

Tencent (700 HK)

Moving into 4Q21E games rebound

We expect Tencent to deliver largely in-line 3Q21E, with rev/adj. net profit +15%/0% YoY, 2%/0% below consensus. We believe the market has well anticipated games deceleration (forecasting +5% YoY), given limited new titles, tough base and teenage gaming anti-addiction. Suggest to move into 4Q21E game momentum, with strong LoLM performance (ranked TOP2 in iOS grossing). We estimate LoLM to generate annual grossing of RMB10bn, contributing 2%/4% of FY21/22E mobile game rev. FBS would be solid (rev +32% YoY), to partly offset soft ads (forecasting +13% YoY in 3Q21E). With sector regulation overhang to be gradually lifted, we believe market focus would shift to its fundamentals. Prudent 3Q21E has been priced in, and we expect Tencent to see re-rating in a 6-month horizon, with upcoming catalysts and better outlook in FY22E. We keep our financials largely unchanged, and maintain our TP at **HK\$640** (31x FY22E P/E).

- Conservative 3Q21E priced in.** We expect 3Q21E rev at RMB143.7bn, up 15% YoY, 2% below consensus, in which VAS/ads/FBS +6%/13%/32% YoY. Non-GAAP net profit grew 0% YoY, in line with consensus. Margin dilution was mainly on stepping-up investment and higher tax rate (ETR to be mid-teens in FY21E).
- Moving into 4Q21E games rebound, with strong LoLM.** We forecast games +5% YoY in 3Q21E (vs. +12% YoY in 2Q21), in which mobile game +8% YoY (vs. +13% YoY in 2Q21). We believe 3Q21E soft momentum was well anticipated by the market, with limited new titles, tough base and teenage gaming anti-addiction. Suggest to look into 4Q21E game momentum, with strong LoLM. LoLM ranked TOP2 in iOS grossing rank after its launch on 8 Oct, and we estimate its first monthly grossing at RMB1.0-1.5bn. Coupled with overseas contribution, we expect 4Q21E games rev +9% YoY.
- Solid FBS to offset soft ads sentiment in 2H21E.** Ads would bear short-term pressure in 2H21E (forecasting +13% YoY in 3Q21E), with soft ads budget under COVID-19 uncertainty and new regulatory environment, despite rising ads adoption of mini-programs & video accounts. By segment, social ads/ media ads +15%/3% YoY, in our estimate. We forecast FBS rev +32% YoY, with Fintech to LT benefit from dismantling walled gardens.
- Maintain BUY.** We keep our financials largely unchanged, and maintain our TP at **HK\$640** (31x FY22E P/E). Further catalysts: 1) upcoming game licenses resumption; and 2) 4Q21E games to rebound.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	571,629	688,289	823,638
YoY growth (%)	20.7	27.8	18.6	20.4	19.7
Net income (RMB mn)	94,351	122,742	129,627	160,650	192,369
Adj. EPS (RMB)	9.7	12.7	13.5	16.7	20.0
YoY growth (%)	22.1	30.1	5.6	23.9	19.7
Consensus EPS (RMB)	NA	NA	14.0	17.0	20.4
P/E (x)	41.1	31.5	29.6	24.0	20.1
P/B (x)	8.9	5.5	4.8	4.2	3.6
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	23.9	21.8	17.4	16.2	17.4
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	32.0%
Current Price	HK\$485.0

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,684,892
Avg 3 mths t/o (HK\$ mn)	15,355.69
52w High/Low (HK\$)	775.50/412.20
Total Issued Shares (mn)	9,596

Source: Bloomberg

Shareholding Structure

Naspers	28.9%
Ma Huateng	7.4%
Vanguard	2.5%

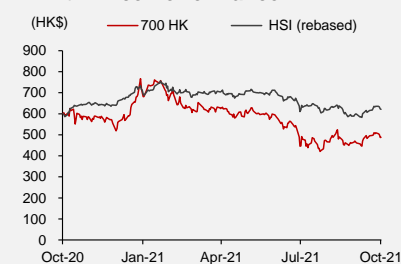
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	4.8%	-1.0%
3-mth	9.2%	6.9%
6-mth	-22.1%	-12.0%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 3Q21 financial preview

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21E	QoQ	YoY	Consensus	Diff %
Revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	143,672	3.9%	14.5%	146,166	-2%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	56,273	52,487	40,703	-22.5%	-7.4%	38,904	5%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	47,767	42,587	32,794	-23.0%	-14.9%	32,014	2%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	33,118	34,039	32,290	-5.1%	0.0%	32,415	0%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.42	3.51	3.38	-3.7%	2.1%	3.34	1%
Margin (%)															
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	42.9%			44.7%	
Operating Margin	43.0%	31.0%	29.9%	19.6%	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	28.3%			26.6%	
Adj. net margin	24.5%	26.5%	25.1%	17.4%	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.5%			22.2%	
Growth (%)															
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	14.5%			16.5%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.9%			5.7%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	-7.4%			-11.5%	
Adj. net profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	0.0%			0.3%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21E	QoQ	YoY
Total revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	143,672	4%	15%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	72,013	74,295	3%	6%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	43,600	43,000	43,361	1%	5%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	28,843	29,013	30,934	7%	9%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,833	24,122	6%	13%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	43,413	45,255	4%	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	571,629	688,289	823,638	576,354	684,303	804,107	-0.8%	0.6%	2.4%
Gross Profit	253,413	303,079	362,389	259,265	306,736	361,755	-2.3%	-1.2%	0.2%
Operating Profit	175,299	209,464	244,089	188,963	205,212	242,374	-7.2%	2.1%	0.7%
Net profit	129,627	160,650	192,369	134,393	162,709	195,924	-3.5%	-1.3%	-1.8%
Adj. EPS (RMB)	13.52	16.71	19.96	14.01	16.99	20.44	-3.5%	-1.7%	-2.4%
Gross Margin	44.3%	44.0%	44.0%	45.0%	44.8%	45.0%	-0.7ppts	-0.8ppts	-1.0ppts
Operating Margin	30.7%	30.4%	29.6%	32.8%	30.0%	30.1%	-2.1ppts	+0.4ppts	-0.5ppts
Net Margin	22.7%	23.3%	23.4%	23.3%	23.8%	24.4%	-0.6ppts	-0.4ppts	-1.0ppts

