

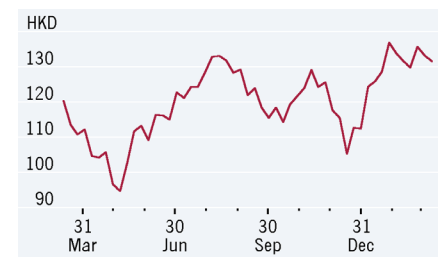
# Tencent Holdings (0700.HK)

## 4Q14 Results Preview

- 4Q14 results to be announced next Wednesday on 18 March** - We estimate total revenue to grow 19% YoY to RMB20.2bn, in line with consensus estimates. Excluding ecommerce, we estimate adjusted revenue to grow 3% QoQ and 47% YoY to RMB20.0bn. For PC games, we estimate it to remain flattish QoQ and grow 24% YoY to RMB9.7bn, with League of Legends (LoL) to benefit from positive seasonality in overseas markets. For smartphone games, we estimate it to rebound by 4% QoQ to RMB2.7bn, thanks to the contributions of new titles and content upgrades for existing games. Non-GAAP operating profit is expected to grow 60% to RMB8.1bn and non-GAAP operating margin to expand 10ppts YoY and decline 1.5ppts to 40.2%. We estimate non-GAAP net income to grow 46% YoY to RMB6.5bn, in line with consensus estimates.
- 2015 outlook the key focus** – We expect the key areas to include (i) mobile games outlook and strategy, in particular 2015 pipeline, growth momentum for legacy titles such as Timi Run Everyday, Thunder Fighter, Timi Speed Everyday and We Fight, as well as the performance of new titles My Name is MT 2 and We Fire launched in December and January respectively; (ii) PC games trend and user feedback for new title Call of Duty Online; (iii) advertising outlook, in particular the feedback and monetization plan on Weixin Moments; (iv) trend in operating expenses and (v) updates on initiatives including O2O, Weixin Payments and internet finance.
- Conference call dial-in details** – Tencent will host a group conference call post result at 8 pm HKT (8 am EST) on 18 March. Dial-in numbers: HK: +852 3018 6770; US Toll Free: 186 6331 9014; International: + 65 6722 7970; Passcode: 6365 5586

<b>Buy</b>	<b>1</b>
Price (12 Mar 15)	HK\$131.80
Target price	HK\$151.00
Expected share price return	14.6%
Expected dividend yield	0.3%
<b>Expected total return</b>	<b>14.8%</b>
Market Cap	HK\$1,235,390M US\$158,980M

### Price Performance (RIC: 0700.HK, BB: 700 HK)



### Statistical Abstract

Year to	Net Profit	Diluted EPS	EPS growth	P/E	P/B	ROE	Yield
31 Dec	(RmbM)	(Rmb)	(%)	(x)	(x)	(%)	(%)
2012A	14,286	1.533	30.5	69.3	23.5	41.0	0.2
2013A	16,975	1.817	18.5	58.4	16.8	34.2	0.2
2014E	23,981	2.563	41.0	41.4	11.9	34.2	0.3
2015E	31,091	3.316	29.4	32.0	8.9	32.2	0.3
2016E	41,120	4.376	32.0	24.3	6.6	31.8	0.4

