

Tencent (700 HK)

Challenges yet over, but LT fundamentals intact

1Q22E would be another challenging quarter, with topline/bottom line +3%/-20% YoY (-2%/+1% vs. consensus). We expect game to slow down (+4% YoY) for lack of key new titles, while ads headwinds continue (-19% YoY in 1Q22E). Given COVID-19 resurgence from Mar, we expect ads recovery to delay and 4Q22E might see positive ads growth if the epidemic does not worsen (suggesting -8% YoY in FY22E). Stock price would bear pressure in near term, but downside risk is limited, given already-low mkt expectation. We slightly trimmed our earnings by 3-8% in FY22-24E to reflect ads pressure and conservative margin, with new TP at **HK\$510**. After financial resetting, we suggest to look into its new game titles (with license resumption), ads recovery and long-term upside from video accounts.

- Factoring in challenging 1Q22E.** We forecast 1Q22E rev +3% YoY, 2% below consensus, in which VAS/ ads/ others +3%/-19%/+15% YoY. Non-GAAP net profit would decline 20% YoY, in our estimate, mainly on soft GPM to continue (on rev sharing with Video Accounts and higher content cost).
- Waiting for new game titles after license resumption.** We expect games +4% YoY in 1Q22 (vs. +9% YoY in 4Q21), with moderate international games and domestic game softness to linger in 1H22E. License resumption supports further game pipeline, but it would take time to see grossing contribution from new key titles (e.g. *Undawn*, *DnF Mobile*). Based on conservative estimates, we keep our game rev forecast unchanged (+7% YoY in FY22E).
- Ads recovery to delay for epidemic resurgence.** We forecast ads -19% YoY in 1Q22E (vs. -13% YoY in 4Q21), 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 -17%/-30% YoY, in our estimates. Given shrinking ads budget for lockdowns from Mar (e.g. ecommerce, auto), we expect ads pressure to continue in 2Q22E, while 4Q22E might see positive growth if the epidemic does not worsen. We forecast ads rev -8% YoY in FY22E (vs. prior 0% YoY).
- Maintain BUY.** We cut our earnings by 3-8% in FY22-23E to reflect prudent ads and margin, with lower TP at **HK\$510** (28x FY23E P/E). We suggest to look into 2H22E recovery, with key game titles to release and ads rebound.

Earnings Summary

| (YE 31 Dec) | FY20A | FY21A | FY22E | FY23E | FY24E |
|---------------------|----------|----------|----------|----------|----------|
| Revenue (RMB mn) | 482,064 | 560,118 | 601,759 | 690,892 | 783,400 |
| YoY growth (%) | 27.8 | 16.2 | 7.4 | 14.8 | 13.4 |
| Net income (RMB mn) | 122,742 | 123,788 | 120,207 | 146,930 | 174,550 |
| Adj. EPS (RMB) | 12.7 | 12.8 | 12.4 | 15.0 | 17.6 |
| YoY growth (%) | 30.1 | 0.9 | (2.9) | 22.2 | 18.8 |
| Consensus EPS (RMB) | NA | NA | 13.4 | 16.2 | 19.6 |
| P/E (x) | 24.3 | 24.2 | 25.0 | 20.7 | 17.6 |
| P/S (x) | 6.2 | 5.3 | 4.9 | 4.3 | 3.8 |
| Yield (%) | 0.4 | 0.5 | 0.4 | 0.5 | 0.6 |
| ROE (%) | 21.8 | 17.4 | 15.4 | 12.6 | 13.1 |
| Net gearing (%) | Net cash | Net cash | Net cash | Net cash | Net cash |

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

| | |
|---------------|---------|
| Target Price | HK\$510 |
| (Previous TP) | HK\$550 |
| Up/Downside | 35.3% |
| Current Price | HK\$377 |

