

Hong Kong

**ADD** (no change)

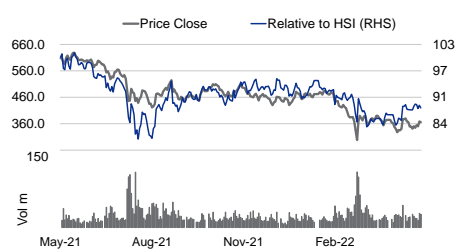
Consensus ratings\*: Buy 62 Hold 6 Sell 2

Current price:	HK\$365.6
Target price:	HK\$440.6
Previous target:	HK\$485.2
Up/downside:	20.5%
CGI / Consensus:	-13.1%
Reuters:	0700.HK
Bloomberg:	700 HK
Market cap:	US\$447,741m
	HK\$3,514,142m
Average daily turnover:	US\$1,343m
	HK\$10,513m
Current shares o/s:	9,720m
Free float:	59.9%

\*Source: Bloomberg

**Key changes in this note**

- FY22F, FY23F and FY24F revenue decreased by 3.5%, 3.6% and 3.6%, respectively.
- FY22F, FY23F and FY24F net profit decreased by 7.2%, 7.1% and 7.3%, respectively.



Source: Bloomberg

Price performance	1M	3M	12M
Absolute (%)	-2.4	-22.2	-39.8
Relative (%)	1.7	-7	-12

Major shareholders	% held
Naspers Ltd	31.0
Ma Huateng	8.4

**Analyst**

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# Tencent

## 1Q22 results lower than expected; shifting to low gear in the near term

- Tencent's 1Q22 results were lower than our and market expectations.
- Domestic online game revenue dropped 3% yoy, and overseas game revenue grew 8% yoy (vs. 24% yoy in 4Q21). Performance of fintech and business services was impacted by macro headwinds (such as the COVID-19 outbreak) and the impact of regulations.
- We reiterate the view that 2022 will be challenging for the industry and for Tencent, especially in 1H, given delays in the launch online game licenses and the implementation of regulations in various segments.
- We lowered our net profit forecasts slightly for 2022F, 2023F and 2024F after the 1Q22 results announcement.
- The cut in net profit forecasts and management guidance is expected to put pressure on Tencent shares in the near term. We still hold a constructive view on the Company, as we believe that its investments will translate into future growth and that the recent message from Chinese government is turning more positive for the sector. Reiterate ADD with a new DCF-based target price of HK\$440.6 (down from HK\$485.2). A near-term catalyst would be the normalization of government policy and a pick-up in the revenue growth rate.

### 1Q22 results highlights

Tencent reported total revenue of Rmb135,471m in 1Q22, flat yoy and down 6% qoq, below market expectations. The impact of government policy and macro headwinds (especially the COVID-19 outbreak) dragged down overall growth. Its gross profit was Rmb57,074m in 1Q22, down 9% yoy, which in our view, was dragged down by the softer-than-expected performance of the online game segment. Its net profit was Rmb23,413m in 1Q22, down 52% yoy. The Company reported non-IFRS net profit of Rmb25,545m in 1Q22, down 23% yoy.

### Fintech and business services remained the driver for 1Q22 top-line growth

Despite the slowdown in yoy revenue growth, Tencent's fintech and business services segment remained a growth driver and still achieved 10% yoy top-line growth in 1Q22. Regarding sub-segment performance in 1Q22: 1) Revenue from social networks increased 1% yoy to Rmb29.1bn, mainly due to an increase in revenue from Tencent's video account live-streaming services but largely offset by drop in revenue from its video and music subscription services. 2) Revenue from games dropped about 2% yoy to Rmb40.3bn in 1Q22, mainly because of a 3% yoy decline in mobile game revenue and a 2% yoy increase in PC game revenue. Domestic game revenue dropped 3% yoy in 1Q22 owing to the government's minor-protection measures to limit playing time for minors. Overseas markets reported an 8% yoy increase in online game revenue in constant currency and a slowdown in overseas online game revenue, according to the Company, owing to the post-COVID normalization of spending by overseas gamers. 3) Revenue from online advertising dropped 18% yoy in 1Q22, attributable mainly to softer advertising demand from verticals, including education, Internet services and e-commerce. 4) Revenue from fintech and business services increased 10% yoy in 1Q22, reflecting the impact of the COVID-19 outbreak. Business services revenue growth was impacted by the Company's strategy of shifting the focus of its IaaS business to quality growth and reducing the number of loss-making contracts.