Source: Powered by dataCentral

**Thomas Chong**  
+852-2501-2059  
thomas.chong@citi.com

**Ravi Sarathy**  
ravi.sarathy@citi.com

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0700.HK: Fiscal year end 31-Dec						Price: HK\$131.80; TP: HK\$151.00; Market Cap: HK\$1,235,390m; Recomm: Buy					
Profit & Loss (Rmbm)	2012	2013	2014E	2015E	2016E	Valuation ratios	2012	2013	2014E	2015E	2016E
Sales revenue	43,894	60,437	78,140	94,152	117,018	PE (x)	69.3	58.4	41.4	32.0	24.3
Cost of sales	-18,207	-27,778	-29,750	-33,537	-40,790	PB (x)	23.5	16.8	11.9	8.9	6.6
Gross profit	25,686	32,659	48,390	60,615	76,229	EV/EBITDA (x)	53.6	42.0	27.3	23.0	17.0
Gross Margin (%)	58.5	54.0	61.9	64.4	65.1	FCF yield (%)	1.6	2.0	2.7	3.0	4.0
<b>EBITDA (Adj)</b>	<b>18,100</b>	<b>22,800</b>	<b>34,269</b>	<b>39,575</b>	<b>51,789</b>	Dividend yield (%)	0.2	0.2	0.3	0.3	0.4
EBITDA Margin (Adj) (%)	41.2	37.7	43.9	42.0	44.3	Payout ratio (%)	11	11	10	10	10
Depreciation	-1,888	-2,500	-2,684	-2,884	-3,084	ROE (%)	36.5	31.2	33.7	29.0	29.2
Amortisation	-733	-1,106	-1,106	-1,106	-1,106	<b>Cashflow (Rmbm)</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>
<b>EBIT (Adj)</b>	<b>17,053</b>	<b>20,497</b>	<b>30,553</b>	<b>38,711</b>	<b>50,975</b>	EBITDA	18,100	22,800	34,269	39,575	51,789
EBIT Margin (Adj) (%)	38.9	33.9	39.1	41.1	43.6	Working capital	3,508	5,915	2,566	2,064	2,696
Net interest	-348	-84	-1,226	-1,226	-1,226	Other	-2,178	-4,341	-4,250	-4,778	-6,762
Associates	-81	170	-211	0	0	<b>Operating cashflow</b>	<b>19,429</b>	<b>24,374</b>	<b>32,586</b>	<b>36,862</b>	<b>47,723</b>
Non-op/Except	0	0	0	0	0	Capex	-3,624	-4,599	-5,470	-6,591	-8,191
<b>Pre-tax profit</b>	<b>15,051</b>	<b>19,280</b>	<b>29,042</b>	<b>34,359</b>	<b>46,373</b>	Net acq/disposals	-5,528	-9,303	-28,146	-9,396	-9,396
Tax	-2,266	-3,718	-5,402	-6,391	-8,625	Other	-7,117	-5,232	-661	-2,661	-2,661
Extraord./Min.Int./Pref.div.	-53	-61	-3	-3	-3	<b>Investing cashflow</b>	<b>-16,270</b>	<b>-19,134</b>	<b>-34,277</b>	<b>-18,648</b>	<b>-20,248</b>
<b>Reported net profit</b>	<b>12,732</b>	<b>15,502</b>	<b>23,637</b>	<b>27,965</b>	<b>37,744</b>	Dividends paid	-1,225	-1,541	-1,818	-2,505	-3,246
Net Margin (%)	29.0	25.6	30.3	29.7	32.3	<b>Financing cashflow</b>	<b>-2,386</b>	<b>1,708</b>	<b>13,182</b>	<b>12,495</b>	<b>-3,246</b>
Core NPAT	14,286	16,975	23,981	31,091	41,120	<b>Net change in cash</b>	<b>771</b>	<b>6,845</b>	<b>11,491</b>	<b>30,709</b>	<b>24,229</b>
<b>Per share data</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>	<b>Free cashflow to s/holders</b>	<b>15,805</b>	<b>19,775</b>	<b>27,116</b>	<b>30,271</b>	<b>39,532</b>
Reported EPS (Rmb)	1.367	1.660	2.526	2.982	4.017						
Core EPS (Rmb)	1.533	1.817	2.563	3.316	4.376						
DPS (Rmb)	0.162	0.194	0.267	0.345	0.456						
CFPS (Rmb)	2.086	2.610	3.482	3.931	5.079						
FCFPS (Rmb)	1.696	2.117	2.897	3.228	4.207						
BVPS (Rmb)	4.519	6.326	8.913	11.952	15.980						
Wtd avg ord shares (m)	9,139	9,160	9,239	9,258	9,276						
Wtd avg diluted shares (m)	9,316	9,340	9,359	9,377	9,396						
<b>Growth rates</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>						
Sales revenue (%)	54.0	37.7	29.3	20.5	24.3						
EBIT (Adj) (%)	29.1	20.2	49.1	26.7	31.7						
Core NPAT (%)	30.6	18.8	41.3	29.6	32.3						
Core EPS (%)	30.5	18.5	41.0	29.4	32.0						
<b>Balance Sheet (Rmbm)</b>	<b>2012</b>	<b>2013</b>	<b>2014E</b>	<b>2015E</b>	<b>2016E</b>						
Cash & cash equiv.	27,189	39,851	51,342	84,051	110,280						
Accounts receivables	2,354	2,955	3,821	4,603	5,721						
Inventory	568	1,384	1,384	1,384	1,384						
Net fixed & other tangibles	20,255	23,881	29,871	37,290	46,721						
Goodwill & intangibles	5,514	4,974	5,064	5,154	5,244						
Financial & other assets	19,376	34,190	62,711	72,333	82,563						
<b>Total assets</b>	<b>75,256</b>	<b>107,235</b>	<b>154,193</b>	<b>204,815</b>	<b>251,912</b>						
Accounts payable	4,212	6,680	7,974	9,309	10,977						
Short-term debt	1,077	2,589	2,589	2,589	2,589						
Long-term debt	9,622	12,464	27,464	42,464	42,464						
Provisions & other liab	18,196	27,039	33,292	39,277	47,116						
<b>Total liabilities</b>	<b>33,108</b>	<b>48,772</b>	<b>71,319</b>	<b>93,639</b>	<b>103,146</b>						
Shareholders' equity	41,298	57,945	82,353	110,652	148,240						
Minority interests	851	518	521	524	527						
<b>Total equity</b>	<b>42,148</b>	<b>58,463</b>	<b>82,874</b>	<b>111,176</b>	<b>148,767</b>						
<b>Net debt (Adj)</b>	<b>-16,490</b>	<b>-24,798</b>	<b>-21,289</b>	<b>-38,998</b>	<b>-65,227</b>						
Net debt to equity (Adj) (%)	-39.1	-42.4	-25.7	-35.1	-43.8						

