

3 July 2018

Hong Kong

EQUITIES

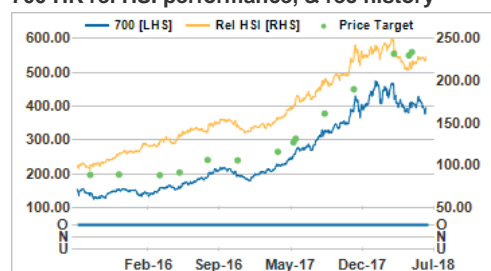
700 HK Outperform
Price (at 13:00, 02 Jul 2018 GMT) HK\$393.80

Valuation	HK\$	560.00
- Sum of Parts		
12-month target	HK\$	560.00
Upside/Downside	%	+42.2
12-month TSR	%	+42.5
Volatility Index		Low
GICS sector		Software & Services
Market cap	HK\$bn	3,743
Market cap	US\$m	477,055
30-day avg turnover	US\$m	1,097.8
Number shares on issue	m	9,504

Investment fundamentals

Year end 31 Dec		2017A	2018E	2019E	2020E
Revenue	bn	237.8	337.4	449.5	542.0
EBIT	bn	90.3	106.3	122.4	142.1
EBIT growth	%	60.9	17.7	15.2	16.0
Reported profit	bn	71.5	81.0	94.6	110.7
Adjusted profit	bn	65.1	81.9	103.2	121.1
EPS rep	Rmb	7.51	8.46	9.83	11.47
EPS rep growth	%	73.2	12.7	16.2	16.6
EPS adj	Rmb	6.83	8.55	10.73	12.54
EPS adj growth	%	42.7	25.1	25.5	16.9
PER rep	x	44.3	39.3	33.8	29.0
PER adj	x	48.7	38.9	31.0	26.5
Total DPS	Rmb	0.74	0.92	1.16	1.35
Total div yield	%	0.2	0.3	0.3	0.4
ROA	%	19.0	17.5	17.0	16.6
ROE	%	28.1	26.0	26.1	24.7
EV/EBITDA	x	27.4	24.2	21.6	19.1
Net debt/equity	%	3.5	-14.8	-31.1	-41.8
P/BV	x	11.4	9.1	7.3	6.0

700 HK rel HSI performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
Source: FactSet, Macquarie Research, July 2018

Analysts

Macquarie Capital Limited



Wendy Huang, CFA +852 3922 3378
wendy.huang@macquarie.com



Marcus Yang +86 21 2412 9087
marcus.yang@macquarie.com



Frank Chen +852 3922 1433
frank.chen@macquarie.com



Ellie Jiang +852 3922 4110
ellie.jiang@macquarie.com

Tencent

A defensive player amid market volatility

Key points

- ▶ We expect mobile game revenue to be weak in 2Q but rebound in 3Q.
- ▶ E-Sports and game streaming to ensure its long-term dominance in game.
- ▶ A hit variety show Produce 101 in 2Q should help video revenue.

Conclusion

- While the stock might be range bound in the near term due to margin pressure, we view Tencent as the most defensive internet stock amid market uncertainties and deglobalization. Reiterate OP and SOTP-based TP HK\$560.

Impact

- **Mobile game: weak 2Q but strong 3Q.** To offset the impact from delayed monetisation of PUBG Mobile, Tencent accelerated the launch of other titles. It launched *FIFA Mobile* on 24 May to ride on the FIFA tide (up to No 4 grossing on iOS at end-June). *King of Fighters Destiny*, another licensed title, ranked up to No16 after the launch on 17 May. *Crossgate Mobile*, the manga RPG based on the hit PC game, has a rank of No 3 now, after the launch on 12 June and has overtaken HoK, No1 on 20 June. *Muses* developed by Kingsoft and published by Tencent is the latest hit. It hit No7 two days after the launch on 27 June. We estimate Tencent's mobile game sales will fall 3% sequentially to Rmb21bn in 2Q18, followed by a 20% rebound to Rmb25bn in 3Q18.
- **Latest regulations on game approval.** On 6 June, [the approval window for China domestic games was closed](#), which we believe is likely due to the reorganization of approval entities. This should have limited impact on Tencent in the near term since it has obtained approval for upcoming titles such as JX II and JX III mobile, etc. In the longer term, we believe the tightening regulations may accelerate industry consolidation and benefit Tencent. On the other hand, PUBG recently [dropped the copyright lawsuit](#) against Fortnite producer Epic Games, which was filed this January. We deem it slightly positive for Tencent, which operates these two hottest games in China.
- **eSports streaming investments to ensure the game dominance.** US\$632m/US\$462m investments in Douyu/Huya in March this year, along with its in-house developed games, have secured Tencent's 89% share in China's game streaming by time spent. That, coupled with its popular tactical tournament titles i.e. League of Legends, PUBG and upcoming Fortnite, has made Tencent unrivaled in the global eSports space, in our view. We believe eSports is increasingly important to Tencent's game ecosystem as eSports now impacts 30% of game revenue in China, generating Rmb86bn value in 2018 per iResearch.

Earnings and target price revision

- 2Q18 earnings cut 4%. 2018/2019 largely unchanged (-1%/0%, respectively).

Price catalyst

- 12-month price target: HK\$560.00 based on a Sum of Parts methodology.
- Catalyst: 2Q18 results in mid-August, launch of Fortnite and JX II

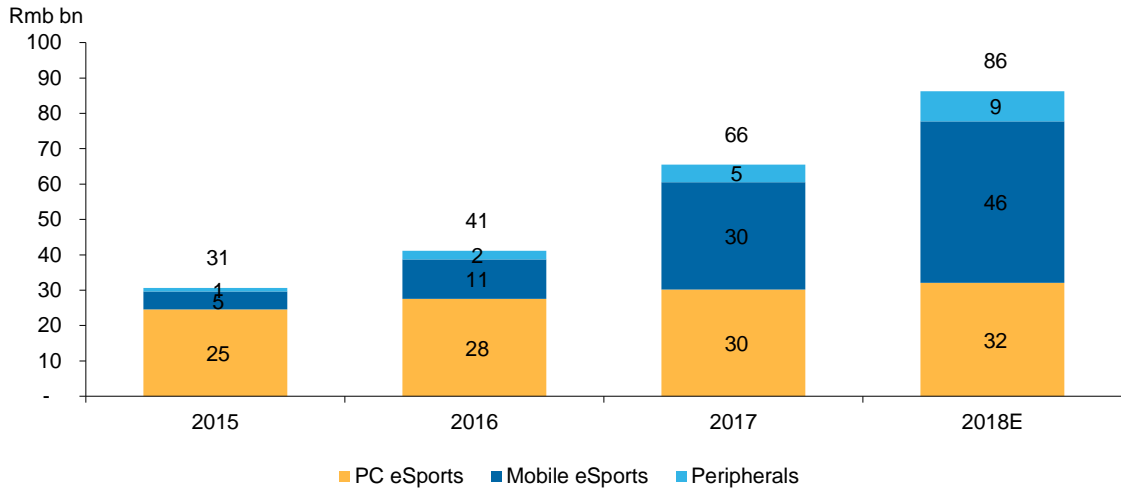
Action and recommendation

- Reiterate Outperform.

eSports: a critical element in Tencent’s evolving game business

According to iResearch, eSports’ related revenue in China has doubled from Rmb31bn in 2015 to Rmb66bn in 2017 and will expand 32% to Rmb86bn in 2018. This will include Rmb32bn from PC esports titles, Rmb46bn from mobile esports titles and Rmb9bn from peripherals such as tournament, sponsorship and merchandize sales etc.

