

SECTOR UPDATE

Internet – China

Recent Divestments Among Tech Giants

We saw the recent news on divestments among tech giants where Alibaba is in discussions to pare down its stake in Weibo after Tencent announced paring its stake in JD by way of a special dividend. We think the move could reduce the tech giants' influence in China's internet industry, which complements the government's anti-trust measures. We maintain our MARKET WEIGHT view on the internet sector with Alibaba as the top pick.

WHAT'S NEW

- Overview on China's internet sector.** We saw divestment news recently among the tech giants: a) Tencent to give out special dividend of up to 457m Class A ordinary shares of JD.com on the basis of every Class A ordinary share of JD for every 21 shares held by the shareholders, and b) Alibaba is in the discussion stage to reduce its stake in Weibo by 30%. Recall back in 15 March, the Chinese regulator had instructed Alibaba to divest its stakes in various digital & media (DME) businesses on allegations that excessive media ownership will prompt potential manipulative activities by the company. On top of that, ever since the start of the sweeping anti-trust regulations in last year, we saw the State Administration for Market Regulation (SAMR) imposing various fines of up to Rmb500,000 (per case) on internet giants such as Alibaba, Tencent, Meituan for failing to report M&A deals.

While we could see the tone of the anti-trust regulations was rather soft in 2021 (as attention was shifted towards cybersecurity), we still think that the divestment could be favourable with the regulators' ambitions to clamp down on a single entity owning and controlling massive user data in China. On the flip side, we think the potential divestment could mean Alibaba losing control in terms of strategic planning of the company if Daniel Zhang (CEO of Alibaba currently sitting in the board of Weibo) steps down after the divestment.

- Our view on Alibaba.** We think the divestment will not have any material financial impact on either Alibaba or Weibo for the reasons being; a) although the strategic collaboration agreement between Weibo and Alibaba had expired on Jan 2016, we notice that the revenue contribution from Alibaba to Weibo had declined over the year to just 3.4% in 3Q21 vs 32.7% back in 3Q14 when Alibaba just became their shareholder in April 2013; and b) based on our back of envelope calculation, the divestment will only resulted in 3.8% decline in share of equity investees under Alibaba's income statement (if based on Sept'21 result) which in turn will lead to 0.7% drop in non-GAAP net profit for the period.

- Our view on Tencent.** Tencent paid the special interim dividend it declared, in the form of a distribution in specie of 457.3m Class A shares of JD.com or a HK\$127.7b value paid to Tencent's shareholders, implying an effective 3% special dividend. Similar to Alibaba, Tencent's share of loss/profit from associates/JV (loss making during 3Q21) is expected to narrow to -Rmb2.9b from -Rmb5.7b. In such case, Tencent's adjusted net profit is expected to see an upside of 8.6%. We also believe the value of minority investments will gradually unlock, while shifting their attention towards core businesses (online game and enterprise services). We expect Tencent to continue to selectively de-vest in part of its portfolio of listed Chinese companies and return capital to shareholders. Currently, the worth of investees is estimated at US\$130b or HK\$106.90 per share.

PEER COMPARISON

Company	Tickers	Rec	Price @ 4 Jan 22 (HK\$)	Target Price (HK\$)	Upside/(Downside) To TP (%)	Market Cap (HK\$m)	PE			EV/EBITDA			EV/Sales			ROE
							2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2021 (x)	2022F (x)	2023F (x)	2022F (%)
Alibaba Group	9988 HK	BUY	116.90	173.00	47.9	2,535,246.4	13.9	23.9	22.3	10.8	10.9	9.2	2.7	2.2	1.9	7.8
Tencent	700 HK	BUY	450.00	557.00	23.8	4,323,770.3	30.1	25.7	19.7	14.5	18.5	15.0	6.8	5.8	4.9	12.1

Source: Bloomberg, UOB Kay Hian

MARKET WEIGHT (Maintained)

STOCK PICKS

Company	Ticker	Rec	Share Price (LC)	Target Price (LC)
Alibaba	9988 HK	BUY	116.90	173.00
Tencent	700 HK	BUY	450.00	557.00

Source: Bloomberg, UOB Kay Hian

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ESSENTIALS

• **Fundamentals remain unchanged.** All in all, it is still business as usual for Alibaba after the divestment as we think the overall regulatory risk has been priced in at this juncture. We would like to point out several considerations which investors should focus on for Alibaba:

