

Tencent (700 HK)

Recovery to delay with epidemic and transitions

Tencent delivered soft 1Q22 results, with topline/bottom line +0.1%/-23% YoY (4%/3% below consensus/ our estimate). By segment, VAS/ ads/ others +0%/-18%/+9% YoY (vs. our estimates of +3%/-19%/+15% YoY). Game decelerated to +0% YoY, mainly on muted international games. We expect 2Q22E games to moderately accelerate, and 2H22E to see new games contribution. Ads (-18% YoY) was in line with our estimates, but headwinds should continue in 2Q22E (expecting rev QoQ decline and GPM still under pressure), given shrinking ads budget for lockdowns from Mar. Meanwhile, FBS & others would further slow down in 2Q22E for epidemic impact and cloud focus shift to quality growth. We trimmed our earnings by 11-15% in FY22-24E to reflect epidemic impact, with new TP at **HK\$480**. Stock price might see short term pressure, but we suggest to look into its new game titles, ads recovery and long-term upside from video accounts.

- 1Q22 missed.** 1Q22 rev was RMB135.5bn, up 0.1% YoY, 4%/3% below consensus/ our estimate, mainly on moderate international games and softer FBS. By segment, VAS/ ads/ others +0%/-18%/+9% YoY (vs. our estimates of +3%/-19%/+15% YoY). Non-GAAP net profit declined 23% YoY, 3% below consensus/ our estimate, while margin was largely in line.
- Looking into games moderate rebound in 2H22E.** Games +0% YoY in 1Q22 (3% below our estimate, vs. +9% YoY in 4Q21), in which domestic game -1% YoY (largely in line) and international games decelerated to +4% YoY (for PUBG grossing decline and overseas traffic normalization). Deferred rev -4% YoY, +10% QoQ. We expect grossing to recover from Apr, and 2Q22E & 2H22E would see moderate acceleration with new games contribution. Next batch of game license could be as further catalyst.
- Lockdowns disruption to dampen ads & others recovery.** Ads -18% YoY in 1Q22 (in line), dragged by soft macro and tightening regulations to weigh on ads budget from multiple verticals (e.g. edu, games). By segment, social ads/ media ads -15%/-30% YoY. Given shrinking ads budget for lockdowns from Mar (e.g. FMCG, ecommerce, travel), we expect softer ads to continue in 2Q22E (expecting sequential decline), while 4Q22E would see gradual recovery with lockdown relaxation and macro recovery. We forecast ads rev -12% YoY in FY22E (vs. prior -8%).
- Maintain BUY.** We cut our earnings by 11-15% in FY22-24E to reflect prudent ads and FBS, with lower TP at **HK\$480** (31x FY23E P/E).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	482,064	560,118	573,431	654,665	738,871
YoY growth (%)	27.8	16.2	2.4	14.2	12.9
Net income (RMB mn)	122,742	123,788	106,882	127,571	148,197
Adj. EPS (RMB)	12.7	12.8	10.9	12.9	14.9
YoY growth (%)	30.1	0.9	(13.7)	19.4	16.2
Consensus EPS (RMB)	NA	NA	13.5	16.3	19.5
P/E (x)	24.7	24.6	28.8	24.3	21.2
P/S (x)	6.3	5.4	5.3	4.6	4.1
Yield (%)	0.4	0.4	0.4	0.4	0.5
ROE (%)	21.8	17.4	15.4	11.6	12.0
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$480**
 (Previous TP **HK\$510**)
 Up/Downside **31.1%**
 Current Price **HK\$366**

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)	3,364,195
Avg 3 mths t/o (HK\$ mn)	11,175.13
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%

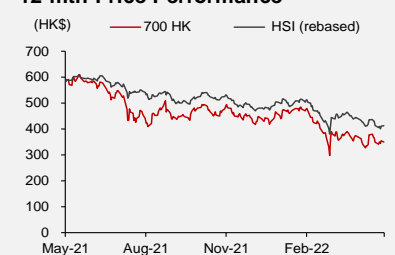
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-5.3%	2.4%
3-mth	-24.6%	-7.7%
6-mth	-25.8%	-5.3%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

Related Reports

- Challenges yet over, but LT fundamentals intact – 3 May 2022
- Looking into 2H21 recovery – 24 Mar 2022
- Factoring in ads & games headwinds – 20 Jan 2022