Fig 1 China eSports market size

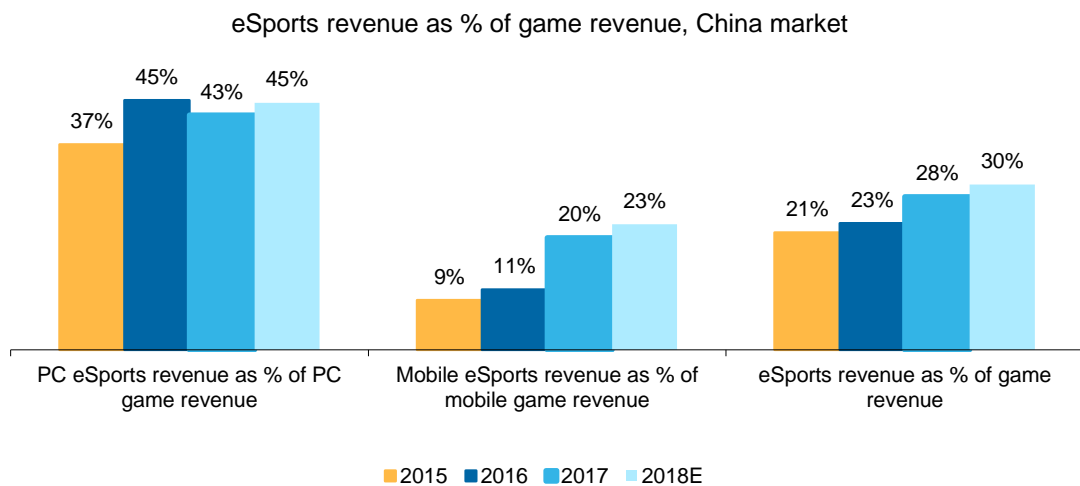


Source: iResearch, July 2018

As Tencent pointed out in 2017, the user time spent within the game is becoming saturated, especially for the PC game. Therefore, Tencent has been expending effort to increase user stickiness through the game interest tribe in Qzone and game streaming as well as esports etc. The increasing importance of eSports is reflected in its revenue impact in recent years. As shown below, 28% of game industry revenue was eSports-related in 2017, and we expect this ratio will go up to 30% in 2018. In particular, major PC games in China and globally are driven by eSports, such as LoL, PUBG and Dota 2. We are not surprised to see esports matter more for the aging PC genre, with 43% of PC game revenue in 2017 eSports-related.

Yet, mobile esports game revenue is growing faster (170% yoy in 2017 and 50% in 2018 per iResearch). This has been driven by titles such as HoK, PUBG mobile. We note the latest hit title Fortnite is also joining the eSports force but as a cross-platform game.

Fig 2 esports impact on China’s game revenue (%)



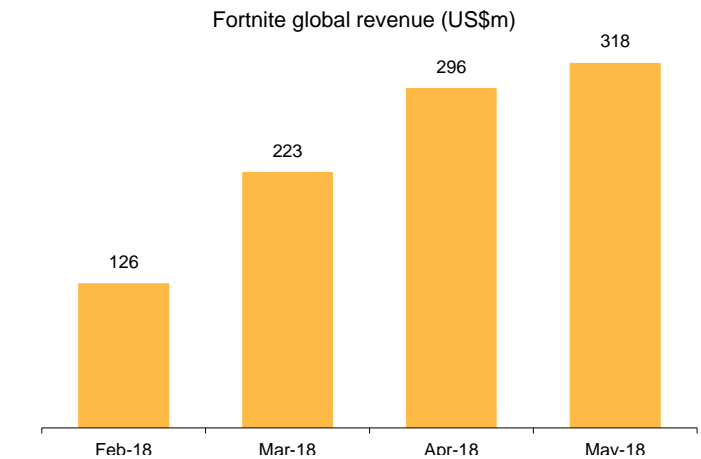
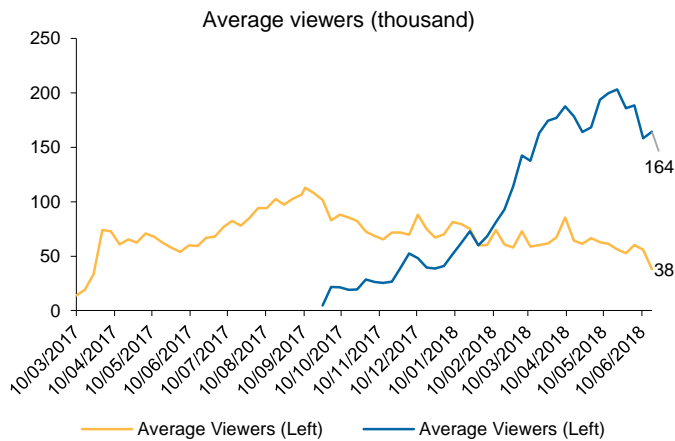
Source: iResearch, Macquarie Research, July 2018

According to latest announcement from PUBG Corp, it draws 87m DAU or 227m MAU globally. Notably, while PUBG mobile is yet to be monetised in China, the DAU and MAU of PUBG: Exciting Battlefield (the major title out of the two PUBG mobile games in China) increased to 34m and 121m in May since its launch in Feb 2018. Even though the matrixes show some softness in May with DAU declining to 31m in the week of 20 May, it recovered entering June and hit an all-time high of 42m.

Another popular global battle royal game Fortnite announced 125m registered users in less than a year. It [announced a US\\$100m prize pool](#) for the esports tournament during the 2018-2019 season.

Fig 3 Twitch average viewers, PUBG vs Fortnite

Fig 4 Fortnite global revenue across all platforms



Source: .Sullygnome, July 2018

Source: SuperData, July 2018

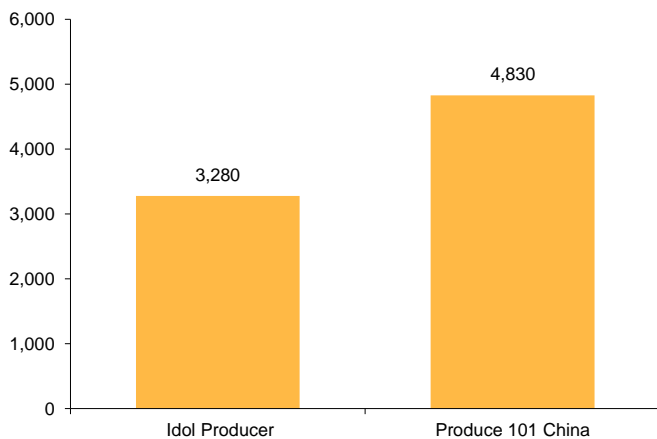
PUBG recently [dropped the copyright lawsuit](#) against Fortnite producer Epic Games, which was filed this January. We deem it slightly positive for Tencent, who operates both PUBG and Fortnite in China.

Tencent is now penetrating further into tier2/3 cities, by holding eSports events, building a stadium and cultivating talent with local governments. In 1H18, fifteen cities collaborated with Tencent on eSports. Tencent will host esports events for LoL in ZhuHai, Cross Fire in ChangSha and HoK in Xi'An. Notably, the esports sponsorship revenue under Tencent surged 197% in 2017, with the sponsor number increasing 171%. Tencent, at the June eSports Conference in China, also announced its sponsor tiering. The first batch of its top-tier sponsors include Vivo and Mercedes Benz.

Tencent video: gaining momentum through Produce 101 China (创造101)

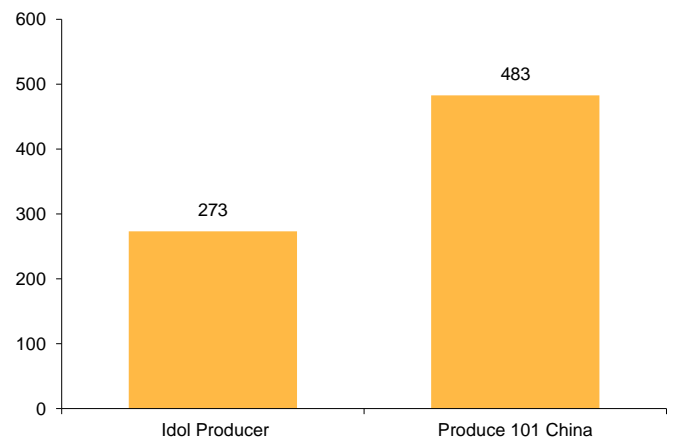
- **Produce 101 China attracted a total of 4.8bn viewership.** Tencent video rolled out the idol competition reality show Produce 101 China on 21 Apr 2018. It consists of 10 episodes with the average length per episode at 159 min. It attracted total viewership of 4.8bn and average viewership of 483m per episodes, 47% and 77% higher than that of iQiyi's Idol Producer (偶像练习生) in Q1, which achieved a total viewership of 3.3bn with 12 episodes and average viewership per episodes at 273m. The final episode of Produce 101 China season 1 aired on 23 Jun 2018, the top 11 young women chosen from among 101 female competitors will go on to form the new girl group Rocket Girls.

