



Aug. 15, 2014
Company Report
Rating: BUY
TP: HK\$ 153

H-Share price (HK\$)	130.1
Est. share price return	17.65%
Est. dividend yield	0.30%
Est. total return	17.95%

Previous Rating & TP	BUY; 138*
Previous Report Date	Mar. 25, 2014

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

*TP is calculated based on the no. of shares after the proposed 1-to-5 share split; share split was effective on 15/05/14.

Key Data

52Wk H/L(HK\$)	133/71
Issued shares (mn)	9,363
Market cap (HK\$ mn)	2,218,126
3-mth avg daily turnover (HK\$ mn)	2,251
Major shareholder(s) (%):	
Naspers Limited	34.02
Ma Huateng	10.25

Source(s): Company, Bloomberg, ABCI Securities

FY14 Revenue breakdown (%)

VAS	78.98
Online advertising	8.50
Ecommerce transactions	10.09
Others	2.44
Total	100.0

Source(s): Company, ABCI Securities

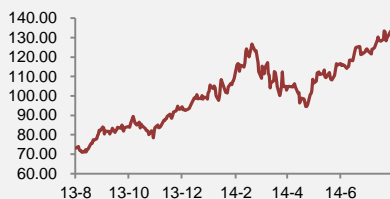
Share performance (%)

	Absolute	Relative*
1-mth	5.09	(0.63)
3-mth	22.16	12.96
6-mth	18.60	7.37

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Tencent (700 HK)

Improved ecosystem help accelerate monetization

- Mobile transfer function is now available on Tencent's WeChat V5.4- a powerful social IM platform with 438.2mn MAU. The enhanced virtual ecosystem will help accelerate monetization for the Group
- Tencent's mobile ad. business is expected to grow rapidly in 2H14 and FY15, based on 1H14 results and management's strategy to expand ad. across different platforms
- Internet banking license enables Tencent to extend its business to credit market
- More models of lower-price 4G-handsets are expected to be available in China; telecom operators plan to compete in the 4G market, which help enlarge smartphone user base and facilitate Tencent's mobile internet service
- Maintain our **BUY** rating with TP being revised up to HK\$ 153, equivalent to 0.75x FY14E PEG

Tencent improved its virtual ecosystem further. The Group's newly installed function of mobile transfer on WeChat V5.4 (Tencent's social IM platform with 438.2mn MAU by June 2014) enables instant money transfer among users. We believe that Tencent has successfully expanded its social and communication platform to different entities in the virtual ecosystem and this will accelerate monetization.

Mobile ads expected to grow rapidly in 2H14 and FY15. Tencent's VAS and online ad. revenue grew 9.02% and 75.36% QoQ; non-GAAP EPS for 1H14 was RMB 0.627, up 42%YoY (+13% QoQ). Management believed that mobile ad. is still at its initial stage of development. We expected this sector to grow rapidly in the coming quarters, generating promising revenue for the Group.

Wider adoption of 4G handsets and services can be expected. We believe 4G handsets will drop below RMB 1,000 and more 4G monthly packages will be released by telecom operators in the near future, which is favorable to OTT service providers such as Tencent. With its WeChat MAU of 438.2mn (up 86%YoY / 11% QoQ), stable ARPU in gaming sector, and synchronized benefits from cooperation with JD.com and China South City, the Group's expansion in the mobile internet market will be facilitated. Having acquired its first internet banking license, Tencent is planning to enter the consumer credit market where traditional banks find it difficult to compete due to the lack of e-commerce consumption-related data.

Maintain BUY and raise TP to HK\$ 153. Considering the Tencent's edges in the mobile internet sector and potentials of its new businesses, we revise up its FY14E VAS revenue and FY14E EPS rises from RMB2.43 to RMB2.66 (+9%). Maintain **BUY** with TP at HK\$ 153, reflecting 0.75x FY14E and 0.72x FY15E PEG.

