



May 20, 2014
Company Report
Rating: BUY
TP: HK\$ 138*

H-Share price (HK\$)	107.6
Est. share price return	28.25%
Est. dividend yield	0.33%
Est. total return	28.58%

Previous Rating & TP	BUY; 138*
Previous Report Date	Apr 30, 2014

Analyst: Mark Chen
Tel: (852) 2147 8819
Email: markchen@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.

Tencent will terminate the temporary code (2988 HK) on May 29. The original code (700 HK) will resume on May 29, 2014.

Key Data

52Wk H/L(HK\$)	129/54
Issued shares (mn)	9,328
Market cap (HK\$ mn)	1,005,558
3-mth avg daily turnover (HK\$ mn)	3,776
Major shareholder(s) (%):	
Naspers Limited	34.02
Ma Huateng	10.25

Source(s): Company, Bloomberg, ABCI Securities

FY13 Revenue breakdown (%)

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

Source(s): Company, ABCI Securities

Share performance (%)

	Absolute	Relative*
1-mth	2.38	2.62
3-mth	(4.69)	(6.08)
6-mth	28.40	32.60

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg, ABCI Securities

Tencent (700 HK) (2988 HK)*
Strategic changes in ecommerce to raise margins

- The IPO of JD.com (start trading on May 22nd) will be beneficial to Tencent; we believe the strategic changes in ecommerce will further raise the Group's profit margin
- Tencent's paying user base for smartphone games more than doubled QoQ in 1Q14; total revenue tripled sequentially to over RMB 1.8 bn, further establishing its leading position in China's gaming sector
- We maintain our **BUY** rating with TP at HK\$ 138, reflecting 0.95x FY14E PEG

The coming IPO of JD.com witnessed a strategic change of Tencent's ecommerce business. We believe that Tencent has reshaped its ecommerce strategy from a high-cost, physical one (B2C) to a relatively low-cost, comprehensive O2O service platform which also provides online financial services- a direction we believe would significantly improve its profitability in the long run. The strategic change, together with its remarkable growth in high-margined VAS sector, has significantly improved the Group's overall GPM from 51.7% in 4Q13 to 57.6% in 1Q14.

Leading position in gaming sector strengthened. The Group's paying user base for smartphone games more than doubled in 1Q14 QoQ, with total revenue tripling to over RMB 1.8 bn. Six of its games were among the Top 10 in China's iOS app store in 1Q14. With the arrival of the peak season during the summer holidays, the Group's gaming business and VAS performance would further improve.

Market share of the ad. sector is increasing and we expect a promising revenue growth in the near future. With the Group's strong social networking capability and potential cooperation with JD.com, online ad. could become another income trigger in coming quarters. In 1Q14, Qzone smart device MAU reached 467mn, representing a 44% YoY growth; combined MAU of Weixin and WeChat increased by 87% YoY and 11.5% QoQ. The impressive growth in MAU indicates a healthy expansion in Tencent's social network.

Maintain BUY with TP at HK\$ 138. Tencent's share price has dipped on recent correction in the TMT sector. However, its 1Q14 results, which were in line with our estimates, have demonstrated its solid fundamentals. We believe impacts of recent government's tightened control on online media and internet finance would only be temporary. Considering its high ROE and fast-growing ecommerce business, we believe Tencent's current valuation is still highly attractive. Maintain **BUY** with TP at HK\$ 138, reflecting 0.95x/0.58x FY14E/FY15E PEG.

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

Results and Valuation

FY ended Dec 31	2011A	2012A	2013A	2014E	2015E
Turnover (RMB mn)	28,496	43,894	60,437	86,031	121,206
Chg (%.yoy)	45.05	54.03	37.69	42.35	40.89
Net Income (RMB mn)	10,203	12,732	15,502	22,943	34,840
Chg (%.YoY)	26.69	24.78	21.76	48.00	51.85
EPS (RMB)*	1.10	1.37	1.66	2.43	3.67
Chg (%.YoY)	26.85	24.46	21.44	46.61	50.99
BVPS (RMB)*	3.06	4.43	6.20	8.07	11.22
Chg (%.yoy)	29.22	44.72	39.96	30.07	39.01
DPS (HK\$)*	0.15	0.20	0.24	0.35	0.53
P/E (x)	-	-	50.65	34.55	22.88
P/B (x)	-	-	13.55	10.42	7.49
Yield (%)	-	-	0.22	0.33	0.50
ROE (%)	40.63	36.50	31.24	34.24	38.19
ROA (%)	17.96	16.92	14.46	19.29	21.82

* Historical EPS, BVPS and DPS are adjusted for share split.

