

### COMPANY UPDATE

## Tencent Holdings (700 HK)

2Q22 Preview: Still Plenty Of Headwinds

We see near-term headwinds from its online game and advertising segments as well as subdued share price performance from its investee companies. However, we believe Tencent will still be able to gain market share in overseas markets as it has a confirmed 20 games pipeline with 20 in 2022, with over 40 new games ready to be published over 2022-24 in overseas markets. We trimmed our target price to HK\$408.00 from HK\$445.00. Maintain BUY as it is trading at the historical trough valuation level.

### WHAT'S NEW

- Online game segment yet to recover till Sep 22.** Tencent Holdings' (Tencent) new game approval by the National Press and Publication Administration (NPPA) had entered into a 13-month streak despite the approval progress resuming in Apr 22. We believe such a long pause will derail the company's medium-term new game pipeline launch plan even though the approval could resume for Tencent anytime soon. Tencent is still left with seven game pipelines under its portfolio and it could run out of new games by end-22 assuming it launches two games per month from August. We notice that the decreasing grossing spend and engagement from minors will hinder domestic game revenue growth till Sep 22. with domestic game growth likely to return to positive growth after Sep 22. For the international market, we forecast 0% growth in 2Q22 in view of the absence of lockdown measures in the overseas market which dragged on user time spent. We expect Tencent's online game segment growth to slow to -3.4% yoy in 2Q22 and +1.6% yoy in 2022.
- Remain pessimistic on online ads segment.** We estimate Tencent's online advertising segment revenue to decline by 23% yoy in 2Q22 on the back of: a) 20% yoy decline from the social advertising segment due to weak merchant spending budget as well as intensified regulatory scrutiny in the sector ie entertainment/online game/education/online insurance/online pharmaceutical industry; and b) 40% yoy decline in the media advertising segment. However, we expect a recovery in 2H22 driven by the absence of impact from regulations and sequentially improving bidding intensity from verticals like game and entertainment. For 2022, we estimate the online advertising segment's revenue to decline 8% yoy. To date, we have yet to see further updates on the company's monetisation progress on Weixin Channel following the company charging users based on subscription fees to watch NBA since Jan 22. While that could mean plenty of upside moving forward, we remain cautiously optimistic for Weixin Channel given the potential monetisation from Tencent's video account.
- FBS segment – Not spared from COVID-19 lockdown.** We forecast the Fintech and Cloud segments' revenue growth to slow to 5% yoy in 2Q22 as the impact from two months of COVID-19 lockdown measures will reduce offline payment transactions. We expect sequential recovery from June with the easing of lockdown. We expect the cloud business to decline by 5% yoy due to the lockdown impact on offline project implementation and scaling back on loss-making contracts. We estimate the Fintech and Business Services' (FBS) segment growth to slow to +11% yoy in 2022.

### KEY FINANCIALS

Year to 31 Dec (Rmbm)	2020	2021	2022F	2023F	2024F
Net turnover	482,064	560,118	579,482	660,682	768,419
EBITDA	230,904	324,617	178,888	190,638	239,626
Operating profit	184,237	271,620	125,291	136,441	184,829
Net profit (rep./act.)	159,847	224,822	94,413	110,537	144,573
Net profit (adj.)	122,742	123,788	114,305	136,965	175,309
EPS (Fen)	1,268.9	1,277.3	1,179.7	1,413.6	1,805.8
PE (x)	20.3	20.2	21.8	18.2	14.3
P/B (x)	3.5	3.0	2.6	2.3	2.1
EV/EBITDA (x)	10.3	7.3	13.2	12.4	9.9
Dividend yield (%)	0.6	0.6	0.6	0.7	0.9
Net margin (%)	33.2	40.1	16.3	16.7	18.8
Net debt/(cash) to equity (%)	(13.8)	(12.2)	(19.0)	(20.1)	(22.5)
Interest cover (x)	29.3	45.6	25.2	29.8	37.5
ROE (%)	28.1	29.8	10.7	10.9	12.8
Consensus net profit	-	-	116,322	142,771	168,288
UOBKH/Consensus (x)	-	-	0.98	0.96	1.04

Source: Tencent Holdings, Bloomberg, UOB Kay Hian

## BUY

(Maintained)

Share Price	HK\$299.60
Target Price	HK\$408.00
Upside	+36.2%
(Previous TP)	HK\$445.00)

### COMPANY DESCRIPTION

The company is one of the largest comprehensive internet service providers.

