

Tencent

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DBS Group Research . Equity

19 May 2022

BUY

Last Traded Price (18 May 2022): HK\$365.60 (HSI : 20,644)
Price Target 12-mth: HK\$447 (22% upside) (Prev HK\$563)

Analyst

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What's New

- Non-IFRS net profit declined by 23% y-o-y to Rmb25bn in 1Q22, below market expectations of c.18% decline
- Sluggish performance was due to slower revenue growth, margin contraction and higher operating expenses
- Revised down non-IFRS net profit by 15% and 12% for FY22F and FY23F, accordingly
- Maintain BUY on long term potential of the WeChat ecosystem, TP lowered to HK\$447

Price Relative



Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	482,064	560,118	594,381	686,937
EBITDA	231,726	301,547	215,298	250,058
Pre-tax Profit	180,022	248,062	158,132	192,892
Net Profit	159,847	224,822	140,900	172,531
Core profit	122,742	123,788	118,748	150,379
Net Profit Gth (Pre-ex)(%)	30.1	0.9	(4.1)	26.6
EPS (RMB)	16.84	23.60	14.79	18.11
EPS (HK\$)	19.57	27.42	17.19	21.04
EPS Gth (%)	70.9	40.1	(37.3)	22.4
Diluted EPS (HK\$)	19.25	26.95	16.89	20.68
DPS (HK\$)	1.86	1.85	1.19	1.46
BV Per Share (HK\$)	85.27	97.67	115.51	137.83
PE (X)	18.7	13.3	21.3	17.4
P/Cash Flow (X)	15.4	17.1	13.8	12.7
P/Free CF (X)	23.4	26.5	19.1	17.1
EV/EBITDA (X)	13.3	10.3	14.0	11.6
Net Div Yield (%)	0.5	0.5	0.3	0.4
P/Book Value (X)	4.3	3.7	3.2	2.7
Net Debt/Equity (X)	0.0	0.0	CASH	CASH
ROAE(%)	28.1	29.8	16.0	16.5
Earnings Rev (%)			(15)	(12)
Consensus EPS (RMB)			13.22	16.09
Other Broker Recs:		B:54	S:2	H:3

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

High monetisation potential of WeChat ecosystem

Investment Thesis

Monetisation of WeChat ecosystem. Tencent has 1.27bn WeChat monthly active users (MAU), covering c.90% of China's population. The represents strong long-term growth potential via ramping up monetization on its Video Accounts and mini programs as well as other social segments, where a large user base is the key value proposition.

Leading online games player in China. Tencent has a strong game portfolio, which includes top-ranked games like Honor of Kings and Peacekeeper Elite. Tencent has the capability to consistently launch blockbuster games. Besides, it is accelerating its overseas expansion. We expect higher game growth in 2H22 after resumption of game approvals in April 22.

Cloud business to target enterprise segments. Tencent Cloud is the second-largest player in China's cloud service market, which is expected to grow at c.41% CAGR during FY21-24. It is leveraging its experience in the consumer market to expand into the enterprise market. FinTech will continue to benefit from higher payment frequency and wider usage.

Valuation:

We derive our TP of HK\$ 447 based on SOTP methodology: (1) 25x FY22F earnings (HK\$371) and (2) fair value of listed investee companies (HK\$76).

Where we differ:

Long-term growth potential. We are more optimistic on the long-term growth outlook of the WeChat ecosystem despite near-term macro challenges.

Key Risks to Our View:

(1) Regulatory tightening on games approval process and anti-trust related market practices, (2) Irrational market competition on social media segments, (3) Execution on WeChat monetization.

At A Glance

Issued Capital (m shrs)	9,608
Mkt Cap (HKm/US\$m)	3,512,685 / 447,521
Major Shareholders (%)	
Prosus NV	28.8
Ma (Huateng)	8.4
Free Float (%)	62.8
3m Avg. Daily Val. (US\$m)	1452.65
GICS Industry: Information Technology / Software & Services	



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WHAT'S NEW

Core net profit declined by 23% in 1Q22, below market expectations; Expect game growth to resume in 2H22

1Q22 results highlights

- Revenue was flat at Rmb135bn, below market expectations of 4% growth.

