

24 July 2014

Tencent Holdings (700.HK)

Hopefully performance of mobile game will exceed the expectation

Rating: **Accumulate**

HONG KONG | INTERNET | COMPANY RESULTS

In the first quarter of 2014, the gross income of Tencent Holdings reached RMB 18.4 billion, increasing by 36% on year-on-year basis and 8% on quarter-on-quarter basis respectively; the net profit reached RMB 6.46 billion, increasing by 60% on year-on-year basis and 65% on quarter-on-quarter basis respectively; and the net profit of Non-GAAP reached RMB 5.2 billion, increasing by 29% on year-on-year basis and 17% on quarter-on-quarter basis respectively. The net amount of other earnings of the company greatly increased by 1.2 billion to 1.6 billion in the first quarter, mainly coming from the profits of RMB 1.942 billion and RMB 743 million made in disposing the e-commerce business and selling the stock rights of China Vision Media Group Limited respectively, which is also the main reason of the net profit growth exceeding expectation;

Tencent Holdings will publish its interim performance and the second quarter performance of 2014 in the middle of August, and we expect that the performance of mobile game will exceed expectation. The income of mobile game of the company in the first quarter rose by 200% to RMB 1.8 billion sharply compared with the last quarter. We expect that the growth momentum of mobile QQ and WeChat game will continue in the second quarter, which is expected to remain the growth on quarter-on-quarter basis of over 70%, exceeding RMB 3 billion. The income of mobile game of the company will reach RMB 12 billion in 2014;

In recent months, Tencent Holdings has purchased the stock rights of several Internet and technology companies, mainly including 214 million USD used for purchasing 15% of Jingdong shares before going public, 736 million USD used for purchasing 19.9% of 58.com shares and RMB 1.17 billion used for purchasing 11.3% of NavInfo shares.

Key Financial Summary

FYE	12A	13A	14E	15E
Revenue (RMB mn)	43,893	60,437	79,862	101,265
Net Profit, adj. (RMB mn)	12,732	15,502	23,300	31,315
EPS, adj. (RMB)	6.97	8.46	2.50	3.36
P/E (X), adj.	28.58	45.60	43.52	32.38
BVPS (RMB)	22.28	31.12	8.10	9.50
P/B (X)	8.94	12.40	13.44	11.45
DPS (RMB)	0.80	0.94	0.22	0.26
Div. Yield (%)	0.40%	0.24%	0.20%	0.24%

Source: Bloomberg, Tencent

*All multiples & yields based on historical price and current market price

Target Price (HKD)	136.00
Forecast Dividend (HKD)	0.28
Closing Price (HKD)	124.30
Potential Upside	9.64%

Company Description

Founded in November, 1998, Tencent has grown into one of China's largest and most used Internet service portal. Since its establishment over the last decade, Tencent has maintained steady growth under its user-oriented operating strategies. On June 16, 2004, Tencent Holdings Limited (SEHK 700) went public on the main board of the Hong Kong Stock Exchange.

Company Data

Raw Beta (Past 2yrs weekly data)	1.07
Market Cap. (HKD Mn)	1,161,278
Ent. Value (HKD Mn)	1,132,349
52 week range (HKD)	65.28-129.2



Major Shareholders	(%)
1.NASPERS LTD	33.73
2.HUATENG MA	10.16

Valuation Method

P/E

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How we view this

We hold a positive opinion on these 3 batches of transactions. The purchase of stock rights of Jingdong is of great significance, because Jingdong will become an e-commerce partner of Tencent Holdings, while the e-commerce business of Tencent Holdings will gradually fade out. The purchase of stock rights of 58.com will actively promote commercialized WeChat, because 58.com will provide WeChat with vertical service, while WeChat will become the third-party mobile platform for multiple offline service businesses of 58.com. As for the purchase of NavInfo, it has made up the deficiency of Tencent Holdings in the field of map service resources, improving the shortcoming of O2O business.

Investment Action

Tencent Holdings is one of the best Internet companies in China. The game business of mobile terminals will continue to drive the rapid growth of its performance in 2014, besides, with the gradual improvement of WeChat ecosphere, O2O business will become another pillar for commercialized mobile terminals from 2015. Better business models and more diversified WeChat services will support the monetization of its mobile terminals, which will become the main driving force of the share price in the future. To sum up, we maintain the rating of "Accumulate" for Tencent Holdings, with 12m TP at HKD 136, corresponding to 43x and 32x of expected P/E ratio in 2014 and 2015 respectively.

