

Tencent (700 HK)

LT outlook intact, despite prudent 2H21E

Tencent delivered better-than-feared 2Q21, with rev/adj. net profit +20%/13% YoY, 0%/4% above consensus. By segment, strong FBS (+40% YoY) momentum and solid ads (+23% YoY) offset soft VAS (+11% YoY). Stock price would react positively in a near term, given manageable regulation impact from teenage gaming anti-addiction (3% grossing mix from minors) and tax rate change (ETR to be mid-teens in FY21E). However, we do not expect a lasting rebound, given 2H21E prudent outlook (game & ads to decelerate continuously) and soft sector sentiment with more policies to come. We trimmed our earnings by 1-2% in FY21-23E to reflect conservative growth, but maintain our TP at **HK\$640**.

- **Better-than-feared 2Q21.** 2Q21 rev was RMB138.3bn, up 20% YoY, 0%/2% above consensus/our estimate, in which games is largely in-line, ads & fintech beat while social network is soft. Non-GAAP net profit grew 13% YoY, 4%/4% above consensus/our estimate. Margin beat on higher GPM.
- **LT outlook intact, despite conservative 2H21E.** Games +12% YoY in 2Q21 (vs. +17% YoY in 1Q21), in which mobile game +13% YoY (largely in line, vs. +19% YoY in 1Q21). Game deceleration would continue in 3Q21E, given limited new key titles. Ads +23% YoY in 2Q21 (2% above our estimate, vs. +23% YoY in 1Q21), in which social ads (+28% YoY) beat on solid contribution from Weixin ecosystem. However, ads would bear heavier pressure in 2H21E (forecasting +15% YoY in 2H21E), with soft ads budget under COVID-19 uncertainty and new regulatory environment, despite rising ads adoption of mini-programs & video accounts.
- **Regulations yet over, but impact more manageable.** Despite tightening regulation ahead in 2H21E, impact from regulations on teenage gaming anti-addiction and tax rate seems to be more manageable, per mgmt. In 2Q21, players aged under 16/12 accounted for 2.6%/0.3% of China game grossing. We think the low grossing mix from minors would partly alleviate market concern. For taxation, mgmt. expected ETR to be mid-teens in FY21E (vs. 11% in FY20), and the differentials would be around 3% (much better than BABA), with lower tax rebates and reduced KSE entities. Compared to peers, Tencent would be more prepared and self-supervisory to upcoming policies.
- **Maintain BUY.** We slightly cut our earnings by 1-2% in FY21-23E to reflect prudent financial outlook, but maintain our TP at **HK\$640** (31x FY22E P/E).

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	571,794	688,047	822,912
YoY growth (%)	20.7	27.8	18.6	20.3	19.6
Net income (RMB mn)	94,351	122,742	129,773	160,822	192,541
Adj. EPS (RMB)	9.7	12.7	13.5	16.7	20.0
YoY growth (%)	22.1	30.1	5.7	23.9	19.7
Consensus EPS (RMB)	NA	NA	14.6	18.1	21.7
P/E (x)	38.4	29.4	27.6	22.3	18.7
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	16.2	17.5
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\$640
Up/Downside	41.0%
Current Price	HK\$437.4

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,199,019
Avg 3 mths t/o (HK\$ mn)	15,157.49
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	2.5%

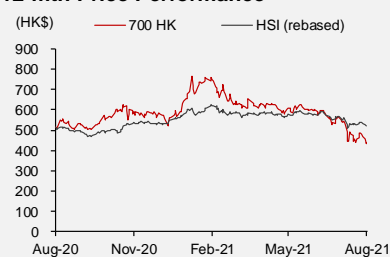
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-22.9%	-16.1%
3-mth	-27.6%	-20.7%
6-mth	-42.6%	-30.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 2Q21 financial review

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	2.2%	20.3%	138,193	0%	135,687	2%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	56,273	52,487	-6.7%	33.5%	40,359	30%	40,525	30%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	47,767	42,587	-10.8%	28.6%	30,769	38%	34,576	23%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	33,118	34,039	2.8%	12.9%	32,838	4%	32,592	4%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.42	3.51	2.8%	12.2%	3.43	2%	3.41	3%
Margin (%)																
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%			44.5%		43.9%	
Operating Margin	43.0%	31.0%	29.9%	20.7%	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%			29.2%		29.9%	
Adj. net margin	24.5%	26.5%	25.1%	18.4%	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%			23.8%		24.0%	
Growth (%)																
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%			20.3%		18.1%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%			2.1%		0.3%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%			2.7%		3.1%	
Adj. net profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%			8.9%		8.1%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	QoQ	YoY
Total revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	2%	20%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	72,013	-1%	11%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	43,600	43,000	-1%	12%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	28,843	29,013	1%	9%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,833	5%	23%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	43,413	6%	39%

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	571,794	688,047	822,912	586,570	703,023	827,220	-2.5%	-2.1%	-0.5%
Gross Profit	253,617	303,241	362,468	263,281	315,911	374,660	-3.7%	-4.0%	-3.3%
Operating Profit	175,467	209,677	244,319	187,624	217,017	259,651	-6.5%	-3.4%	-5.9%
Net profit	129,773	160,822	192,541	140,716	173,596	207,038	-7.8%	-7.4%	-7.0%
Adj. EPS (RMB)	13.53	16.73	19.98	14.63	18.13	21.71	-7.5%	-7.7%	-8.0%
Gross Margin	44.4%	44.1%	44.0%	44.9%	44.9%	45.3%	-0.5ppts	-0.9ppts	-1.2ppts
Operating Margin	30.7%	30.5%	29.7%	32.0%	30.9%	31.4%	-1.3ppts	-0.4ppts	-1.7ppts
Net Margin	22.7%	23.4%	23.4%	24.0%	24.7%	25.0%	-1.3ppts	-1.3ppts	-1.6ppts

