

November 27, 2013 Company Report Rating: BUY TP: HK\$ 479.0

H-Share price (HK\$) 437.0
 Est. share price return 9.61%
 Est. dividend yield 0.34%
 Est. total return 9.61%

Previous Rating & TP BUY; HK\$479
 Previous Report Date Oct. 15 2013

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Key Data

52Wk H/L(HK\$)	455/237
Issued shares (mn)	1,859.4
Market cap (HK\$ mn)	812,637
3-mth avg daily turnover (HK\$ mn)	1584
Major shareholder(s) (%):	
Naspers Limited	33.9
Ma Huateng	10.2

Source(s): Company, Bloomberg, ABCI Securities

1H13 Revenue breakdown (%)

VAS	76.68
Online advertising	7.69
e-Commerce transactions	14.72
Others	0.91
Total	100.00

Source(s): Company, ABCI Securities

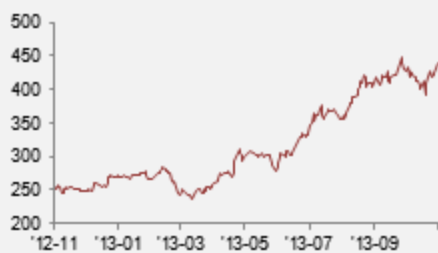
Share performance (%)

	Absolute	Relative*
1-mth	2.5	(1.8)
3-mth	22.7	12.7
6-mth	43.7	40.4

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg

Tencent (700 HK)

Key takeaways from Tencent's investors meeting

- Recent anti-monopoly lawsuit against Tencent would not affect the group's policy on fee-based services. Tencent successfully diversified its revenue sources in the past years while providing free IM services. The growth of online ad. business increased faster than peers
- While the Group's e-commerce business is still in its initial stage, the mobile payment attached to WeChat will improve the growth potential of this business segment
- We believe more corporate clients can help the Group to expand its e-commerce segment. Maintain **BUY**.

Diversifying business for long-term growth. Tencent has the largest instant messaging (IM) community in China and provides free (basic) internet services (such as IM, email account, blog account etc.). The recent anti-monopoly lawsuit against the Group would not change the management's policy to provide free basic services as these services help the profit-generating business. E.g. the Group generates profits from various monthly or item-based fee subscriptions (such as QQ Show, QQ privilege account, QQ music and QQ Space) via its free service of QQ IM. As a strategic development, the counter diversified its revenue streams by entering the e-commerce sector, attracting corporate clients while strengthening its (individual) user-paid services. Tencent's revenue growth in online ad has been stronger than its peers despite its contribution to total revenue remains low.

Mobile payment to accelerate monetization. Tencent regarded its mobile payment platform as crucial to monetization. The platform, unlike Q-coin that can only be used to purchase virtual online VAS products, links the WeChat account to the bank account, enables its users pay for real-world offline products and services. Tencent has devoted great effort to expand the number of third-party cooperators (such as McDonald and www.xiaomi.com, one of the most popular online smartphone stores in China). We expect more third-party cooperators to join the platform in the future.

Revenue drivers of WeChat/WeXin? The management regards WeChat as a mobile lifestyle platform rather than just an IM software. Short-term drivers of revenue will be mainly from games; e-commerce, online ad. and various mobile VAS will be the major revenue sources in the long run.

Maintain BUY with TP unchanged. Our 12-month TP of HK\$ 479 is based on a PEG ratio of 0.8x and reflects a valuation of 32.4x FY14E P/E and 9.8x FY14E P/B. However, we may revise up our TP if the Group achieves better-than-expected monetization from WeChat and e-commerce growth. *For more information, please refer to our initiation report on Oct. 8, 2013.*

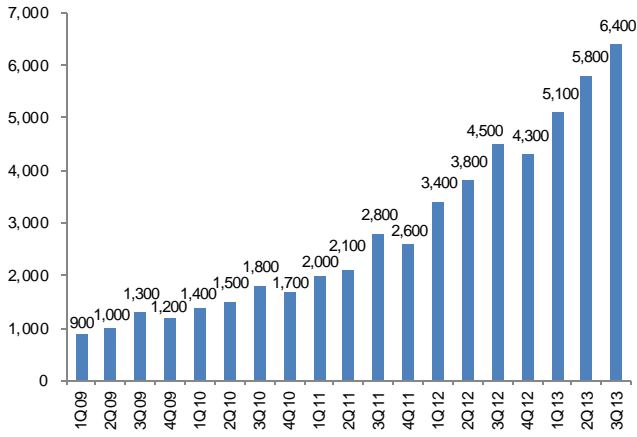
Risk factors: 1) Regulatory risks concerning e-commerce; 2) Disappointing monetization from WeChat and increasing marketing cost; 3) Intensifying competition with domestic e-commerce companies; (4) Slowdown in PC gaming sector; (5) Declines in 2H13 profit growth on HoH basis..

