

18 August 2014

Tencent Holdings (700.HK)

Performance of mobile game in Q2 met market expectation

HONG KONG | INTERNET | COMPANY RESULTS

Rating:

Neutral

- In Q2 Tencent's revenue reached RMB 19.75bn, increasing 37% YoY and 7% QoQ, gross profit was 12.17bn, increasing 56% YoY and 15% QoQ, and net profit reached 5.84bn, increasing 59% YoY and decreasing 9% QoQ. On the whole, in spite of negative impact of administrative expense and tax, performance in Q2 exceeded the market forecast.
- Soaring revenue of mobile game had driven profit increase in 2014. In past quarters Tencent's revenue of mobile game kept high growth. Its revenue in Q2 reached 3bn, equal to 5 times of revenue of mobile game in 14Q4. Total revenues generated from smart phone games integrated with Mobile QQ and Wechat increased sequentially to approximately RMB3 billion for the second quarter of 2014, reflecting growth in our paying user base and ARPU driven by mid-core games and in-game promotions. MAU of mobile QQ and Wechat was 520 and 440, respectively rising 45% and 57% YoY. Tencent's ARPU reached 100-110 in Q2 from 80-90 in Q1, increasing 25% QoQ, bringing obvious effect on revenue increase.
- Tencent continued to enrich our O2O ecosystem by making strategic investments in and partnering with classified listings company 58.com and map service provider NavInfo. We believe its users will benefit from the expanding range of quality services enabled by O2O partners, broadening and enhancing their user experiences.

How we view this

Sharp increase of mobile game is the major driver of performance growth of Tencent currently. We think that revenue of mobile game has reached enough large scales because Tencent enlarged user number and user stickiness, so it's hard to maintain the high growth. We expect that revenue of mobile game in future quarters will keep stable basically but with increasing gross profit margin. 1H2014.

Investment Action

The game business of mobile terminals had become performance driver of Tencent Holdings in 2014. 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 "Neutral" for Tencent Holdings, with 12m TP at HKD 136, corresponding to 43x and 32x of expected P/E ratio in 2014 and 2015 respectively.

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)	0.33
Closing Price (HKD)	130.30
Potential Upside	4.61%

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)	1.069
Market Cap. (HKD Bn)	1,220
Ent. Value (HKD Bn)	538
52 week range (HKD)	70.2-134.0



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

Valuation Method

P/E

Analyst

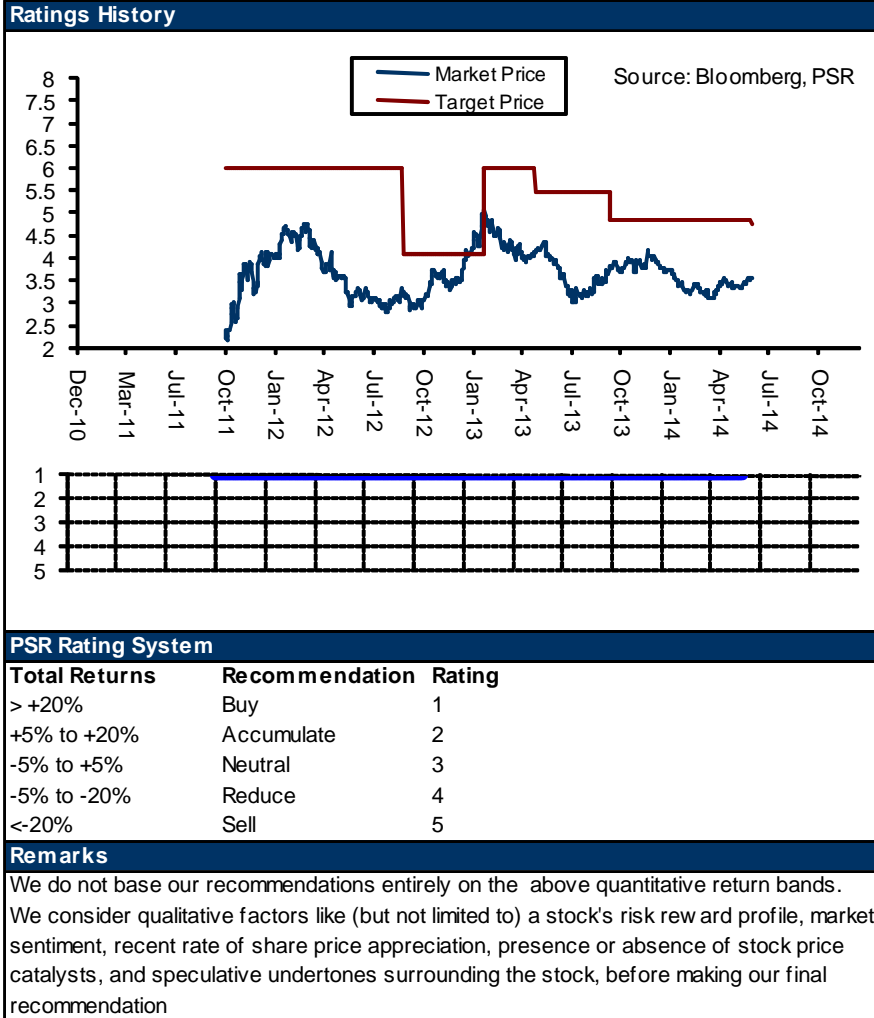
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FYE	FY12	FY13	FY14F	FY15F
Valuation Ratios				
P/E (X), adj.	28.58	45.60	43.52	32.38
P/B (X)	8.94	12.40	13.44	11.45
EV/EBITDA (X), adj.	33.27	38.89	24.99	19.12
Dividend Yield (%)	0.40%	0.24%	0.20%	0.24%
Per share data (RMB)				
EPS, reported	6.97	8.46	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



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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