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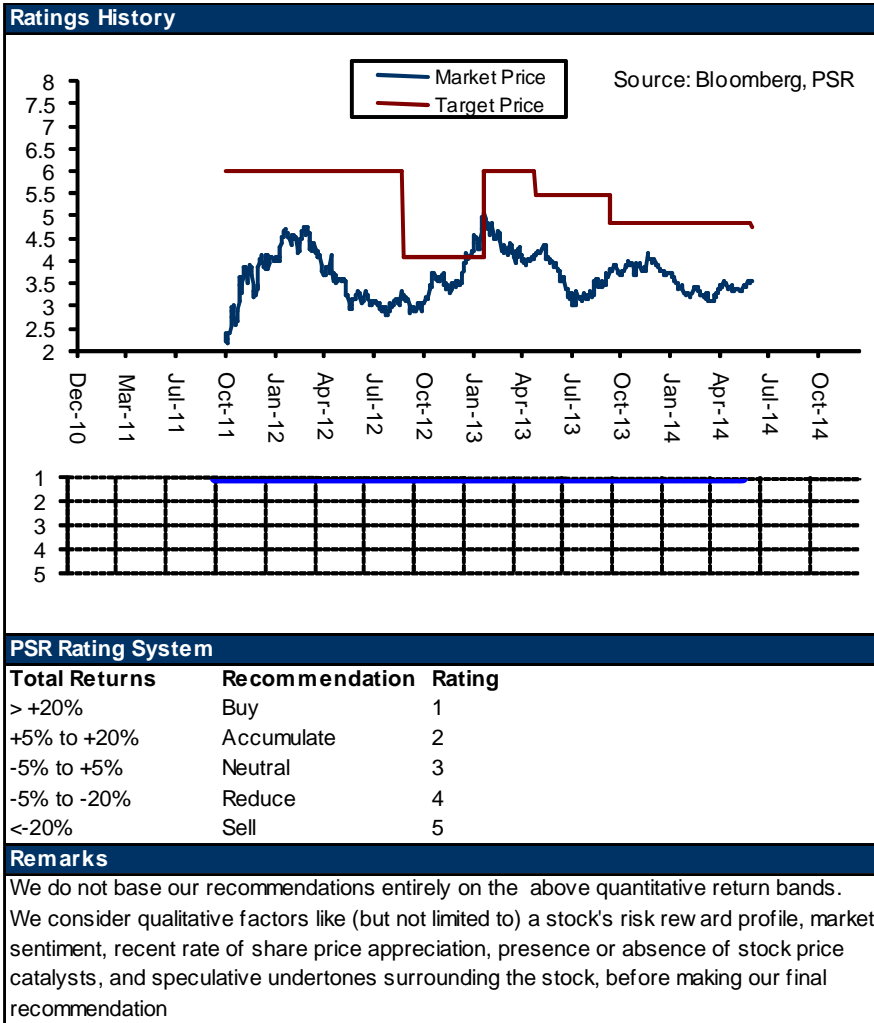
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FYE	FY12	FY13	FY14F	FY15F
Valuation Ratios				
P/E (X), adj.	28.58	45.60	43.52	32.38
P/B (X)	8.94	12.40	13.44	11.45
EV/EBITDA (X), adj.	33.27	38.89	24.99	19.12
Dividend Yield (%)	0.40%	0.24%	0.20%	0.24%
Per share data (RMB)				
EPS, reported	6.97	8.46	2.50	3.36
EPS, adj.	6.97	8.46	2.50	3.36
DPS	0.80	0.94	0.22	0.26
BVPS	22.28	31.12	8.10	9.50
Growth & Margins (%)				
Growth				
Revenue	54.03%	37.69%	32.14%	26.80%
Operating profit	26.33%	24.00%	44.74%	33.55%
EBT	24.40%	28.10%	42.82%	34.43%
Net Income, adj.	24.79%	21.76%	50.30%	34.40%
Margins				
Gross profit margin	58.52%	54.04%	54.20%	53.60%
Operating margin	35.27%	31.76%	34.79%	36.64%
Net profit margin	29.01%	25.65%	29.18%	30.92%
Key Ratios				
ROE (%)	36.50%	31.20%	30.88%	35.35%
ROA (%)	19.30%	17.00%	16.52%	18.30%
Net Debt/(Cash)	net cash	net cash	net cash	net cash
Net Gearing (X)	net cash	net cash	net cash	net cash
Income Statement (RMB mn)				
	FY12	FY13	FY14F	FY15F
Revenue	43,893	60,437	79,862	101,265
Cost of sales	(18,207)	(27,778)	(36,577)	(46,987)
Gross profit	25,686	32,659	43,285	54,278
Operating profit	15,479	19,194	27,782	37,102
EBT	15,051	19,281	27,538	37,019
Tax	(2,266)	(3,718)	(4,158)	(5,560)
Tax rate	15.06%	19.28%	15.10%	15.02%
Profit for the year	12,785	15,563	23,380	31,448
Minority interests	(53)	(61)	(80)	(133)
Net profit	12,732	15,502	23,300	31,315

Source: BLOOMBERG, Tencent and Phillip Securities

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PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within \pm 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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