Results and Valuation

FY ended Dec 31	2011A	2012A	2013E	2014E	2015E
Turnover (RMB mn)	28,496	43,894	63,856	99,410	142,686
Chg (%.yoy)	45.05	54.03	45.48	55.68	43.53
Net Income (RMB mn)	10,203	12,732	15,481	21,891	32,437
Chg (%.YoY)	26.69	24.78	21.59	41.40	48.18
EPS (RMB)	5.49	6.83	8.28	11.64	17.17
Chg (%.YoY)	26.85	24.46	21.24	40.53	47.50
BVPS (RMB)	15.32	22.16	28.83	38.73	53.10
Chg (%.yoy)	29.22	44.72	30.07	34.34	37.12
DPS	0.75	1.00	1.17	1.68	2.45
P/E (x)	-	50.36	41.54	29.56	20.04
P/B (x)	-	15.53	11.94	8.88	6.48
Yield (%)	-	0.29	0.34	0.49	0.71
ROE (%)	40.63	36.50	32.53	34.56	37.47
ROA (%)	17.96	16.92	17.10	18.87	21.83
Net debt/total equity (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

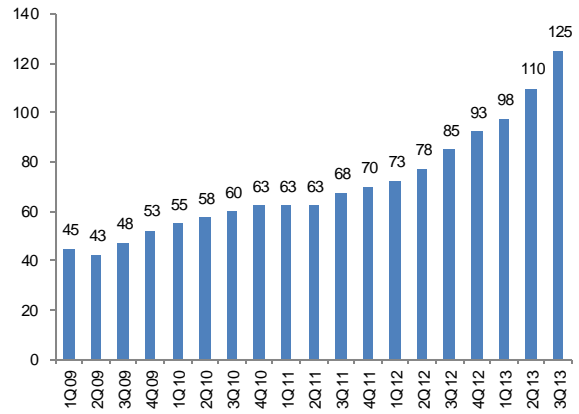
Source(s): Bloomberg, ABCI estimates

Exhibit: Combined ACU of ACG platform grew steadily in 1Q09-3Q13 (Unit '000)



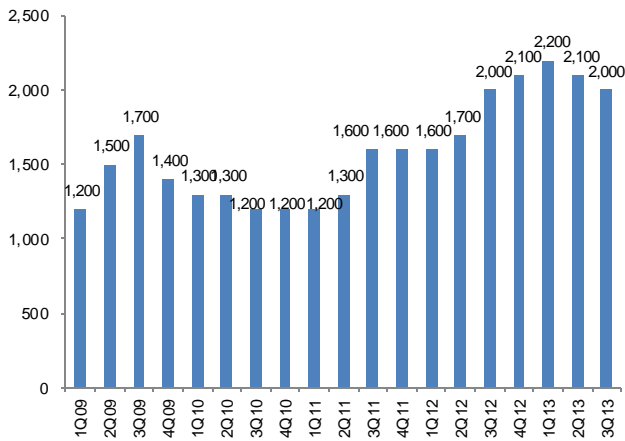
Source(s): Company, ABCI Securities

Exhibit: ACG ARPU median trend in 1Q09-3Q03 (RMB)



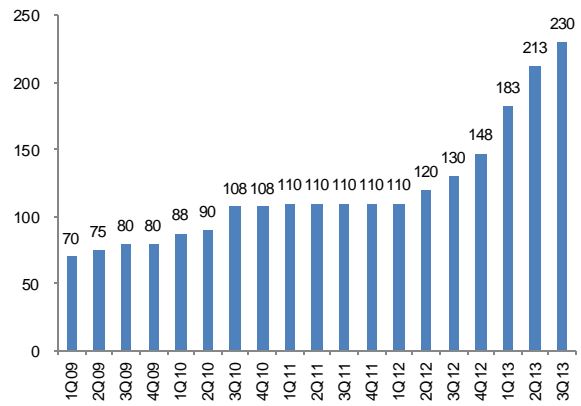
Source(s): Company, ABCI Securities

Exhibit: Combined ACU of massively multiplayer online game (MMOG) platform in 1Q09- 3Q13 (Unit '000)