### STOCK DATA

GICS sector	Communication Services
Bloomberg ticker:	700 HK
Shares issued (m):	9,628.6
Market cap (HK\$m):	2,884,720.5
Market cap (US\$m):	367,485.0
3-mth avg daily t'over (US\$m):	1,130.0

### Price Performance (%)

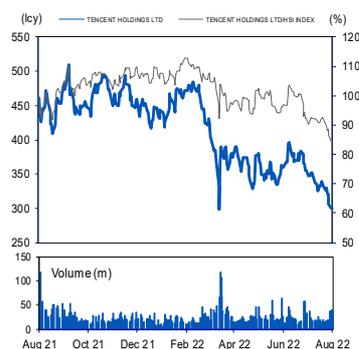
52-week high/low	HK\$509.08/HK\$298.00			
<b>1mth</b>	<b>3mth</b>	<b>6mth</b>	<b>1yr</b>	<b>YTD</b>
(15.5)	(20.6)	(36.5)	(35.6)	(32.4)

### Major Shareholders

Naspers Limited	29.0
Pony Ma	7.4
The Vanguard Group	2.6

FY22 NAV/Share (Rmb)	100.69
FY22 Net Cash/Share (Rmb)	19.13

### PRICE CHART



Source: Bloomberg

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### STOCK IMPACT

- Share price expected to be supported by share buyback.** Following the announcement by Naspers to dispose of Tencent's shares at an open ended basis in late-Jun 22 (to fund the repurchase of Prosus' share), Tencent's share price had corrected by 21% to-date. We estimate the potential disposal size could be as big as US\$11.7b (HK\$91.9b) where 264.9m (mandated repurchased shares of Prosus on 21 Aug 21) is subtracted by 56.7m (total share repurchased from 21 Aug 21 to 27 Jun 22) and multiplied by €53.07 (Prosus last closing price). Recall on 8 Apr 21 when Prosus sold 2% of Tencent's shares (amounting to US\$14.7b), the company's share price tumbled by 1.6% during that day. Similarly in Mar 18, Prosus announced it intended to offload Tencent's shares (on a gradual basis, amounting to US\$9.8b by the end of the disposal programme), which saw Tencent's shares falling as much as 4.6% during the day of the announcement. In the near term, we expect Tencent's share price to be largely supported by its share repurchase programme (estimated around HK\$288b, assuming average repurchase price of HK\$300 multiplied by 961m mandated repurchase shares size) which could sufficiently absorb the potential disposal size of Naspers. Tencent had total cash of Rmb274.1b (HK\$318.6b) as at Mar 22. In the near term, we believe Tencent could experience near-term valuation cap; it is trading sideways pending further catalysts as downside risk should be largely capped by the repurchase programme.
- Our trough valuation analysis.** Tencent is trading at 19x 12-month forward PE, 1.7SD below its historical mean. At this kind of valuation, we could associate the similar trough level back in Mar 20 where China was facing unprecedented headwinds brought by COVID-19 where Tencent was trading at -1.2 to -1.5 SD below mean range. Recall back during May-Dec 18 where NPPA temporarily suspended new game approval due to the organisational reshuffling, Tencent was seen to hover between +1SD and -1SD from the mean level where a positive recovery (from -0.8SD to -0.4SD) was observed during Dec 18 when the NPPA resumed its approval process. Based on our scenario analysis, Tencent should still see a minimum of 14% upside from the current price level assuming 22x 12-month forward PE which should translate to share price of HK\$345.00 (representing -1.5SD from mean level). We believe Tencent's share price may have found its bottom in the near term taking into consideration that most of the negative news had been largely priced in.

### EARNINGS REVISION/RISK

- We lower our 2Q22/2022 revenue estimates by 5%/4% respectively as we expect the VAS/online advertising/FBS segment to post revenue growth of -2.5%/-23%/+5% in 2Q22 and +2.1%/-8%/+11% in 2022 with the online advertising sector expected to remain the key laggard. We lower our 2Q22/2022 non-GAAP net profit estimates by 10%/7% respectively which should translate into non-GAAP net margin of 19.1%/19.7% respectively, implying 5.5ppt/2.4ppt yoy margin contraction.
- Risks: Regulatory risks, slowing growth from the traditional media advertising segment, earnings downgrade.

