

Tencent Holdings (700.HK)

Optimistic "Internet +" Strategic Outlook

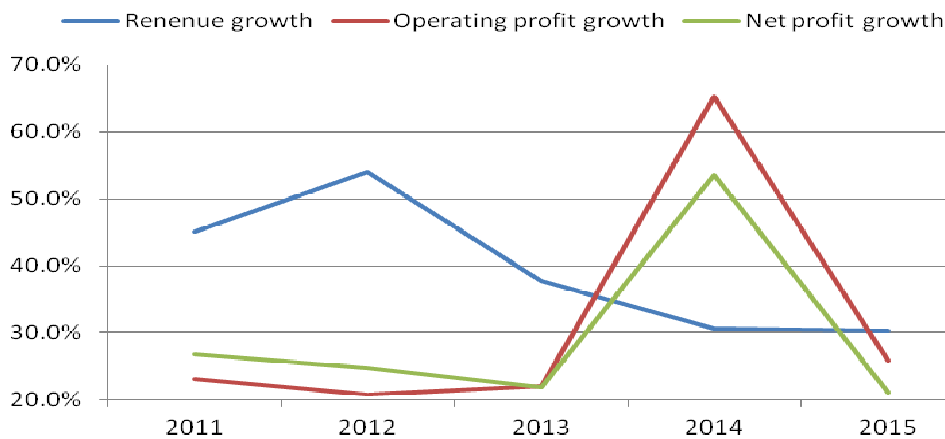
Hong Kong | TMT | Company report

23 March 2016

2015 Results Continued to Grow Rapidly

The total revenue and net profit of Tencent Holdings in 2015 stood at RMB102.9 billion and RMB28.8 billion, a YoY increase of 30% and 21% respectively. Besides, its EPS amounted to RMB3.1, and its net operating cash flow soared by 32% to RMB45.4 billion. Overall, it maintained the rapid growth in 2015.

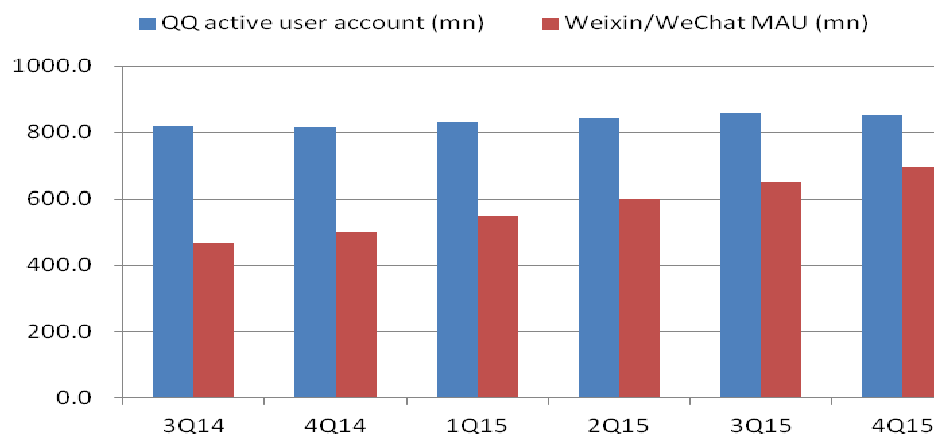
Performance Growth of Tencent



Source: Company reports, Phillip Securities (HK) Research

The revenue growth was mainly attributed to the increase in smart device MAU of QQ and MAU of WeChat, rising by 11% to 697 million and by 39% and to 642 million respectively over the same period last year. Such rise fueled the surge in online ads revenue by 110% to RMB17.5 billion, of which performance advertising and brand advertising jumped by 172% and 72% respectively. Additionally, the contribution proportion of the mobile platform to the revenues was up to 65%, and its proportion exceeded 85% in the fourth quarter. Meanwhile, thanks to the Company's powerful concession operations of computer games and the huge mobile traffic, its online game business saw an increase of 26% and its social network revenues witnessed a growth of 30%, maintaining a steady growth.

