

Internet	Last Close	Target Price	Upside	22 March 2018
	HK\$462.6	HK\$535.00	+15.7%	

Tencent Holdings (700 HK)

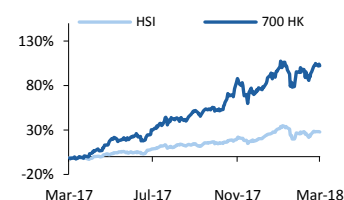
4Q17 top-line miss on game seasonality and gamer shift

- ⊕ **Top line missed on game revenue; bottom line beat on lower G&A expenses.** Total revenue was RMB66.4bn, up 51% YoY/ 2% QoQ but 3% lower than our estimate. Non-GAAP diluted EPS was RMB1.83, beating our estimate by 10%. Non-GAAP net profit margin was 26%, flat QoQ/ down 2ppts YoY.
- ⊕ **Digital content platforms led; games under seasonal pressure; advertising supported by Weixin platform.** Game revenue was down 9% QoQ, due to seasonality of PC games, the timing of new games releases, and user time shifting from existing games to new PUBG mobile games, while the latter has not started monetization. The broadcast of hot drama series and self-produced content on Tencent Video (DAU: 137m, subscribers: 62m) drove the growth in media ad and subscription revenue. The growth of social ad was driven by increased ad impression in Weixin Moments and Official Accounts, considering higher ad demand benefiting from enhanced ad targeting capability. Offline payment transaction volume more than doubled YoY.
- ⊕ **2018 outlook:** In our view, the lack of monetization of PUBG games and relatively stable performance of Honor of Kings may not contribute much incremental revenue in 2018, while the mobile versions of hot IP games, i.e. QQ Speed (DAU: 20m) and JX series, may provide additional revenue. Moreover, we believe the 170m mini-program DAU and various Weixin ads will be the major driver for ad revenue. Offering retail solutions to supermarkets, FMCG and department stores leveraging big data and sale channels, will in turn drive the growth of payment, in our view.
- ⊕ **Valuation.** Given the continuous investment in video content, innovated business model, as well as payment, we expect the margin will see 2-3ppt decrease from 2017 for the coming years. Although the pressure exists, we are positive on Tencent's continuous monetization on its leading platforms and new initiatives, i.e. cloud, financial services (RMB300bn AUM/ RMB 100bn loans), and new retail ecosystem. Maintain **Buy** and TP at HK\$535, implying 53x/42x 2018/19E P/E.

Stock Rating

BUY

1-year stock performance



Source: Bloomberg

Stock data

52w high (HK\$)	476.60
52w low (HK \$)	218.2
Market cap (HK \$ m)	4,394,411
Avg daily vol (m)	28.28
YTD change (%)	13.94
200d MA (HK\$)	366.16

Source: Bloomberg

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Financial highlights

Y/E 31 Dec	2016	2017	2018E	2019E	2020E
Revenue (RMB m)	151,938	237,760	332,841	436,116	535,349
YoY growth (%)	48	56	40	31	23
Net profit (RMB m)^	45,420	65,126	83,887	104,584	122,797
EPS (RMB) ^	4.79	6.83	8.77	10.92	12.79
YoY growth (%)	40	43	29	25	17
Previous EPS (RMB)			8.83	10.87	-
Change (%)			-0.7%	0.4%	-
P/E (x)	83	58	45	36	30
BVPS (RMB)	20	26	38	53	69
P/B (x)	29	22	15	11	8