- Segment-wise, online game revenue was flat compared with 1Q21 at Rmb43.6bn. In terms of geographical performance, domestic game revenue decreased by 1% to Rmb33bn, while international game revenue grew by 4% to Rmb10.6bn. FinTech and business services (FBS) revenue increased by 10%, below consensus.

- Online ads revenue decreased by 18% to Rmb18bn, with social ads lower by 15%, while brand ads declined by 30%. The weak performance was mainly due to continued macro slowdown.

- Gross profit decreased by 9% to Rmb57bn, with the margin contracting by 4ppts y-o-y to 42%, which was partly due to increasing content cost for Video Accounts.

- Non-IFRS net profit decreased by 23% to Rmb25.5bn, below market expectations of c.18% decline.

Outlook

The sluggish non-IFRS net profit was due to slower revenue growth, margin contraction and higher operating costs.

The slowdown in FBS growth was mainly caused by weak commercial payment volume due to the resurgence of Covid. We expect that the situation will continue in 2Q22.

We expect online game to gradually resume growth in 2H22 after resumption of game approvals in April. Management shared that more new titles will be launched in 2023 and beyond. We are positive on the games segment in the medium-to-long term.

Overall advertising sentiment remained weak as advertisers in categories such as FMCG, e-commerce and travel have reduced their spending significantly under a slowing macro environment.

Going forward, the company will focus on key strategic areas, including accelerating the monetisation pace of Video Accounts and gaining more market share in the international games business.

We have revised down our non-IFRS net profit by 15% and 12% for FY22 and FY23 respectively, to reflect the slower revenue growth and lower margins for ads and FBS business amid a slowing macro environment. However, we remain bullish on the mid-long term monetisation potential of the WeChat ecosystem as well as online game business.

We maintain BUY with lower TP of HK\$ 447, based on SOTP methodology: (1) 25x FY22F earnings (HK\$371) and (2) Fair value of listed investee companies (HK\$76).

Company Background

Established in 1998, Tencent is an internet company focusing on social communication and online games. Tencent operates WeChat – the largest social communications platform in China with 1 billion+ monthly active users (MAUs). It is also the largest game developer and publisher in China. It monetises its users via (1) value-added services (PC games, mobile games, and digital content subscription), (2) online advertising, (3) fintech and business services (i.e. payment and cloud services), and (4) others, accounting for 52%, 16%, 31%, and 1% of Tencent's FY21 revenue respectively.

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Quarterly / Interim Income Statement (RMBm)

FY Dec	1Q2021	4Q2021	1Q2022	% chg yoy	% chg qoq
Revenue	135,303	144,188	135,471	0.1	(6.0)
Cost of Goods Sold	(72,668)	(86,371)	(78,397)	7.9	(9.2)
Gross Profit	62,635	57,817	57,074	(8.9)	(1.3)
Other Oper. (Exp)/Inc	(27,497)	(35,996)	(34,727)	26.3	(3.5)
Operating Profit	35,138	21,821	22,347	(36.4)	2.4
Other Non Opg (Exp)/Inc	19,521	86,199	13,133	(32.7)	(84.8)
Associates & JV Inc	1,348	(8,267)	(6,280)	nm	(24.0)
Net Interest (Exp)/Inc	247	(160)	(198)	nm	(23.8)
Exceptional Gain/(Loss)	0.0	0.0	0.0	nm	nm
Pre-tax Profit	56,254	99,593	29,002	(48.4)	(70.9)
Tax	(7,246)	(3,888)	(5,269)	(27.3)	35.5
Minority Interest	(1,241)	(747)	(320)	74.2	(57.2)
Net Profit	47,767	94,958	23,413	(51.0)	(75.3)
Net profit bef Except.	47,767	94,958	23,413	(51.0)	(75.3)
EBITDA	70,224	114,500	45,136	(35.7)	(60.6)
Margins (%)					
Gross Margins	46.3	40.1	42.1		
Opg Profit Margins	26.0	15.1	16.5		
Net Profit Margins	35.3	65.9	17.3		