Fig 5 Total viewership comparison (m)



Source: Company data, Macquarie Research, July 2018

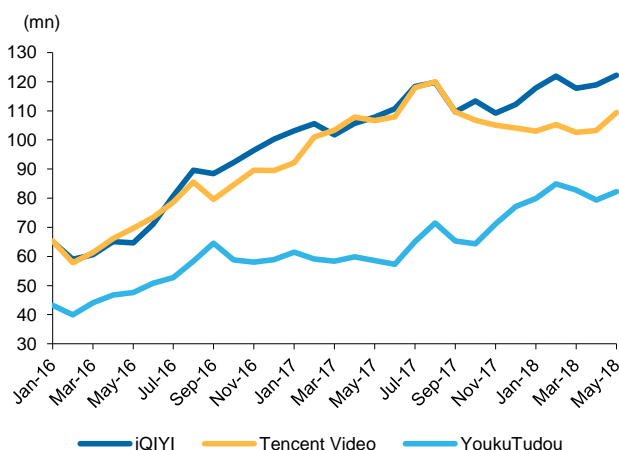
Fig 6 Average viewership per episodes comparison (m)



Source: Company data, Macquarie Research, July 2018

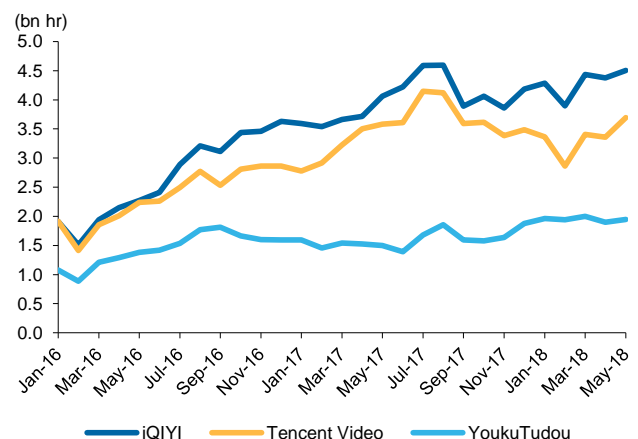
- **Narrowing the gap with iQiyi.** Tencent video is gaining momentum through its blockbuster variety show Produce 101 China. According Questmobile, Tencent video achieved 109m DAU in May 2018, narrowing the gap with iQiyi from -16m in Q1 to -13m in May. In terms of total monthly mobile time spent, Tencent video reached 3.7bn hours and the gap between Tencent video and iQiyi also declined from 1.0bn hours in Q1 to 0.8bn hours in May.

Fig 7 Mobile video DAU comparison



Source: Questmobile, Macquarie Research, July 2018

Fig 8 Mobile video time spent comparison



Source: Questmobile, Macquarie Research, July 2018

With the increasing ad load for Wechat Moment and improving quality of in-house produced content such as Produce 101, we estimate Tencent's ad revenue to increase 35% qoq or 42% yoy to Rmb14bn in 2Q18. On the other hand, we believe the intensifying competition for 3rd party content will keep its advertising margins low for the near term. We also believe Tencent will benefit from an ad budget shift from Toutiao in the near term. After Toutiao's several products being regulated in the past six month, its fastest growing product Douyin (Tik Tok) has also recently been banned from advertising in late June.

2Q18 results due in mid-August

Fig 9 Tencent 2Q18 results preview

(RMB mn)	2Q17A	1Q18A	2Q18E	QoQ	YoY	Consensus	vs consensus
Revenue	56,606	73,528	79,622	8%	41%	79,762	0%
Social networking	12,943	18,099	18,703	3%	44%		
Online games	23,861	28,778	27,359	-5%	15%		
Online ads	10,148	10,689	14,407	35%	42%		
Others	9,654	15,962	19,154	20%	98%		
Cost of sales	-28,300	-36,486	-41,068	13%	45%		
Gross profit	28,306	37,042	38,555	4%	36%	37,594	3%
Operating expenses	-11,830	-15,000	-16,620	11%	40%		
S&M	-3,660	-5,570	-5,944	7%	62%		
G&A	-3,929	-4,424	-5,255	19%	34%		
R&D	-4,241	-5,006	-5,421	8%	28%		
Operating profit	22,560	30,692	23,934	-22%	6%	25,692	-7%
Non-GAAP OP	20,720	21,614	25,271	17%	22%	NA	NA
Net income	18,231	23,290	17,847	-23%	-2%	19,603	-9%
Non-GAAP net income	16,391	18,313	19,527	7%	19%	19,981	-2%
Diluted EPS (RMB)	1.91	2.44	1.86	-23%	-3%	2.01	-7%
Non-GAAP diluted EPS (RMB)	1.72	1.91	2.04	7%	19%	2.10	-3%
GPM	50.0%	50.4%	48.4%	(196 bps)	(158 bps)	47.0%	146 bps
GAAP OPM	39.9%	41.7%	30.1%	(1168 bps)	(980 bps)	32.2%	(215 bps)
Non-GAAP OPM	36.6%	35.0%	32.2%	(280 bps)	(443 bps)		

Source: Bloomberg, Macquarie Research, July 2018

Fig 10 Estimates revision

New estimates (RMB mn)	2Q18E	2018E	2019E	2020E
Revenue	79,622	337,426	449,518	541,952
Social networking	18,703	79,997	105,897	121,305
Online games	27,359	119,514	145,839	165,377
Online advertising	14,407	58,552	76,517	99,178
Others	19,154	79,363	121,265	156,093
Operating profit	23,934	106,253	122,447	142,058
Net profit	17,847	81,028	94,558	110,707
Non-GAAP net profit	19,527	81,893	103,178	121,052
Non-GAAP EPS (RMB)	2.04	8.55	10.73	12.54
Old estimates (RMB mn)	2Q18E	2018E	2019E	2020E
Revenue	81,985	339,934	449,637	544,471
Social networking	19,482	80,825	105,936	122,136
Online games	28,941	121,194	145,919	167,064
Online advertising	14,407	58,552	76,517	99,178
Others	19,154	79,363	121,265	156,093
Operating profit	24,924	107,301	122,490	143,085
Net profit	18,639	81,864	94,604	111,542
Non-GAAP net profit	20,319	82,729	103,224	121,887
Non-GAAP EPS (RMB)	2.12	8.64	10.73	12.62
Estimate revision (RMB mn)	2Q18E	2018E	2019E	2020E
Revenue	-3%	-1%	0%	0%
Social networking	-4%	-1%	0%	-1%
Online games	-5%	-1%	0%	-1%
Online advertising	0%	0%	0%	0%
Others	0%	0%	0%	0%
Operating profit	-4%	-1%	0%	-1%
Net profit	-4%	-1%	0%	-1%
Non-GAAP net profit	-4%	-1%	0%	-1%
Non-GAAP EPS	-4%	-1%	0%	-1%

Source: Macquarie Research, July 2018

Fig 11 China's top grossing mobile games

Grossing rank							Grossing rank						
Jun-29	May-25	Chinese name	English name	Publisher	IP	IP type	May-25	Apr-27	Mar-30	Feb-23	Jan-26	Dec-29	Nov-24
1	=	王者荣耀	Honour of Kings	Tencent	Y	Game	1	1	1	1	1	1	1
2	=	梦幻西游	Fantasy Westward Journey	NetEase	Y	Game, Chinese literature	2	3	3	3	3	3	2
3	New	魔力宝贝手机版	Crossgate Mobile	Tencent	Y	Game	-	-	-	-	-	-	-
4	▲6	乱世王者	King of the times	Tencent	N		10	5	10	22	7	17	8
5	▲4	大话西游	Westward Journey	NetEase	Y	Game	9	7	8	10	9	6	6
6	▲10	崩坏3	Beng Huai 3	MiHoYo	Y	Game	16	9	7	16	24	10	3
7	New	云裳羽衣	Muses	Tencent	N		-	-	-	-	-	-	-
8	▼5	QQ炫舞	QQ Dancers	Tencent	Y	Game	3	18	4	-	-	-	-
9	▼5	FIFA足球世界	FIFA World	Tencent	Y	Game	4	-	-	-	-	-	-
10	▲3	倩女幽魂	Ghost	NetEase	Y	Game	13	12	11	13	11	8	9
11	New	武林外传	Wulin Mobile	Perfect World	Y	Game	-	-	-	-	-	-	-
12	▲2	天龙八部手游	TLBB Mobile	Tencent	Y	Game, Chinese literature	14	13	9	21	17	7	12
13	▲27	全民飞机大战	We Fly	Tencent	N		40	-	35	20	59	36	17
14	▲64	决战！平安京	Onmyoji Arena	NetEase	Y	Game	78	-	59	-	82	-	-
15	▲5	阴阳师	Onmyoji	NetEase	Y	Japanese novel	20	4	23	18	23	12	10