China Internet Sector

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Stock Data

| | |
|--------------------------|--------------|
| Mkt Cap (HK\$ mn) | 3,585,271 |
| Avg 3 mths t/o (HK\$ mn) | 11,083.58 |
| 52w High/Low (HK\$) | 621.2/ 297.0 |
| Total Issued Shares (mn) | 9,612 |

Source: Bloomberg

Shareholding Structure

| | |
|------------|--------|
| Naspers | 28.81% |
| Ma Huateng | 7.39% |
| Vanguard | 2.10% |

Source: Bloomberg

Share Performance

| | Absolute | Relative |
|-------|----------|----------|
| 1-mth | -7.3% | -0.8% |
| 3-mth | -26.1% | -14.2% |
| 6-mth | -28.3% | -9.6% |

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

- Looking into 2H21 recovery – 24 Mar 2022
- Factoring in ads & games headwinds – 20 Jan 2022
- Looking beyond 2H21 ads headwinds – 11 Nov 2021

Figure 1: 1Q22E financial preview

| RMB mn | 1Q20 | 2Q20 | 3Q20 | 4Q20 | 1Q21 | 2Q21 | 3Q21 | 4Q21 | 1Q22E | QoQ | YoY | Consensus | Diff % |
|-------------------|---------|---------|---------|---------|---------|---------|---------|---------|---------|--------|--------|-----------|--------|
| Revenue | 108,065 | 114,883 | 125,447 | 133,669 | 135,303 | 138,259 | 142,368 | 144,188 | 139,269 | -3.4% | 2.9% | 141,713 | -2% |
| Operating Profit | 37,260 | 39,311 | 43,953 | 63,713 | 56,273 | 52,487 | 53,137 | 109,723 | 36,622 | -66.6% | -34.9% | 39,575 | -7% |
| Net profit | 28,896 | 33,107 | 38,542 | 59,302 | 47,767 | 42,587 | 39,510 | 94,958 | 28,053 | -70.5% | -41.3% | 29,153 | -4% |
| Adj. net profit | 27,079 | 30,153 | 32,303 | 33,207 | 33,118 | 34,039 | 31,751 | 24,880 | 26,391 | 6.1% | -20.3% | 26,088 | 1% |
| Adj. EPS | 2.82 | 3.13 | 3.31 | 3.41 | 3.42 | 3.51 | 3.33 | 2.55 | 2.72 | 6.8% | -20.4% | 2.69 | 1% |
| Margin (%) | | | | | | | | | | | | | |
| Gross Margin | 48.9% | 46.3% | 45.2% | 44.0% | 46.3% | 45.4% | 44.1% | 40.1% | 41.8% | | | 42.2% | |
| Operating Margin | 34.5% | 34.2% | 35.0% | 47.7% | 41.6% | 38.0% | 37.3% | 76.1% | 26.3% | | | 27.9% | |
| Adj. net margin | 25.1% | 26.2% | 25.8% | 24.8% | 24.5% | 24.6% | 22.3% | 17.3% | 18.9% | | | 18.4% | |
| Growth (%) | | | | | | | | | | | | | |
| Revenue (YoY) | 26.4% | 29.3% | 29.0% | 26.4% | 25.2% | 20.3% | 13.5% | 7.9% | 2.9% | | | 4.7% | |
| Revenue (QoQ) | 2.2% | 6.3% | 9.2% | 6.6% | 1.2% | 2.2% | 3.0% | 1.3% | -3.4% | | | -1.7% | |
| Operating Profit | 1.4% | 42.8% | 51.0% | 122.7% | 51.0% | 33.5% | 20.9% | 72.2% | -34.9% | | | -29.7% | |
| Adj. net profit | 29.4% | 28.2% | 32.3% | 30.3% | 22.3% | 12.9% | -1.7% | -25.1% | -20.3% | | | -21.2% | |