Increased sports population in China



Source: Company reports, Phillip Securities (HK) Research

Accumulate (Initially)

CMP: HKD 158.10
 (Closing price as at 21 Mar 2016)
 TARGET: HKD 182.00 (+15.2%)

COMPANY DATA

O/S SHARES (MN) :	9,404
MARKET CAP (HKDMN) :	1,486,772
52 - WK HI/LO (HKD):	171/ 124

SHARE HOLDING PATTERN, %

MIH TC Holdings Limited.	33.51
Advance Data Services Limited	9.17

PRICE PERFORMANCE, %

	1M	3M	1Y
Tencent	11.83	4.36	8.90
HSI	4.64	9.34	24.42

PRICE VS. HSI



Source: Phillip Securities (HK) Research

KEY FINANCIALS

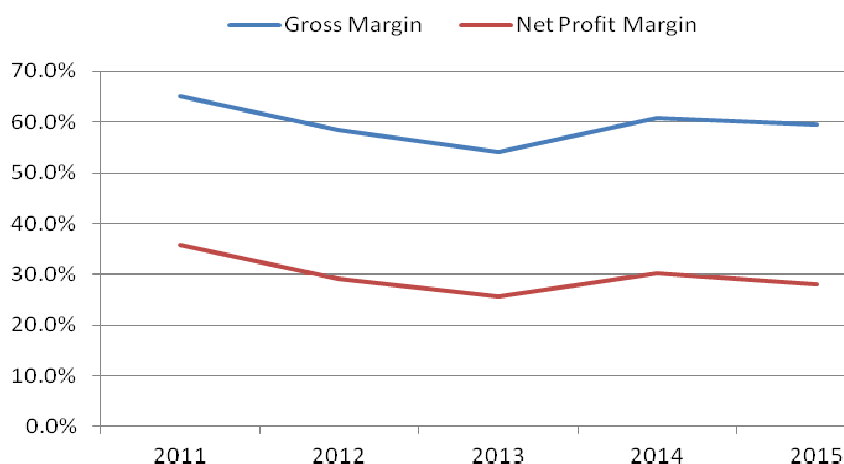
CNY mn	FY14	FY15	FY16E	FY17E
Net Sales	78932	102863	136779	177070
Net Profit	23810	28806	39419	50350
EPS, CNY	2.58	3.10	4.19	5.35
PER, x	51.51	42.90	31.70	24.81
BVPS, CNY	8.54	12.76	16.78	21.69
P/BV, x	15.56	10.41	7.92	6.13
ROE, %	34.52	28.21	28.16	27.84
Debt/Equity (%)	108.4	151.3	150.0	150.0

Source: Company reports, Phillip Securities Est.

Research Analyst
Fan Guohe
 (+ 86 21 51699400-110)
 fanguohe@phillip.com.cn

In respect of profitability, although the gross profit margin fell by 1.4 percentage points to 59.5% year on year, the main reason for the fall is that the gross profit margin included the commissions to third-party game and content providers. The relatively low net profit growth was primarily because the Company's financial costs grew by 37% due to increased loans and because the income tax expense also shot up by 39%. Furthermore, provision for impairment of the Company's listed associate corporations engaging in e-business led its share of losses from the associate corporations increase RMB2.45 billion as compared with the same period last year, which also produced a significant negative impact on the results. But this is a non-recurring factor.

Earning capabilities of Tencent



Source: Company reports, Phillip Securities (HK) Research

WeChat Supported Mobile Advertising Business Development

Large as the customer base of WeChat was, yet, as of September 2015, the penetration rate of WeChat was 69%, 43%, 27% and 28% in the second-tier to the fifth-tier cities respectively, far lower than the penetration rate of over 90% in the first-tier cities. Therefore, WeChat still has potential for development in the second-tier to the fifth-tier cities. Presently, WeChat has already found its way in all aspects of the users' life including socializing, reading, shopping and sports, so its dividends will continue to be released and thus the mobile advertising business is expected to become the engine of growth.