Source: AppAnnie, Macquarie Research, July 2018

Fig 12 Key assumptions

	2015A	2016A	2017A	2018E	2019E	2020E
Revenue (RMB mn)	102,863	151,938	237,760	337,426	449,518	541,952
Social Networking	24,082	36,966	56,100	79,997	105,897	121,305
Online games	56,587	70,844	97,883	119,514	145,839	165,377
Online ads	17,468	26,970	40,439	58,552	76,517	99,178
e-Commerce	645	0	0	0	0	0
Others	4,081	17,158	43,338	79,363	121,265	156,093
% of total revenue						
Social Networking	23%	24%	24%	24%	24%	22%
Online games	55%	47%	41%	35%	32%	31%
Online ads	17%	18%	17%	17%	17%	18%
e-Commerce	1%	0%	0%	0%	0%	0%
Others	4%	11%	18%	24%	27%	29%
YoY growth						
Net revenue	30%	48%	56%	42%	33%	21%
Social Networking	30%	54%	52%	43%	32%	15%
Online games	26%	25%	38%	22%	22%	13%
Online ads	110%	54%	50%	45%	31%	30%
e-Commerce	-86%	0%	0%	0%	0%	0%
Others	59%	320%	153%	83%	53%	29%
Key metrics						
QQ active user account (m)	847	880	834	806	797	789
QQ paying account (m)	87	107	124	159	188	194
VAS ARPU (RMB/month)	77	84	103	104	112	123
Weixin/WeChat MAU (m)	624	826	967	1056	1099	1143

Source: Company data, Macquarie Research, July 2018

Fig 13 New SOTP valuation (2019)

(RMB mn)	2019E revenue	2019E non-GAAP earnings	Valuation (2019)	Est. fair value (RMB bn)	Fair value (US\$ bn)	Fair value/ share (HK\$)
Social networking (QQ + Weixin VAS)	105,897	40,513	30x PE	1,215	187	151
Online game (PC + Mobile game)	145,839	55,793	18x PE	1,004	155	125
Online ads (Portal + Video + Social ads)	76,517	8,702	30x PE	261	40	33
Payment + Cloud	121,265		15x PS	1,819	280	227
Total EV				4,300	661	536
2019E cash per share (HK\$)					29	24
Target price (HK\$)						560

Source: Macquarie Research, July 2018

Fig 14 Old SOTP valuation (2019)

(RMB mn)	2019E revenue	2019E non-GAAP earnings	Valuation (2019)	Est. fair value (RMB bn)	Fair value (US\$ bn)	Fair value/ share (HK\$)
Social networking (QQ + Weixin VAS)	105,936	40,528	30x PE	1,216	187	152
Online game (PC + Mobile game)	145,919	55,824	18x PE	1,005	155	125
Online ads (Portal + Video + Social ads)	76,517	8,703	30x PE	261	40	33
Payment + Cloud	121,265		15x PS	1,819	280	227
Total EV				4,301	662	536
2019E cash per share (HK\$)					29	24
Target price (HK\$)						560

Source: Macquarie Research, July 2018

Fig 15 Ratio summary

YE 31 December		2015	2016	2017	2018E	2019E	2020E	17-18E	18E-19E	18E-21E
Key ratios										
EPS (Non-GAAP diluted)	(HK\$)	4.13	5.38	8.16	10.61	13.31	15.55	30%	25%	20%
EPS (diluted)	(HK\$)	3.67	4.87	8.96	10.49	12.20	14.22	17%	16%	16%
DPS	(HK\$)	0.47	0.61	0.88	1.14	1.44	1.68	30%	25%	20%
BVPS	(HK\$)	15.55	22.08	34.72	45.61	56.64	69.36	31%	24%	23%
Cash per share	(HK\$)	9.90	2.65	0.31	10.78	24.40	38.03	3353%	126%	70%
Diluted share - year end	(mn)	9,430	9,484	9,528	9,578	9,617	9,655	1%	0%	0%
Per Share										
EPS (non-GAAP diluted)	(RMB)	3.44	4.79	6.84	8.55	10.73	12.54	25%	25%	20%
EPS (diluted)	(RMB)	3.05	4.33	7.51	8.46	9.83	11.47	13%	16%	16%
DPS	(RMB)	0.39	0.54	0.74	0.92	1.16	1.35	25%	25%	20%
BVPS	(RMB)	12.95	19.64	29.08	36.77	45.66	55.92	26%	24%	23%
Cash per share	(RMB)	8.24	2.36	0.26	8.69	19.67	30.66	3223%	126%	70%
Value										
EV/Revenue	X	29.5 x	21.3 x	12.8 x	8.7 x	6.5 x	5.4 x	--	--	--
EV/EBITDA	X	64.2 x	47.1 x	26.8 x	22.5 x	20.0 x	17.5 x	--	--	--
EV/FCF	X	65.9 x	5600.5 x	312.0 x	30.1 x	23.7 x	23.2 x	--	--	--
P/E (non-GAAP)	X	95.4 x	73.1 x	48.3 x	37.1 x	29.6 x	25.3 x	--	--	--
P/E (non-GAAP), ex cash	X	93.0 x	72.6 x	48.2 x	36.3 x	27.9 x	23.0 x	--	--	--
Price/ Sales	X	29.8 x	21.6 x	13.0 x	8.8 x	6.6 x	5.5 x	--	--	--
Price/ Book	X	25.3 x	17.8 x	11.3 x	8.6 x	7.0 x	5.7 x	--	--	--
Key forecasts										
Revenue	(RMB mn)	102,863	151,938	237,760	337,426	449,518	541,952	42%	33%	23%
EBITDA	(RMB mn)	47,256	68,746	113,775	130,325	147,119	167,330	15%	13%	13%
Operating Profit	(RMB mn)	40,627	56,117	90,303	106,253	122,447	142,058	18%	15%	16%
Net Income	(RMB mn)	28,806	41,095	71,511	81,028	94,558	110,707	13%	17%	17%
Profitability										
EBITDA Margin	%	46%	45%	48%	39%	33%	31%	(923 bps)	(590 bps)	(821 bps)
Operating Margin	%	39%	37%	38%	31%	27%	26%	(649 bps)	(425 bps)	(521 bps)
Net Margin	%	28%	27%	30%	24%	21%	20%	(606 bps)	(298 bps)	(342 bps)
Cash Flow										
Operating Cash Flow	(RMB mn)	92,732	67,259	130,963	127,448	161,248	170,909	-3%	27%	13%
Free Cash Flow :	(RMB mn)	46,286	578	9,839	98,184	124,570	127,530	898%	27%	12%
+EBIT*(1-t)	(RMB mn)	32,653	45,040	74,186	86,533	99,579	115,489	17%	15%	16%
+D&A	(RMB mn)	6,629	12,629	23,472	24,072	24,672	25,272	3%	2%	2%
+Capex & Investments	(RMB mn)	-51,912	-72,581	-126,707	-37,854	-44,513	-50,682	-70%	18%	15%
+Change in NWC	(RMB mn)	58,915	15,490	38,888	25,433	44,833	37,451	-35%	76%	10%
Yield										
Dividend Yield	%	0.12%	0.15%	0.22%	0.29%	0.36%	0.43%	7 bps	7 bps	21 bps
FCF Yield	%	1.5%	0.0%	0.3%	3.2%	4.1%	4.1%	290 bps	85 bps	121 bps
Earnings Yield	%	0.8%	1.1%	1.9%	2.1%	2.5%	2.9%	24 bps	35 bps	124 bps
Balance Sheet										
Net debt (cash)	(RMB mn)	-77,731	-22,356	-2,492	-83,258	-189,141	-295,986	3241%	127%	70%
Net debt/ equity	(RMB mn)	cash	cash	cash	cash	cash	cash	--	--	--
Shareholders Equity	(RMB mn)	122,100	186,247	277,093	352,208	439,099	539,903	27%	25%	23%
Efficiency										
ROE (average)	%	28%	27%	31%	26%	24%	23%	(512 bps)	(185 bps)	(421 bps)
ROA (average)	%	12%	12%	15%	13%	13%	13%	(167 bps)	(25 bps)	(59 bps)
ROIC (average)	%	27%	24%	26%	24%	24%	24%	(162 bps)	(23 bps)	(95 bps)