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	58,458	74,322
MVAS	3,271	3,723			
Online advertising	1,992	3,382	5,034	7,048	10,219
e-Commerce transactions	0	4,428	9,796	19,592	35,266
Others	190	365	622	933	1,400
Revenues	28,496	43,894	60,437	86,031	121,206
Cost of revenues	(9,928)	(18,207)	(27,778)	(39,540)	(50,906)
Gross profit	18,568	25,686	32,659	46,491	70,299
SG&A	(7,204)	(10,759)	(15,683)	(23,345)	(30,301)
Other income and gains	(735)	(123)	(2,305)	(1,055)	(1,161)
Pre-tax profit	12,099	15,051	19,281	24,200	41,159
Income tax	(1,874)	(2,266)	(3,718)	(3,630)	(6,174)
Net profit	10,225	12,785	15,563	23,039	34,985
Profit attributable to:					
Minority interests	22	53	61	95	145
Equity holders of the Company	10,203	12,732	15,502	22,943	34,840
EPS (Basic)*, RMB	1.12	1.39	1.69	2.46	3.69
EPS, Diluted*, RMB	1.10	1.37	1.66	2.43	3.67
DPS*, HK\$	0.15	0.20	0.24	0.35	0.53

* 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		568	1,384	2,939	5,290
Accounts receivable	2,021	2,354	2,955	5,162	8,484
Prepayments, deposits and other assets	2,212	3,878	5,365	4,621	4,993
Cash and cash equivalents	12,612	13,383	20,228	33,536	57,844
Other current assets	18,659	16,326	23,754	20,040	21,897
Current Assets	35,503	36,509	53,686	66,298	98,508
Total assets	56,804	75,256	107,235	118,949	159,683
Accounts payable	2,244	4,212	6,680	8,603	10,909
Other payables and accruals	5,014	6,301	10,246	11,184	14,545
Borrowings	7,999	1,077	2,589	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	28,044	38,125
Borrowings		2,106	3,323	3,323	3,323
Long-term notes payable	3,733	7,517	9,141	8,329	8,735
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	14,130	14,581
Total liabilities	27,716	33,108	48,772	42,175	52,706
Total equity	29,088	42,148	58,463	76,774	106,977
Non-controlling interests	625	851	518	684	601
Equity of the firm	28,464	41,298	57,945	76,090	106,375
BVPS*, RMB	3.06	4.43	6.20	8.07	11.22

* 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	23,039	34,985
Adjustments for:					
Income tax expense	1,874	2,266	3,718	3,630	6,174
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	1,718	2,381
Changes in working capital:					
Accounts receivable	(251)	(267)	(606)	(2,207)	(3,323)
Inventories	–	(301)	(815)	(1,555)	(2,351)
Prepayments, deposits and other receivables	(2,630)	(2,255)	(940)	744	(372)
Accounts payable	828	1,689	2,036	1,923	2,305
Other adjusted items	2,951	5,461	5,601	3,541	5,427
Net Cash generated from operating activities	15,194	21,654	27,492	32,603	47,082
Income tax paid	(1,836)	(2,225)	(3,118)	(3,564)	(6,061)
Net cash flow generated from operating activities	13,358	19,429	24,374	29,039	41,021
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	13,360	24,386
Cash and cash equivalents at beginning of the year	10,408	12,612	13,383	20,228	33,536
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	33,536	57,844

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	55.00	54.04	58.00	58.00
Operating Margin, %	43.00	35.27	31.76	28.32	34.10
Net Margin, %	35.81	29.01	25.65	26.67	28.74
ROE, %	40.63	36.50	31.24	34.24	38.19
ROA, %	17.96	16.92	14.46	19.29	21.82
Total Liability/Total Asset, %	48.79	43.99	45.48	35.46	33.01

Source(s): Company, ABCI Securities estimates

Disclosures

Analyst Certification

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

Disclosures of Interests

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

Definition of equity rating

Rating	Definition
Buy	Stock return \geq Market return rate
Hold	Market return - 6% \leq Stock return < Market return rate
Sell	Stock return < Market return - 6%

Stock return is defined as the expected % change of share price plus gross dividend yield over the next 12 months

Market return: 5-year average market return rate from 2009-2013

Time horizon of share price target: 12-month

Definition of share price risk

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

We measure share price risk by its volatility relative to volatility of benchmark index. Benchmark index: Hang Seng Index.

Volatility is calculated from the standard deviation of day to day logarithmic historic price change. The 180-day price volatility equals the annualized standard deviation of the relative price change for the 180 most recent trading days closing price.

Disclaimers

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



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

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

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

Copyright 2014 ABCI Securities Company Limited

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

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

Tel: (852) 2868 2183