differences

Individual items may varies from reported figures due to rounding differences/definition differences



Disclosures

Analyst Certification

I, Chow Sau Shing, Steve, 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 (except "Disclosures of Interests" below) 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, within the past 12 months, have investment banking relationship with one or more of the companies mentioned in the report.

Definition of equity rating

Rating	Definition
Buy	Stock return rate \geq Market return rate (10%)
Hold	- Market return rate (-10%) \leq Stock return rate < Market return rate (+10%)
Sell	Stock return < - Market return (-10%)

Notes: Stock return rate: expected percentage change of share price plus gross dividend yield over the next 12 months

Market return rate: average market return rate since 2008 (HSI total return index 2008-19 CAGR at 10%)

Time horizon of share price target: 12-month

Stock rating, however, may vary from the stated framework due to factors including but not limited to: corporate governance, market capitalization, historical price volatility relative to corresponding benchmark index, average daily turnover of the stock relative to market capitalization of the stock, competitive advantages in corresponding industry, etc.

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.

Copyright 2020 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