Source(s): Company, ABCI Securities

Exhibit: Median of MMOG ARPU in 1Q09-2Q03 (RMB)



Source(s) Company, ABCI Securities

Exhibit: Comparison of different internet/online social media companies (as of Nov. 26, 2013)

Ticker	Company	Mkt_Cap	P/E FY13E	P/E FY14E	PEG FY13E	PEG FY14E	EV/Shr	EPS FY13E	EPS FY14E
HK Internet, HK\$									
700HK Equity-ABCI	Tencent	812,637	39.83	28.34	2.14	0.80	----	8.28	11.64
700HK Equity	Tencent	812,637	38.41	30.14	1.44	1.13	191.86	8.94	11.39
3888HK Equity	Kingsoft	22,000	26.63	21.20	1.06	0.84	2.82	0.55	0.69
777HK Equity	Netdragon	8,326	10.58	12.90	2.00	2.43	6.66	1.22	1.00
484HK Equity	Forgame	6,725	----	----	----	----	----	----	----
CN Internet @US, US\$									
SINA US Equity	Sina	4,986	78.44	36.38	1.46	0.68	39.65	0.95	2.06
SOHU US Equity	Sohu	2,458	46.60	34.23	3.05	2.24	34.27	1.38	1.88
NTES US Equity	NetEase	8,791	11.90	10.63	0.90	0.80	23.07	5.65	6.33
BIDU US Equity	BaiDu	54,822	30.41	23.68	1.24	0.97	91.53	31.38	40.30
QIHU US Equity	Qihoo 360	9,625	60.63	37.73	1.33	0.82	26.59	1.29	2.08
CTRP US Equity	Ctrip	5,838	31.48	25.69	1.48	1.20	18.74	1.43	1.76
JOBS US Equity	51job	2,097	25.27	21.93	1.26	1.10	32.69	2.87	3.31
PWRD US Equity	Perfect World	919	11.87	9.82	1.06	0.88	9.66	9.68	11.70
YY US Equity	YY Inc.	2,612	34.09	24.02	0.74	0.52	10.12	1.39	1.97
Global Internet, US\$									
GOOG US Equity	Google	349,432	23.74	20.01	1.43	1.20	573.98	44.06	52.27
FB US Equity	Facebook	111,685	54.20	40.16	1.82	1.35	23.55	0.83	1.12
YHOO US Equity	Yahoo	36,814	24.94	22.02	2.11	1.86	14.58	1.46	1.65
Amzn US Equity	Amazon	172,401	153.61	81.21	4.14	2.19	235.31	2.45	4.64
Ebay US Equity	EBay	63,487	18.21	15.63	1.24	1.07	47.22	2.69	3.14
AOL US Equity	American Online	3,489	22.06	19.15	1.55	1.34	25.07	2.02	2.32
LNKD US Equity	LinkedIn	25,865	135.13	97.53	2.57	1.86	107.99	1.60	2.22
GRPN US Equity	GROUPON	6,060	101.91	37.63	3.10	1.14	3.02	0.09	0.24
YNDX US Equity	Yandex N.V.	12,620	33.90	27.75	1.09	0.89	19.30	37.63	45.98
Global Internet, JPY									
4689 JP Equity	Yahoo Japan	2,795,418	22.28	20.71	2.03	1.89	384.88	21.82	23.47
Global Internet, KRW									
035720 KS Equity	Daum Communications	1,118,620	14.47	12.51	1.16	1.00	71.69	1110.00	1110.00

Source(s): Bloomberg, ABCI Securities estimates

Consolidated income statement (2011A-2015E)

FY Ended Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
IVAS	23,043	31,995	49,254	72,953	97,574
MVAS	3,271	3,723			
Online advertising	1,992	3,382	5,919	10,358	17,609
e-Commerce transactions	0	4,428	7,970	14,745	25,066
Others	190	365	713	1,354	2,437
Revenues	28,496	43,894	63,856	99,410	142,686
Cost of revenues	(9,928)	(18,207)	(28,735)	(44,734)	(64,209)
Gross profit	18,568	25,686	35,121	54,675	78,478
SG&A	(7,204)	(10,759)	(17,241)	(29,237)	(40,476)
Other income and gains	(735)	(123)	(409)	(423)	(318)
Pre-tax profit	12,099	15,051	18,289	25,861	38,320
Income tax	(1,874)	(2,266)	(2,743)	(3,879)	(5,748)
Net profit	10,225	12,785	15,546	21,982	32,572
Profit attributable to:					
Minority interests	22	53	64	91	135
Equity holders of the Company	10,203	12,732	15,481	21,891	32,437
EPS (Basic), RMB	5.61	6.97	8.31	11.71	17.25
EPS, Diluted, RMB	5.49	6.83	8.28	11.64	17.17
DPS, RMB	0.75	1.00	1.17	1.68	2.45