- i) **Potential widening loss from key strategic investment.** During 2QFY22, Alibaba's key strategic investments had yield an adjusted EBITA loss of Rmb19b (vs Sep 20: Rmb6.4b) with community marketplace and Taobao Deals accounting for a larger share of the losses followed by merchant support initiatives. We think Alibaba needs to continue to penetrate into the lower tier cities in search for new user growth as we estimate core commerce adjusted EBITA to stay below the 30% mark until FY26.
- ii) **Near-term headwinds persist.** Xian has imposed lockdown measures due to the resurgence of COVID-19 cases. On top of that, several provincial governments have encouraged the celebration of Chinese New Year locally to curb the spread of the pandemic prior to the Winter Olympic in Feb 22. As such, we think consumer sentiment will be deeply impacted leading to reduced spending on discretionary goods while spending on staples goods should benefit.
- iii) **Interoperability with Tencent.** We had still yet to see Taobao Deal being available on the WeChat mini-program since the news circulated in Mar 21. In terms of the interoperability, we only saw Taobao Deal enabling the WeChat pay QR code payment function during 11.11 but the user experience was still rather bad (as consumers were still unable to pay directly via WeChat pay). Till then, we still think that by removing the "Wall Garden" among internet giants, it will ultimately create mutual benefits for the users and platform operators in the long term.

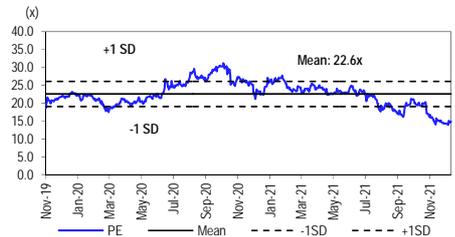
• **Tencent.** The divestment could be a short-term positive for Tencent given that most of its investee companies (like Meituan, JD, Bili) were still loss making (under PATAMI line). However, the key lingering issue with Tencent was still due to the suspended new game licence approval which happened since Jul 21. On top of that, Tencent will divest 14.5m shares in Sea, reducing its stake from 21.3% to 18.7%, at a selling price of US\$208.00-212.00. This will bring the total divestment to up to US\$3.1b. Tencent will be subject to a lockup period which restricts the further sale of Sea shares held by Tencent during the next six months. We think the divestment comes amid slowing e-commerce revenue growth from Sea in recent quarter as well as the intention of Tencent to selectively divest its investee holdings to return capital to shareholders.

• **Total investee valuation.** We had Ant Group, Weibo, Suning, Alibaba Picture, Didi, Momo, Bili and Groupon in Alibaba's SOTP valuation, which accounted for 3.2% of our target price of HK\$173.00. Meanwhile for Tencent, we had companies such as Didi, Meituan, PDD, JD, Bili, Kuaishou which accounted for 19.2% of our target price of HK\$557.00.

TENCENT SOTP VALUATION

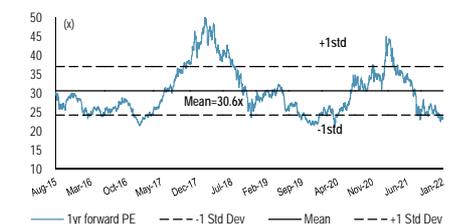
(Rmb m)	2022F revenue	2022F non-GAAP earnings	2022-25E non-GAAP earnings CAGR	Valuation (2022)	Value (LC bn)	% Tencent holding	Est. fair value to Tencent (RMB bn)	Fair value/ share (HK\$)	% of total SOTP
Online game (PC + Mobile game)	197,613	62,508	18%	20x PE	1,250	100%	1,250	143	26%
Social networking (QQ + Weixin VAS)	138,432	43,788	15%	18x PE	788	100%	788	90	16%
Online ads (Portal + Video + Social ads)	100,358	28,039	11%	12x PE	336	100%	336	39	7%
Payment	157,723	15,772		25x PE	394	100%	394	45	8%
Cloud	75,765			10x PS	758	100%	758	87	16%
Total EV	436,403	150,108	17%	16x PE	2,375	100%	2,375	405	73%
Investees	% owned		To Tencent (Rmb mn)	Rmb/sh.			Valuation Rmb mn		
Online games					USD b		Rmb b	HK\$ b	
EPIC Games					20.0	42%	53.7	6.7	
NetMarble (251270 KS)					9.4	18%	10.8	1.4	
Douyu					1.1	37%	2.6	0.3	
Huya (HUYA US)					2.2	30%	3.0	0.4	
Seasun Games					9.7	100%	1.0	1.2	
Kingsoft (3888 HK)					6.3	7%	3.0	0.4	
Sea Ltd					161.7	19%	193.2	30.2	
Shunwang (300113 CH)					1.2	0%	-	-	
Cheetah (CMCM US)					0.3	17%	0.3	0.0	
Supercell					10.0	38%	24.6	3.1	
Glumobile (GLUU US)						14%	-	-	
Ecommerce and O2O									
JD.com (JD US)					100.2	18%	115.3	14.5	
Pinduoduo (PDD US)					99.6	17%	108.4	13.6	
MeituanDianping (3690 HK)					167.8	21%	224.1	28.2	
DidiChuxing					51.0	5%	14.7	1.8	

