



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

| | |
|-------------------------|--------|
| H-Share price (HK\$) | 129.2 |
| Est. share price return | 18.43% |
| Est. dividend yield | 0.27% |
| Est. total return | 18.7% |

| | |
|----------------------|---------------|
| Previous Rating & TP | BUY; 153* |
| Previous Report Date | Aug. 15, 2014 |

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*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\$) | 134/77.39 |
| Issued shares (mn) | 9,367 |
| Market cap (HK\$ mn) | 1,209,700 |
| 3-mth avg daily turnover (HK\$ mn) | 2,171 |
| Major shareholder(s) (%): | |
| Naspers Limited | 34.02 |
| Ma Huateng | 10.25 |

Source(s): Company, Bloomberg, ABCI Securities

1H14 Revenue breakdown (%)

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

Source(s): Company, ABCI Securities

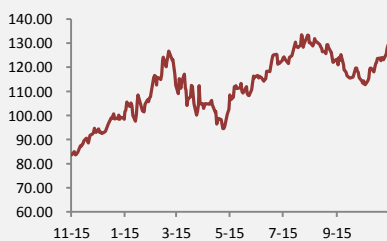
Share performance (%)

| | Absolute | Relative* |
|-------|----------|-----------|
| 1-mth | 13.93 | 10.07 |
| 3-mth | (0.84) | 3.23 |
| 6-mth | 21.31 | 15.92 |

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Tencent (700 HK)

Maintain BUY on multiple near-term catalysts

- A flat revenue (+0.31% QoQ) and a declining net profit (-3%QoQ) indicate monetization of mobile business may take longer than expected. Nonetheless, 3Q14 data shows that client base has been transferring smoothly from PC to mobile
- Management expects monetization of WeChat to grow progressively; strong growth is expected for mobile ad. business. Online banking business is smoothly underway
- Near-term catalysts for the counter include high growth in VAS, launching of new businesses and commencement of the Shanghai-Hong Kong stock connect
- Maintain our **BUY** rating with TP unchanged at HK\$ 153, reflecting 0.77x FY15E PEG

Weaker-than-expected 3Q14 results. Revenue was up 28% YoY but flat QoQ (+0.31%) at RMB 19,808 mn for 3Q14; net profit was up 46%YoY but down 3%QoQ to RMB 5,657mn. Management explained total revenues from smartphone games integrated with Mobile QQ and Weixin declined QoQ on delayed upgrades. The Group believes the issue has been resolved and therefore would not affect 4Q14 results.

VAS will continue to grow rapidly, transferring smoothly from PC to mobile. MAU of QQ IM was down 1% QoQ, declining for the second consecutive quarter; Qzone's MAU was down 1% QoQ but the figure in WeChat was up 7% QoQ, indicating a smooth transfer of client base from PC to mobile. In addition, the ARPU ranges of ACG and MOG continue to trend up, and the ACU of ACG grew 8% QoQ. We expect VAS business to grow at a high rate, although we lower the fee-based VAS registered subscription ratio in our estimates to reflect the slower growth in WeChat's MAU. Besides, Tencent would need more time to educate its mobile users to utilize their fee-based items and services. Nonetheless, its growth potential is still ample.

Mobile ads to grow rapidly in 2H14 and FY15. Tencent's online ad. revenue grew 18% QoQ in 3Q. Management believes that the business is still at its early stage of development. We expect this sector to grow rapidly and generate substantial revenue for the Group.

Solid growth in social services and internet finance can be expected. We believe Tencent will soon improve its market shares in social life services market (including services such as restaurant ordering, taxi call, ecommerce, online education and online booking, etc.) and mobile payment market. Management said preparation for the online bank business has been smooth. Hence, we expect the new business will commence in the next 3 months. Tencent has 2 mobile payment apps on WeChat and Mobile QQ. The Group has expressed interests in online Visa card business early this year. With its online bank license and connection with multiple social life services apps, as well as the upbeat growth in Visa and MasterCard(both enjoy two-digit growth in ROE in recent years), we are optimistic on the growth potential with profit outlook of the online payment business.