Source: Company data, Bloomberg, CMBIGM estimates

Figure 2: Revenue breakdown

| RMB mn | 1Q20 | 2Q20 | 3Q20 | 4Q20 | 1Q21 | 2Q21 | 3Q21 | 4Q21 | 1Q22E | QoQ | YoY |
|----------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|------------|-----------|
| Total revenue | 108,065 | 114,883 | 125,447 | 133,669 | 135,303 | 138,259 | 142,368 | 144,188 | 139,269 | -3% | 3% |
| VAS | 62,429 | 65,002 | 69,802 | 66,979 | 72,443 | 72,013 | 75,203 | 71,913 | 74,262 | 3% | 3% |
| - Online games | 37,298 | 38,288 | 41,422 | 39,100 | 43,600 | 43,000 | 44,903 | 42,813 | 45,136 | 5% | 4% |
| - Social network | 25,131 | 26,714 | 28,380 | 27,879 | 28,843 | 29,013 | 30,300 | 29,100 | 29,126 | 0% | 1% |
| Online advertising | 17,713 | 18,552 | 21,351 | 24,655 | 21,820 | 22,833 | 22,495 | 21,518 | 17,738 | -18% | -19% |
| Others | 27,923 | 31,329 | 34,294 | 42,035 | 41,040 | 43,413 | 44,670 | 50,757 | 47,270 | -7% | 15% |

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 | 601,759 | 690,892 | 783,400 | 618,331 | 711,054 | 810,540 | -2.7% | -2.8% | -3.3% |
| Gross Profit | 257,124 | 299,460 | 342,826 | 261,298 | 307,142 | 354,977 | -1.6% | -2.5% | -3.4% |
| Operating Profit | 160,014 | 182,485 | 209,435 | 182,630 | 209,160 | 242,531 | -12.4% | -12.8% | -13.6% |
| Net profit | 120,207 | 146,930 | 174,550 | 127,500 | 157,313 | 186,303 | -5.7% | -6.6% | -6.3% |
| Adj. EPS (RMB) | 12.37 | 14.97 | 17.60 | 13.37 | 16.24 | 19.56 | -7.5% | -7.9% | -10.0% |
| Gross Margin | 42.7% | 43.3% | 43.8% | 42.3% | 43.2% | 43.8% | +0.5ppts | +0.1ppts | -0.0ppts |
| Operating Margin | 26.6% | 26.4% | 26.7% | 29.5% | 29.4% | 29.9% | -2.9ppts | -3.0ppts | -3.2ppts |
| Net Margin | 20.0% | 21.3% | 22.3% | 20.6% | 22.1% | 23.0% | -0.6ppts | -0.9ppts | -0.7ppts |

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 | 601,759 | 690,892 | 783,400 | 618,321 | 708,575 | 802,228 | -2.7% | -2.5% | -2.3% |
| Gross Profit | 257,124 | 299,460 | 342,826 | 259,355 | 299,267 | 342,661 | -0.9% | 0.1% | 0.0% |
| Operating Profit | 160,014 | 182,485 | 209,435 | 206,968 | 234,821 | 267,418 | -22.7% | -22.3% | -21.7% |
| Adj. net profit | 120,207 | 146,930 | 174,550 | 130,854 | 153,743 | 180,470 | -8.1% | -4.4% | -3.3% |
| EPS (RMB) | 12.37 | 14.97 | 17.60 | 13.61 | 15.95 | 18.68 | -9.1% | -6.2% | -5.8% |
| Gross Margin | 42.7% | 43.3% | 43.8% | 41.9% | 42.2% | 42.7% | +0.8ppts | +1.1ppts | +1.0ppts |
| Operating Margin | 26.6% | 26.4% | 26.7% | 33.5% | 33.1% | 33.3% | -6.9ppts | -6.7ppts | -6.6ppts |
| Net Margin | 20.0% | 21.3% | 22.3% | 21.2% | 21.7% | 22.5% | -1.2ppts | -0.4ppts | -0.2ppts |