Source: Company, DBS HK

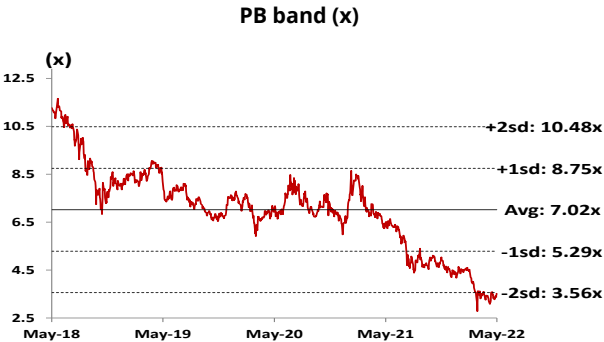
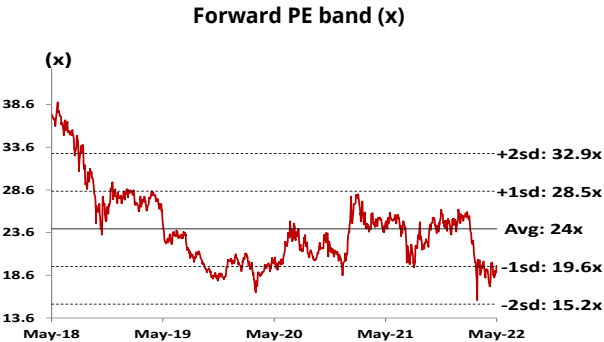
Income Statement (RMB m)

FY Dec	2020A	2021A	% chg vov
Revenue	482,064	560,118	16.2
Cost of Goods Sold	(260,532)	(314,174)	20.6
Gross Profit	221,532	245,944	11.0
Other Opng (Exp)/Inc	(101,383)	(130,441)	28.7
Operating Profit	120,149	115,503	(3.9)
Other Non Opg (Exp)/Inc	57,131	149,467	161.6
Associates & JV Inc	3,672	(16,444)	nm
Net Interest (Exp)/Inc	(930)	(464)	50.1
Exceptional Gain/(Loss)	0	0	nm
Pre-tax Profit	180,022	248,062	37.8
Tax	(19,897)	(20,252)	1.8
Minority Interest	(278)	(2,988)	(974.8)
Net Profit	159,847	224,822	40.6
Net Profit before Except.	159,847	224,822	40.6
EBITDA	231,726	301,547	30.1
Margins & Ratio			
Gross Margins (%)	46.0	43.9	
Opg Profit Margin (%)	24.9	20.6	
Net Profit Margin (%)	33.2	40.1	

Source: Company, DBS HK

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Historical PE and PB band



Source: Thomson Reuters, DBS HK

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Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
Online game rev growth (%)	10.3	36.1	11.7	5.8	9.8
Ad rev growth (%)	17.7	20.3	7.8	(7.3)	15.4

Source: Company, DBS HK

Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenues (RMB m)					
Online game	114,710	156,100	174,300	184,325	202,399
Social network	85,300	108,100	117,272	126,969	140,542
Online advertising	68,377	82,271	88,666	82,228	94,923
Fintech and business services	101,355	128,086	172,195	192,858	241,073
Others	7,566	7,495	7,685	8,000	8,000
Total	377,308	482,052	560,118	594,381	686,937

Source: Company, DBS HK

Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	377,289	482,064	560,118	594,381	686,937
Cost of Goods Sold	(209,756)	(260,532)	(314,174)	(344,741)	(391,554)
Gross Profit	167,533	221,532	245,944	249,640	295,383
Other Opng (Exp)/Inc	(74,842)	(101,383)	(130,441)	(136,708)	(147,692)
Operating Profit	92,691	120,149	115,503	112,932	147,692
Other Non Opg (Exp)/Inc	19,689	57,131	149,467	56,200	56,200
Associates & JV Inc	(1,681)	3,672	(16,444)	(10,000)	(10,000)
Net Interest (Exp)/Inc	(1,299)	(930)	(464)	(1,000)	(1,000)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	109,400	180,022	248,062	158,132	192,892
Tax	(13,512)	(19,897)	(20,252)	(14,232)	(17,360)
Minority Interest	(2,578)	(278)	(2,988)	(3,000)	(3,000)
Preference Dividend	0	0	0	0	0
Net Profit	93,310	159,847	224,822	140,900	172,531
Net Profit before Except.	93,310	159,847	224,822	140,900	172,531
EBITDA	155,372	231,726	301,547	215,298	250,058