*Assume RMB: HKD = 0.81 in this table; Source: Company data, Macquarie Research, July 2018

Fig 16 Financial statements

YE 31 December (RMB mn)	2015	2016	2017	2018E	2019E	2020E	17-18E	18E-19E	18E-21E
Consolidated Income Statement									
Revenue	102,863	151,938	237,760	337,426	449,518	541,952	42%	33%	23%
Social Network	24,082	36,966	56,100	79,997	105,897	121,305	43%	32%	20%
Online Game	56,587	70,844	97,883	119,514	145,839	165,377	22%	22%	15%
Online Ads	17,468	26,970	40,439	58,552	76,517	99,178	45%	31%	29%
e-commerce	645	0	0	0	0	0	--	--	--
Others	4,081	17,158	43,338	79,363	121,265	156,093	83%	53%	31%
Gross Profit	61,232	84,499	116,926	163,413	208,856	247,761	40%	28%	21%
GPM	60%	56%	49%	48%	46%	46%	(75 bps)	(197 bps)	(259 bps)
SG&A	24,818	34,595	50,703	71,811	94,409	113,703	42%	31%	22%
Operating Profit	40,627	56,117	90,303	106,253	122,447	142,058	18%	15%	16%
OPM	39%	37%	38%	31%	27%	26%	(649 bps)	(425 bps)	(521 bps)
PBT	36,216	51,640	88,216	102,848	119,632	139,537	17%	16%	16%
Income Taxes (Credit)	7,108	10,193	15,744	19,088	22,343	26,097	21%	17%	17%
Net Income	28,806	41,095	71,511	81,028	94,558	110,707	13%	17%	17%
Non-GAAP net income	32,410	45,420	65,127	81,893	103,178	121,052	26%	26%	20%
NPM	28%	27%	30%	24%	21%	20%	(606 bps)	(298 bps)	(342 bps)
Non-GAAP NPM	32%	30%	27%	24%	23%	22%	(312 bps)	(132 bps)	(169 bps)
EBITDA	47,256	68,746	113,775	130,325	147,119	167,330	15%	13%	13%
EBITDA Margin	45.9%	45.2%	47.9%	38.6%	33%	31%	(923 bps)	(590 bps)	(821 bps)
Consolidated Balance Sheet									
Current Assets	155,378	149,154	178,446	260,922	361,728	475,862	46%	39%	32%
Cash +	135,500	122,972	144,027	217,904	308,974	414,547	51%	42%	34%
Receivables	7,061	10,152	16,549	23,486	31,288	37,722	42%	33%	23%
Inventories	222	263	295	200	200	200	-32%	0%	0%
Other	12,595	15,767	17,575	19,333	21,266	23,392	10%	10%	10%
Non-current Assets	151,440	246,745	376,226	396,008	421,849	453,259	5%	7%	7%
PP&E	14,513	19,428	27,560	35,116	46,460	60,839	27%	32%	30%
Intangibles	15,732	41,641	45,377	32,655	19,833	6,911	-28%	-39%	--
Available-for-sale financial assets	44,339	83,806	127,218	133,579	140,258	147,271	5%	5%	5%
Deferred Taxes	757	7,033	9,793	11,752	14,102	16,922	20%	20%	20%
Term deposits	3,674	5,415	5,365	5,902	6,492	7,141	10%	10%	10%
Others (incl investment)	72,425	89,422	160,913	177,004	194,705	214,175	10%	10%	10%
Total Assets	306,818	395,899	554,672	656,930	783,577	929,121	18%	19%	18%
Current Liabilities	124,406	101,197	151,740	184,203	237,359	282,099	21%	29%	21%
Deferred revenue	21,122	31,203	42,132	59,793	79,656	96,036	42%	33%	23%
Payables	15,700	27,413	50,085	70,935	93,258	112,317	42%	31%	22%
ST debt	11,429	12,278	15,696	14,126	12,714	11,442	-10%	-10%	-10%
Others	76,155	30,303	43,827	39,348	51,731	62,303	-10%	31%	22%
LT Liabilities	60,312	108,455	125,839	120,519	107,119	107,119	-4%	-11%	-4%
Total Liabilities	184,718	209,652	277,579	304,722	344,478	389,218	10%	13%	12%
Shareholders Equity	122,100	186,247	277,093	352,208	439,099	539,903	27%	25%	23%
Common Stock	0.2	0.2	0.2	0.2	0.2	0.2	0%	0%	0%
Surplus	12,167	17,324	22,204	23,314	24,480	25,704	5%	5%	5%
Retained Earnings	101,503	138,908	205,274	279,278	365,004	464,583	36%	31%	28%
Others	8,430	30,015	49,615	49,615	49,615	49,615	0%	0%	0%
Total Sh. Equity + Liabilities	306,818	395,899	554,672	656,930	783,577	929,121	18%	19%	18%
Consolidated Cash Flow									
Net Income	28,806	41,095	71,511	81,028	94,558	110,707	13%	17%	17%
+ Depreciation and amortization	6,629	12,629	23,472	24,072	24,672	25,272	3%	2%	2%
+ Interest (Income)/Expense	-1,618	-1,955	-2,908	-3,085	-2,815	-2,521	6%	-9%	-6%
+/- Change in NWC	58,915	15,490	38,888	25,433	44,833	37,451	-35%	76%	10%
Operating Cash Flow	92,732	67,259	130,963	127,448	161,248	170,909	-3%	27%	13%
Capex	-4,491	-8,100	-9,094	-12,906	-17,194	-20,729	42%	33%	23%
Intangibles	-3,218	-4,000	-4,491	-6,000	-6,000	-6,000	34%	0%	0%
Other investment	-47,421	-64,481	-117,613	-24,947	-27,320	-29,953	-79%	10%	10%
Investing Cash Flow	-55,130	-76,581	-131,198	-43,854	-50,513	-56,682	-67%	15%	13%
Shares issued (redeemed)	13,813	26,742	24,481	1,110	1,166	1,224	-95%	5%	5%
Cash Dividends	-2,643	-3,690	-5,145	-7,024	-8,832	-11,128	37%	26%	23%
Debt increase (decrease)	29,519	48,992	20,802	-6,890	-14,813	-1,271	--	115%	-45%
Interest Income/(Expense)	1,618	1,955	2,908	3,085	2,815	2,521	6%	-9%	-6%
Others	(7,094)	(77,205)	(21,755)	0	0	0	--	--	--
Financing Cash Flow	35,213	-3,206	21,290	-9,718	-19,664	-8,654	--	102%	2%
Net Change in Cash	72,815	-12,528	21,055	73,877	91,070	105,574	251%	23%	15%
Cash at beginning of period	62,685	135,500	122,972	144,027	217,904	308,974	17%	51%	42%
Cash at end of period	135,500	122,972	144,027	217,904	308,974	414,547	51%	42%	34%

Source: Company data, Macquarie Research, July 2018

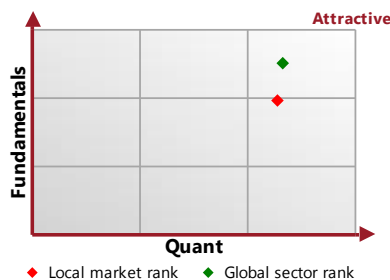
Macquarie Quant View

The quant model currently holds a reasonably positive view on Tencent. The strongest style exposure is Profitability, indicating this stock is efficiently converting investments to earnings; proxied by ratios like ROE or ROA. The weakest style exposure is Valuations, indicating this stock is over-priced in the market relative to its peers.