### VALUATION/RECOMMENDATION

- Maintain BUY on Tencent with a lower target price of HK\$408.00** as we roll forward our SOTP valuation to 2023. The company currently trades at 19x 12-month forward PE, 1.7SD below historical mean of 30x. Our target price implies 26x 2023F PE, 0.7 SD below its historical average. We expect further room for monetisation from the Weixin ecosystem and the resumption of new game approval for Tencent should provide meaningful valuation correction to its share price.

### SHARE PRICE CATALYST

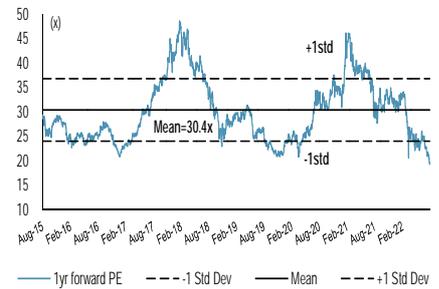
- a) Resumption of new game approval for Tencent, b) improved user stickiness on WeChat's platform, c) continued improvement in the ratio of paying users in online games, and d) increased adoption rate by merchants as well as collaboration with various internet platform operators on Tencent's WeChat ecosystem.

### SOTP DETAILS

(Rmb m)	2023F revenue	2023F non-GAAP earnings	Valuation (2023)	Value (LC bn)	% Tencent holding	Est. fair value to Tencent (RMB bn)	Fair value to Tencent (US\$ b)	Fair value/ share (HK\$)
Online game (PC + Mobile game)	195,846	58,576	15x PE	879	100%	879	130	101
Social networking (QQ + Weixin VAS)	132,917	39,755	16x PE	636	100%	636	94	73
Online ads (Portal + Video + Social ads)	90,449	15,054	10x PE	151	100%	151	22	17
Payment	169,813	23,774	20%	428	100%	428	63	49
Cloud	71,658		8x PS	573	100%	573	85	66
<b>Total EV</b>	<b>419,211</b>	<b>137,158</b>	<b>12x PE</b>	<b>1,665</b>	<b>100%</b>	<b>1,665</b>	<b>180</b>	<b>306</b>
<b>Investees</b>	<b>% owned</b>		<b>Rmb/sh.</b>			<b>Valuation Rmb mn</b>		
Total (15% discount)						559.3	84.3	68.2
2023F cash per share (HK\$)								34
<b>Target price (HK\$)</b>								<b>408</b>

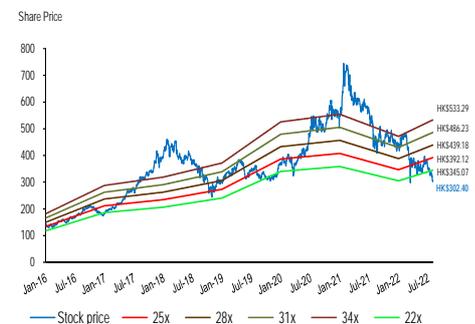
Source: UOB Kay Hian

### FIVE-YEAR FORWARD PE BAND



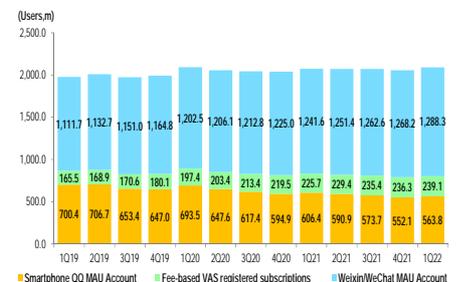
Source: Bloomberg, UOB Kay Hian

### SHARE PRICE BASED ON DIFFERENT VALUATION MULTIPLE



Source: Bloomberg, UOB Kay Hian

### USERS TREND



Source: Tencent, UOB Kay Hian

### PROFIT & LOSS

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
<b>Net turnover</b>	<b>560,118</b>	<b>579,482</b>	<b>660,682</b>	<b>768,419</b>
EBITDA	324,617	178,888	190,638	239,626
Deprec. & amort.	52,997	53,597	54,197	54,797
EBIT	271,620	125,291	136,441	184,829
Associate contributions	(16,444)	(6,280)	0	6,917
Net interest income/(expense)	(7,114)	(7,107)	(6,397)	(6,397)
<b>Pre-tax profit</b>	<b>248,062</b>	<b>111,904</b>	<b>130,044</b>	<b>185,350</b>
Tax	(20,252)	(17,171)	(19,507)	(40,777)
Minorities	(2,988)	(320)	0	0
<b>Net profit</b>	<b>224,822</b>	<b>94,413</b>	<b>110,537</b>	<b>144,573</b>
Net profit (adj.)	123,788	114,305	136,965	175,309

