

Last Closing: HK\$ 135.9

Upside: +11.8%

Target Price: HK\$152.0 →

Internet Sector

Tencent (700.HK)

4Q14 top-line beat; Maintain Buy

UP

MP

OP

Financial Highlights

Y/E 31 Dec	2013	2014	2015E	2016E	2017E
Revenue (RMB m)	60,437	78,932	98,753	120,180	139,677
YoY growth	38%	31%	25%	22%	16%
Net profit (RMB m)	17,005	24,224	29,503	36,741	41,737
YoY growth	20%	42%	22%	25%	14%
EPS (RMB non-GAAP)	1.82	2.29	3.17	3.94	4.46
EPS (HK\$ non-GAAP)	2.30	2.86	3.99	5.02	5.76
DPS (RMB)	0.85	0.26	0.29	0.36	0.78
Dividend yield	0.62%	0.19%	0.21%	0.27%	0.58%
PE	59	47	34	27	24

Source: Company, BOCOM Int'l estimates

- 4Q14 top-line beat.** Non-GAAP diluted EPS was RMB0.68, lower than consensus and our estimate of RMB0.70. Revenue reached RMB20.98bn, up 6%/24% QoQ/YoY, beating consensus and our estimate of RMB20.36bn and RMB20.78bn. Gross margin decreased from 64% in 3Q14 to 60% in 4Q14, mainly due to a significant decrease in gross margin of the online advertising business (from 52% in 3Q14 to 40%) as a result of greater investment in video contents, which offset the improvement in ecommerce gross margin (from 25% to 40%). Operating margin in 4Q14 decreased from 38% in the previous quarter to 35%, mainly due to larger subsidy costs to Didi to enhance the position of Weixin Payment, increasing marketing spending, and R&D costs. Non-GAAP profit margin in 4Q14 stayed flat sequentially at 32%, compared with 26% in 4Q13.
- VAS revenue was RMB17.14bn, up 7%/44% QoQ/YoY, where 70% came from game revenue.** In 4Q14 Tencent retained its leading position in game market, with online game revenue increased by 6%/41% QoQ/YoY, reaching RMB11.96bn. The increase of game revenue was mainly driven by 1) a substantial increase in PC client game players and revenue contribution from major ACG titles such as League of Legends, FIFA Online3 and newly launched shooting games such as Assault Fire. 2) mobile games maintained strong growth momentum, which reached RMB3.8bn, up by 26%/416% QoQ/YoY, contributing 32% of total online game revenue, compared with 23% in the previous quarter.
- Online advertising revenue was RMB2.63bn, up 8%/75% QoQ/YoY, mainly driven by performance-based ads.** Performance-based ads increased by 19% QoQ, reaching RMB1.1bn or 42% of total ad revenue, compared with 38% in the previous quarter. The increase in performance-based ads is driven by 1) CPC growth for Qzone feed ad 2) expanding advertiser base for weixin official accounts. Weixin started testing news feed in Moments in January 2015, which has received encouraging feedback. In the future, Tencent will continue 1) working with Weixin official accounts to provide better content and gain more user engagement 2) working on improving the accuracy of ads delivery to target consumers without compromising user experience.
- Connection strategy.** In line with the "Internet +" strategy proposed by Pony Ma, in 2014 Tencent has invested actively in vertical areas such as 58.com, Dianping, Didi and JD.com with a focus on eCommerce and leveraging offline resources. In 2015, Tencent will continue building strategic partnerships in vertical areas, which will further expand usage scenarios for Weixin Payment.
- Valuation.** We believe that Weixin O2O initiatives and the enhanced position of Weixin Payment will generate more growth opportunities in the long run. We are positive on the revenue contribution from mobile games and performance-based ads, and potential margin improvement driven by performance-based ads. We fine-tune 2015E revenue by 1% to RMB98.8bn considering the higher-than-expected e-commerce business, and correspondingly increase 2015E EPS from RMB3.16 to RMB3.17. Maintain TP at HK\$152, based on 38x 2015E PE, and maintain Buy rating.



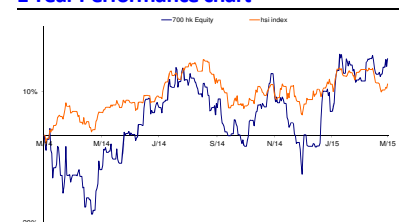
- Tencent 4Q14 top-line beat, reaching RMB20.98bn, mainly driven by game and performance-based ad revenue...
- The increase of game revenue was mainly driven by 1) a substantial increase in PC client game revenue 2) strong growth of mobile games, reaching RMB3.8bn, or 32% of ad revenue.
- The increase in performance-based ads was driven by 1) CPC growth for Qzone feed ad 2) expanding advertiser base for weixin official accounts.
- We believe that Weixin O2O initiatives and the enhanced position of Weixin Payment will generate more growth opportunities in the long run.
- We fine-tune 2015E revenue by 1%. Maintain TP at HK\$152, based on 38x 2015E PE, and maintain Buy rating.