Growth

Revenue Gth (%)	20.7	27.8	16.2	6.1	15.6
EBITDA Gth (%)	20.6	49.1	30.1	(28.6)	16.1
Opg Profit Gth (%)	21.4	29.6	(3.9)	(2.2)	30.8
Net Profit Gth (%)	18.5	71.3	40.6	(37.3)	22.4

Margins & Ratio

Gross Margins (%)	44.4	46.0	43.9	42.0	43.0
Opg Profit Margin (%)	24.6	24.9	20.6	19.0	21.5
Net Profit Margin (%)	24.7	33.2	40.1	23.7	25.1
ROAE (%)	24.7	28.1	29.8	16.0	16.5
ROA (%)	11.1	14.0	15.3	8.6	9.6
ROCE (%)	12.4	11.7	9.2	7.9	9.1
Div Payout Ratio (%)	11.2	9.6	6.8	7.0	7.0
Net Interest Cover (x)	71.4	129.2	248.9	112.9	147.7

Source: Company, DBS HK

Tencent

Quarterly Income Statement (RMB m)

FY Dec	1Q2021	2Q2021	3Q2021	4Q2021	1Q2022
Revenue	135,303	138,259	142,368	144,188	135,471
Cost of Goods Sold	(72,668)	(75,514)	(79,621)	(86,371)	(78,397)
Gross Profit	62,635	62,745	62,747	57,817	57,074
Other Oper. (Exp)/Inc	(27,497)	(32,651)	(34,297)	(35,996)	(34,727)
Operating Profit	35,138	30,094	28,450	21,821	22,347
Other Non Opg (Exp)/Inc	19,521	20,763	22,984	86,199	13,133
Associates & JV Inc	1,348	(3,857)	(5,668)	(8,267)	(6,280)
Net Interest (Exp)/Inc	247	(312)	(239)	(160)	(198)
Exceptional Gain/(Loss)	0	0	0	0	0
Pre-tax Profit	56,254	46,688	45,527	99,593	29,002
Tax	(7,246)	(3,666)	(5,452)	(3,888)	(5,269)
Minority Interest	(1,241)	(435)	(565)	(747)	(320)
Net Profit	47,767	42,587	39,510	94,958	23,413
Net profit bef Except.	47,767	42,587	39,510	94,958	23,413
EBITDA	61,473	61,473	59,999	114,500	45,136

Growth (QoQ)

Revenue Gth (%)	1.2	2.2	3.0	1.3	(6.0)
EBITDA Gth (%)	(9.3)	(12.5)	(2.4)	90.8	(60.6)
Opg Profit Gth (%)	20.9	(14.4)	(5.5)	(23.3)	2.4
Net Profit Gth (%)	(19.5)	(10.8)	(7.2)	140.3	(75.3)

Growth (YoY)

Revenue Gth (%)	25.2	20.3	13.5	7.9	0.1
EBITDA Gth (%)	52.7	25.9	1.3	47.9	(35.7)
Opg Profit Gth (%)	11.2	3.9	(6.8)	(24.9)	(36.4)
Net Profit Gth (%)	65.3	28.6	2.5	60.1	(51.0)

Margins

Gross Margins (%)	46.3	45.4	44.1	40.1	42.1
Opg Profit Margins (%)	26.0	21.8	20.0	15.1	16.5
Net Profit Margins (%)	35.3	30.8	27.8	65.9	17.3

