

Tencent (700 HK)

Stay unfazed

- 4Q17 results were mixed - revenue was slightly below consensus but non-GAAP net profit exceeded expectation
- Strong mobile gaming pipeline in 1H18 may rev up growth in gaming revenue after a moderation in 4Q17
- Solid online advertising and payment/cloud business momentums
- Smart Retail initiatives could enrich payment scenarios and allow exploration of potential new growth drivers

A mixed bag. 4Q17 revenue grew 51% to RMB 66.4bn, 3% below expectation due to slower revenue growth in mobile gaming, while non-GAAP net profit grew 42% YoY to RMB 17.5bn, 4% above consensus, thanks to sequential margin improvement in online advertising and payment/cloud business. 4Q17 GAAP net profit rose 98% to RMB 20.8bn (25% above expectation) thanks to IPO-related gains.

Strong gaming pipeline in 1H18. Growth in online gaming revenue moderated to 32% in 4Q17 vs. 48% in 3Q17 due to higher base of "HOK (王者荣耀)" and lack of key titles launched during the quarter. On a positive note, recent launches of two PUBG mobile games and causal game "QQ speed (QQ飞车)" in 1Q18 have received good response, which we believe would re-accelerate growth in gaming revenue in 1H18.

Online advertising and payment/cloud remained sound. Growth in online advertising revenue stayed solid at 49% in 4Q17. Other revenues (mainly payment and cloud) continued to achieve triple-digit growth. Gross margin in these segments improved sequentially, which helped mitigate the moderated growth in online gaming.

Smart retail initiatives. Tencent has recently announced its Smart Retail strategy followed by various investments in projects such as Yonghui, Wanda, and Heilan Home. In our view, these investments would support Tencent's payment business in the near term and allow the Group to explore various online-to-offline (O2O) business models with retailers, providing potential new growth drivers in the long term.

Maintain BUY with new TP of HK\$ 520. Overall, we believe the moderation in mobile gaming revenue would be temporary. We maintain **BUY** with a new SOTP-based TP of HK\$ 520.

Risk factors: 1) Tightening regulation on mobile game/online payment; 2) Entry of foreign competitors such as Facebook; 3) Slowdown in ecommerce; 4) Lifecycle of mobile games.

Results and Valuation

FY ended Dec 31	2016A	2017A	2018E	2019E
Revenue (RMB mn)	151,938	237,760	333,832	445,074
Chg (% YoY)	47.7	56.5	40.4	33.3
Net profit (RMB mn)	41,095	71,895	85,135	109,576
Chg (% YoY)	42.7	74.9	18.4	28.7
Non-GAAP net profit (RMB mn)	45,420	65,126	89,635	115,076
Chg (% YoY)	40.1	43.4	37.6	28.4
Underlying EPS (RMB)	4.4	7.6	9.0	11.5
Chg (% YoY)	41.5	73.4	18.0	28.7
BVPS (RMB)	18.6	27.0	35.2	45.9
Chg (% YoY)	44.3	44.8	30.7	30.3
Core P/E (x)	74.1	51.7	37.6	29.3
P/B (x)	19.0	13.2	10.1	7.7
ROAE (%)	26.7	31.0	26.9	26.9
ROAA (%)	11.7	15.1	14.4	16.0
DPS(HKD)	0.47	0.61	0.88	1.04
Dividend Yield (%)	0.1	0.1	0.2	0.2

Source(s): Bloomberg, ABCI Securities estimates

Company Report

Mar 22, 2018

Rating: BUY

TP: HK\$ 520

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Share price (HK\$)	439.4
Est. share price return	18.4%
Est. dividend yield	0.2%
Est. total return	18.6%
Previous Rating & TP	BUY/HK\$441
Previous Report Date	Nov 17, 2017

Source(s): Bloomberg, ABCI Securities

Key Data

52Wk H/L(HK\$)	476.6/218.2
Issued shares (mn)	9,499
Market cap (HK\$ bn)	4,394
Avg daily turnover (HK\$ mn)	7,185
Major shareholder(s)	
Naspers	33.25%
Huateng Ma	8.73%

Source(s): Company, ABCI Securities

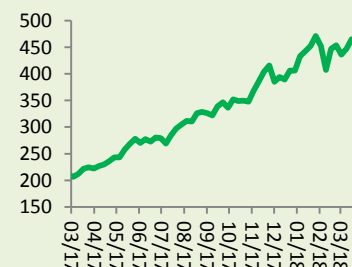
Share Performance (%)

	Absolute	Relative*
1-mth	3.6	2.2
3-mth	10.9	4.7
6-mth	30.0	17.3

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

Share performance(HK\$)