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2011A-2015E)

As of Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Fixed assets	5,885	7,403	10,703	13,830	17,043
Intangible assets	3,780	4,719	5,548	6,397	7,235
Interests in associates	4,433	7,310	5,872	6,591	6,231
Other non-current assets	7,203	19,315	19,898	22,737	20,532
Total non-current assets	21,301	38,747	42,020	49,555	51,042
Inventories		568	1,116	2,212	3,760
Accounts receivable	2,021	2,354	3,193	5,965	9,988
Prepayments, deposits and other assets	2,212	3,878	3,045	3,461	3,253
Cash and cash equivalents	12,612	13,383	23,671	37,937	63,343
Other current assets	18,659	16,326	17,492	16,909	17,201
Current Assets	35,503	36,509	48,517	66,484	97,545
Total assets	56,804	75,256	90,537	116,039	148,586
Accounts payable	2,244	4,212	6,386	9,941	12,842
Other payables and accruals	5,014	6,301	9,578	12,923	17,122
Borrowings	7,999	1,077	3,595	2,336	2,966
Current income tax liabilities	709	420	564	492	528
Deferred revenue	5,016	8,115	6,566	7,340	6,953
Other short-term liabilities	200	540	381	471	426
Total current liabilities	21,183	20,665	27,070	33,504	40,837
Borrowings		2,106	2,011	1,917	1,341
Long-term notes payable	3,733	7,517	4,035	4,186	2,520
Deferred income tax liabilities	940	1,312	1,126	1,219	1,172
Long-term payables	1,860	1,509	1,684	1,596	1,640
Total non-current liabilities	6,533	12,443	8,856	8,918	6,674
Total liabilities	27,716	33,108	35,926	42,421	47,510
Total equity	29,088	42,148	54,611	73,618	101,076
Non-controlling interests	625	851	738	794	766
Equity of the firm	28,464	41,298	53,873	72,823	100,310
BVPS, RMB	15.32	22.16	28.83	38.73	53.10

Source(s): Company, ABCI Securities estimates

Consolidated cash flow statement (2011A-2015E)

FY ended Dec 31 (RMB mn)	2011A	2012A	2013E	2014E	2015E
Profit for the year	10,225	12,785	15,546	21,982	32,572
Adjustments for:					
Income tax expense	1,874	2,266	2,743	3,879	5,748
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)	(520)	(608)	(655)
Equity-settled share-based compensation expenses	733	905	1,479	2,176	3,214
Changes in working capital:					
Accounts receivable	(251)	(267)	(839)	(2,772)	(4,023)
Inventories	–	(301)	(548)	(1,096)	(1,548)
Prepayments, deposits and other receivables	(2,630)	(2,255)	833	(416)	208
Accounts payable	828	1,689	2,174	3,555	2,901
Other adjusted items	2,951	5,461	5,153	6,120	6,525
Net Cash generated from operating activities	15,194	21,654	27,887	34,857	46,893
Income tax paid	(1,836)	(2,225)	(2,693)	(3,808)	(5,643)
Net cash flows generated from operating activities	13,358	19,429	25,194	31,048	41,250
Cash flows from investing activities					
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)	(3,858)	(3,758)	(3,808)
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)
Net cash flows used in investing activities	(15,355)	(16,270)	(15,812)	(16,041)	(15,927)
Cash flows from financing activities					
Proceeds from short-term borrowings	6,683	983	3,833	2,408	3,120
Proceed from long-term borrowings	0	2,215	1,108	1,661	1,385
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)
Net cash flows (used in)/generated from financing activities	4,373	(2,386)	994	(696)	149
Net increase in cash and cash equivalents	2,376	773	10,375	14,311	25,472
Cash and cash equivalents at beginning of the year	10,408	12,612	13,383	23,671	37,937
Exchange losses on cash and cash equivalents	(172)	(2)	(87)	(45)	(66)
Cash and cash equivalents at end of the year	12,612	13,383	23,671	37,937	63,343

