



January 29, 2014
Company Report
Rating: BUY
TP: HK\$ 610

H-Share price (HK\$)	503
Est. share price return	21.27%
Est. dividend yield	0.44%
Est. total return	21.71%

Previous Rating & TP	BUY; 479
Previous Report Date	Oct. 15, 2013

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Key Data

52Wk H/L(HK\$)	536/237
Issued shares (mn)	1,862
Market cap (HK\$ mn)	936,586
3-mth avg daily turnover (HK\$ mn)	1916
Major shareholder(s) (%):	
Naspers Limited	34.02
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

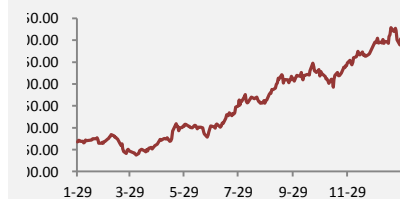
Share performance (%)

	Absolute	Relative*
1-mth	4.10	9.62
3-mth	20.22	24.10
6-mth	43.88	43.37

*Relative to HSI

Source(s): Bloomberg, ABCI Securities

1-Year stock performance (HK\$)



Source(s): Bloomberg

Tencent (0700 HK)
Market leader with e-commerce accelerated

- Aside from the increased fee-charging functions included in the latest version of WeChat, aggressive promotional campaigns in the U.S. and the launch of more MI games will accelerate monetization of Tencent's platform
- Strategic cooperation with logistics partners such as SF Express and investment in South China City will be beneficial to its e-commerce business
- We deem its present valuation of ~0.7x FY14E PEG as attractive and maintain BUY with revised TP at HK\$ 610, reflecting 0.9x FY14E PEG

MI platform (WeChat) promotion and monetization procedure accelerated. The Group initiated many fee-charging services in its MI (Mobile Internet) platform WeChat, i.e., sales of gaming tools and carton icons. Also, according to our sources, more game developers will be launching games through WeChat, which we expect will accelerate monetization. Tencent has also begun its strategic development in the U.S. market. E.g., WeChat users who log in through their Google accounts would receive a 25-dollar restaurant coupon after inviting 5 friends to join WeChat service. We believe these promotions would increase WeChat's penetration and brand exposure in U.S. market, enhancing WeChat's monetization potential in the near future.

E-commerce to benefit from cooperation with logistics partners. In Nov 2013, Tencent's e-commerce fleet Yixun announced a cooperation with SF Express (顺丰速递), one of China's premium express delivery solution providers. Our sources indicated that after the partnership, Yixun's service would increase from less than 100 cities in 15 provinces to over 300 cities in all provinces, covering an area with over 90% of China's GDP. Besides, about 80%-90% of orders handled by SF will be second-day deliveries; deliveries to remote regions (more than 1,000 km away from merchandise location) will arrive on the third day after transaction. In fact, Yixun is currently applying for an express business license that would allow the company to provide logistics and distribution services to other enterprises in the country.

In addition, Tencent has strategically invested in China South City (1668 HK), a leading developer and operator of large-scale, integrated logistics and trade centers in China in Jan 2014. We expect these steps would help expand Tencent's e-commerce business.

Maintain BUY with TP at HK\$ 610. We revise up Tencent's e-commerce revenue in FY14E to reflect the latest development. Considering its leading position, high ROE and fast-growing e-commerce business, we believe the counter's current valuation is still attractive. Maintain BUY with TP at HK\$ 610, reflecting 0.9x FY14E PEG.

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; (6) High stock volatility in an overheating internet sector.

Results and Valuation

FY ended Dec 31	2011A	2012A	2013E	2014E	2015E
Revenue (RMB mn)	28,496	43,894	64,742	102,376	147,730
Chg (% YoY)	45.05	54.03	47.50	58.13	44.30
Net Profit (RMB mn)	10,203	12,732	15,691	22,534	33,574
Chg (% YoY)	26.69	24.78	23.24	43.61	49.00
EPS (RMB)	5.49	6.83	8.40	11.98	17.77
Chg (% YoY)	26.85	24.46	22.88	42.72	48.32
BVPS (RMB)	15.32	22.16	28.92	39.11	54.00
Chg (% YoY)	29.22	44.72	30.50	35.23	38.06
P/E (x)	0.75	1.00	1.19	1.72	2.54
P/B (x)	-	57.06	46.44	32.54	21.94
DPS(RMB)	-	17.59	13.48	9.97	7.22
Yield (%)	-	0.26	0.30	0.44	0.65
ROE (%)	40.63	36.50	32.91	35.32	38.25
ROA (%)	17.96	16.92	17.24	19.15	22.11