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

| YE 31 Dec (RMB mn) | FY20A | FY21A | FY22E | FY23E | FY24E |
|-------------------------|------------------|------------------|------------------|------------------|------------------|
| Revenue | 482,064 | 560,118 | 601,759 | 690,892 | 783,400 |
| VAS | 264,212 | 291,572 | 309,299 | 338,990 | 366,555 |
| Ads | 82,271 | 88,666 | 81,740 | 94,998 | 109,533 |
| E-commerce | - | - | - | - | - |
| Others | 135,581 | 179,880 | 210,720 | 256,905 | 307,312 |
| COGS | (260,532) | (314,174) | (344,635) | (391,432) | (440,574) |
| Gross profit | 221,532 | 245,944 | 257,124 | 299,460 | 342,826 |
| S&M | (33,758) | (40,594) | (36,106) | (49,744) | (56,405) |
| Admin.Exp. | (67,625) | (89,847) | (103,438) | (114,501) | (126,375) |
| Interest income | 6,957 | 6,650 | 6,846 | 7,647 | 9,728 |
| Others | 57,131 | 149,467 | 35,588 | 39,623 | 39,660 |
| Operating profit | 184,237 | 271,620 | 160,014 | 182,485 | 209,435 |
| Financial cost | (7,887) | (7,114) | (7,732) | (7,624) | (7,624) |
| Associates | - | - | (2,671) | 3,354 | 7,235 |
| Pre-tax Income | 180,022 | 248,062 | 149,611 | 178,216 | 209,045 |
| Income Tax | (19,897) | (20,252) | (22,842) | (26,229) | (30,272) |
| MI | - | - | (2,880) | (3,168) | (3,485) |
| Net profit | 159,847 | 224,822 | 123,889 | 148,818 | 175,288 |
| Adj. net profit | 122,742 | 123,788 | 120,207 | 146,930 | 174,550 |

Cash flow summary

| YE 31 Dec (RMB mn) | FY20A | FY21A | FY22E | FY23E | FY24E |
|---------------------------|------------------|------------------|------------------|------------------|------------------|
| Net income | 159,847 | 224,822 | 126,769 | 151,986 | 178,773 |
| D&A | 17,923 | 24,892 | 70,259 | 91,870 | 116,219 |
| Change in WC | 12,843 | 14,484 | 3,950 | 9,844 | 7,454 |
| Income tax paid | 166 | 216 | (22,842) | (26,229) | (30,272) |
| Others | 3,340 | 167,341 | 42,181 | 39,876 | 41,355 |
| Operating CF | 194,119 | 431,755 | 220,317 | 267,348 | 313,530 |
| Capex | (33,960) | (33,392) | (98,781) | (113,043) | (127,844) |
| Associates | (48,036) | (52,839) | (31,810) | (51,288) | (51,288) |
| Others | (99,959) | (14,178) | (26,903) | (6,140) | (6,828) |
| Investing CF | (181,955) | (100,409) | (157,494) | (170,471) | (185,960) |
| Equity raised | 0 | 0 | 0 | 0 | 0 |
| Change of Debts | 0 | 0 | (12,000) | 0 | 0 |
| Others | 13,647 | (25,648) | (16,850) | (12,925) | (15,768) |
| Financing CF | 13,647 | (25,648) | (28,850) | (12,925) | (15,768) |
| Net change in cash | 25,811 | 305,698 | 33,973 | 83,951 | 111,802 |
| Cash (beg of yr) | 132,991 | 152,798 | 167,966 | 201,939 | 285,891 |
| FX | (6,004) | 0 | 0 | 0 | 0 |
| Cash (end of yr) | 152,798 | 458,496 | 201,939 | 285,891 | 397,693 |