For definitions of the items in this table, please click [here](#).

## Tencent Holdings

### Company description

Founded in 1998, Tencent is a leading Internet company in China, with instant messaging platform QQ exceeding 800m monthly active users in 2013. It engages in multiple business lines including online games, social networking services, online advertising, and mobile value-added services. It has extended leadership in PC over to mobile Internet with Mobile QQ and Weixin/WeChat reaching over 400m and 350m monthly active users in 2013. The company was listed on the main board of Hong Kong Stock Exchange in June 2004.

### Investment strategy

We rate Tencent shares as Buy. We believe the company is well positioned to capture the evolutionary trend in mobile Internet, thanks to its solid execution and huge social traffic. Tencent is a market creator in mobile games with diversified genres, powered by its social traffic with strong viral effects. We believe Tencent is accelerating momentum to capture the opportunities in O2O through strategic investments and nurturing official accounts with Weixin Payments. We believe Tencent has become a platform for category leaders to ride the wave in mobile Internet.

### Valuation

Our target price of HK\$151 is based on 1.2x PEG with non-GAAP 2015E EPS of HK\$4.20 and three-year CAGR of 30%. We apply a 20% premium to PEG on Tencent's huge social traffic and execution. We believe Tencent is well positioned to ride the evolutionary trend of the mobile Internet, thanks to its huge user traffic with strong stickiness from viral effects. In addition, Tencent demonstrates solid execution with a clear roadmap for long-term growth. Its ecosystem is a platform of choice for category leaders to ride on the wave of mobile Internet. We use PEG as our primary valuation methodology as we reckon earnings growth in the medium term can best capture the performance of Internet companies amidst fast-changing developments of the sector.

### Risks

We believe downside risks that could prevent the shares from reaching our target price are: (i) platform enhancements for its mobile games take longer time than expected; (ii) faster-than-expected slowdown in PC games revenue growth due to cannibalization with mobile games; (iii) unsuccessful integration and execution in M&A; and (iv) regulatory overhang on new initiatives.

## Appendix A-1

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**Tencent Holdings (0700.HK)**  
**Ratings and Target Price History**  
**Fundamental Research**

Analyst: Thomas Chong  
Covered since July 24 2014



	Date	Rating	Target Price	Closing Price
1	7-Oct-11	Stock rating system changed		
2	14-Mar-12	1	*59.00	40.12
3	16-May-12	1	*63.40	43.92

\* Indicates change

	Date	Rating	Target Price	Closing Price
4	15-Aug-12	1	*65.00	46.00
5	15-Jul-13	1	*77.60	64.28
6	8-Sep-13	1	*96.00	77.40

	Date	Rating	Target Price	Closing Price
7	25-Jul-14	1	*144.00	124.90
8	13-Aug-14	1	*156.00	133.20
9	12-Nov-14	1	*151.00	129.20

Rating/target price changes above reflect Eastern Standard Time

**Tencent Holdings (0700.HK)**  
**Ratings and Target Price History**  
**Best Ideas Research**  
**Relative Call (3 Month)**

Analyst: Thomas Chong  
Covered since July 24 2014



	Date	Rating	Target Price	Closing Price
1	22-Oct-12	*ADD MP	-	53.12

\* Indicates change

	Date	Rating	Target Price	Closing Price
2	10-Feb-14	*REM MP	-	-

Rating/target price changes above reflect Eastern Standard Time

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12 Month Rating

Relative Rating

**Data current as of 31 Dec 2014**

	Buy	Hold	Sell	Buy	Hold	Sell
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% of companies in each rating category that are investment banking clients	65%	62%	54%	0%	63%	0%

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