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	0	0	0
Online advertising	1,992	3,382	5,919	10,358	17,609
e-Commerce transactions	0	4,428	8,856	17,711	30,109
Others	190	365	713	1,354	2,437
Revenues	28,496	43,894	64,742	102,376	147,730
Cost of revenues	(9,928)	(18,207)	(29,134)	(46,069)	(66,478)
Gross profit	18,568	25,686	35,608	56,307	81,251
SG&A	(7,204)	(10,759)	(17,480)	(30,109)	(41,907)
Other income and gains	(735)	(123)	(409)	(423)	(318)
Pre-tax profit	12,099	15,051	18,537	26,620	39,663
Income tax	(1,874)	(2,266)	(2,781)	(3,993)	(5,949)
Net profit	10,225	12,785	15,756	22,627	33,714
Profit attributable to:					
Minority interests	22	53	65	94	140
Equity holders of the Company	10,203	12,732	15,691	22,534	33,574
EPS (Basic), RMB	5.61	6.97	8.42	12.06	17.85
EPS, Diluted, RMB	5.49	6.83	8.40	11.98	17.77
DPS, RMB	0.75	1.00	1.19	1.72	2.54

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	1,240	2,657	4,516
Accounts receivable	2,021	2,354	3,237	6,143	10,341
Prepayments, deposits and other assets	2,212	3,878	3,045	3,461	3,253
Cash and cash equivalents	12,612	13,383	23,957	38,941	65,496
Other current assets	18,659	16,326	17,492	16,909	17,201
Current Assets	35,503	36,509	48,971	68,111	100,807
Total assets	56,804	75,256	90,991	117,666	151,849
Accounts payable	2,244	4,212	6,474	10,238	13,296
Other payables and accruals	5,014	6,301	9,711	13,309	17,728
Borrowings	7,999	1,077	3,648	2,554	3,474
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	27,344	34,404	42,404
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	36,200	43,322	49,078
Total equity	29,088	42,148	54,790	74,344	102,771
Non-controlling interests	625	851	738	794	766
Equity of the firm	28,464	41,298	54,053	73,549	102,005
BVPS, RMB	15.32	22.16	28.92	39.11	54.00

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	15,756	22,627	33,714
Adjustments for:					
Income tax expense	1,874	2,266	2,781	3,993	5,949
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	1,500	2,241	3,328
Changes in working capital:					
Accounts receivable	(251)	(267)	(883)	(2,905)	(4,199)
Inventories	–	(301)	(672)	(1,417)	(1,860)
Prepayments, deposits and other receivables	(2,630)	(2,255)	833	(416)	208
Accounts payable	828	1,689	2,262	3,763	3,058
Other adjusted items	2,951	5,461	5,286	6,373	6,744
Net Cash generated from operating activities	15,194	21,654	28,209	35,687	48,240
Income tax paid	(1,836)	(2,225)	(2,730)	(3,920)	(5,841)
Net cash flows generated from operating activities	13,358	19,429	25,479	31,767	42,399
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	10,660	15,029	26,621
Cash and cash equivalents at beginning of the year	10,408	12,612	13,383	23,957	38,941
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	23,957	38,941	65,496

Source(s): Company, ABCI Securities estimates

Financial ratio table (2011A-2015E)

FY Ended Dec 31	2011A	2012A	2013E	2014E	2015E
Gross Profit Margin, %	58.52	55.00	55.00	55.00	55.00
Operating Margin, %	43.00	35.27	28.89	26.25	27.04
Net Margin, %	35.81	29.01	24.24	22.01	22.73
ROE, %	40.63	36.50	32.91	35.32	38.25
ROA, %	17.96	16.92	17.24	19.15	22.11
Total Liability/Total Asset, %	48.79	43.99	39.78	36.82	32.32

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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