Results and Valuation

| FY ended Dec 31 | 2011A | 2012A | 2013A | 2014E | 2015E |
|---------------------|--------|--------|--------|--------|---------|
| Turnover (RMB mn) | 28,496 | 43,894 | 60,437 | 80,487 | 111,418 |
| Chg (%.yoy) | 45.05 | 54.03 | 37.69 | 33.18 | 38.43 |
| Net Income (RMB mn) | 10,203 | 12,732 | 15,502 | 22,472 | 32,623 |
| Chg (%.YoY) | 26.69 | 24.78 | 21.76 | 44.96 | 45.17 |
| EPS (RMB) | 1.10 | 1.37 | 1.66 | 2.40 | 3.48 |
| Chg (%.YoY) | 26.85 | 24.46 | 21.44 | 44.62 | 44.85 |
| BVPS (RMB) | 3.06 | 4.43 | 6.20 | 8.08 | 11.09 |
| Chg (%.yoy) | 29.22 | 44.72 | 39.96 | 30.30 | 37.22 |
| DPS (HK\$) | 0.15 | 0.20 | 0.24 | 0.35 | 0.50 |
| P/E (x) | - | - | 61.24 | 42.50 | 29.34 |
| P/B (x) | - | - | 16.38 | 12.62 | 9.20 |
| Yield (%) | - | - | 0.18 | 0.27 | 0.39 |
| ROE (%) | 40.63 | 36.50 | 31.24 | 33.63 | 36.29 |
| ROA (%) | 17.96 | 16.92 | 14.46 | 15.14 | 19.21 |

Source(s): Bloomberg, ABCI Securities estimates



Benefiting from Shanghai-Hong Kong stock connect. The counter is among the first round of stocks eligible for trading under the SH-HK stock connect launching next Monday (Nov. 17, 2014). Tencent is one of the largest internet companies in China and is a leader in both IM and online games segments. Since the Group is not listed in China, the stock access should attract investors interested in gaining exposure to the online industry. Also, compared with its peers, Tencent's valuation is attractive with a current valuation of 29.34x FY15E P/E, much lower than its A-share peers such as Ourpalm (300315 CH; 32.5x) or Leshi (300104 CH; 54.3x), and is significantly lower than the average valuation of WIND's A-share Internet Sector at 134x FY15E P/E.

Maintain BUY with TP unchanged at HK\$ 153. We reduce Tencent's FY14E EPS from RMB 2.66 to RMB 2.40 (-9.8%) to reflect its weaker -than-expected monetization of WeChat. However, the Group's edges in mobile internet, and strong potentials in mobile advertising and internet social services will support its earnings. We expect its FY15E EPS to increase by 44.85% YoY to RMB 3.48. Our TP reflects 0.77x FY15E PEG. At this point, our valuation does not include the value of its online banking business.

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.



Consolidated income statement (2011A-2015E)

| FY Ended Dec 31 (RMB mn) | 2011A | 2012A | 2013A | 2014E | 2015E |
|--------------------------------------|---------------|---------------|---------------|---------------|----------------|
| IVAS | 23,043 | 31,995 | 44,985 | 65,996 | 92,356 |
| MVAS | 3,271 | 3,723 | | | |
| Online advertising | 1,992 | 3,382 | 5,034 | 8,155 | 11,417 |
| e-Commerce transactions | 0 | 4,428 | 9,796 | 4,408 | 4,849 |
| Others | 190 | 365 | 622 | 1,928 | 2,796 |
| Revenues | 28,496 | 43,894 | 60,437 | 80,487 | 111,418 |
| Cost of revenues | (9,928) | (18,207) | (27,778) | -37,829 | -46,795 |
| Gross profit | 18,568 | 25,686 | 32,659 | 42,658 | 64,622 |
| SG&A | (7,204) | (10,759) | (15,683) | -21,841 | -27,854 |
| Other income and gains | (735) | (123) | (2,305) | -2,886 | -1,771 |
| Pre-tax profit | 12,099 | 15,051 | 19,281 | 23,703 | 38,539 |
| Income tax | (1,874) | (2,266) | (3,718) | -3,556 | -5,781 |
| Net profit | 10,225 | 12,785 | 15,563 | 22,566 | 32,758 |
| Profit attributable to: | | | | | |
| Minority interests | 22 | 53 | 61 | 94 | 136 |
| Equity holders of the Company | 10,203 | 12,732 | 15,502 | 22,472 | 32,623 |
| EPS (Basic)*, RMB | 5.61 | 6.97 | 1.69 | 2.41 | 3.48 |
| EPS, Diluted*, RMB | 5.49 | 6.83 | 1.66 | 2.40 | 3.48 |
| DPS*, HK\$ | 0.75 | 1.00 | 0.24 | 0.35 | 0.50 |