### Financial Summary

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue (Rmbm)	482,064	560,118	589,334	719,806	861,012
Net Profit (Rmbm)	159,848	224,823	116,014	159,967	194,154
Normalised EPS (Rmb)	16.49	23.13	11.94	16.46	19.97
Normalised EPS Growth	70.5%	40.3%	(48.4%)	37.9%	21.4%
FD Normalised P/E (x)	19.06	13.58	26.32	19.09	15.73
Price To Sales (x)	6.32	5.45	5.18	4.24	3.55
DPS (Rmb)	1.34	1.34	1.61	1.94	1.94
Dividend Yield	0.43%	0.43%	0.51%	0.62%	0.62%
EV/EBITDA (x)	15.27	15.30	18.92	12.88	10.13
P/FCFE (x)	40.8	15.4	107.5	20.3	18.6
Net Gearing	(2.9%)	(0.8%)	(6.3%)	(12.5%)	(14.9%)
P/BV (x)	4.34	3.79	3.37	2.91	2.50
ROE	28.1%	29.8%	13.5%	16.4%	17.1%
% Change In Normalised EPS Estimates			(7.16%)	(7.13%)	(7.26%)
Normalised EPS/consensus EPS (x)			0.89	1.01	1.03

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## Lower forecasts and target price

We cut our revenue forecasts for 2022F, 2023F and 2024F by 3.5%, 3.6% and 3.6%, respectively, to reflect weaker performance in the social network, games, online advertising and fintech segments. We cut our net profit forecasts for 2022F, 2023F and 2024F by 7.2%, 7.1% and 7.3%, respectively, mainly after factoring in slower revenue growth, especially in 2022. We reiterate our ADD rating with a new DCF-based target price of HK\$440.6.