Figure 1: 1Q22 financial review

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	135,471	-6.0%	0.1%	141,058	-4%	139,269	-3%
Operating Profit	37,260	39,311	43,953	63,713	56,273	52,487	53,137	109,723	37,217	-66.1%	-33.9%	39,601	-6%	36,622	2%
Net profit	28,896	33,107	38,542	59,302	47,767	42,587	39,510	94,958	23,413	-75.3%	-51.0%	29,311	-20%	28,053	-17%
Adj. net profit	27,079	30,153	32,303	33,207	33,118	34,039	31,751	24,880	25,545	2.7%	-22.9%	26,439	-3%	26,391	-3%
Adj. EPS	2.82	3.13	3.31	3.41	3.42	3.51	3.33	2.55	2.62	2.9%	-23.3%	2.77	-5%	2.72	-4%
Margin (%)															
Gross Margin	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.1%	40.1%	42.1%			41.7%		41.8%	
Operating Margin	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	37.3%	76.1%	27.5%			28.1%		26.3%	
Adj. net margin	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.3%	17.3%	18.9%			18.7%		18.9%	
Growth (%)															
Revenue (YoY)	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%	7.9%	0.1%			4.3%		2.9%	
Revenue (QoQ)	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%	1.3%	-6.0%			-2.2%		-3.4%	
Operating Profit	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	20.9%	72.2%	-33.9%			-29.6%		-34.9%	
Adj. net profit	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	-1.7%	-25.1%	-22.9%			-20.2%		-20.3%	

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	135,471	-6%	0%
VAS	62,429	65,002	69,802	66,979	72,443	72,013	75,203	71,913	72,738	1%	0%
- Online games	37,298	38,288	41,422	39,100	43,600	43,000	44,903	42,813	43,608	2%	0%
- Social network	25,131	26,714	28,380	27,879	28,843	29,013	30,300	29,100	29,130	0%	1%
Online advertising	17,713	18,552	21,351	24,655	21,820	22,833	22,495	21,518	17,988	-16%	-18%
Others	27,923	31,329	34,294	42,035	41,040	43,413	44,670	50,757	44,745	-12%	9%

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	573,431	654,665	738,871	617,194	709,933	808,375	-7.1%	-7.8%	-8.6%
Gross profit	245,389	283,645	323,003	260,630	306,225	353,411	-5.8%	-7.4%	-8.6%
Operating profit	135,224	160,447	181,591	178,067	204,300	234,603	-24.1%	-21.5%	-22.6%
Net profit	106,882	127,571	148,197	127,721	157,133	184,777	-16.3%	-18.8%	-19.8%
Adj. EPS (RMB)	10.95	12.94	14.88	13.48	16.29	19.47	-18.8%	-20.6%	-23.6%
Gross margin	42.8%	43.3%	43.7%	42.2%	43.1%	43.7%	+0.6pppts	+0.2pppts	-0.0pppts
Operating margin	23.6%	24.5%	24.6%	28.9%	28.8%	29.0%	-5.3pppts	-4.3pppts	-4.4pppts
Net margin	18.6%	19.5%	20.1%	20.7%	22.1%	22.9%	-2.1pppts	-2.6pppts	-2.8pppts

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	573,431	654,665	738,871	601,759	690,892	783,400	-4.7%	-5.2%	-5.7%
Gross profit	245,389	283,645	323,003	257,124	299,460	342,826	-4.6%	-5.3%	-5.8%
Operating profit	135,224	160,447	181,591	160,014	182,485	209,435	-15.5%	-12.1%	-13.3%
Adj. net profit	106,882	127,571	148,197	120,207	146,930	174,550	-11.1%	-13.2%	-15.1%
EPS (RMB)	10.95	12.94	14.88	12.37	14.97	17.60	-11.5%	-13.6%	-15.5%
Gross margin	42.8%	43.3%	43.7%	42.7%	43.3%	43.8%	+0.1pppts	-0.0pppts	-0.0pppts
Operating margin	23.6%	24.5%	24.6%	26.6%	26.4%	26.7%	-3.0pppts	-1.9pppts	-2.2pppts
Net margin	18.6%	19.5%	20.1%	20.0%	21.3%	22.3%	-1.3pppts	-1.8pppts	-2.2pppts