Source(s): Company, ABCI Securities estimates

Financial Ratios (2011A-2015E)	2011A	2012A	2013E	2014E	2015E
Gross Margin, %	58.52	55.00	55.00	55.00	55.00
Operating Margin, %	43.00	35.27	28.91	26.27	27.05
Net Margin, %	35.81	29.01	24.24	22.02	22.73
ROE, %	40.63	36.50	32.53	34.56	37.47
ROA, %	17.96	16.92	17.10	18.87	21.83
Total Equity/Total Debt, %	104.95	127.31	152.01	173.54	212.74

Working capital data and Ratios

Inventory turnover		32.05	25.75	20.23	17.08
Receivables turnover		18.65	20.00	16.67	14.29
Payables turnover		5.82	5.53	5.61	5.77
Days' inventory on hand (DOH)		11.39	14.17	18.05	21.37
Days' of sales outstanding (DSO)		19.57	18.25	21.90	25.55
Days' payables		62.75	66.05	65.01	63.23
Cash conversion cycle		(31.79)	(33.62)	(25.07)	(16.31)

Source(s): Company, ABCI Securities estimates

Key Glossary

Abbreviation	Definitions and explanation (provided by Tencent)	定义
ACG	Advanced Casual Game	高级休闲游戏
ACU	Average Concurrent User accounts. Quarterly ACU is the average number of simultaneous online user accounts during the quarter.	平均同时在线用户数
ARPU	Average Revenue Per User. Quarterly ARPU is online game net revenues derived from ACG or MMOG during the quarterly period divided by the quarterly active paying user accounts of these ACGs or MMOGs during the quarterly period. Tencent's definition of ARPU may not be comparable to similarly titled measures presented by other online game companies.	平均每月用户收入
B2C	Business-to-consumer / Business-to-customer	商家（企业）至消费者销售
C2C	Consumer To Consumer / Customer to Customer	消费者至消费者的销售
Combined MAU of Weixin & WeChat:	Total number of user accounts that logged in Weixin or WeChat to send out messages at least once during the last month of the quarter.	微信 WeChat 合并月活跃账户数
CPA	Cost-per-Action	每次访问行动的费用
CPC	Cost-per-click	每次点击行动的费用
CPD	Cost per day	每天点击成本
CPM	Cost Per Mille	每千人成本网络广告费用
CPT	Cost Per Time	根据广告展示时间收取的费用
DAU	Daily Active User Accounts	日活跃用户数
DNF	Dungeon and Fighter	地下城与勇士
FPS	First Person Shooting	第一人称射击游戏
FTTH	fibres-to-the-home	光纤到户
GMV	Gross Merchandise Volume	（网站）成交金额
IVAS	Internet value-added services	互联网增值服务
LOL	League of Legends	英雄联盟
LTE	Long Term Evolution (LTE)	4G LTE 技术
MAU	Monthly Active User accounts;	月活跃账户数
MAU--QQ IM	Total number of user accounts that logged in QQ at least once during the last month.	QQ 月活跃账户数
Mbps	megabits per second	兆位/秒
MCG	Mini Casual Game	小型休闲游戏
MM ORGS	Massive Multiplayer Online Role-Playing Game	大型多人在线角色扮演游戏
MMO Racing	Massive Multiplayer Online Racing	大型多人在线赛车游戏
MMOFPS	Massive Multiplayer Online First-Person Shoot	大型多人在线第一人称射击游戏
MMOG	Massive Multiplayer Online Game	大型多人在线游戏
MMORTS	Massive Multiplayer Online Real-Time Strategy	大型多人在线实时战略游戏
MVAS	mobile & telecommunications value-added services	移动及电讯增值服务
O2O	Online To Offline	离线商务模式（线上营销线下消费）
PCU	Peak Concurrent User Accounts. Quarterly PCU is the highest number of simultaneous online user accounts during the quarter.	最高同时在线用户数
PCU	Peak Concurrent User accounts	最高同时在线户
PCU-- QQ IM PCU	The highest number of logged-in user accounts recorded on any time of a day during the quarter.	QQ 最高同时在线户
SNS	Social Network Site	社交网站
TAC	Traffic Acquisition Cost	流量获得成本
VAS	value-added services which contains IVAS and MVAS	增值服务
WeChat	A product of Tencent that leverages Weixin's technology to serve the international markets.	微信（海外版）
Weixin	An extension of Tencent's mobile IM service, whose functions have been developed and become a mobile community.	微信

Source(s): Company, ABCI Securities

Disclosures

Analyst Certification

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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 2008-2012

Time horizon of share price target: 12-month

Definition of share price risk

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

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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