

Tencent (700 HK)

Looking into 2H22E recovery

Tencent delivered soft 4Q21, as stated in our preview, with topline/bottom line +8%/-25% YoY (1%/15% below consensus, but 2%/0% above our estimate). We view this result as relatively forgivable, given widely-expected weak ads and margin dilution. 1Q22E would be another challenging quarter for Tencent, for lack of key new titles and weak ads (forecasting ads mid-teens decline). Stock price would react negatively in a near term, but downside risk is limited, given already-low mkt expectation and shares buybacks by Tencent. We expect 2H22E to see gradual ads recovery (positive growth) with easy base, and solid game product cycle and overseas expansion to drive LT momentum. We forecast ads/games rev +0%/7% YoY in FY22E, and slightly trimmed our earnings by 1-2% in FY22-23E to reflect conservative GPM, with new TP at **HK\$550**.

- 4Q21 missed on margin.** 4Q21 rev was RMB144.2bn, up 8% YoY, 1% below consensus but 2% above our estimate, in which games is better-than-feared, FBS & ads largely is in-line. Non-GAAP net profit declined 25% YoY to RMB24.9bn, 15% below consensus but in line with our estimate, mainly on soft GPM (on rev sharing with Video Accounts and higher content cost).
- International titles to drive game momentum.** Games +9% YoY in 4Q21 (vs. +8% YoY in 3Q21), in which domestic game +1% YoY (largely in line) and international games accelerated to +34% YoY (3% above our estimate). Deferred rev +3% YoY, -7% QoQ. Social network +4% YoY, largely in line. We expect potential game license resumption as further catalyst, and solid product cycle & overseas expansion as LT driver. For conservative estimate, we keep our game rev forecast unchanged (+7% YoY in FY22E).
- Ads headwinds to linger in 1Q22E.** Ads -13% YoY in 4Q21 (in line with our estimate, vs. +5% YoY in 3Q21), dragged by soft macro and tightening regulations to weigh on ads budget from multiple verticals (e.g. edu, games, insurance). By segment, social ads/ media ads -10%/-25% YoY (vs. +7%/-4% YoY in 3Q21). Given multiple headwinds to linger (e.g. PIPL, new ads rules draft, epidemic resurgence), we expect soft ads to continue in 1Q22E (forecasting mid-teens decline), while 2H22E would see positive growth with easy base and macro recovery. We forecast ads rev flat YoY in FY22E.
- Maintain BUY.** We cut our earnings by 1-2% in FY22-23E to reflect prudent GPM, with lower TP at **HK\$550** (28x FY23E P/E). Given already-low market expectation, we view 1Q22E as trough and expect 2H22E rebound.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	482,064	560,118	618,321	708,575	802,228
YoY growth (%)	27.8	16.2	10.4	14.6	13.2
Net income (RMB mn)	122,742	123,788	130,854	153,743	180,470
Adj. EPS (RMB)	12.7	12.8	13.6	16.0	18.7
YoY growth (%)	30.1	0.9	5.7	17.5	17.4
Consensus EPS (RMB)	NA	NA	15.0	18.0	22.1
P/E (x)	25.1	25.0	23.4	20.0	17.1
P/B (x)	4.4	3.5	3.2	2.8	2.5
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	21.8	17.4	14.2	13.6	14.2
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$550
(Previous TP)	HK\$590
Up/Downside	41.4%
Current Price	HK\$389

China Internet Sector

Sophie Huang
 (852) 3900 0889
 sophiehuang@cmbi.com.hk

Eason Xu
 (852) 3900 0849
 easonxu@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	3,687,258
Avg 3 mths t/o (HK\$ mn)	10875.25
52w High/Low (HK\$)	638.66/ 297.0
Total Issued Shares (mn)	9,612

Source: Bloomberg

Shareholding Structure

Naspers	28.81%
Ma Huateng	7.38%
Vanguard	2.12%

Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-18.9%	-7.9%
3-mth	-8.7%	-3.0%
6-mth	-13.6%	-2.7%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

- Factoring in ads & games headwinds – 20 Jan 2022
- Looking beyond 2H21 ads headwinds – 11 Nov 2021
- China Internet: Embracing a new normal of regulation – 8 Nov 2021
- Moving into 4Q21E games rebound – 29 Oct 2021