185/818

Global rank in
Software & Services

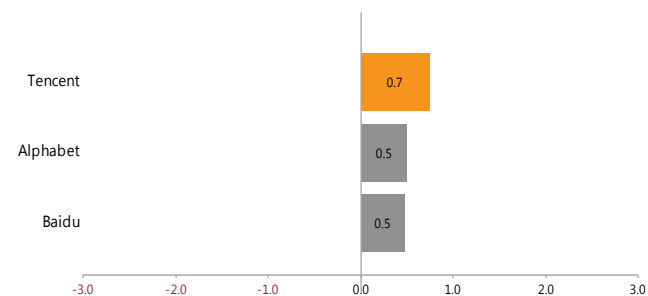
% of BUY recommendations 96% (46/48)
Number of Price Target downgrades 0
Number of Price Target upgrades 7



Displays where the company's ranked based on the fundamental consensus Price Target and Macquarie's Quantitative Alpha model.
Two rankings: Local market (Hong Kong) and Global sector (Software & Services)

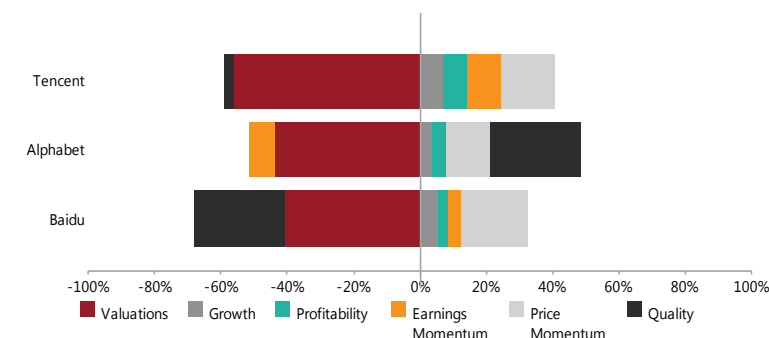
Macquarie Alpha Model ranking

A list of comparable companies and their Macquarie Alpha model score (higher is better).



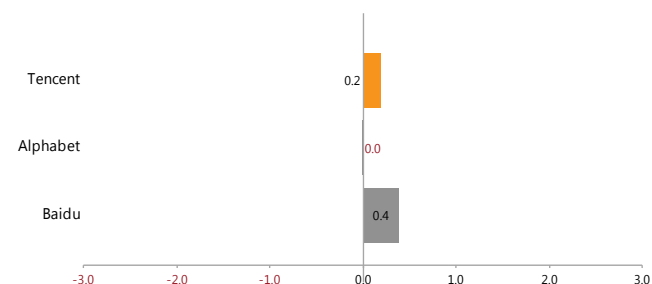
Factors driving the Alpha Model

For the comparable firms this chart shows the key underlying styles and their contribution to the current overall Alpha score.



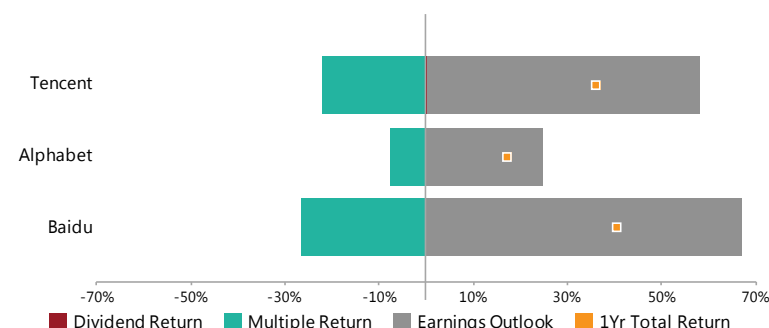
Macquarie Earnings Sentiment Indicator

The Macquarie Sentiment Indicator is an enhanced earnings revisions signal that favours analysts who have more timely and higher conviction revisions. Current score shown below.



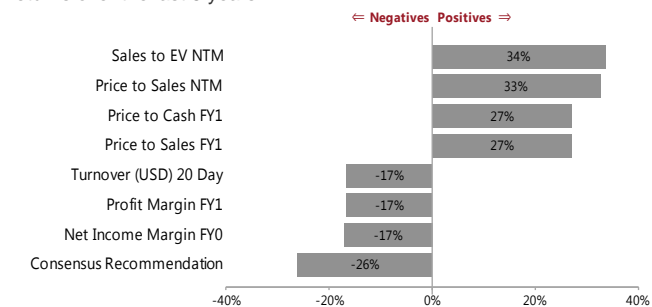
Drivers of Stock Return

Breakdown of 1 year total return (local currency) into returns from dividends, changes in forward earnings estimates and the resulting change in earnings multiple.



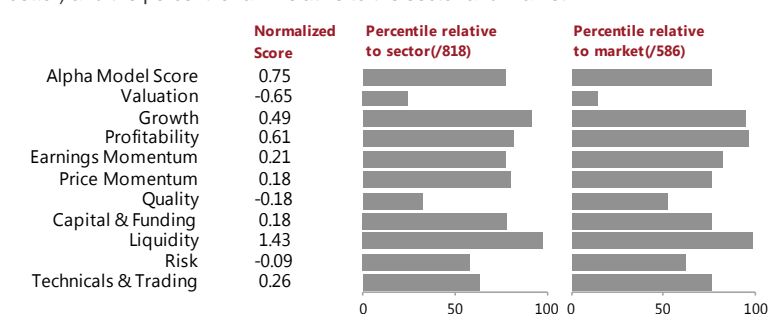
What drove this Company in the last 5 years

Which factor score has had the greatest correlation with the company's returns over the last 5 years.



How it looks on the Alpha model

A more granular view of the underlying style scores that drive the alpha (higher is better) and the percentile rank relative to the sector and market.



Source (all charts): FactSet, Thomson Reuters, and Macquarie Research. For more details on the Macquarie Alpha model or for more customised analysis and screens, please contact the Macquarie Global Quantitative/Custom Products Group (cpq@macquarie.com)

Tencent (700 HK, Outperform, Target Price: HK\$560.00)