* 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 | 7,900 | 10,690 |
| Intangible assets | 3,780 | 4,719 | 4,103 | 4,000 | 5,117 |
| Interests in associates | 4,433 | 7,310 | 12,170 | 48,000 | 30,085 |
| Other non-current assets | 7,203 | 19,315 | 28,583 | 27,080 | 30,481 |
| Total non-current assets | 21,301 | 38,747 | 53,549 | 86,980 | 76,373 |
| Inventories | 0 | 568 | 1,384 | 200 | 727 |
| Accounts receivable | 2,021 | 2,354 | 2,955 | 4,829 | 7,799 |
| 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 | 34,896 | 59,599 |
| Other current assets | 18,659 | 16,326 | 23,754 | 16,900 | 20,327 |
| Current Assets | 35,503 | 36,509 | 53,686 | 61,447 | 93,445 |
| Total assets | 56,804 | 75,256 | 107,235 | 148,427 | 169,819 |
| Accounts payable | 2,244 | 4,212 | 6,680 | 8,049 | 10,028 |
| Other payables and accruals | 5,014 | 6,301 | 10,246 | 10,463 | 13,370 |
| 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 | 2,700 | 7,271 |
| Other short-term liabilities | 200 | 540 | 593 | 567 | 580 |
| Total current liabilities | 21,183 | 20,665 | 33,267 | 24,481 | 34,925 |
| Borrowings | 0 | 2,106 | 3,323 | 8,000 | 5,669 |
| Long-term notes payable | 3,733 | 7,517 | 9,141 | 25,573 | 17,357 |
| Deferred income tax liabilities | 940 | 1,312 | 1,441 | 12,000 | 5,376 |
| Long-term payables | 1,860 | 1,509 | 1,600 | 2,000 | 1,800 |
| Total non-current liabilities | 6,533 | 12,443 | 15,505 | 47,573 | 30,202 |
| Total liabilities | 27,716 | 33,108 | 48,772 | 72,053 | 65,127 |
| Total equity | 29,088 | 42,148 | 58,463 | 76,373 | 104,692 |
| Non-controlling interests | 625 | 851 | 518 | 684 | 601 |
| Equity of the firm | 28,464 | 41,298 | 57,945 | 75,689 | 104,090 |
| BVPS*, RMB | 3.06 | 4.43 | 6.20 | 8.08 | 11.09 |

* 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 | 22,566 | 32,758 |
| Adjustments for: | | | | | |
| Income tax expense | 1,874 | 2,266 | 3,718 | 3,556 | 5,781 |
| 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) | (1,644) | (1,265) |
| Equity-settled share-based compensation expenses | 733 | 905 | 1,168 | 2,019 | 3,044 |
| Changes in working capital: | | | | | |
| Accounts receivable | (251) | (267) | (606) | (1,874) | (2,970) |
| Inventories | – | (301) | (815) | 1,184 | (527) |
| Prepayments, deposits and other receivables | (2,630) | (2,255) | (940) | 744 | (372) |
| Accounts payable | 828 | 1,689 | 2,036 | 1,369 | 1,979 |
| Other adjusted items | 2,951 | 5,461 | 5,601 | 2,820 | 4,973 |
| Net Cash generated from operating activities | 15,194 | 21,654 | 27,492 | 33,381 | 46,263 |
| Income tax paid | (1,836) | (2,225) | (3,118) | (2,982) | (4,848) |
| Net cash flow generated from operating activities | 13,358 | 19,429 | 24,374 | 30,400 | 41,415 |
| 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 | 14,720 | 24,780 |
| Cash and cash equivalents at beginning of the year | 10,408 | 12,612 | 13,383 | 20,228 | 34,896 |
| 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 | 34,896 | 59,599 |

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 | 31.01 | 35.07 |
| Net Margin, % | 35.81 | 29.01 | 25.65 | 27.92 | 29.28 |
| ROE, % | 40.63 | 36.50 | 31.24 | 33.63 | 36.29 |
| ROA, % | 17.96 | 16.92 | 14.46 | 15.14 | 19.21 |
| Total Liability/Total Asset, % | 48.79 | 43.99 | 45.48 | 48.54 | 38.35 |

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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