

Tencent (700 HK)

Factoring in ads & games headwinds

4Q21E & 1Q22E would be soft quarters for Tencent. We expect its rev/adj. net profit +5.5%/-25% YoY, 5%/19% below consensus. By segment, games & ads continues to slow down (+4%/-14% YoY) while FBS is largely on track. To factor in more challenging macro and tightening regulations, we reset ads/games rev growth at +0%/7% YoY in FY22E. Stock price would react negatively in the near term, but downside risk is limited, given already-low mkt expectation and a new round of shares buybacks by Tencent. We expect 2H22E to see gradual ads recovery with easy base, and solid game product cycle and overseas expansion to drive LT momentum. We trimmed our earnings by 3-11% in FY21-23E to reflect conservative growth, with new TP at **HK\$590**.

- **Expecting soft 4Q21E.** We forecast 4Q21E rev/adj. net profit +5.5%/-25% YoY, 5%/19% below consensus, in which games & ads is under pressure while FBS is largely on track (+21% YoY).
- **4Q21E games to decelerate, but is forgivable.** We expect games +4% YoY in 4Q21 (vs. +8% YoY in 3Q21), due to: 1) limited contribution from LoLM for longer deferral period, despite its eye-catching iOS grossing rank (TOP3-5); 2) minors protection impact; and 3) few new titles under license suspension. However, we suggest to look beyond 4Q21E game deceleration, and expect solid product cycle and overseas expansion to drive LT momentum. For conservative estimate, we reset game rev growth at +7% YoY in FY22E, given license suspension and moderate monetization.
- **Factoring in challenging ads in 4Q21E & FY22E.** Ads saw multiple headwinds from 2H21E, and we see low visibility for it to rebound before 2Q22E. To factor in softer macro and tightening regulations (e.g. PIPL, new ads rules draft, algorithm management), we cut its ads rev to -14% YoY in 4Q21E. Multiple verticals should still bear pressure, including edu, games and insurance. 1Q22E continues to be a challenging quarter, especially on epidemic resurgence. We forecast flat YoY growth for ads in FY22E, with positive YoY growth in 2H22E on easy base and macro recovery.
- **Maintain BUY.** We slightly cut our earnings by 3-11% in FY21-23E to reflect prudent financial outlook, and lowered TP to **HK\$590** (35x FY22E P/E). Given already-low market expectation, we view this financial estimate reset as relatively reasonable. Suggest to buy on dips, backed by its share buybacks and limited downside risk on valuation.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	377,289	482,064	556,972	617,149	706,584
YoY growth (%)	20.7	27.8	15.5	10.8	14.5
Net income (RMB mn)	94,351	122,742	123,853	131,557	156,887
Adj. EPS (RMB)	9.7	12.7	12.9	13.7	16.3
YoY growth (%)	22.1	30.1	0.9	6.2	19.3
Consensus EPS (RMB)	NA	NA	13.8	15.5	18.9
P/E (x)	38.4	29.5	29.0	27.3	23.0
P/B (x)	8.3	5.1	4.4	3.9	3.4
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	23.9	21.8	17.4	15.2	14.2
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price **HK\$590**
 (Previous TP) **HK\$640**
Up/Downside **33.5%**
Current Price **HK\$442**

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	4,420,156
Avg 3 mths t/o (HK\$ mn)	9,259.04
52w High/Low (HK\$)	775.5/ 412.2
Total Issued Shares (mn)	9,609

Source: Bloomberg

Shareholding Structure

Naspers	28.8%
Ma Huateng	7.4%
Vanguard	2.3%

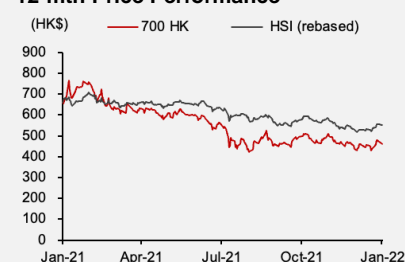
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	6.3%	1.8%
3-mth	-6.1%	-1.7%
6-mth	-17.4%	-14.8%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

1. Looking beyond 2H21 ads headwinds – 11 Nov 2021
2. China Internet: Embracing a new normal of regulation – 8 Nov 2021
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Figure 1: 4Q21E financial review