### CASH FLOW

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
<b>Operating</b>	<b>175,186</b>	<b>147,297</b>	<b>177,675</b>	<b>222,027</b>
Pre-tax profit	248,062	111,904	130,044	185,350
Tax	(20,252)	(17,171)	(19,507)	(40,777)
Deprec. & amort.	52,997	53,597	54,197	54,797
Working capital changes	(7,457)	6,394	19,337	29,053
Other operating cashflows	(98,164)	(7,427)	(6,397)	(6,397)
<b>Investing</b>	<b>(178,549)</b>	<b>(129,940)</b>	<b>(144,242)</b>	<b>(161,176)</b>
Capex (growth)	(33,392)	(34,546)	(39,387)	(45,810)
Others	(145,157)	(95,394)	(104,855)	(115,366)
<b>Financing</b>	<b>21,620</b>	<b>151,209</b>	<b>(4,751)</b>	<b>(6,974)</b>
Dividend payments	(13,929)	(14,048)	(12,972)	(15,543)
Issue of shares	(36,462)	3,367	3,535	3,712
Proceeds from borrowings	7,114	7,107	6,397	6,397
Others/interest paid	64,897	154,783	(1,710)	(1,539)
<b>Net cash inflow (outflow)</b>	<b>18,257</b>	<b>168,565</b>	<b>28,682</b>	<b>53,876</b>
<b>Beginning cash &amp; cash equivalent</b>	<b>152,798</b>	<b>167,966</b>	<b>336,531</b>	<b>365,213</b>
Changes due to forex impact	83,200	0	0	0
<b>Ending cash &amp; cash equivalent</b>	<b>254,255</b>	<b>336,531</b>	<b>365,213</b>	<b>419,089</b>

### BALANCE SHEET

Year to 31 Dec (Rmbm)	2021	2022F	2023F	2024F
Fixed assets	88,305	100,858	117,753	140,570
Other LT assets	1,039,247	1,103,037	1,176,188	1,259,749
Cash/ST investment	254,255	336,531	365,213	419,089
Other current assets	230,557	249,416	276,385	307,674
<b>Total assets</b>	<b>1,612,364</b>	<b>1,789,842</b>	<b>1,935,538</b>	<b>2,127,082</b>
ST debt	19,003	17,103	15,392	13,853
Other current liabilities	384,095	409,348	455,654	515,996
LT debt	136,936	136,936	136,936	136,936
Other LT liabilities	195,637	195,637	195,637	195,637
Shareholders' equity	806,299	960,424	1,061,525	1,194,266
Minority interest	70,394	70,394	70,394	70,394
<b>Total liabilities &amp; equity</b>	<b>1,612,364</b>	<b>1,789,842</b>	<b>1,935,538</b>	<b>2,127,082</b>

### KEY METRICS

Year to 31 Dec (%)	2021	2022F	2023F	2024F
<b>Profitability</b>				
EBITDA margin	58.0	30.9	28.9	31.2
Pre-tax margin	44.3	19.3	19.7	24.1
Net margin	40.1	16.3	16.7	18.8
ROA	15.3	5.6	5.9	7.1
ROE	29.8	10.7	10.9	12.8
<b>Growth</b>				
Turnover	16.2	3.5	14.0	16.3
EBITDA	40.6	(44.9)	6.6	25.7
Pre-tax profit	37.8	(54.9)	16.2	42.5
Net profit	40.6	(58.0)	17.1	30.8
Net profit (adj.)	0.9	(7.7)	19.8	28.0
EPS	0.7	(7.6)	19.8	27.7
<b>Leverage</b>				
Debt to total capital	15.1	13.0	11.9	10.7
Debt to equity	19.3	16.0	14.3	12.6
Net debt/(cash) to equity	(12.2)	(19.0)	(20.1)	(22.5)
Interest cover (x)	45.6	25.2	29.8	37.5

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