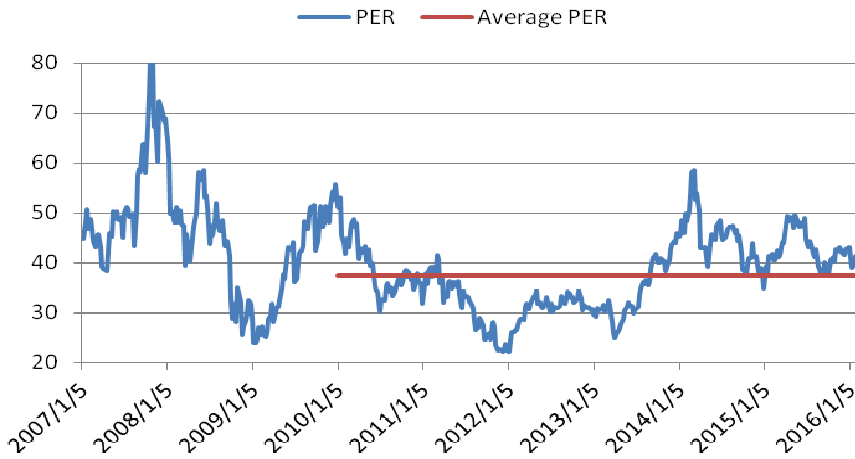
Additionally, by virtue of WeChat Payment and more diverse payment scenarios, the Company's online payment business is booming, the users who have integrated bank cards with WeChat Payment has rapidly increased to 300 million, the vast majority of whom are active users. According to estimates, the monthly transfer transaction amount between users of WeChat has exceeded RMB100 billion, so the Company's future prospects for Internet financial services are worth looking forward to.

Optimistic "Internet +" Strategic Outlook

Tencent actively promotes the "Internet +" strategy, with the vision of becoming China's all-rounded service Internet provider featured by "Connect Everything." We believe the Company boasts immense amounts of users' data and traffic, gets a comprehensive understanding of consumer demand through big data resources, and by expanding products and services, invests in a wide range of vertical areas and enriches application scenarios, so its outlook for the "Internet +" ecosystem construction is optimistic.

Specifically, the Company's game business will keep a leading position by its platform position and leading VR layout. Moreover, its online ads business will maintain rapid growth thanks to enhanced user participation by more video inputs and online payment. We grant the Company the target price of HK\$182, equivalent to 36.5x EPS in 2016, with the "Accumulate" rating. (Closing price as at 21 Mar 2016)

Historical P/E Valuation



Source: Bloomberg, Phillip Securities (HK) Research

Risk

The terminal game business declines more than expected;
Headway in mobile advertising service falls short of expectation.