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21E	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	142,368	141,042	-0.9%	5.5%	148,535	-5%
Operating Profit	36,742	27,521	29,110	28,604	37,260	39,311	43,953	63,713	56,273	52,487	53,137	40,710	-23.4%	-36.1%	42,527	-4%
Net profit	27,210	24,136	23,004	21,582	28,896	33,107	38,542	59,302	47,767	42,587	39,510	26,451	-33.1%	-55.4%	32,628	-19%
Adj. net profit	20,930	23,525	24,412	25,484	27,079	30,153	32,303	33,207	33,118	34,039	31,751	24,945	-21.4%	-24.9%	30,726	-19%
Adj. EPS	2.19	2.46	2.62	2.64	2.82	3.13	3.31	3.41	3.42	3.51	3.33	2.70	-18.8%	-20.8%	3.21	-16%
Margin (%)																
Gross Margin	46.6%	44.1%	46.0%	45.0%	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.1%	43.1%			43.0%	
Operating Margin	43.0%	31.0%	29.9%	19.3%	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	37.3%	28.9%			28.6%	
Adj. net margin	24.5%	26.5%	25.1%	17.2%	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.3%	17.7%			20.7%	
Growth (%)																
Revenue (YoY)	16.2%	20.6%	20.6%	24.6%	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%	5.5%			11.1%	
Revenue (QoQ)	0.7%	3.9%	9.5%	8.8%	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%	-0.9%			4.3%	
Operating Profit	19.7%	26.2%	4.5%	65.5%	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	20.9%	-36.1%			-33.3%	
Adj. net profit	14.3%	19.3%	23.9%	29.2%	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	-1.7%	-24.9%			-7.5%	

Source: Company data, Bloomberg, CMBIS estimates

Figure 2: Revenue breakdown

RMB mn	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21E	QoQ	YoY
Total revenue	85,465	88,821	97,236	105,767	108,065	114,883	125,447	133,669	135,303	138,259	142,368	141,042	-1%	6%
VAS	48,974	48,080	50,629	52,308	62,429	65,002	69,802	66,979	72,443	72,013	75,203	68,689	-9%	3%
- Online games	28,513	27,307	28,604	30,286	37,298	38,288	41,422	39,100	43,600	43,000	44,903	40,810	-9%	4%
- Social network	20,461	20,773	22,025	22,022	25,131	26,714	28,380	27,879	28,843	29,013	30,300	27,879	-8%	0%
Online advertising	13,377	16,409	18,366	20,225	17,713	18,552	21,351	24,655	21,820	22,833	22,495	21,304	-5%	-14%
Others	23,114	24,332	28,241	33,234	27,923	31,329	34,294	42,035	41,040	43,413	44,670	51,049	14%	21%

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	556,972	617,149	706,584	566,720	657,040	765,777	-1.7%	-6.1%	-7.7%
Gross Profit	248,931	274,176	314,454	253,519	290,377	337,494	-1.8%	-5.6%	-6.8%
Operating Profit	202,607	220,040	251,622	203,893	197,737	227,043	-0.6%	11.3%	10.8%
Net profit	123,853	131,557	156,887	129,054	149,386	181,829	-4.0%	-11.9%	-13.7%
Adj. EPS (RMB)	12.92	13.69	16.28	13.73	15.45	18.81	-6.0%	-11.4%	-13.5%
Gross Margin	44.7%	44.4%	44.5%	44.7%	44.2%	44.1%	-0.0ppts	+0.2ppts	+0.4ppts
Operating Margin	36.4%	35.7%	35.6%	36.0%	30.1%	29.6%	+0.4ppts	+5.6ppts	+6.0ppts
Net Margin	22.2%	21.3%	22.2%	22.8%	22.7%	23.7%	-0.5ppts	-1.4ppts	-1.5ppts

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	556,972	617,149	706,584	564,776	644,585	737,806	-1.4%	-4.3%	-4.2%
Gross Profit	248,931	274,176	314,454	250,180	283,555	326,706	-0.5%	-3.3%	-3.8%
Operating Profit	202,607	220,040	251,622	173,573	196,668	225,855	16.7%	11.9%	11.4%
Adj. net profit	123,853	131,557	156,887	127,989	148,696	174,676	-3.2%	-11.5%	-10.2%
EPS (RMB)	12.92	13.69	16.28	13.35	15.47	18.13	-3.2%	-11.5%	-10.2%
Gross Margin	44.7%	44.4%	44.5%	44.3%	44.0%	44.3%	+0.4ppts	+0.4ppts	+0.2ppts
Operating Margin	36.4%	35.7%	35.6%	30.7%	30.5%	30.6%	+5.6ppts	+5.1ppts	+5.0ppts
Net Margin	22.2%	21.3%	22.2%	22.7%	23.1%	23.7%	-0.4ppts	-1.8ppts	-1.5ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue	377,289	482,064	556,972	617,149	706,584
VAS	199,991	264,212	288,348	310,020	345,065
Ads	68,377	82,271	88,452	97,527	108,705
E-commerce	-	-	-	-	-
Others	108,921	135,581	180,172	218,652	262,066
COGS	(209,756)	(260,532)	(308,041)	(342,974)	(392,129)
Gross profit	167,533	221,532	248,931	274,176	314,454
S&M	(21,396)	(33,758)	(38,988)	(38,880)	(45,928)
Admin.Exp.	(53,446)	(67,625)	(83,546)	(95,658)	(101,748)
Interest income	6,314	6,957	7,653	8,418	9,260
Others	19,689	57,131	68,557	71,985	75,584
Operating profit	118,694	184,237	202,607	220,040	251,622
Financial cost	(7,613)	(7,887)	(7,887)	(7,887)	(6,983)
Associates	(2,578)	-	-	-	-
Pre-tax Income	109,400	180,022	184,220	195,353	226,495
Income Tax	(13,512)	(19,897)	(27,633)	(29,303)	(33,974)
MI	(2,578)	-	-	-	-
Net profit	93,310	159,847	156,315	165,762	192,187
Adj. net profit	94,351	122,742	123,853	131,557	156,887