ALIBABA (9988 HK) 12-MONTH FORWARD PE BAND



Source: Respective companies, UOB Kay Hian

TENCENT 12-MONTH FORWARD PE BAND



Source: Respective companies, UOB Kay Hian

(Rmb m)	2022F revenue	2022F non-GAAP earnings	2022-25E non-GAAP earnings CAGR	Valuation (2022)	Value (LC bn)	% Tencent holding	Est. fair value to Tencent (RMB bn)	Fair value/ share (HK\$)	% of total SOTP
58.com (WUBA US)						1%	-	-	
NavInfo (002405 CH)					4.3	10%	2.7	0.3	
Tongcheng - eLong (780 HK)					4.4	23%	1.2	0.5	
BitAuto (BITA US)						1%	-	-	
Others									
Bilibili (BILI US)					29.8	18%	34.2	4.3	
Kuaishou (1024 HK)					49.2	18%	55.7	7.0	
Zhongan (6060 HK)					5.0	10%	3.3	0.4	
China Literature (772 HK)					7.0	57%	25.4	3.2	
Yixin (2858 HK)					1.2	21%	1.6	0.2	
Sogou (SOGO US)					-	39%	-	-	
WeBank					23.0	30%	44.1	5.5	
Total (10% discount)								99.8	18%
2022F cash per share (HK\$)								53	9%
Target price (HK\$)								557	

Source: Bloomberg, UOB Kay Hian

ALIBABA SOTP VALUATION

Description	FY22-23 Revenue (HK\$,b)	EBITA (HK\$,b)	EV / Revenue	EV / EBITA	Value (HK\$,b)	% BABA holding	Value to BABA (HK\$,b)	HK\$ per share	% of NAV	
Core+initiatives										
Core commerce business	Taobao, Tmall, New retail, International	888.6	222	2	8	1,777	100.0%	1,777	80.8	47%
Online marketing service		289.4	185.2				100.0%			
Commission		116.2	98.8				100.0%			
New retail + Alihealth		366.9	29.4				100.0%			
International commerce		95.1	-61.9				100.0%			
Cainiao		61.4		3	184	51.0%	94	4.3	2%	
Ele.me		46.9		3	141	100.0%	141	6.4	4%	
Cloud Computing, other		110.6		8	885	100.0%	885	40.2	23%	
Youku Tudou and other initiatives	Online video	51.3		3	154	100.0%	154	7.0	4%	
Total Core+initiatives valuation							3,050.5	138.7	80%	
Investees										
Ant Financial	Internet finance				390	33%	129	5.9	3%	
Weibo (WB US)	Social media				58	7%	4	0.2	0%	
Suning (002024 CH)	Retail				45	20%	9	0.4	0%	
Alibaba Pictures (1060 HK)	Entertainment				21	49%	10	0.5	0%	
Sun Art (6808 HK)	Retail				21	21%	4	0.2	0%	
Didi	O2O - TAYI app				56	7%	4	0.2		
Momo	Social media				19	3%	0	0.0	0%	
Bili	video									
Groupon										
Total investees valuation					533		121	5.5	3%	
Net cash							642	29	17%	
Total							3,813	173		

Source: Bloomberg, UOB Kay Hian

EARNINGS REVISION

- Our earnings estimates remain unchanged.

SECTOR CATALYST AND RISK

- **Catalysts:** a) Recovery in China's online retail sales, b) increasing online retail penetration driven by less developed areas and the younger generation, and c) continuous improvement in technology and e-commerce infrastructure.
- **Risks:** a) Challenging regulatory landscape, b) increasing competition as multiple players are looking for the incremental market share such as Kuaishou, Douyin and Bilibili, and c) heavy investment in new retail will drag down e-commerce companies' margins and ROE.

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