Financials

Periodicity:	2013	2014	2015	2016F	2017F
Valuation Ratios					
Price Earnings	78.48	51.51	42.90	31.70	24.81
Price to Book	21.35	15.56	10.41	7.92	6.13
Dividend Yield	0.12%	0.22%	0.30%	0.34%	0.45%
Per share data(CNY)					
EPS Adjusted	1.69	2.58	3.10	4.19	5.35
Book Value Per Share	6.22	8.54	12.76	16.78	21.69
Dividends Per Share	0.16	0.29	0.39	0.45	0.60
Growth & Margin					
Revenue growth	37.69%	30.60%	30.32%	32.97%	29.46%
Gross profit growth	27.15%	47.15%	27.41%	31.35%	28.58%
Net profit growth	21.76%	53.59%	20.98%	36.84%	27.73%
Gross Margin	54.04%	60.89%	59.53%	58.80%	58.40%
Operating Margin	28.74%	36.39%	35.12%	35.11%	34.68%
Net Profit Margin	25.65%	30.17%	28.00%	28.82%	28.44%
Dividend Payout Ratio %	9.47%	11.34%	12.85%	10.74%	11.21%
Key ratios					
Return on Assets	16.99%	17.10%	12.05%	11.24%	11.13%
Return on Equity	31.24%	34.52%	28.21%	28.16%	27.84%
Liability ratio	45.48%	52.02%	60.20%	60.00%	60.00%
Effective Tax Rate	19.28%	17.66%	19.63%	17.50%	17.50%
Income Statement(CNY: mn)					
Revenue	60,437	78,932	102,863	136,779	177,070
- Cost of Goods Sold	27,778	30,873	41,631	56,353	73,661
Gross Income	32,659	48,059	61,232	80,426	103,409
- Selling, General & Admin Expense	15,923	24,840	25,437	32,827	42,497
Operating Income	17,371	28,722	36,126	48,029	61,412
Pretax Income	19,281	29,013	36,216	48,229	61,612
- Income Tax Expense	3,718	5,125	7,108	8,440	10,782
Income Before XO Items	15,563	23,888	29,108	39,789	50,830
Net Profit	15,502	23,810	28,806	39,419	50,350

Source: Company, Phillip Securities (HK) Research Estimates

(Financial figures as at 21 Mar 2016)

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

GENERAL DISCLAIMER

This publication is prepared by Phillip Securities (Hong Kong) Ltd ("Phillip Securities"). By receiving or reading this publication, you agree to be bound by the terms and limitations set out below.

This publication shall not be reproduced in whole or in part, distributed or published by you for any purpose. Phillip Securities shall not be liable for any direct or consequential loss arising from any use of material contained in this publication.

The information contained in this publication has been obtained from public sources which Phillip Securities has no reason to believe are unreliable and any analysis, forecasts, projections, expectations and opinions (collectively the "Research") contained in this publication are based on such information and are expressions of belief only. Phillip Securities has not verified this information and no representation or warranty, express or implied, is made that such information or Research is accurate, complete or verified or should be relied upon as such. Any such information or Research contained in this publication is subject to change, and Phillip Securities shall not have any responsibility to maintain the information or Research made available or to supply any corrections, updates or releases in connection therewith. In no event will Phillip Securities be liable for any special, indirect, incidental or consequential damages which may be incurred from the use of the information or Research made available, even if it has been advised of the possibility of such damages.

Any opinions, forecasts, assumptions, estimates, valuations and prices contained in this material are as of the date indicated and are subject to change at any time without prior notice.

This material is intended for general circulation only and does not take into account the specific investment objectives, financial situation or particular needs of any particular person. The products mentioned in this material may not be suitable for all investors and a person receiving or reading this material should seek advice from a financial adviser regarding the suitability of such products, taking into account the specific investment objectives, financial situation or particular needs of that person, before making a commitment to invest in any of such products.

This publication should not be relied upon as authoritative without further being subject to the recipient's own independent verification and exercise of judgment. The fact that this publication has been made available constitutes neither a recommendation to enter into a particular transaction nor a representation that any product described in this material is suitable or appropriate for the recipient. Recipients should be aware that many of the products which may be described in this publication involve significant risks and may not be suitable for all investors, and that any decision to enter into transactions involving such products should not be made unless all such risks are understood and an independent determination has been made that such transactions would be appropriate. Any discussion of the risks contained herein with respect to any product should not be considered to be a disclosure of all risks or a complete discussion of such risks.

Nothing in this report shall be construed to be an offer or solicitation for the purchase or sale of a security. Any decision to purchase securities mentioned in this research should take into account existing public information, including any registered prospectus in respect of such security.

Disclosure of Interest

Analyst Disclosure: Neither the analyst(s) preparing this report nor his associate has any financial interest in or serves as an officer of the listed corporation covered in this report.