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	571,629	688,289	823,638	571,794	688,047	822,912	0.0%	0.0%	0.1%
Gross Profit	253,413	303,079	362,389	253,617	303,241	362,468	-0.1%	-0.1%	0.0%
Operating Profit	175,299	209,464	244,089	175,467	209,677	244,319	-0.1%	-0.1%	-0.1%
Adj. net profit	129,627	160,650	192,369	129,773	160,822	192,541	-0.1%	-0.1%	-0.1%
EPS (RMB)	13.52	16.71	19.96	13.53	16.73	19.98	-0.1%	-0.1%	-0.1%
Gross Margin	44.3%	44.0%	44.0%	44.4%	44.1%	44.0%	-0.0ppts	-0.0ppts	-0.0ppts
Operating Margin	30.7%	30.4%	29.6%	30.7%	30.5%	29.7%	-0.0ppts	-0.0ppts	-0.1ppts
Net Margin	22.7%	23.3%	23.4%	22.7%	23.4%	23.4%	-0.0ppts	-0.0ppts	-0.0ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	377,289	482,064	571,629	688,289	823,638
VAS	199,991	264,212	291,748	334,038	381,879
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)	(318,216)	(385,210)	(461,248)
Gross profit	167,533	221,532	253,413	303,079	362,389
S&M	(21,396)	(33,758)	(40,014)	(43,362)	(54,808)
Admin.Exp.	(53,446)	(67,625)	(85,744)	(100,662)	(116,843)
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	175,299	209,464	244,089
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
Pre-tax Income	109,400	180,022	169,612	205,097	240,907
Income Tax	(13,512)	(19,897)	(27,138)	(32,815)	(38,545)
MI	(2,578)	-	-	-	-
Net profit	93,310	159,847	142,226	171,982	202,011
Adj. net profit	94,351	122,742	129,627	160,650	192,369

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	93,310	159,847	142,226	171,982	202,011
D&A	13,539	17,923	20,431	23,280	26,484
Change in WC	8,972	12,843	14,398	19,043	20,579
Income tax paid	(2,735)	166	4,416	3,462	3,494
Others	35,504	3,340	47,906	52,459	57,558
Operating CF	148,590	194,119	229,378	270,226	310,127
Capex	(32,369)	(33,960)	(40,270)	(47,276)	(55,158)
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)	(106,284)	(123,093)	(142,815)
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(24,373)	(31,349)
Financing CF	1,672	13,647	(25,648)	(24,373)	(31,349)
Net change in cash	34,092	25,811	97,446	122,760	135,963
Cash (beg of yr)	97,814	132,991	152,798	250,244	373,004
FX	1,085	(6,004)	0	0	0
Cash (end of yr)	132,991	152,798	250,244	373,004	508,967

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	700,018	1,015,778	1,090,898	1,186,854	1,297,807
Fixed asset	77,215	93,802	120,027	150,410	185,471
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	518,949	597,297	685,963
Current assets	253,968	317,647	431,410	575,423	736,043
Cash	132,991	152,798	250,244	373,004	508,967
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	53,338	64,224	76,853
Others	38,227	51,381	59,341	69,708	81,737
Current liabilities	240,156	269,079	345,388	446,860	571,805
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	114,849	139,028	166,472
Tax payable	10,978	14,283	18,699	22,161	25,655
Other	125,793	146,524	197,598	271,429	365,436
Non-current liabilities	225,006	286,303	292,335	297,180	291,806
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	21,906	26,489	31,114
Others	107,908	158,097	158,284	158,546	148,547
MI	56,118	74,059	84,200	96,922	111,391
Total net assets	488,824	778,043	884,584	1,018,237	1,170,240
Shareholders' equity	432,706	703,984	800,383	921,315	1,058,849

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
VAS	53.0	54.8	51.0	48.5	46.4
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	20.4	19.7
Gross profit	17.9	32.2	14.4	19.6	19.6
EBIT	21.6	55.2	-4.9	19.5	16.5
Net profit	22.1	30.1	5.6	23.9	19.7
P&L ratios (%)					
Operating margin	31.5	38.2	30.7	30.4	29.6
Pre-tax margin	29.0	37.3	29.7	29.8	29.2
Adj. net margin	25.0	25.5	22.7	23.3	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	17.4
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	3.7
BVPS (RMB)	45.2	73.3	82.9	96.1	110.1

Source: Company data, CMBIS estimates

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