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	571,794	688,047	822,912	582,013	706,392	848,978	-1.8%	-2.6%	-3.1%
Gross Profit	253,617	303,241	362,468	259,299	312,822	375,477	-2.2%	-3.1%	-3.5%
Operating Profit	175,467	209,677	244,319	178,901	215,418	251,895	-1.9%	-2.7%	-3.0%
Adj. net profit	129,773	160,822	192,541	131,209	164,043	197,142	-1.1%	-2.0%	-2.3%
EPS (RMB)	13.53	16.73	19.98	13.68	17.06	20.46	-1.1%	-2.0%	-2.3%
Gross Margin	44.4%	44.1%	44.0%	44.6%	44.3%	44.2%	-0.2ppts	-0.2ppts	-0.2ppts
Operating Margin	30.7%	30.5%	29.7%	30.7%	30.5%	29.7%	-0.1ppts	-0.0ppts	+0.0ppts
Net Margin	22.7%	23.4%	23.4%	22.5%	23.2%	23.2%	+0.2ppts	+0.2ppts	+0.2ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	377,289	482,064	571,794	688,047	822,912
VAS	199,991	264,212	291,084	333,310	381,086
Ads	68,377	82,271	97,390	116,752	137,802
E-commerce	-	-	-	-	-
Others	108,921	135,581	183,320	237,985	304,023
COGS	(209,756)	(260,532)	(318,177)	(384,806)	(460,444)
Gross profit	167,533	221,532	253,617	303,241	362,468
S&M	(21,396)	(33,758)	(40,026)	(43,347)	(54,760)
Admin.Exp.	(53,446)	(67,625)	(85,769)	(100,627)	(116,740)
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	175,467	209,677	244,319
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
Pre-tax Income	109,400	180,022	169,780	205,310	241,137
Income Tax	(13,512)	(19,897)	(27,165)	(32,850)	(38,582)
MI	(2,578)	-	-	-	-
Net profit	93,310	159,847	142,368	172,161	202,204
Adj. net profit	94,351	122,742	129,773	160,822	192,541

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	93,310	159,847	142,368	172,161	202,204
D&A	13,539	17,923	20,431	23,282	26,483
Change in WC	8,972	12,843	14,481	19,018	20,558
Income tax paid	(2,735)	166	4,432	3,467	3,496
Others	35,504	3,340	47,911	52,452	57,538
Operating CF	148,590	194,119	229,623	270,380	310,279
Capex	(32,369)	(33,960)	(40,281)	(47,259)	(55,109)
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)	(106,296)	(123,076)	(142,766)
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(24,397)	(31,382)
Financing CF	1,672	13,647	(25,648)	(24,397)	(31,382)
Net change in cash	34,092	25,811	97,680	122,906	136,131
Cash (beg of yr)	97,814	132,991	152,798	250,478	373,384
FX	1,085	(6,004)	0	0	0
Cash (end of yr)	132,991	152,798	250,478	373,384	509,515

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	700,018	1,015,778	1,091,043	1,187,007	1,297,928
Fixed asset	77,215	93,802	120,039	150,403	185,417
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	519,083	597,456	686,138
Current assets	253,968	317,647	431,674	575,759	736,459
Cash	132,991	152,798	250,478	373,384	509,515
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	53,354	64,201	76,785
Others	38,227	51,381	59,355	69,687	81,672
Current liabilities	240,156	269,079	345,637	447,043	571,892
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	114,835	138,882	166,181
Tax payable	10,978	14,283	18,715	22,182	25,678
Other	125,793	146,524	197,845	271,737	365,791
Non-current liabilities	225,006	286,303	292,364	297,214	291,841
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	21,928	26,516	31,144
Others	107,908	158,097	158,291	158,552	148,553
MI	56,118	74,059	84,213	96,948	111,430
Total net assets	488,824	778,043	884,715	1,018,509	1,170,654
Shareholders' equity	432,706	703,984	800,502	921,561	1,059,223

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
VAS	53.0	54.8	50.9	48.4	46.3
Ads	18.1	17.1	17.0	17.0	16.7
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.9	28.1	32.1	34.6	36.9
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	20.7	27.8	18.6	20.3	19.6
Gross profit	17.9	32.2	14.5	19.6	19.5
EBIT	21.6	55.2	-4.8	19.5	16.5
Net profit	22.1	30.1	5.7	23.9	19.7
P&L ratios (%)					
Operating margin	31.5	38.2	30.7	30.5	29.7
Pre-tax margin	29.0	37.3	29.7	29.8	29.3
Adj. net margin	25.0	25.5	22.7	23.4	23.4
Effective tax rate	(12.4)	(11.1)	(16.0)	(16.0)	(16.0)
Returns (%)					
ROE	23.9	21.8	17.4	16.2	17.5
ROA	10.7	9.9	9.2	8.5	9.1
Per share					
EPS (RMB)	9.7	12.7	13.5	16.7	20.0
DPS (RMB)	1.4	2.5	2.4	3.0	3.8
BVPS (RMB)	45.2	73.3	83.0	96.1	110.2

Source: Company data, CMBIS estimates

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