Source: Company data, BOCOM Int'l estimates ^non-GAAP basis

Figure 1: 4Q17 results summary

(RMB m) Year end 31 Dec	4Q16	3Q17	4Q17	QoQ (%)	YoY (%)	BOCOM forecasts	Difference	Comments
Revenue								
VAS	29,191	42,124	39,947	-5	37	44,140	-9.5	QoQ down due to seasonality of PC games, and the timing of new games releases
Online advertising	8,288	11,042	12,361	12	49	11,861	4.2	Driven by Video, Weixin Moments and Official Accounts
Others	6,385	12,044	14,084	17	121	12,545	12.3	Payment and cloud grew rapidly
Total revenue	43,864	65,210	66,392	2	51	68,546	-3.1	
Cost of revenue	20,238	33,529	34,897	4	72	-34,765	0.4	Increased investment in video content and cloud
Gross profit	23,626	31,681	31,495	-1	33	33,780	-6.8	
<i>Gross margin (%)</i>	<i>54</i>	<i>49</i>	<i>47</i>			<i>49</i>		
Other operating (exp)/inc	1,675	4,935	9,062	84	441	965	839.5	Including disposal gains of investee companies, excluded from non-GAAP adjustments
Selling and marketing expenses	-4,462	-4,812	-6,022	25	35	-6,169	-2.4	
General and administrative expenses	-6,909	-9,058	-8,811	-3	28	-10,105	-12.8	QoQ down reflecting true-up of bonus forecast
Profit from operations	13,930	22,746	25,724	13	85	18,471	39.3	
Finance (expenses)/income	-483	-524	-859	64	78	-737	16.6	
Equity investment/share of loss of associates	-522	818	-120	-115	-77	-450	-73.3	
Equity investment/share of loss of JV	0	0	0			30	-100.0	
<i>Operating margin (%)</i>	<i>32</i>	<i>35</i>	<i>39</i>			<i>27</i>		
Profit before taxation	12,925	23,040	24,745	7	91	17,314	42.9	
Taxation	-2,402	-4,993	-3,123	-37	30	-3,449	-9.4	
Net profit	10,523	18,047	21,622	20	105	13,866	55.9	
Minority interests	6	-41	-825	1,912	-13,850	-120		
Net profit attributable to shareholders of company	10,529	18,006	20,797	16	98	13,746	51.3	
<i>Net margin (%)</i>	<i>24</i>	<i>28</i>	<i>31</i>			<i>20</i>		
Non-GAAP net profit	12,332	17,070	17,454	2	42	15,742	10.9	
<i>Non-GAAP net margin (%)</i>	<i>28</i>	<i>26</i>	<i>26</i>			<i>23</i>		
Diluted EPS (RMB)	1.11	1.89	2.18	15	96	1.44	51.1	
Non-GAAP dil. EPS (RMB)	1.30	1.79	1.83	2	41	1.65	10.8	

Source: Company data, BOCOM Int'l

Figure 2: P&L forecasts

(RMB m)	4Q16	1Q17	4Q17E	1Q18E	2017	2018E	2019E	2020E
Total revenue	43,864	49,552	66,392	71,290	237,760	332,841	436,116	535,349
YoY (%)	44	55	51	44	56	40	31	23
Gross profit	23,626	25,443	31,495	33,537	116,925	153,244	198,666	238,303
YoY (%)	33	37	33	32	38	31	30	20
Gross margin (%)	54	51	47	47	49	46	46	45
Operating profit	13,930	19,272	25,724	22,561	90,302	97,853	122,640	144,616
YoY (%)	28	44	85	17	61	8	25	18
Operating margin (%)	32	39	39	32	38	29	28	27
Non-GAAP net profit	12,332	14,211	17,454	19,366	65,126	83,887	104,584	122,797
YoY (%)	38	42	42	36	43	29	25	17
Non-GAAP net margin (%)	28	29	26	27	27	25	24	23
Diluted EPS (RMB)	1.11	1.52	2.18	1.78	7.50	7.77	9.87	11.71
Non-GAAP Diluted EPS (RMB)	1.30	1.49	1.83	2.03	6.83	8.77	10.92	12.79
Non-GAAP Diluted EPS (HK\$)	1.45	1.68	2.18	2.37	7.91	10.29	13.02	15.25
YoY (%)	28	32	50	41	43	30	26	17

Source: Company data, BOCOM Int'l estimates

22 March 2018

Tencent (700 HK)

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Analyst Stock Ratings:

Buy: The stock's total return is expected to **exceed** that of the corresponding industry over the next 12 months.

Neutral: The stock's total return is expected to be **in line with** that of the corresponding industry over the next 12 months.

Sell: The stock's total return is expected to be **below** that of the corresponding industry over the next 12 months.

Not-Rated: The analyst **does not have conviction** regarding the outlook of the stock's total return relative to that of the corresponding industry over the next 12 months.

Analyst Industry Views:

Outperform: The analyst expects the industry coverage universe to be **attractive** relative to the relevant broad market benchmark over the next 12 months.

Market perform: The analyst expects the industry coverage universe to be **in line with** the relevant broad market benchmark over the next 12 months.

Underperform: The analyst expects the industry coverage universe to be **unattractive** relative to the relevant broad market benchmark over the next 12 months.

Broad market benchmark for Hong Kong is **the Hang Seng Composite Index**, for China A-shares is the **MSCI China A Index**, for US-listed Chinese companies is **S&P US Listed China 50 (USD) Index**.

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