**Figure 1: Quarterly performance**

RMBm	1Q 2018	2Q 2018	3Q 2018	4Q 2018	1Q 2019	2Q 2019	3Q 2019	4Q 2019	1Q 2020	2Q 2020	3Q 2020	4Q 2020	1Q 2021	2Q 2021	3Q 2021	4Q 2021	1Q 2022
Revenue	73,528	73,675	80,595	84,896	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	135,471
VAS	46,877	42,069	44,049	43,651	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	72,013	75,203	71,913	72,738
-online games	28,778	25,202	25,813	25,813	30,123	29,119	28,603	28,450	34,267	40,767	41,422	36,700	44,205	52,590	53,434	39,636	43,321
-social network	18,099	16,867	18,236	17,838	18,851	18,961	22,026	23,858	28,162	24,235	28,380	30,279	28,238	19,423	21,769	32,277	29,417
Online advertising	10,689	14,110	16,247	17,033	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,833	22,495	21,518	17,988
e-Commerce																	
Others	15,962	17,496	20,299	24,212	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	43,413	44,670	50,757	44,745
Total Revenue	73,528	73,675	80,595	84,896	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	135,471
YoY ch	48.4%	30.2%	23.6%	27.9%	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%	7.9%	0.1%
QoQ ch	10.7%	0.2%	9.4%	5.3%	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%	1.3%	-6.0%
Cost of Revenue																	
VAS	17,220	17,253	19,158	20,330	20,781	22,783	24,402	26,120	25,577	30,100	33,098	32,512	32,533	33,890	35,344	36,869	36,055
Online advertising	7,356	8,838	10,279	10,800	7,776	8,432	9,411	9,241	9,003	9,008	10,480	11,520	11,986	11,697	12,051	12,338	11,394
e-Commerce																	
Others	11,910	13,138	15,678	18,614	17,088	18,480	20,944	24,298	20,691	22,565	25,222	30,756	28,149	29,927	32,226	37,164	30,948
Total cost of revenue	36,486	39,229	45,115	49,744	45,645	49,695	54,757	59,659	55,271	61,673	68,800	74,788	72,668	75,514	79,621	86,371	78,397
Gross profit	37,042	34,446	35,480	35,152	39,820	39,126	42,479	46,108	52,794	53,210	56,647	58,881	62,635	62,745	62,747	57,817	57,074
Gross margin	50.4%	46.8%	44.0%	41.4%	46.6%	44.1%	43.7%	43.6%	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.1%	40.1%	42.1%
Gross profit growth	45.6%	21.7%	12.0%	11.6%	7.5%	13.6%											
Interest Income	1065	1072	1082	1350	1408	1652	1674	1580	1636	1749	1864	1708	1614	1630	1703	1703	1737
Selling & mktg	(5,570)	(6,360)	(6,573)	(5,730)	(4,244)	(4,718)	(5,722)	(6,712)	(7,049)	(7,756)	(8,920)	(10,033)	(8,530)	(10,013)	(10,435)	(11,616)	(8,058)
Gen & Admin	(9,430)	(9,857)	(10,890)	(11,345)	(11,331)	(12,577)	(13,536)	(16,002)	(14,158)	(16,499)	(17,189)	(17,979)	(18,967)	(22,638)	(23,862)	(24,380)	(26,669)
Other income	7,585	2,506	8,762	-2,139	11,089	4,038	932	3,630	4,037	8,607	11,551	32,936	19,521	20,763	22,984	86,199	13,133
Total operating exp	(6350)	(12639)	(7619)	(17864)	(3078)	(11605)	(16652)	(17504)	(15534)	(13899)	(12694)	4832	(6362)	(10258)	(9610)	51906	(19857)
Operating income (loss)	30692.0	21807.0	27861.0	17288.0	36742.0	27521.0	25827.0	28604.0	37260.0	39311.0	43953.0	63713.0	56273.0	52487.0	53137.0	109723.0	37217.0
Finance costs	(654.0)	(1151.0)	(1492.0)	(1372.0)	(1117.0)	(1982.0)	(1747.0)	(2767.0)	(1684.0)	(2005.0)	(1945.0)	(2253.0)	(1367.0)	(1942.0)	(1942.0)	(1863.0)	(1935.0)
Share of Results of Associates	(319)	1,526	264	16	-2,957	2,370	234	-1,328	-281	-295	2,630	1,618	1,348	-3,857	-5,668	-8,267	-6,280
Pretax profit	29719	22182	26633	15932	32668	27909	24314	24509	35295	37011	44638	63078	56254	46688	45527	99593	29002
Tax	(5746.0)	(3602.0)	(3228.0)	(1906.0)	(4812.0)	(3225.0)	(3338.0)	(2137.0)	(5892.0)	(4557.0)	(5739.0)	(3709.0)	(7246.0)	(3666.0)	(5452.0)	(3888.0)	(5269.0)
Effective tax rate	19.0%	19.0%	12.1%	12.0%	14.7%	11.6%	13.7%	8.7%	16.7%	12.3%	12.9%	5.9%	12.9%	7.9%	12.0%	3.9%	18.2%
Minorities	(683)	(713)	72	(203)	(646)	(548)	(594)	790	(507)	653	(357)	67	(1,241)	(435)	(565)	747	(320)
Profit after tax	23290	17867	23333	14229	27210	24136	20382	23162	28896	33107	38542	59302	47767	42587	39510	94958	24053
Net margin	31.7%	24.3%	29.0%	16.8%	31.8%	27.2%	21.0%	21.9%	26.7%	28.8%	30.7%	44.4%	35.3%	30.8%	27.8%	65.9%	17.8%

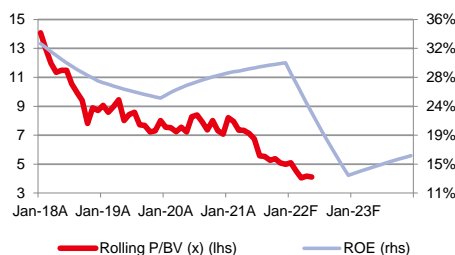
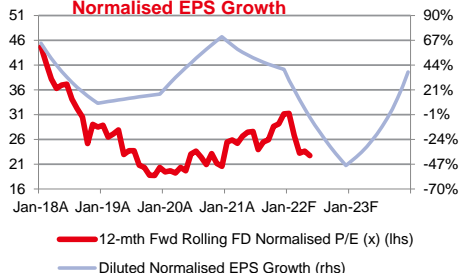
SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