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	482,064	560,118	573,431	654,665	738,871
VAS	264,212	291,572	299,222	324,872	348,358
Ads	82,271	88,666	77,624	90,235	104,062
E-commerce	-	-	-	-	-
Others	135,581	179,880	196,585	239,558	286,451
COGS	(260,532)	(314,174)	(328,042)	(371,021)	(415,868)
Gross profit	221,532	245,944	245,389	283,645	323,003
S&M	(33,758)	(40,594)	(34,406)	(47,791)	(55,415)
Admin.Exp.	(67,625)	(89,847)	(106,302)	(118,789)	(131,496)
Interest income	6,957	6,650	6,846	7,647	9,728
Others	57,131	149,467	23,697	35,735	35,772
Operating profit	184,237	271,620	135,224	160,447	181,591
Financial cost	(7,887)	(7,114)	(7,732)	(7,624)	(7,624)
Associates	3,672	(16,444)	(14,671)	(2,646)	(765)
Pre-tax income	180,022	248,062	112,821	150,177	173,202
Income Tax	(19,897)	(20,252)	(19,124)	(22,923)	(26,095)
MI	(278)	(2,988)	(1,868)	(2,055)	(2,609)
Net profit	159,847	224,822	91,829	125,199	144,846
Adj. net profit	122,742	123,788	106,882	127,571	148,197

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	160,125	227,810	93,697	127,254	147,107
D&A	50,774	55,895	69,885	90,642	113,695
Change in WC	27,423	(15,391)	(3,431)	7,975	5,749
Income tax paid	(20,322)	(20,252)	(19,124)	(22,923)	(26,095)
Others	(23,881)	(72,876)	47,510	41,672	43,433
Operating CF	194,119	175,186	188,537	244,620	283,888
Capex	(66,599)	(96,943)	(94,249)	(107,246)	(120,719)
Associates	(30,533)	(48,050)	(31,810)	(51,288)	(51,288)
Others	(84,823)	(33,556)	(26,903)	(6,140)	(6,828)
Investing CF	(181,955)	(178,549)	(152,962)	(164,674)	(178,836)
Equity raised	1,716	0	0	0	0
Change of Debts	5,090	12,000	(12,000)	0	0
Others	6,841	9,620	(16,850)	(11,682)	(13,916)
Financing CF	13,647	21,620	(28,850)	(11,682)	(13,916)
Net change in cash	25,811	18,257	6,725	68,264	91,137
Cash (beg of yr)	132,991	152,798	167,966	174,691	242,955
FX	(6,004)	(3,089)	0	0	0
Cash (end of yr)	152,798	167,966	174,691	242,955	334,092

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	1,015,778	1,127,552	1,226,297	1,307,260	1,381,309
Fixed asset	59,843	61,914	78,282	84,081	87,748
Associates	297,609	316,574	333,713	382,355	432,878
Intangible assets	159,437	171,376	196,587	204,891	205,749
Others	498,889	577,688	617,717	635,933	654,934
Current assets	317,647	484,812	391,257	475,657	583,491
Cash	152,798	167,966	174,691	242,955	334,092
Deposit over 3 months	68,487	83,813	83,813	83,813	83,813
Account receivable	44,981	49,331	50,775	57,176	63,672
Others	51,381	183,702	81,977	91,713	101,914
Current liabilities	269,079	403,098	294,831	322,363	347,782
Borrowings	14,242	19,003	14,242	14,242	14,242
Account payable	148,338	170,052	168,433	185,743	202,244
Tax payable	82,827	87,846	88,871	97,210	104,729
Other	23,672	126,197	23,286	25,169	26,567
Non-current liabilities	286,303	332,573	329,040	329,040	329,040
Borrowings	112,145	136,936	136,936	136,936	136,936
Deferred taxation	16,061	13,142	13,142	13,142	13,142
Others	158,097	182,495	178,962	178,962	178,962
MI	74,059	70,394	70,394	70,394	70,394
Total net assets	778,043	876,693	993,683	1,131,513	1,287,978
Shareholders' equity	703,984	806,299	923,289	1,061,119	1,217,584

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
VAS	54.8	52.1	52.2	49.6	47.1
Ads	17.1	15.8	13.5	13.8	14.1
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.1	32.1	34.3	36.6	38.8
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	27.8	16.2	2.4	14.2	12.9
Gross profit	32.2	11.0	-0.2	15.6	13.9
EBIT	55.2	47.4	-50.2	18.7	13.2
Net profit	30.1	0.9	-13.7	19.4	16.2
P&L ratios (%)					
Operating margin	38.2	48.5	23.6	24.5	24.6
Pre-tax margin	37.3	44.3	19.7	22.9	23.4
Adj. net margin	25.5	22.1	18.6	19.5	20.1
Effective tax rate	(11.1)	(8.2)	(17.0)	(15.3)	(15.1)
Returns (%)					
ROE	21.8	17.4	15.4	11.6	12.0
ROA	9.9	9.2	7.7	6.6	7.2
Per share					
EPS (RMB)	12.7	12.8	10.9	12.9	14.9
DPS (RMB)	1.3	1.4	1.2	1.4	1.6
BVPS (RMB)	73.1	83.2	94.6	107.6	122.2

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.