Firm's Disclosure: Phillip Securities does not have any investment banking relationship with the listed corporation covered in this report nor any financial interest of 1% or more of the market capitalization in the listed corporation. In addition, no executive staff of Phillip Securities serves as an officer of the listed corporation.

Availability

The information, tools and material presented herein are not directed, intended for distribution to or use by, any person or entity in any jurisdiction or country where such distribution, publication, availability or use would be contrary to the applicable law or regulation or which would subject Phillip Securities to any registration or licensing or other requirement, or penalty for contravention of such requirements within such jurisdiction.

Information contained herein is based on sources that Phillip Securities (Hong Kong) Limited ("PSHK") believed to be accurate. PSHK does not bear responsibility for any loss occasioned by reliance placed upon the contents hereof. PSHK (or its affiliates or employees) may have positions in relevant investment products. For details of different product's risks, please visit the Risk Disclosures Statement on <http://www.phillip.com.hk>.

© 2016 Phillip Securities (Hong Kong) Limited

Contact Information (Regional Member Companies)

SINGAPORE

Phillip Securities Pte Ltd
Raffles City Tower
250, North Bridge Road #06-00
Singapore 179101
Tel : (65) 6533 6001
Fax : (65) 6535 6631
Website: www.poems.com.sg

HONG KONG

Phillip Securities (HK) Ltd
Exchange Participant of the Stock Exchange of Hong Kong
11/F United Centre 95 Queensway
Hong Kong
Tel (852) 22776600
Fax (852) 28685307
Websites: www.phillip.com.hk

INDONESIA

PT Phillip Securities Indonesia
ANZ Tower Level 23B,
Jl Jend Sudirman Kav 33A
Jakarta 10220 – Indonesia
Tel (62-21) 57900800
Fax (62-21) 57900809
Website: www.phillip.co.id

THAILAND

Phillip Securities (Thailand) Public Co. Ltd
15th Floor, Vorawat Building,
849 Silom Road, Silom, Bangrak,
Bangkok 10500 Thailand
Tel (66-2) 6351700 / 22680999
Fax (66-2) 22680921
Website: www.phillip.co.th

UNITED KINGDOM

King & Shaxson Capital Limited
6th Floor, Candlewick House,
120 Cannon Street,
London, EC4N 6AS
Tel (44-20) 7426 5950
Fax (44-20) 7626 1757
Website: www.kingandshaxson.com

AUSTRALIA

PhillipCapital Australia
Level 12, 15 William Street,
Melbourne, Victoria 3000, Australia
Tel (613) 96188238
Fax (613) 92002272
Website: www.phillipcapital.com.au

MALAYSIA

Phillip Capital Management Sdn Bhd
B-3-6 Block B Level 3 Megan Avenue II,
No. 12, Jalan Yap Kwan Seng, 50450
Kuala Lumpur
Tel (603) 21628841
Fax (603) 21665099
Website: www.poems.com.my

JAPAN

PhillipCapital Japan K.K.
Nagata-cho Bldg.,
8F, 2-4-3 Nagata-cho,
Chiyoda-ku, Tokyo 100-0014
Tel (81-3) 35953631
Fax (81-3) 35953630
Website: www.phillip.co.jp

CHINA

Phillip Financial Advisory (Shanghai) Co. Ltd
No 436 Hengfeng Road,
Greentech Unit 604,
Postal code 200070
Tel (86-21) 51699400
Fax (86-21) 63532643
Website: www.phillip.com.cn

FRANCE

King & Shaxson Capital Limited
3rd Floor, 35 Rue de la Bienfaisance 75008
Paris France
Tel (33-1) 45633100
Fax (33-1) 45636017
Website: www.kingandshaxson.com

UNITED STATES

Phillip Futures Inc
141 W Jackson Blvd Ste 3050
The Chicago Board of Trade Building
Chicago, IL 60604 USA
Tel +1.312.356.9000
Fax +1.312.356.9005