Risk factors: 1) Regulatory risks; 2) Disappointing monetization from WeChat; 3) Intensifying competition among domestic peers; (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	86,320	122,586
Chg (%.yoy)	45.05	54.03	37.69	42.83	42.01
Net Income (RMB mn)	10,203	12,732	15,502	24,867	35,776
Chg (%.YoY)	26.69	24.78	21.76	60.41	43.87
EPS (RMB)	1.10	1.37	1.66	2.66	3.81
Chg (%.YoY)	26.85	24.46	21.44	60.03	43.56
BVPS (RMB)	3.06	4.43	6.20	8.30	11.60
Chg (%.yoy)	29.22	44.72	39.96	33.80	39.68
DPS (HK\$)	0.15	0.20	0.24	0.39	0.55
P/E (x)	-	-	61.24	38.27	26.66
P/B (x)	-	-	16.38	12.24	8.77
Yield (%)	-	-	0.18	0.30	0.43
ROE (%)	40.63	36.50	31.24	36.66	38.36
ROA (%)	17.96	16.92	14.46	20.39	21.59

Source(s): Bloomberg, ABCI Securities estimates

Consolidated income statement (2011A-2015E)

FY Ended Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
IVAS	23,043	31,995	44,985	69,753	99,792
MVAS	3,271	3,723			
Online advertising	1,992	3,382	5,034	8,155	12,233
e-Commerce transactions	0	4,428	9,796	6,857	8,229
Others	190	365	622	1,555	2,333
Revenues	28,496	43,894	60,437	86,320	122,586
Cost of revenues	(9,928)	(18,207)	(27,778)	(39,673)	(51,486)
Gross profit	18,568	25,686	32,659	46,648	71,100
SG&A	(7,204)	(10,759)	(15,683)	(23,424)	(30,646)
Other income and gains	(735)	(123)	(2,305)	(3,006)	(1,811)
Pre-tax profit	12,099	15,051	19,281	26,229	42,265
Income tax	(1,874)	(2,266)	(3,718)	(3,934)	(6,340)
Net profit	10,225	12,785	15,563	24,970	35,925
Profit attributable to:					
Minority interests	22	53	61	103	149
Equity holders of the Company	10,203	12,732	15,502	24,867	35,776
EPS (Basic)*, RMB	5.61	6.97	1.69	2.66	3.82
EPS, Diluted*, RMB	5.49	6.83	1.66	2.66	3.81
DPS*, HK\$	0.75	1.00	0.24	0.39	0.55

* Historical EPS and DPS are adjusted for share split.
 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	10,694	13,484
Intangible assets	3,780	4,719	4,103	5,138	6,255
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	30,481
Total non-current assets	21,301	38,747	53,549	52,651	61,174
Inventories	0	568	1,384	1,029	1,234
Accounts receivable	2,021	2,354	2,955	5,179	8,581
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	38,443	67,857
Other current assets	18,659	16,326	23,754	20,040	21,897
Current Assets	35,503	36,509	53,686	69,312	104,563
Total assets	56,804	75,256	107,235	121,963	165,737
Accounts payable	2,244	4,212	6,680	8,632	11,033
Other payables and accruals	5,014	6,301	10,246	11,222	14,710
Borrowings	7,999	1,077	2,589	1,833	2,584
Current income tax liabilities	709	420	1,318	869	1,093
Deferred revenue	5,016	8,115	11,841	4,989	8,415
Other short-term liabilities	200	540	593	567	580
Total current liabilities	21,183	20,665	33,267	28,111	38,415
Borrowings	0	2,106	3,323	2,323	2,323
Long-term notes payable	3,733	7,517	9,141	10,642	13,071
Deferred income tax liabilities	940	1,312	1,441	924	946
Long-term payables	1,860	1,509	1,600	1,554	1,577
Total non-current liabilities	6,533	12,443	15,505	15,444	17,917
Total liabilities	27,716	33,108	48,772	43,555	56,331
Total equity	29,088	42,148	58,463	78,408	109,406
Non-controlling interests	625	851	518	684	601
Equity of the firm	28,464	41,298	57,945	77,724	108,804
BVPS*, RMB	3.06	4.43	6.20	8.30	11.60

