

Tencent (700 HK)

Regulation headwinds yet over

We expect Tencent to deliver in-line 2Q21E, with revenue/adj. net profit +18%/8% YoY. FBS would still perform well to offset soft games and ads. We believe market has well anticipated game deceleration, and we suggest focusing on recent regulation impact. Stock price might face short-term pressure with weak sector sentiment due to tightening regulation ahead in 2H21E. We estimate its fundamental price floor at HK\$402, indicating 24x FY21E P/E (historical trough valuation). We trimmed its earnings by 8-11% in FY21-23E, and cut our TP to HK\$640. Maintain BUY on earnings sustainability and solid LT growth outlook.

- Expecting 2Q21E largely in-line.** We forecast 2Q21E rev/earnings +18%/8% YoY, 2%/1% below consensus, in which VAS/ ads/ Others rev +11%/21%/32% YoY. Given low market expectation, we think soft game trend and margin dilution are well-digested. Market concerns lie in regulation uncertainties, including policies on teenage gaming addiction, tax rate change, and anti-trust law.
- Ads and new biz on track, despite soft game.** We expect Game +8% YoY in 2Q21 (vs. +17% YoY in 1Q21), in which mobile game +12% YoY (vs. +19% YoY in 1Q21). We believe market has well anticipated game growth to normalize for high base, with limited new titles in 2Q21. Apart from the timeline uncertainty of DnF mobile and LoL, investors focus more on recent tightening regulations. We forecast social network +15% YoY. Ads +21% YoY in 2Q21E (better-than-feared), with social ads/ media ads +24%/+9% YoY (vs. +27%/+7% YoY in 1Q21). Stronger Tencent video content in 3Q21E would boost ads momentum, despite multiple ads headwinds.
- Eyes on regulation impact.** We expect tightening regulation ahead in 2H21E, with more detailed policies to come. However, we expect limited financial impact from regulation on teenage gaming addiction, given that 1) anti-addiction measures were already conducted; and 2) teenagers only contributed 6% of total domestic grossing for Tencent in 4Q20. Recent pullback was driven more by sentiments than fundamentals. For taxation, we expect higher effective rate ahead (EIT up to 15% from 10%) for internet sector (including game), with potential removal of Key Software. New tax rate would pose 5-10% earnings drag, in our estimates. More color will be shared on earnings call.
- Maintain BUY.** Given rising investment and potential higher tax rate, we tweaked its earnings by 8-11% in FY21-23E, and cut our SOTP-based TP to **HK\$640** (implying 31x FY22E P/E) from HK\$753.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	582,013	706,392	848,978
YoY growth (%)	20.7	27.8	20.7	21.4	20.2
Net income (RMB mn)	94,351	122,742	131,209	164,043	197,142
Adj. EPS (RMB)	9.7	12.7	13.7	17.1	20.5
YoY growth (%)	22.1	30.1	6.9	25.0	20.2
Consensus EPS (RMB)	NA	NA	14.7	18.1	22.1
P/E (x)	38.6	29.6	27.5	22.0	18.4
P/B (x)	8.3	5.1	4.5	3.9	3.4
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	23.9	21.8	17.4	16.4	17.7
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$640**
 (Previous TP **HK\$753**)
 Up/Downside **41.0%**
 Current Price **HK\$453.6**

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,354,538
Avg 3 mths t/o (HK\$ mn)	14,980.30
52w High/Low (HK\$)	775.5/ 422.0
Total Issued Shares (mn)	9,600

Source: Bloomberg

Shareholding Structure

Naspers	28.9%
Ma Huateng	7.4%
Vanguard	2.8%

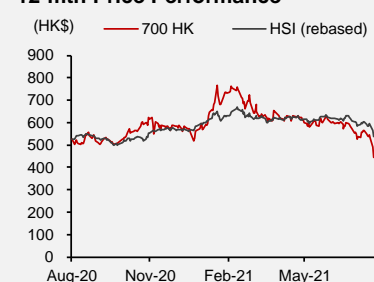
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-18.9%	-13.0%
3-mth	-25.7%	-18.7%
6-mth	-38.1%	-30.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 2Q21E financial preview