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net income	93,310	159,847	156,315	165,762	192,187
D&A	13,539	17,923	24,544	27,196	29,537
Change in WC	8,972	12,843	12,031	11,534	13,568
Income tax paid	(2,735)	166	4,718	1,018	2,849
Others	35,504	3,340	76,086	80,450	85,757
Operating CF	148,590	194,119	273,694	285,960	323,898
Capex	(32,369)	(33,960)	(39,237)	(42,389)	(47,319)
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)	(105,252)	(118,207)	(134,976)
Equity raised	0	0	0	0	0
Change of Debts	40,800	0	0	0	0
Others	(39,128)	13,647	(25,648)	(26,787)	(30,215)
Financing CF	1,672	13,647	(25,648)	(26,787)	(30,215)
Net change in cash	34,092	25,811	142,794	140,966	158,707
Cash (beg of yr)	97,814	132,991	152,798	295,592	436,558
FX	1,085	(6,004)	0	0	0
Cash (end of yr)	132,991	152,798	295,592	436,558	595,265

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	700,018	1,015,778	1,097,839	1,178,457	1,274,103
Fixed asset	77,215	93,802	118,995	144,688	172,971
Associates	221,894	305,258	305,258	305,258	305,258
Intangible assets	128,860	159,437	138,437	117,437	96,437
Others	272,049	457,281	535,150	611,074	699,437
Current assets	253,968	317,647	474,088	626,017	801,017
Cash	132,991	152,798	295,592	436,558	595,265
Deposit over 3 months	46,911	68,487	68,487	68,487	68,487
Account receivable	35,839	44,981	51,971	57,586	65,931
Others	38,227	51,381	58,038	63,386	71,334
Current liabilities	240,156	269,079	381,433	487,052	619,753
Borrowings	22,695	14,242	14,242	14,242	14,242
Account payable	80,690	94,030	111,177	123,784	141,526
Tax payable	10,978	14,283	19,001	20,019	22,868
Other	125,793	146,524	237,014	329,007	441,117
Non-current liabilities	225,006	286,303	292,784	294,230	287,960
Borrowings	104,257	112,145	112,145	112,145	112,145
Deferred taxation	12,841	16,061	22,306	23,654	27,424
Others	107,908	158,097	158,334	158,431	148,390
MI	56,118	74,059	85,450	97,394	111,121
Total net assets	488,824	778,043	897,710	1,023,192	1,167,407
Shareholders' equity	432,706	703,984	812,260	925,799	1,056,286

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
VAS	53.0	54.8	51.8	50.2	48.8
Ads	18.1	17.1	15.9	15.8	15.4
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.9	28.1	32.3	35.4	37.1
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	20.7	27.8	15.5	10.8	14.5
Gross profit	17.9	32.2	12.4	10.1	14.7
EBIT	21.6	55.2	10.0	8.6	14.4
Net profit	22.1	30.1	0.9	6.2	19.3
P&L ratios (%)					
Operating margin	31.5	38.2	36.4	35.7	35.6
Pre-tax margin	29.0	37.3	33.1	31.7	32.1
Adj. net margin	25.0	25.5	22.2	21.3	22.2
Effective tax rate	(12.4)	(11.1)	(15.0)	(15.0)	(15.0)
Returns (%)					
ROE	23.9	21.8	17.4	15.2	14.2
ROA	10.7	9.9	9.2	7.9	7.3
Per share					
EPS (RMB)	9.7	12.7	12.9	13.7	16.3
DPS (RMB)	1.4	2.5	2.6	2.9	3.6
BVPS (RMB)	45.2	73.3	84.2	96.5	109.9

Source: Company data, CMBIS estimates

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