* Historical BVPS is adjusted for share split.
 Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2011A-2015E)

FY ended Dec 31 (RMB mn)	2011A	2012A	2013A	2014E	2015E
Profit for the year	10,225	12,785	15,563	24,970	35,925
Adjustments for:					
Income tax expense	1,874	2,266	3,718	3,934	6,340
Dividend income	–	(407)	(509)	(458)	(484)
Depreciation of fixed assets and investment properties	1,208	1,880	2,484	2,182	2,333
Amortization of intangible assets	726	733	1,106	919	1,013
Interest income	(469)	(836)	(1,314)	(873)	(1,008)
Equity-settled share-based compensation expenses	733	905	1,168	2,165	3,349
Changes in working capital:					
Accounts receivable	(251)	(267)	(606)	(2,224)	(3,402)
Inventories	–	(301)	(815)	355	(206)
Prepayments, deposits and other receivables	(2,630)	(2,255)	(940)	744	(372)
Accounts payable	828	1,689	2,036	1,952	2,401
Other adjusted items	2,951	5,461	5,601	3,578	5,555
Net Cash generated from operating activities	15,194	21,654	27,492	37,245	51,444
Income tax paid	(1,836)	(2,225)	(3,118)	(3,299)	(5,317)
Net cash flow generated from operating activities	13,358	19,429	24,374	33,946	46,128
Cash flow from investing activities					
Payments for business combinations, net of cash acquired	(1,444)	(435)	4	(215)	(106)
Purchase fixed assets, construction in progress & investment properties	(4,060)	(3,657)	(4,788)	(2,956)	(3,872)
Payments for interests in associates	(3,529)	(3,668)	(4,456)	(4,062)	(4,259)
Purchase/prepayment of intangible assets	(788)	(869)	(1,200)	(1,035)	(1,117)
Receipt from maturity of term deposits with initial term of over 3 months	5,989	18,532	15,950	17,241	16,595
Interest received	415	626	536	581	558
Dividends received	20	440	551	495	523
Other adjusted items	(11,958)	(27,239)	(25,731)	(26,550)	(26,223)
Net cash flow used in investing activities	(15,355)	(16,270)	(19,134)	(16,501)	(17,900)
Cash flow from financing activities					
Proceeds from short-term borrowings	6,683	983	2,320	1,651	1,986
Proceed from long-term borrowings	0	2,215	2,846	4,555	3,701
Net proceed from issuance of long-term notes	3,761	3,768	1,847	2,807	2,327
Proceeds from issuance of ordinary shares	160	238	308	273	291
Dividends paid to the Company's shareholders	(838)	(1,108)	(1,468)	(1,288)	(1,378)
Other adjusted items	(5,392)	(8,483)	(4,145)	(7,178)	(5,661)
Net cash flow (used in)/generated from financing activities	4,373	(2,386)	1,708	822	1,265
Net increase in cash and cash equivalents	2,376	773	6,948	18,267	29,492
Cash and cash equivalents at beginning of the year	10,408	12,612	13,383	20,228	38,443
Exchange losses on cash and cash equivalents	(172)	(2)	(103)	(53)	(78)
Cash and cash equivalents at end of the year	12,612	13,383	20,228	38,443	67,857

Source(s): Company, ABCI Securities estimates

Financial ratio table (2011A-2015E)

FY Ended Dec 31	2011A	2012A	2013A	2014E	2015E
Gross Profit Margin, %	58.52	54.04	54.04	58.00	58.00
Operating Margin, %	43.00	35.27	31.76	30.58	34.62
Net Margin, %	35.81	29.01	25.65	28.81	29.18
ROE, %	40.63	36.50	31.24	36.66	38.36
ROA, %	17.96	16.92	14.46	20.39	21.59
Total Liability/Total Asset, %	48.79	43.99	45.48	35.71	33.99

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 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.

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

Tel: (852) 2868 2183