**Figure 2: DCF valuation**

RMB (m)	2017A	2018A	2019A	2020A	2021A	2022E	2023E	2024E
Operating Profit	90,302	97,648	118,695	184,238	271,621	143,153	193,977	233,760
Interest Income	(3,940)	(4,569)	(6,314)	(6,957)	(6,650)	(7,072)	(10,077)	(11,193)
Other gains	(20,140)	(16,714)	(19,689)	(57,131)	(149,467)	(52,628)	(52,628)	(52,628)
Depreciation	4,850	8,233	10,575	12,621	13,952	14,820	15,958	17,330
Amortization	18,622	18,622	18,622	18,622	18,622	18,622	18,622	18,622
Share-based compensation	6,253	6,253	6,253	6,253	6,253	6,253	6,253	6,253
EBITDA	95,947	109,474	128,142	157,645	154,331	123,147	172,104	212,143
Change in WC	(23,663)	(14,813)	(25,501)	(22,907)	(97,638)	60,237	(39,176)	(44,543)
Capex	(14,643)	(14,944)	(16,438)	(16,438)	(16,438)	(18,082)	(19,890)	(21,879)
Tax	(15,744)	(14,482)	(13,512)	(19,897)	(20,252)	(14,529)	(20,034)	(24,315)
FCF	41,897	65,235	72,691	98,404	20,003	150,773	93,004	121,406
NPV of FCF			194,418	296,988	232,975	463,619	462,586	559,193
Discounted value			88,486	110,314	20,646	143,284	81,396	97,829
Terminal value								2,334,863
Explicit Forecasts		714,464						
Terminal Valuation								2,334,863
Total Expected Operating Value								3,049,326
Bank & Other Debt								155,939
Minorities								74,059
Total Value Attributable to Equity Holders								3,522,621
Value Per Share (HK\$)								440.6
Risk free rate								3.0%
Beta								1.10
Risk Premium								8.1%
Cost of equity								11.9%
Cost of debt								4.3%
WACC								8.6%
Terminal growth rate								2.8%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## BY THE NUMBERS

**P/BV vs ROE**

**12-mth Fwd FD Normalised P/E vs FD Normalised EPS Growth**


### Profit & Loss

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
<b>Total Net Revenues</b>	<b>482,064</b>	<b>560,118</b>	<b>589,334</b>	<b>719,806</b>	<b>861,012</b>
<b>Gross Profit</b>	<b>252,884</b>	<b>278,628</b>	<b>258,443</b>	<b>313,520</b>	<b>369,591</b>
<b>Operating EBITDA</b>	<b>151,501</b>	<b>148,187</b>	<b>117,003</b>	<b>165,960</b>	<b>205,999</b>
Depreciation And Amortisation	(31,352)	(32,683)	(33,551)	(34,689)	(36,061)
<b>Operating EBIT</b>	<b>120,150</b>	<b>115,504</b>	<b>83,452</b>	<b>131,271</b>	<b>169,938</b>
Financial Income/(Expense)	(930)	(464)	(753)	1,469	1,724
Pretax Income/(Loss) from Assoc.	3,672	(16,444)	(3,242)	(3,242)	(3,242)
Non-Operating Income/(Expense)	57,131	149,467	52,628	52,628	52,628
<b>Profit Before Tax (pre-EI)</b>	<b>180,023</b>	<b>248,063</b>	<b>132,086</b>	<b>182,127</b>	<b>221,049</b>
Exceptional Items					
<b>Pre-tax Profit</b>	<b>180,023</b>	<b>248,063</b>	<b>132,086</b>	<b>182,127</b>	<b>221,049</b>
Taxation	(19,897)	(20,252)	(14,529)	(20,034)	(24,315)
Exceptional Income - post-tax					
<b>Profit After Tax</b>	<b>160,126</b>	<b>227,811</b>	<b>117,556</b>	<b>162,093</b>	<b>196,734</b>
Minority Interests	(278)	(2,988)	(1,542)	(2,126)	(2,580)
Preferred Dividends					
FX Gain/(Loss) - post tax					
Other Adjustments - post-tax					
Preference Dividends (Australia)					
<b>Net Profit</b>	<b>159,848</b>	<b>224,823</b>	<b>116,014</b>	<b>159,967</b>	<b>194,154</b>
Normalised Net Profit	160,126	227,811	117,556	162,093	196,734
<b>Fully Diluted Normalised Profit</b>	<b>159,848</b>	<b>224,823</b>	<b>116,014</b>	<b>159,967</b>	<b>194,154</b>