Figure 1: 4Q21 financial review

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	1.3%	7.9%	145,306	-1%	141,042	2%
Operating Profit	37,260	39,311	43,953	63,713	56,273	52,487	53,137	109,723	106.5%	72.2%	41,452	165%	40,710	170%
Net profit	28,896	33,107	38,542	59,302	47,767	42,587	39,510	94,958	140.3%	60.1%	31,488	202%	26,451	259%
Adj. net profit	27,079	30,153	32,303	33,207	33,118	34,039	31,751	24,880	-21.6%	-25.1%	29,179	-15%	24,945	0%
Adj. EPS	2.82	3.13	3.31	3.41	3.42	3.51	3.33	2.55	-23.5%	-25.4%	3.06	-17%	2.70	-6%
Margin (%)														
Gross Margin	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.1%	40.1%			42.7%		43.1%	
Operating Margin	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	37.3%	76.1%			28.5%		28.9%	
Adj. net margin	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.3%	17.3%			20.1%		17.7%	
Growth (%)														
Revenue (YoY)	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%	7.9%			8.7%		5.5%	
Revenue (QoQ)	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%	1.3%			2.1%		-0.9%	
Operating Profit	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	20.9%	72.2%			-34.9%		-36.1%	
Adj. net profit	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	-1.7%	-25.1%			-12.1%		-24.9%	

Source: Company data, Bloomberg, CMBIGM estimates

Figure 2: Revenue breakdown

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	QoQ	YoY
Total revenue	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	1%	8%
VAS	62,429	65,002	69,802	66,979	72,443	72,013	75,203	71,913	-4%	7%
- Online games	37,298	38,288	41,422	39,100	43,600	43,000	44,903	42,813	-5%	9%
- Social network	25,131	26,714	28,380	27,879	28,843	29,013	30,300	29,100	-4%	4%
Online advertising	17,713	18,552	21,351	24,655	21,820	22,833	22,495	21,518	-4%	-13%
Others	27,923	31,329	34,294	42,035	41,040	43,413	44,670	50,757	14%	21%

Source: Company data

Figure 3: CMBIGM estimates vs. consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	618,321	708,575	802,228	647,883	751,283	851,336	-4.6%	-5.7%	-5.8%
Gross Profit	259,355	299,267	342,661	285,722	330,759	375,550	-9.2%	-9.5%	-8.8%
Operating Profit	206,968	234,821	267,418	197,079	224,414	252,987	5.0%	4.6%	5.7%
Net profit	130,854	153,743	180,470	145,757	176,532	212,058	-10.2%	-12.9%	-14.9%
Adj. EPS (RMB)	13.61	15.95	18.68	14.96	17.96	22.11	-9.0%	-11.2%	-15.5%
Gross Margin	41.9%	42.2%	42.7%	44.1%	44.0%	44.1%	-2.2ppts	-1.8ppts	-1.4ppts
Operating Margin	33.5%	33.1%	33.3%	30.4%	29.9%	29.7%	+3.1ppts	+3.3ppts	+3.6ppts
Net Margin	21.2%	21.7%	22.5%	22.5%	23.5%	24.9%	-1.3ppts	-1.8ppts	-2.4ppts

Source: CMBIGM estimates, Bloomberg

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	618,321	708,575	802,228	617,149	706,584	NA	0.2%	0.3%	NA
Gross Profit	259,355	299,267	342,661	274,176	314,454	NA	-5.4%	-4.8%	NA
Operating Profit	206,968	234,821	267,418	220,040	251,622	NA	-5.9%	-6.7%	NA
Adj. net profit	130,854	153,743	180,470	131,557	156,887	NA	-0.5%	-2.0%	NA
EPS (RMB)	13.61	15.95	18.68	13.69	16.28	NA	-0.6%	-2.0%	NA
Gross Margin	41.9%	42.2%	42.7%	44.4%	44.5%	NA	-2.5ppts	-2.3ppts	NA
Operating Margin	33.5%	33.1%	33.3%	35.7%	35.6%	NA	-2.2ppts	-2.5ppts	NA
Net Margin	21.2%	21.7%	22.5%	21.3%	22.2%	NA	-0.1ppts	-0.5ppts	NA

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	482,064	560,118	618,321	708,575	802,228
VAS	264,212	291,572	311,386	346,595	382,893
Ads	82,271	88,666	88,688	99,714	110,990
E-commerce	-	-	-	-	-
Others	135,581	179,880	218,247	262,266	308,345
COGS	(260,532)	(314,174)	(358,965)	(409,308)	(459,567)
Gross profit	221,532	245,944	259,355	299,267	342,661
S&M	(33,758)	(40,594)	(38,954)	(46,057)	(50,841)
Admin.Exp.	(67,625)	(89,847)	(92,748)	(102,035)	(112,633)
Interest income	6,957	6,650	7,315	8,047	8,851
Others	57,131	149,467	72,000	75,600	79,380
Operating profit	184,237	271,620	206,968	234,821	267,418
Financial cost	(7,887)	(7,114)	(7,114)	(6,210)	(5,306)
Associates	-	-	-	-	-
Pre-tax Income	180,022	248,062	181,766	209,076	241,014
Income Tax	(19,897)	(20,252)	(27,265)	(31,361)	(36,152)
MI	-	-	-	-	-
Net profit	159,847	224,822	152,474	175,383	202,174
Adj. net profit	122,742	123,788	130,854	153,743	180,470