Quarterly Results					Profit & Loss						
	1Q/18A	2Q/18E	3Q/18E	4Q/18E		2017A	2018E	2019E	2020E		
Revenue	m	73,528	79,622	88,465	95,810	Revenue	m	237,760	337,426	449,518	541,952
Gross Profit	m	37,042	38,555	42,235	45,581	Gross Profit	m	116,926	163,413	208,856	247,761
Cost of Goods Sold	m	36,486	41,068	46,230	50,229	Cost of Goods Sold	m	120,834	174,012	240,662	294,192
EBITDA	m	36,560	29,802	30,929	32,433	EBITDA	m	113,775	129,725	145,919	165,530
Depreciation	m	5,868	5,868	5,868	5,868	Depreciation	m	23,472	23,472	23,472	23,472
Amortisation of Goodwill	m	0	0	0	0	Amortisation of Goodwill	m	0	0	0	0
Other Amortisation	m	0	0	0	0	Other Amortisation	m	0	0	0	0
EBIT	m	30,692	23,934	25,061	26,565	EBIT	m	90,303	106,253	122,447	142,058
Net Interest Income	m	-973	-771	-771	-889	Net Interest Income	m	-2,087	-3,404	-2,815	-2,521
Associates	m	0	0	0	0	Associates	m	0	0	0	0
Exceptionals	m	4,977	-1,680	-1,781	-2,381	Exceptionals	m	6,384	-865	-8,620	-10,344
Forex Gains / Losses	m	0	0	0	0	Forex Gains / Losses	m	0	0	0	0
Other Pre-Tax Income	m	-4,977	1,680	1,781	2,381	Other Pre-Tax Income	m	-6,384	865	8,620	10,344
Pre-Tax Profit	m	29,719	23,163	24,290	25,676	Pre-Tax Profit	m	88,216	102,848	119,632	139,537
Tax Expense	m	-6,429	-5,316	-5,541	-4,534	Tax Expense	m	-16,705	-21,820	-25,075	-28,829
Net Profit	m	23,290	17,847	18,749	21,142	Net Profit	m	71,511	81,028	94,558	110,707
Minority Interests	m	0	0	0	0	Minority Interests	m	0	0	0	0
Reported Earnings	m	23,290	17,847	18,749	21,142	Reported Earnings	m	71,511	81,028	94,558	110,707
Adjusted Earnings	m	18,313	19,527	20,530	23,523	Adjusted Earnings	m	65,127	81,893	103,178	121,052
EPS (rep)		2.44	1.86	1.96	2.20	EPS (rep)		7.51	8.46	9.83	11.47
EPS (adj)		1.91	2.04	2.14	2.45	EPS (adj)		6.83	8.55	10.73	12.54
EPS Growth yoy (adj)	%	28.2	18.5	19.7	34.0	EPS Growth (adj)	%	42.7	25.1	25.5	16.9
						PE (rep)	x	44.3	39.3	33.8	29.0
						PE (adj)	x	48.7	38.9	31.0	26.5
EBITDA Margin	%	49.7	37.4	35.0	33.9	Total DPS		0.74	0.92	1.16	1.35
EBIT Margin	%	41.7	30.1	28.3	27.7	Total Div Yield	%	0.2	0.3	0.3	0.4
Earnings Split	%	22.4	23.8	25.1	28.7	Basic Shares Outstanding	m	9,536	9,593	9,631	9,670
Revenue Growth	%	48.4	40.7	35.7	44.3	Diluted Shares Outstanding	m	9,528	9,578	9,617	9,655
EBIT Growth	%	59.3	6.1	10.2	3.3						
Profit and Loss Ratios					Cashflow Analysis						
	2017A	2018E	2019E	2020E		2017A	2018E	2019E	2020E		
Revenue Growth	%	56.5	41.9	33.2	20.6	EBITDA	m	113,775	129,725	145,919	165,530
EBITDA Growth	%	65.5	14.0	12.5	13.4	Tax Paid	m	0	0	0	0
EBIT Growth	%	60.9	17.7	15.2	16.0	Chgs in Working Cap	m	-38,888	-25,433	-44,833	-37,451
Gross Profit Margin	%	49.2	48.4	46.5	45.7	Net Interest Paid	m	0	0	0	0
EBITDA Margin	%	47.9	38.4	32.5	30.5	Other	m	56,076	23,156	60,162	42,831
EBIT Margin	%	38.0	31.5	27.2	26.2	Operating Cashflow	m	130,963	127,448	161,248	170,909
Net Profit Margin	%	27.4	24.3	23.0	22.3	Acquisitions	m	0	0	0	0
Payout Ratio	%	10.8	10.8	10.8	10.8	Capex	m	-9,094	-12,906	-17,194	-20,729
EV/EBITDA	x	27.4	24.2	21.6	19.1	Asset Sales	m	0	0	0	0
EV/EBIT	x	34.5	29.5	25.7	22.3	Other	m	-122,104	-30,947	-33,320	-35,953
Investing Cashflow	m	-131,198	-43,854	-50,513	-56,682	Dividend (Ordinary)	m	0	0	0	0
Equity Raised	m	24,481	1,110	1,166	1,224	Debt Movements	m	20,802	-6,890	-14,813	-1,271
Other	m	-23,992	-3,938	-6,017	-8,606	Other	m	-23,992	-3,938	-6,017	-8,606
Financing Cashflow	m	21,290	-9,718	-19,664	-8,654	Net Chg in Cash/Debt	m	21,055	73,877	91,070	105,574
Free Cashflow	m	121,869	114,542	144,054	150,180						
Balance Sheet Ratios					Balance Sheet						
	2017A	2018E	2019E	2020E		2017A	2018E	2019E	2020E		
ROE	%	28.1	26.0	26.1	24.7	Cash	m	144,027	217,904	308,974	414,547
ROA	%	19.0	17.5	17.0	16.6	Receivables	m	16,549	23,486	31,288	37,722
ROIC	%	38.9	29.2	32.2	37.3	Inventories	m	295	200	200	200
Net Debt/Equity	%	3.5	-14.8	-31.1	-41.8	Investments	m	0	0	0	0
Interest Cover	x	43.3	31.2	43.5	56.3	Fixed Assets	m	27,560	35,116	46,460	60,839
Price/Book	x	11.4	9.1	7.3	6.0	Intangibles	m	55,170	44,407	33,935	23,833
Book Value per Share		29.1	36.7	45.6	55.8	Other Assets	m	311,071	335,817	362,720	391,979
						Total Assets	m	554,672	656,930	783,577	929,121
						Payables	m	50,085	70,935	93,258	112,317
						Short Term Debt	m	42,132	59,793	79,656	96,036
						Long Term Debt	m	111,457	106,137	92,737	92,737
						Provisions	m	15,696	14,126	12,714	11,442
						Other Liabilities	m	58,209	53,730	66,113	76,685
						Total Liabilities	m	277,579	304,722	344,478	389,218
						Shareholders' Funds	m	277,093	352,208	439,099	539,903
						Minority Interests	m	0	0	0	0
						Other	m	0	0	0	0
						Total S/H Equity	m	277,093	352,208	439,099	539,903
						Total Liab & S/H Funds	m	554,672	656,930	783,577	929,121

All figures in Rmb unless noted.

Source: Company data, Macquarie Research, July 2018

Important disclosures:

Recommendation definitions

Macquarie - Australia/New Zealand

Outperform – return >3% in excess of benchmark return
 Neutral – return within 3% of benchmark return
 Underperform – return >3% below benchmark return

Benchmark return is determined by long term nominal GDP growth plus 12 month forward market dividend yield

Macquarie – Asia/Europe

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie – South Africa

Outperform – expected return >+10%
 Neutral – expected return from -10% to +10%
 Underperform – expected return <-10%

Macquarie - Canada

Outperform – return >5% in excess of benchmark return
 Neutral – return within 5% of benchmark return
 Underperform – return >5% below benchmark return

Macquarie - USA

Outperform (Buy) – return >5% in excess of Russell 3000 index return
 Neutral (Hold) – return within 5% of Russell 3000 index return
 Underperform (Sell) – return >5% below Russell 3000 index return

Volatility index definition*

This is calculated from the volatility of historical price movements.

Very high-highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.

High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.

Medium – stock should be expected to move up or down at least 30–40% in a year.

Low-medium – stock should be expected to move up or down at least 25–30% in a year.

Low – stock should be expected to move up or down at least 15–25% in a year.

* Applicable to Asia/Australian/NZ/Canada stocks only

Recommendations – 12 months

Note: Quant recommendations may differ from Fundamental Analyst recommendations

Financial definitions

All "Adjusted" data items have had the following adjustments made:

Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense
 Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests

EPS = adjusted net profit / epowa*

ROA = adjusted ebit / average total assets

ROA Banks/Insurance = adjusted net profit / average total assets

ROE = adjusted net profit / average shareholders funds

Gross cashflow = adjusted net profit + depreciation

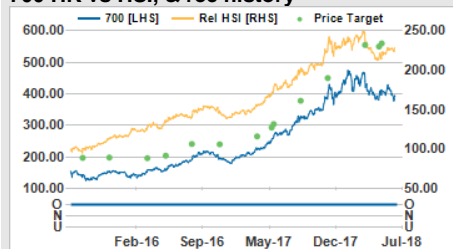
*equivalent fully paid ordinary weighted average number of shares

All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).

Recommendation proportions – For quarter ending 30 June 2018

	AU/NZ	Asia	RSA	USA	CA	EUR	
Outperform	52.87%	61.26%	48.86%	47.54%	69.86%	46.61%	(for global coverage by Macquarie, 3.51% of stocks followed are investment banking clients)
Neutral	34.10%	27.25%	36.36%	46.72%	21.92%	43.22%	(for global coverage by Macquarie, 2.10% of stocks followed are investment banking clients)
Underperform	13.03%	11.49%	14.77%	5.74%	8.22%	10.17%	(for global coverage by Macquarie, 0.00% of stocks followed are investment banking clients)

700 HK vs HSI, & rec history



(all figures in HKD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, June 2018

12-month target price methodology

700 HK: HK\$560.00 based on a Sum of Parts methodology

Company-specific disclosures:

700 HK: Macquarie Capital Limited makes a market in the securities of Tencent Holdings Ltd.

Important disclosure information regarding the subject companies covered in this report is available at www.macquarie.com/research/disclosures.