### Cash Flow

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
<b>EBITDA</b>	<b>151,501</b>	<b>148,187</b>	<b>117,003</b>	<b>165,960</b>	<b>205,999</b>
Cash Flow from Inv. & Assoc.					
Change In Working Capital	22,907	97,638	(60,237)	39,176	44,543
(Incr)/Decr in Total Provisions					
Other Non-Cash (Income)/Expense					
Other Operating Cashflow	57,389	153,676	56,857	61,591	66,551
Net Interest (Paid)/Received	(7,887)	(7,114)	(7,825)	(8,608)	(9,469)
Tax Paid	6,444	5,183	(3,534)	3,399	2,644
<b>Cashflow From Operations</b>	<b>230,354</b>	<b>397,570</b>	<b>102,264</b>	<b>261,518</b>	<b>310,268</b>
Capex	(16,438)	(16,438)	(18,082)	(19,890)	(21,879)
Disposals Of FAs/subsidiaries					
Acq. Of Subsidiaries/investments	(128,070)	(211,985)	(63,910)	(127,456)	(163,791)
Other Investing Cashflow					
<b>Cash Flow From Investing</b>	<b>(144,508)</b>	<b>(228,423)</b>	<b>(81,992)</b>	<b>(147,346)</b>	<b>(185,670)</b>
Debt Raised/(repaid)	(11,099)	29,552	8,134	36,324	39,312
Proceeds From Issue Of Shares	0	0	0	0	0
Shares Repurchased					
Dividends Paid	(13,069)	(13,069)	(15,683)	(18,819)	(18,819)
Preferred Dividends					
Other Financing Cashflow	0	0	0	0	0
<b>Cash Flow From Financing</b>	<b>(24,168)</b>	<b>16,483</b>	<b>(7,549)</b>	<b>17,505</b>	<b>20,493</b>
Total Cash Generated	61,678	185,630	12,723	131,677	145,092
<b>Free Cashflow To Equity</b>	<b>74,747</b>	<b>198,699</b>	<b>28,406</b>	<b>150,496</b>	<b>163,911</b>
<b>Free Cashflow To Firm</b>	<b>93,733</b>	<b>176,261</b>	<b>28,098</b>	<b>122,781</b>	<b>134,067</b>

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

## BY THE NUMBERS... cont'd

### Balance Sheet

(Rmbm)	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Total Cash And Equivalents	152,798	167,966	226,088	340,292	433,878
Total Debtors	44,981	49,331	51,904	63,395	75,831
Inventories	814	1,063	1,233	1,492	1,785
Total Other Current Assets	119,054	266,452	167,412	182,643	199,128
<b>Total Current Assets</b>	<b>317,647</b>	<b>484,812</b>	<b>446,637</b>	<b>587,822</b>	<b>710,622</b>
Fixed Assets	39,987	42,473	45,735	49,667	54,216
Total Investments	784,640	850,130	850,130	850,130	850,130
Intangible Assets	181,941	225,356	286,543	387,358	548,677
Total Other Non-Current Assets	9,209	9,594	10,027	10,515	11,062
<b>Total Non-current Assets</b>	<b>1,015,778</b>	<b>1,127,552</b>	<b>1,192,434</b>	<b>1,297,669</b>	<b>1,464,085</b>
Short-term Debt	18,064	24,449	19,994	24,421	29,211
Current Portion of Long-Term Debt					
Total Creditors	94,030	109,470	126,985	153,652	183,794
Other Current Liabilities	156,985	269,179	194,047	236,937	283,195
<b>Total Current Liabilities</b>	<b>269,079</b>	<b>403,098</b>	<b>341,026</b>	<b>415,009</b>	<b>496,200</b>
Total Long-term Debt	112,145	136,936	144,079	175,976	210,498
Hybrid Debt - Debt Component					
Total Other Non-Current Liabilities	147,899	165,994	154,133	143,341	132,663
<b>Total Non-current Liabilities</b>	<b>260,044</b>	<b>302,930</b>	<b>298,212</b>	<b>319,317</b>	<b>343,161</b>
Total Provisions	26,259	29,643	21,267	29,324	35,591
<b>Total Liabilities</b>	<b>555,382</b>	<b>735,671</b>	<b>660,505</b>	<b>763,651</b>	<b>874,952</b>
Shareholders' Equity	703,984	806,299	906,631	1,047,779	1,223,113
Minority Interests	74,059	70,394	71,936	74,062	76,642
<b>Total Equity</b>	<b>778,043</b>	<b>876,693</b>	<b>978,567</b>	<b>1,121,841</b>	<b>1,299,755</b>