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21E	QoQ	YoY	Consensus	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	135,687	0.3%	18.1%	138,328	-2%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	56,273	40,525	-28.0%	3.1%	40,338	0%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	47,767	34,576	-27.6%	4.4%	30,531	13%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	33,118	32,592	-1.6%	8.1%	32,826	-1%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.42	3.41	-0.1%	9.0%	3.44	-1%
Margin (%)														
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%	46.3%	43.9%			44.7%	
Operating Margin	43.0%	31.0%	29.9%	20.7%	34.5%	34.2%	35.0%	47.7%	41.6%	29.9%			29.2%	
Adj. net margin	24.5%	26.5%	25.1%	18.4%	25.1%	26.2%	25.8%	24.8%	24.5%	24.0%			23.7%	
Growth (%)														
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	18.1%			20.4%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	0.3%			2.2%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%	51.0%	3.1%			2.6%	
Adj. net profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%	22.3%	8.1%			8.9%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21E	QoQ	YoY
Total revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	135,687	0%	18%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	71,972	-1%	11%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	43,600	41,251	-5%	8%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	28,843	30,721	7%	15%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,511	3%	21%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	41,204	0%	32%

Source: Company data

Figure 3: CMBIS estimates vs. consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	582,013	706,392	848,978	588,162	706,180	832,260	-1.0%	0.0%	2.0%
Gross Profit	259,299	312,822	375,477	264,604	317,533	377,709	-2.0%	-1.5%	-0.6%
Operating Profit	178,901	215,418	251,895	189,824	219,146	264,989	-5.8%	-1.7%	-4.9%
Net profit	131,209	164,043	197,142	141,210	174,302	211,262	-7.1%	-5.9%	-6.7%
Adj. EPS (RMB)	13.68	17.06	20.46	14.69	18.13	22.10	-6.9%	-5.9%	-7.4%
Gross Margin	44.6%	44.3%	44.2%	45.0%	45.0%	45.4%	-0.4ppts	-0.7ppts	-1.2ppts
Operating Margin	30.7%	30.5%	29.7%	32.3%	31.0%	31.8%	-1.5ppts	-0.5ppts	-2.2ppts
Net Margin	22.5%	23.2%	23.2%	24.0%	24.7%	25.4%	-1.5ppts	-1.5ppts	-2.2ppts

Source: CMBIS estimates, Bloomberg

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	582,013	706,392	848,978	584,135	708,058	850,900	-0.4%	-0.2%	-0.2%
Gross Profit	259,299	312,822	375,477	260,466	314,064	374,531	-0.4%	-0.4%	0.3%
Operating Profit	178,901	215,418	251,895	210,791	250,538	299,341	-15.1%	-14.0%	-15.9%
Adj. net profit	131,209	164,043	197,142	144,538	179,282	221,837	-9.2%	-8.5%	-11.1%
EPS (RMB)	13.68	17.06	20.46	15.07	18.65	23.02	-9.2%	-8.5%	-11.1%
Gross Margin	44.6%	44.3%	44.2%	44.6%	44.4%	44.0%	-0.0ppts	-0.1ppts	+0.2ppts
Operating Margin	30.7%	30.5%	29.7%	36.1%	35.4%	35.2%	-5.3ppts	-4.9ppts	-5.5ppts
Net Margin	22.5%	23.2%	23.2%	24.7%	25.3%	26.1%	-2.2ppts	-2.1ppts	-2.8ppts

Source: Company data, CMBIS estimates

Figure 5: SOTP Valuation

SOTP	Valuation (HK\$ bn)	HK\$/Share	Implied FY22P/E
Core business	5,175	540	26x
Unlisted associates	128	13	
JD	211	22	
58.com	24	2	
Meituan	379	40	
PDD	213	22	
Total Valuation	6,129	640	31x