Date	Stock Code (BBG code)	Recommendation	Target Price
17-May-2018	700 HK	Outperform	HK\$560.00
08-May-2018	700 HK	Outperform	HK\$550.00
22-Mar-2018	700 HK	Outperform	HK\$555.00
16-Nov-2017	700 HK	Outperform	HK\$450.00
17-Aug-2017	700 HK	Outperform	HK\$378.00
18-May-2017	700 HK	Outperform	HK\$304.00
11-May-2017	700 HK	Outperform	HK\$293.00
23-Mar-2017	700 HK	Outperform	HK\$265.00
17-Nov-2016	700 HK	Outperform	HK\$240.00
15-Aug-2016	700 HK	Outperform	HK\$241.00
19-May-2016	700 HK	Outperform	HK\$204.00
18-Mar-2016	700 HK	Outperform	HK\$196.00
11-Nov-2015	700 HK	Outperform	HK\$198.00
13-Aug-2015	700 HK	Outperform	HK\$197.00

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Equities

Asia Research

Head of Equity Research

Jake Lynch (Asia – Head)	(852) 3922 3583
Hiroyuki Sakaida (Japan – Head)	(813) 3512 6695
Conrad Werner (ASEAN – Head)	(65) 6601 0182

Automobiles, Auto Parts

Janet Lewis (China, Japan)	(813) 3512 7856
Allen Yuan (China)	(8621) 2412 9009
James Hong (Korea)	(813) 3512 7476
Amit Mishra (India)	(9122) 6720 4084

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Scott Russell (Asia)	(852) 3922 3567
Dexter Hsu (China, Taiwan)	(8862) 2734 7530
Keisuke Moriyama (Japan)	(813) 3512 7476
Chan Hwang (Korea)	(822) 3705 8643
Suresh Ganapathy (India)	(9122) 6720 4078
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
Anand Pathmakanthan (Malaysia)	(603) 2059 8833
Gilbert Lopez (Philippines)	(632) 857 0892
Ken Ang (Singapore)	(65) 6601 0836

Basic Materials

Polina Diyachkina (Asia, Japan)	(813) 3512 7886
Yasuhiro Nakada (Japan)	(813) 3512 7862
Anna Park (Korea)	(822) 3705 8669
Sumangal Nevatia (India)	(9122) 6720 4093
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
Farrah Aqlima (Malaysia)	(603) 2059 8987

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Conrad Werner (Singapore)	(65) 6601 0182
Gilbert Lopez (Philippines)	(632) 857 0892

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Sunny Chow (China, Hong Kong)	(852) 3922 3768
Stella Li (China, Taiwan)	(8862) 2734 7514
Leon Rapp (Japan)	(813) 3512 7879
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Karisa Magpayo (Philippines)	(632) 857 0899
Chaline Congmuang (Thailand)	(662) 694 7993
Robert Pranata (Indonesia)	(6221) 2598 8366
Richardo Walujo (Indonesia)	(6221) 2598 8369
Denise Soon (Malaysia)	(603) 2059 8845

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Jake Lynch (Asia)	(852) 3922 3583
Kwang Cho (Korea)	(822) 3705 4953
Corinne Jian (Greater China)	(8862) 2734 7522
Conrad Werner (ASEAN)	(65) 6601 0182
Bo Denworlak (Thailand)	(662) 694 7774

Infrastructure, Industrials, Transportation

Patrick Dai (China)	(8621) 2412 9082
Eric Zong (China, Hong Kong)	(852) 3922 4749
Kunio Sakaida (Japan)	(813) 3512 7873
James Hong (Korea)	(822) 3705 8661
Corinne Jian (Taiwan)	(8862) 2734 7522
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Azita Nazrene (ASEAN)	(65) 6601 0560

Internet, Media and Software

Wendy Huang (Asia)	(852) 3922 3378
Marcus Yang (Greater China)	(8862) 2734 7532
David Gibson (Japan)	(813) 3512 7880
Alankar Garude (India)	(9122) 6720 4134

Oil, Gas and Petrochemicals

Aditya Suresh (Asia)	(852) 3922 1265
Anna Park (Asia)	(822) 3705 8669
Polina Diyachkina (Japan)	(813) 3512 7886
Yasuhiro Nakada (Japan)	(813) 3512 7862
Corinne Jian (Taiwan)	(8862) 2734 7522
Ben Shane Lim (Malaysia)	(603) 2059 8868
Yupapan Polpornprasert (Thailand)	(662) 694 7729

Pharmaceuticals and Healthcare

Corinne Jian (China)	(8862) 2734 7522
Alankar Garude (India)	(9122) 6720 4134
Richardo Walujo (Indonesia)	(6221) 259 88 369

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Tomoyoshi Omuro (Japan)	(813) 3512 7474
Abhishek Bhandari (India)	(9122) 6720 4088
Aiman Mohamad (Malaysia)	(603) 2059 8986
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Roy Chen (Singapore)	(65) 6601 0760

Technology

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Kaylin Tsai (Greater China)	(8862) 2734 7523
Lynn Luo (Greater China)	(8862) 2734 7534
Patrick Liao (Greater China)	(8862) 2734 7515
Verena Jeng (Greater China)	(852) 3922 3766
Daniel Kim (Korea)	(822) 3705 8641
Abhishek Bhandari (India)	(9122) 6720 4088
Farrah Aqlima (Malaysia)	(603) 2059 8987

Telecoms

Allen Chang (Greater China)	(852) 3922 1136
Prem Jearajasingam (ASEAN)	(603) 2059 8989
Kervin Sisayan (Philippines)	(632) 857 0893
Nathania Nurhalim (Indonesia)	(6221) 2598 8365

Utilities, Renewables

Hiroyuki Sakaida (Japan)	(813) 3512 6695
Patrick Dai (China)	(8621) 2412 9082
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Karisa Magpayo (Philippines)	(632) 857 0899

Gurvinder Brar (Global)	(44 20) 3037 4036
John Conomos (Asia)	(612) 8232 5157
Alvin Chao (Asia)	(852) 3922 1108
Tracy Chow (Asia)	(852) 3922 4285
YingYing Hou (Asia)	(852) 3922 5422

Strategy, Country

Viktor Shvets (Asia, Global)	(852) 3922 3883
David Ng (China, Hong Kong)	(852) 3922 1291
Hiroyuki Sakaida (Japan)	(813) 3512 6695
Chan Hwang (Korea)	(822) 3705 8643
Jeffrey Ohlweiler (Taiwan)	(8862) 2734 7512
Inderjeetsingh Bhatia (India)	(9122) 6720 4087
Jayden Vantarakis (Indonesia)	(6221) 2598 8310
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Amelia Mehta (Asia)	(65) 6601 0211
Jeffrey Shiu (China, Hong Kong)	(852) 3922 2061
Sandeep Bhatia (India)	(9122) 6720 4101
Thomas Renz (Geneva)	(41 22) 818 7712
Tomohiro Takahashi (Japan)	(813) 3512 7823
John Jay Lee (Korea)	(822) 3705 9988
Nik Hadi (Malaysia)	(603) 2059 8888
Gino C Rojas (Philippines)	(632) 857 0861

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Paul Colaco (San Francisco)	(1 415) 762 5003
Angus Kent (Thailand)	(662) 694 7601
Ben Musgrave (UK/Europe)	(44 20) 3037 4882
Christina Lee (UK/Europe)	(44 20) 3037 4873

Sales Trading

Adam Zaki (Asia)	(852) 3922 2002
Stanley Dunda (Indonesia)	(6221) 515 1555

Sales Trading cont'd

Suhaida Samsudin (Malaysia)	(603) 2059 8888
Michael Santos (Philippines)	(632) 857 0813
Chris Reale (New York)	(1 212) 231 2555
Marc Rosa (New York)	(1 212) 231 2555
Justin Morrison (Singapore)	(65) 6601 0288
Daniel Clarke (Taiwan)	(8862) 2734 7580
Brendan Rake (Thailand)	(662) 694 7707
Mike Keen (UK/Europe)	(44 20) 3037 4905