### Key Ratios

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Revenue Growth	27.8%	16.2%	5.2%	22.1%	19.6%
Operating EBITDA Growth	24.2%	(2.2%)	(21.0%)	41.8%	24.1%
Operating EBITDA Margin	31.4%	26.5%	19.9%	23.1%	23.9%
Net Cash Per Share (Rmb)	2.32	0.68	6.38	14.39	19.98
BVPS (Rmb)	72.4	83.0	93.3	107.8	125.8
Gross Interest Cover	15.23	16.24	10.66	15.25	17.95
Effective Tax Rate	11.1%	8.2%	11.0%	11.0%	11.0%
Net Dividend Payout Ratio	8.2%	5.8%	13.5%	11.8%	9.7%
Accounts Receivables Days	30.68	30.73	31.35	29.23	29.59
Inventory Days	1.22	1.22	1.27	1.22	1.22
Accounts Payables Days	139.5	131.9	130.4	126.1	125.7
ROIC (%)	129%	80%	39%	54%	56%
ROCE (%)	16.1%	12.2%	8.1%	11.2%	12.4%
Return On Average Assets	14.1%	15.5%	7.3%	9.1%	9.6%

### Key Drivers

	Dec-20A	Dec-21A	Dec-22F	Dec-23F	Dec-24F
Growth rate - VAS (%)	32.1%	10.4%	2.0%	18.0%	16.0%
Growth rate - Online ads (%)	20.3%	7.8%	0.0%	18.0%	18.0%
Growth rate - Fintech & others (%)	24.5%	32.7%	13.0%	30.0%	25.0%

SOURCES: CGIS RESEARCH, COMPANY DATA, BLOOMBERG

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Distribution of stock ratings and investment banking clients for quarter ended on 31 Mar 2022		
632 companies under coverage for quarter ended on 31 Mar 2022		
	Rating Distribution (%)	Investment Banking clients (%)
Add	70.3%	0.8%
Hold	22.0%	0.0%
Reduce	7.8%	0.2%

**Spitzer Chart for stock being researched ( 2 year data )**

**Tencent (700 HK)**

## RECOMMENDATION FRAMEWORK

### Stock Ratings Definition:

Add	The stock's total return is expected to reach 15% or higher over the next 12 months.
Hold	The stock's total return is expected to be between negative 10% and positive 15% over the next 12 months.
Reduce	The stock's total return is expected to fall below negative 10% over the next 12 months.

*The total expected return of a stock is defined as the sum of the: (i) percentage difference between the target price and the current price and (ii) the forward net dividend yields of the stock. Stock price targets have an investment horizon of 12 months.*

### Sector Ratings Definition:

Overweight	An Overweight rating means stocks in the sector have, on a market cap-weighted basis, a positive absolute recommendation.
Neutral	A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
Underweight	An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

### Country Ratings Definition:

Overweight	An Overweight rating means investors should be positioned with an above-market weight in this country relative to benchmark.
Neutral	A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
Underweight	An Underweight rating means investors should be positioned with a below-market weight in this country relative to benchmark.

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