Stock data

52w High	138.00
52w Low	93.00
Market cap (HK\$m)	1,273,820
Issued shares (m)	9,373
Avg daily vol (m)	22.93
1-mth change %	4.62
YTD change %	20.80
50d MA	131.14
200d MA	123.63
14-day RSI	53.81

Source: Company data, Bloomberg

1 Year Performance chart



Source: Company data, Bloomberg

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Figure 1: Summary of 4Q14 results

(RMB,mn)	4Q13	3Q14	4Q14	QoQ	YoY	Bocom Forecast	Difference
Revenue							
VAS	11,932	16,047	17,137	7%	44%	17,028	0.6%
Online advertising	1,497	2,440	2,627	8%	75%	2,620	0.3%
Ecommerce transaction	3,324	459	446	-3%	-87%	257	73.5%
Others	217	862	768	-11%	254%	871	-11.8%
	16,970	19,808	20,978	6%	24%	20,776	1.0%
Cost of revenues	-8,198	-7,167	-8,332	16%	2%	-8,252	1.0%
Gross Profit	8,772	12,641	12,646	0%	44%	12,524	1.0%
<i>Gross margin</i>	<i>52%</i>	<i>64%</i>	<i>60%</i>			<i>60%</i>	
Other operating (exp)/inc	782	570	786	38%	1%	1,058	-25.7%
Selling and marketing expenses	-2,033	-1,906	-2,063	8%	1%	-2,493	-17.3%
General and administrative expenses	-2,770	-3,790	-3,975	5%	44%	-3,686	7.8%
Profit from operations	4,751	7,515	7,394	-2%	56%	7,403	-0.1%
Finance (expenses)/income	6	-317	-273	-14%	-4650%	-62	337.0%
Equity investment/share of loss of associates	-14	-139	-275	98%	1864%	-43	545.0%
Equity investment/share of loss of JV	-4	0	0			10	N/A
<i>Operating margin</i>	<i>28%</i>	<i>38%</i>	<i>35%</i>			<i>36%</i>	
Profit before taxation	4,739	7,059	6,846	-3%	44%	7,308	-6.3%
Taxation	-808	-1,383	-892	-36%	10%	-1,418	-37.1%
Netprofit	3,931	5,676	5,954	5%	51%	5,890	1.1%
Minority interest	-20	-19	-94	395%	370%	-7	1203.2%
Net profit attributable to shareholders of compay	3,911	5,657	5,860	4%	50%	5,883	-0.4%
<i>Net margin</i>	<i>23%</i>	<i>29%</i>	<i>28%</i>			<i>28%</i>	
Non-GAAP Net Profit	4,189	6,315	6,380	1%	52%	6,504	-1.9%
<i>Net margin</i>	<i>25%</i>	<i>32%</i>	<i>30%</i>			<i>31%</i>	
Diluted EPS	0.42	0.60	0.63	3%	49%	0.63	-1.3%
Non-GAAP dil. EPS	0.48	0.68	0.68	1%	43%	0.70	-2.8%

Source: BOCOM Int'l

Figure 2: Summary of Income statement

Earnings Forecast (RMB,mn)	2Q14	3Q14	4Q14	1Q15E	2013	2014E	2015E	Consensus 2014E	Consensus 2015E
Total Revenue	19,746	19,808	20,978	22,478	60,437	78,932	98,753	78,933	96,908
YoY	37%	28%	24%	22%	38%	31%	25%		
Gross Profit	12,172	12,641	12,646	13,125	32,659	48,059	57,726	48,124	61,121
YoY	56%	49%	44%	24%	27%	47%	20%		
Gross Margin	62%	64%	60%	58%	54%	61%	58%	61%	63%
Operating Profit	7,843	7,515	7,394	7,837	19,194	30,542	33,742	29,037	37,004
YoY	72%	56%	56%	1%	24%	59%	10%		
Operating Margin	40%	38%	35%	35%	32%	39%	34%	37%	38%
Non-GAAP Net Profit	5,874	6,433	6,723	6,853	17,005	24,224	29,503	24,180	31,737
YoY	41%	47%	51%	32%	20%	42%	22%		
Net Margin	30%	32%	32%	30%	28%	31%	30%	31%	33%
Dilluted EPS(RMB)	0.62	0.60	0.63	0.67	1.66	2.54	2.88	2.55	3.24
Non-GAAP Diluted EPS(RMB)	0.55	0.68	0.68	0.74	1.82	2.29	3.17	2.59	3.42
Non-GAAP Diluted EPS(HK\$)	0.69	0.84	0.85	0.92	2.27	2.86	3.99	3.21	4.25
YOY	40%	46%	48%	93%	22%	26%	39%		

Source: BOCOM Int'l

BOCOM International

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Main: + 852 3710 3328**Fax: + 852 3798 0133****www.bocomgroup.com****Rating System****Company Rating**

Buy: Expect more than 20% upside in 12 months

LT Buy: Expect more than 20% upside but longer than 12 months

Neutral: Expect low volatility

Sell: Expect more than 20% downside in 12 months

Sector Rating

Outperform ("OP"): Expect more than 10% upside in 12 months

Market perform ("MP"): Expect low volatility

Underperform ("UP"): Expect more than 10% downside in 12 months

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