Source: Company, DBS HK

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Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	77,215	93,802	106,033	109,169	112,305
Invts in Associates & JVs	221,894	305,258	323,188	363,279	403,370
Other LT Assets	400,909	616,718	698,331	699,490	700,649
Cash & ST Invts	189,571	231,531	266,577	356,693	470,243
Inventory	718	814	1,063	1,063	1,063
Debtors	63,679	85,302	114,721	152,349	206,818
Other Current Assets	0	0	102,451	0	0
Total Assets	953,986	1,333,425	1,612,364	1,682,044	1,894,448
ST Debt	33,229	14,242	19,003	19,003	19,003
Creditors	125,864	148,338	170,052	188,027	208,954
Other Current Liab	81,063	106,499	214,043	116,863	122,450
LT Debt	187,584	234,202	282,526	282,526	282,526
Other LT Liabilities	37,422	52,101	50,047	50,047	50,047
Shareholder's Equity	432,706	703,984	806,299	953,586	1,137,880
Minority Interests	56,118	74,059	70,394	71,991	73,588
Total Cap. & Liab.	953,986	1,333,425	1,612,364	1,682,043	1,894,448
Non-Cash Wkg. Capital	(142,530)	(168,721)	(165,860)	(151,478)	(123,523)
Net Cash/(Debt)	(31,242)	(16,913)	(34,952)	55,164	168,714
Debtors Turn (avg days)	53.5	56.4	65.2	82.0	95.4
Creditors Turn (avg days)	257.5	238.6	222.5	226.5	216.0
Inventory Turn (avg days)	1.2	1.3	1.3	1.3	1.2
Asset Turnover (x)	0.4	0.4	0.4	0.4	0.4
Current Ratio (x)	1.1	1.2	1.2	1.6	1.9
Quick Ratio (x)	1.1	1.2	0.9	1.6	1.9
Net Debt/Equity (X)	0.1	0.0	0.0	CASH	CASH
Net Debt/Equity ex MI (X)	0.1	0.0	0.0	CASH	CASH
Capex to Debt (%)	25.8	26.8	20.6	20.1	20.1
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	95,888	160,125	227,810	143,900	175,531
Dep. & Amort.	44,673	50,774	57,670	56,166	56,166
Tax Paid	(17,228)	(20,322)	(28,526)	(14,232)	(17,360)
Assoc. & JV Inc/(loss)	1,681	(3,672)	16,444	10,000	10,000
(Pft)/ Loss on disposal of FAs	(8,492)	(24,390)	(118,051)	0	0
Chg in Wkg.Cap.	15,330	27,423	891	(14,382)	(27,955)
Other Operating CF	16,738	4,181	18,948	36,197	39,325
Net Operating CF	148,590	194,119	175,186	217,649	235,707
Capital Exp.(net)	(56,988)	(66,599)	(62,165)	(60,461)	(60,461)
Other Invts.(net)	(44,105)	(66,299)	(69,088)	0	0
Invts in Assoc. & JV	(14,957)	(28,572)	(45,037)	(50,091)	(50,091)
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(120)	(20,485)	(2,259)	7,660	7,660
Net Investing CF	(116,170)	(181,955)	(178,549)	(102,892)	(102,892)
Div Paid	(8,315)	(10,339)	(12,503)	(15,238)	(9,863)
Chg in Gross Debt	22,961	44,490	59,790	0	0
Capital Issues	40,202	47,948	27,060	0	0
Other Financing CF	(53,176)	(68,452)	(52,727)	(9,403)	(9,403)
Net Financing CF	1,672	13,647	21,620	(24,641)	(19,266)
Currency Adjustments	1,085	(6,004)	(3,089)	0	0
Chg in Cash	35,177	19,807	15,168	90,116	113,549
Opg CFPS (RMB)	14.07	17.57	18.29	24.35	27.67
Free CFPS (RMB)	9.67	13.44	11.86	16.50	18.39

Source: Company, DBS HK

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Target Price & Ratings History



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	21-May-21	HK\$609.00	HK\$939.00	Buy
2:	20-Aug-21	HK\$421.20	HK\$689.00	Buy
3:	11-Nov-21	HK\$483.60	HK\$671.00	Buy
4:	24-Mar-22	HK\$389.00	HK\$563.00	Buy

Source: DBS HK

Analyst: Tsz Wang Tam
Lilian Lv

DBS HK recommendations are based on an Absolute Total Return* Rating system, defined as follows:

STRONG BUY (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

BUY (>15% total return over the next 12 months for small caps, >10% for large caps)

HOLD (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

FULLY VALUED (negative total return, i.e., > -10% over the next 12 months)

SELL (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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