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	159,847	224,822	152,474	175,383	202,174
D&A	17,923	24,892	26,429	27,924	29,708
Change in WC	12,843	14,484	14,645	13,852	13,675
Income tax paid	166	216	4,277	2,498	2,922
Others	3,340	167,341	90,557	97,310	104,357
Operating CF	194,119	431,755	288,383	316,968	352,836
Capex	(33,960)	(33,392)	(35,940)	(40,157)	(44,328)
Associates	(48,036)	(52,839)	(63,407)	(76,089)	(91,306)
Others	(99,959)	(14,178)	(13,513)	(12,782)	(11,977)
Investing CF	(181,955)	(100,409)	(112,861)	(129,027)	(147,611)
Equity raised	0	0	0	0	0
Change of Debts	0	0	0	0	0
Others	13,647	(25,648)	(38,527)	(27,793)	(33,883)
Financing CF	13,647	(25,648)	(38,527)	(27,793)	(33,883)
Net change in cash	25,811	305,698	136,995	160,148	171,342
Cash (beg of yr)	132,991	152,798	458,496	595,492	755,639
FX	(6,004)	0	0	0	0
Cash (end of yr)	152,798	458,496	595,492	755,639	926,981

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	1,015,778	1,165,480	1,235,045	1,322,705	1,419,634
Fixed asset	93,802	105,677	126,036	149,117	174,584
Associates	305,258	305,258	305,258	305,258	305,258
Intangible assets	159,437	143,938	122,242	100,546	78,850
Others	457,281	610,607	681,509	767,784	860,943
Current assets	317,647	637,565	785,164	961,754	1,150,158
Cash	152,798	458,496	595,492	755,639	926,981
Deposit over 3 months	68,487	68,487	68,487	68,487	68,487
Account receivable	44,981	52,264	57,695	66,117	74,855
Others	51,381	58,318	63,490	71,511	79,834
Current liabilities	269,079	554,748	664,725	804,326	948,521
Borrowings	14,242	14,242	14,242	14,242	14,242
Account payable	94,030	113,390	129,556	147,726	165,865
Tax payable	14,283	14,499	18,776	21,274	24,196
Other	146,524	412,616	502,151	621,084	744,218
Non-current liabilities	286,303	286,761	292,584	285,850	279,638
Borrowings	112,145	112,145	112,145	112,145	112,145
Deferred taxation	16,061	16,348	22,008	25,315	29,182
Others	158,097	158,269	158,431	148,390	138,311
MI	74,059	91,525	101,173	113,679	127,705
Total net assets	778,043	961,536	1,062,899	1,194,282	1,341,633
Shareholders' equity	703,984	870,011	961,726	1,080,603	1,213,928

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
VAS	54.8	52.1	50.4	48.9	47.7
Ads	17.1	15.8	14.3	14.1	13.8
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.1	32.1	35.3	37.0	38.4
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	27.8	16.2	10.4	14.6	13.2
Gross profit	32.2	11.0	5.5	15.4	14.5
EBIT	55.2	47.4	-23.8	13.5	13.9
Net profit	30.1	0.9	5.7	17.5	17.4
P&L ratios (%)					
Operating margin	38.2	48.5	33.5	33.1	33.3
Pre-tax margin	37.3	44.3	29.4	29.5	30.0
Adj. net margin	25.5	22.1	21.2	21.7	22.5
Effective tax rate	(11.1)	(8.2)	(15.0)	(15.0)	(15.0)
Returns (%)					
ROE	21.8	17.4	14.2	13.6	14.2
ROA	9.9	9.2	6.9	6.5	6.7
Per share					
EPS (RMB)	12.7	12.8	13.6	16.0	18.7
DPS (RMB)	2.5	3.7	2.7	3.3	4.0
BVPS (RMB)	73.3	90.2	99.2	112.4	126.0

Source: Company data, CMBIGM estimates

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report.

Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM or its affiliate(s) have investment banking relationship with the issuers covered in this report in preceding 12 months.

CMBIGM Ratings

BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM.

Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US, Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.