Balance sheet

| YE 31 Dec (RMB mn) | FY20A | FY21A | FY22E | FY23E | FY24E |
|--------------------------------|------------------|------------------|------------------|------------------|------------------|
| Non-current assets | 1,015,778 | 1,165,480 | 1,242,455 | 1,333,986 | 1,420,635 |
| Fixed asset | 93,802 | 105,677 | 79,835 | 87,329 | 92,773 |
| Associates | 305,258 | 305,258 | 345,713 | 400,355 | 458,878 |
| Intangible assets | 159,437 | 143,938 | 199,191 | 210,369 | 214,051 |
| Others | 457,281 | 610,607 | 617,717 | 635,933 | 654,934 |
| Current assets | 317,647 | 637,565 | 423,667 | 525,350 | 655,532 |
| Cash | 152,798 | 458,496 | 201,939 | 285,891 | 397,693 |
| Deposit over 3 months | 68,487 | 68,487 | 83,813 | 83,813 | 83,813 |
| Account receivable | 44,981 | 52,264 | 52,687 | 59,776 | 67,003 |
| Others | 51,381 | 58,318 | 85,228 | 95,870 | 107,023 |
| Current liabilities | 269,079 | 554,748 | 309,485 | 340,147 | 369,296 |
| Borrowings | 14,242 | 14,242 | 14,242 | 14,242 | 14,242 |
| Account payable | 94,030 | 113,390 | 176,745 | 196,015 | 214,424 |
| Tax payable | 14,283 | 14,499 | 93,075 | 102,832 | 111,814 |
| Other | 146,524 | 412,616 | 25,424 | 27,058 | 28,816 |
| Non-current liabilities | 286,303 | 286,761 | 329,040 | 329,040 | 329,040 |
| Borrowings | 112,145 | 112,145 | 136,936 | 136,936 | 136,936 |
| Deferred taxation | 16,061 | 16,348 | 13,142 | 13,142 | 13,142 |
| Others | 158,097 | 158,269 | 178,962 | 178,962 | 178,962 |
| MI | 74,059 | 91,525 | 70,394 | 70,394 | 70,394 |
| Total net assets | 778,043 | 961,536 | 1,027,597 | 1,190,148 | 1,377,831 |
| Shareholders' equity | 703,984 | 870,011 | 957,203 | 1,119,754 | 1,307,437 |

Key ratios

| YE 31 Dec | FY20A | FY21A | FY22E | FY23E | FY24E |
|---------------------------|--------------|--------------|--------------|--------------|--------------|
| Sales mix (%) | | | | | |
| VAS | 54.8 | 52.1 | 51.4 | 49.1 | 46.8 |
| Ads | 17.1 | 15.8 | 13.6 | 13.8 | 14.0 |
| E-commerce | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Others | 28.1 | 32.1 | 35.0 | 37.2 | 39.2 |
| Total | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |
| Growth rate (%) | | | | | |
| Revenue | 27.8 | 16.2 | 7.4 | 14.8 | 13.4 |
| Gross profit | 32.2 | 11.0 | 4.5 | 16.5 | 14.5 |
| EBIT | 55.2 | 47.4 | -41.1 | 14.0 | 14.8 |
| Net profit | 30.1 | 0.9 | -2.9 | 22.2 | 18.8 |
| P&L ratios (%) | | | | | |
| Operating margin | 38.2 | 48.5 | 26.6 | 26.4 | 26.7 |
| Pre-tax margin | 37.3 | 44.3 | 24.9 | 25.8 | 26.7 |
| Adj. net margin | 25.5 | 22.1 | 20.0 | 21.3 | 22.3 |
| Effective tax rate | (11.1) | (8.2) | (15.3) | (14.7) | (14.5) |
| Returns (%) | | | | | |
| ROE | 21.8 | 17.4 | 15.4 | 12.6 | 13.1 |
| ROA | 9.9 | 9.2 | 7.7 | 7.2 | 7.9 |
| Per share | | | | | |
| EPS (RMB) | 12.7 | 12.8 | 12.4 | 15.0 | 17.6 |
| DPS (RMB) | 2.5 | 3.7 | 1.4 | 1.6 | 1.9 |
| BVPS (RMB) | 73.3 | 90.2 | 98.5 | 114.1 | 131.9 |

Source: Company data, CMBIGM estimates

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