Source: CMBIS estimates, Bloomberg, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	377,289	482,064	582,013	706,392	848,978
VAS	199,991	264,212	301,161	350,579	405,000
Ads	68,377	82,271	100,016	121,795	145,477
E-commerce	-	-	-	-	-
Others	108,921	135,581	180,837	234,018	298,501
COGS	(209,756)	(260,532)	(322,714)	(393,571)	(473,501)
Gross profit	167,533	221,532	259,299	312,822	375,477
S&M	(21,396)	(33,758)	(40,741)	(44,503)	(56,494)
Admin.Exp.	(53,446)	(67,625)	(87,302)	(103,310)	(120,438)
Interest income	6,314	6,957	7,653	8,418	9,260
Others	19,689	57,131	39,992	41,991	44,091
Operating profit	118,694	184,237	178,901	215,418	251,895
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
Pre-tax Income	109,400	180,022	173,214	211,051	248,714
Income Tax	(13,512)	(19,897)	(29,446)	(35,879)	(42,281)
MI	(2,578)	-	-	-	-
Net profit	93,310	159,847	143,518	174,869	206,074
Adj. net profit	94,351	122,742	131,209	164,043	197,142

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	93,310	159,847	143,518	174,869	206,074
D&A	13,539	17,923	20,431	23,419	26,813
Change in WC	8,972	12,843	15,734	19,437	21,102
Income tax paid	(2,735)	166	5,824	3,923	3,905
Others	35,504	3,340	48,199	52,970	58,275
Operating CF	148,590	194,119	233,705	274,618	316,169
Capex	(32,369)	(33,960)	(41,001)	(48,519)	(56,855)
Associates	(43,669)	(48,036)	(52,839)	(63,407)	(76,089)
Others	(40,132)	(99,959)	(13,175)	(12,410)	(11,568)
Investing CF	(116,170)	(181,955)	(107,016)	(124,336)	(144,512)
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(24,594)	(31,875)
Financing CF	1,672	13,647	(25,648)	(24,594)	(31,875)
Net change in cash	34,092	25,811	101,042	125,687	139,782
Cash (beg of yr)	97,814	132,991	152,798	253,840	379,527
FX	1,085	(6,004)	0	0	0
Cash (end of yr)	132,991	152,798	253,840	379,527	519,309

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	700,018	1,015,778	1,094,644	1,194,341	1,309,815
Fixed asset	77,215	93,802	120,759	152,246	188,675
Associates	221,894	305,258	305,258	305,258	305,258
Intangible assets	128,860	159,437	146,663	133,889	121,115
Others	272,049	457,281	521,964	602,948	694,767
Current assets	253,968	317,647	436,898	585,244	751,002
Cash	132,991	152,798	253,840	379,527	519,309
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	54,307	65,913	79,217
Others	38,227	51,381	60,263	71,317	83,989
Current liabilities	240,156	269,079	351,501	458,010	588,912
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	116,473	142,046	170,894
Tax payable	10,978	14,283	20,107	24,029	27,934
Other	125,793	146,524	200,680	277,693	375,843
Non-current liabilities	225,006	286,303	294,254	299,701	294,866
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	23,769	28,962	34,130
Others	107,908	158,097	158,339	158,595	148,591
MI	56,118	74,059	84,315	97,268	112,038
Total net assets	488,824	778,043	885,787	1,021,873	1,177,039
Shareholders' equity	432,706	703,984	801,472	924,605	1,065,001

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
VAS	53.0	54.8	51.7	49.6	47.7
Ads	18.1	17.1	17.2	17.2	17.1
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.9	28.1	31.1	33.1	35.2
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	20.7	27.8	20.7	21.4	20.2
Gross profit	17.9	32.2	17.0	20.6	20.0
EBIT	21.6	55.2	(2.9)	20.4	16.9
Net profit	22.1	30.1	6.9	25.0	20.2
P&L ratios (%)					
Operating margin	31.5	38.2	30.7	30.5	29.7
Pre-tax margin	29.0	37.3	29.8	29.9	29.3
Adj. net margin	25.0	25.5	22.5	23.2	23.2
Effective tax rate	(3.6)	(4.1)	(5.1)	(5.1)	(5.0)
Returns (%)					
ROE	23.9	21.8	17.4	16.4	17.7
ROA	10.7	9.9	9.2	8.6	9.2
Per share					
EPS (RMB)	9.7	12.7	13.7	17.1	20.5
DPS (RMB)	1.4	2.5	2.4	3.1	3.8
BVPS (RMB)	45.2	73.3	83.1	96.4	110.8

Source: Company data, CMBIS estimates

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