Source(s): Bloomberg, ABCI Securities



Exhibit 1: 4Q17 results highlights

Results review:				
(RMB mn)	4Q16	4Q17	YoY chg	Remark
Online game	18,469	24,367	32%	Less favorable base
Social network	10,722	15,580	45%	Virtual item sales including video, music, and literature
Online advertising	8,288	12,361	49%	Driven by Weixin Moments and Official Accounts
Others	6,385	14,084	121%	Payment and cloud services
Revenue	43,864	66,392	51%	3% below consensus
Gross profit	23,626	31,495	33%	
Interest income	653	1,156	77%	
Other gains, net	1,022	7,906	674%	IPOs of Yixin, Sea and Sogou
Selling & marketing expenses	(4,462)	(6,022)	35%	
General & admin expenses	(6,909)	(8,811)	28%	
Operating profit	13,930	25,724	85%	
Finance costs, net	(483)	(859)	78%	
Share of profit/(losses) of associates & JVs	(522)	(120)	-77%	
Profit before tax	12,925	24,745	91%	
Income tax expenses	(2,402)	(3,123)	30%	
Non-controlling interests	6	(825)	-13850%	
Net profit	10,529	20,797	98%	
Core profit (non-GAAP)	12,332	17,454	42%	4% above consensus
Profitability (%):				
	4Q16	4Q17	YoY chg (ppt)	
Gross margin	53.9	47.4	(6.4)	
Operating margin	31.8	38.7	7.0	
Net margin	24.0	31.3	7.3	
Core net margin (non-GAAP)	28.1	26.3	(1.8)	

Source(s): Company, ABCI Securities

Exhibit 2: SOTP valuation

	Valuation (HKD per share)	Remark
Core business	483	38x 12M-forward core PE#
Listed investments:		Market value [^] ; Assume 20% holding discount
- JD	7	
- Others*	17	
Unlisted investments	13	Dec-17 value; Assume 20% holding discount
Total	520	

Source(s): Companies, Bloomberg, ABCI Securities

*China Literature, Zhong An, Yixin, 58.com, Sogou, Tesla, Snap, Activision Blizzard, Sea, Netmarble, and others

12 month end-Mar 19

[^]As of Mar 22



Consolidated income statement (2016A-2019E)

FY Ended Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Value added services (VAS)	107,810	153,983	207,877	274,398
Online advertising	26,970	40,439	56,615	73,599
Others	17,158	43,338	69,341	97,077
Total revenue	151,938	237,760	333,832	445,074
Cost of sales	67,439	120,835	173,187	231,847
Gross profit	84,499	116,925	160,646	213,227
Interest income	2,619	3,600	4,000	4,000
Other gains/losses	3,594	20,140	10,000	10,000
Selling & marketing expenses	12,136	17,652	25,037	33,381
General & admin expenses	22,459	33,051	44,400	59,195
Operating Profits	56,117	89,962	105,208	134,652
Finance cost	1,955	2,908	3,200	3,200
Share of profit of investments in associates	-2,522	821	900	1,000
Profit before tax	51,640	87,875	102,908	132,452
Tax	10,193	15,744	17,494	22,517
Profit after tax	41,447	72,131	85,414	109,935
Minority interests	352	236	279	359
Profits attributable to shareholders	41,095	71,895	85,135	109,576
Non-GAAP profits attributable to shareholders	45,420	65,126	89,635	115,076
Growth				
Total revenue (%)	47.7	56.5	40.4	33.3
Gross Profits (%)	38.0	38.4	37.4	32.7
Operating Profits (%)	38.1	60.3	16.9	28.0
Net profit (%)	42.7	74.9	18.4	28.7
Non-GAAP net profit (%)	40.1	43.4	37.6	28.4
Operating performance				
Operating margin (%)	36.9	37.8	31.5	30.3
Net margin (%)	27.0	30.2	25.5	24.6
Core net margin (%)	29.9	27.4	26.9	25.9
ROAE (%)	26.7	31.0	26.9	26.9
ROAA (%)	11.7	15.1	14.4	16.0

Source(s): Company, ABCI Securities estimates

Consolidated balance sheet (2016A-2019E)

As of Dec 31 (RMB mn)	2016A	2017A	2018E	2019E
Fixed assets	24,602	32,671	34,671	36,671
Intangible assets	36,467	40,266	43,766	47,266
Investment in associates and JV	80,299	144,581	164,581	204,581
AFS	85,566	132,377	142,377	152,377
Term deposit	5,415	5,365	5,365	5,365
Other non-current assets	14,396	20,966	20,966	20,966
Total non-current assets	246,745	376,226	411,726	467,226
Cash & equivalents	71,902	105,697	139,143	192,166
Restricted cash	750	1,606	1,606	1,606
Term deposit	50,320	36,724	36,724	36,724
Account receivables	10,152	16,549	19,609	27,363
Other receivables and prepayments	14,118	17,110	17,110	17,110
Inventories	263	295	295	295
Other current assets	1,649	465	465	465
Total current assets	149,154	178,446	214,953	275,729
Total assets	395,899	554,672	626,679	742,955
Accounts payable	27,413	50,085	43,091	57,686
Other payables & accruals	20,873	29,433	29,433	29,433
Borrowings and notes	15,744	20,448	20,448	20,448
Deferred revenue	31,203	42,132	42,132	42,132
Other current liabilities	5,964	9,642	9,642	9,642
Total current liabilities	101,197	151,740	144,746	159,341
Loans and bonds payables	93,753	111,457	111,457	111,457
Deferred revenue	2,038	2,391	2,391	2,391
Other non-current liabilities	12,664	11,991	11,991	11,991
Total non-current liabilities	108,455	125,839	125,839	125,839
Total liabilities	209,652	277,579	270,585	285,180
Net current assets	47,957	26,706	70,207	116,388
Equity attributable to shareholders	174,624	256,074	334,796	436,119
Non-controlling interests	11,623	21,019	21,298	21,657
Total equity	186,247	277,093	356,094	457,775

Source(s): Company, ABCI Securities estimates

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Steve Chow holds H-shares of Tencent (700 HK).

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

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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