

Equity research report

TMT

Outperform
(Maintain)

Target Price: 345.8 HKD
Current Price: 310.6HKD
Projected Growth: 11.26%

Market Data

Date	2018-12-24
Closing Price (HKD)	310.6
Total shares (millions)	95.22
Market Cap (billions)	29,575
Net Asset (billions)	3,428
Total Asset (billions)	6,909
Net asset per share	33.26
Source: Wind	

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0700.HK Tencent

Restart approvals of license numbers, the growth of game business is expected to increase by 6%, valuation will reach 24 HKD

November 25, 2018

Key Financials

Year	FY2017A	FY2018E	FY2019E	FY2020E
Revenue (millions RMB)	237,760	312,695	413,296	520,477
YOY (%)	56.5%	31.5%	32.2%	25.9%
Non-GAAP Net profit attributable to Tencent (millions RMB)	66,404	79,039	96,125	127,299
YOY (%)	44.4%	19.0%	21.6%	32.4%
Gross profit margin (%)	49.2%	45.8%	43.9%	43.1%
Net profit margin (%)	30.5%	27.5%	25.2%	26.0%
ROE (%)	171.9%	31.0%	20.4%	19.9%
Non-GAAP EPS (RMB)	6.96	8.30	10.09	13.37
Operating cash flow per share	11.28	11.94	14.64	17.55

Source: Company Disclosure, Industrial Securities Research Institute

Investment highlights

- **Event:** The announcement was made by Feng Shixin, a deputy head in the Communist Party Propaganda Department on 21 December. According to his speech, a list of titles has been approved and will shortly receive license numbers. We believe the announcement is a positive signal to gaming industry, the game business contributes the most profit in the Tencent and the Chinese version of «PUBG Mobile» might benefit from the release of new licenses.
- **The gaming industry was underperforming in 2018, top companies continue to accumulate more market shares.** The increase in China's game business appears to be slowing in 2018, the domestic game business revenue reached 214.44 billion RMB (YoY 5.3%), the mobile game revenue reached 133.96 billion RMB (YoY 15.4%) which is the minimum increase in the past ten years. Tencent's research and development / issue of shares has increased from 27.8%/40.4% in 2016 to 41.7%/58.5% in 2018 (January – November).
- **PUBG is still popular, in term of the game monetization, we see it as positive.** The Chinese version of «PUBG Mobile» has occupied 66% market shares in 18Q3, the MAU has reached 76.34 million on September, which is only behind the «Glory of the king» (MAU: 1.24 billion). Along with the issuing of new licenses, these most popular types of game will boost the Tencent game revenues.
- **Investing proposal: We suggest adjusting the price to 345.8 HKD, and to maintain the outperform rating.** Since the game-business contributes the largest profit in Tencent, we believe that if the Chinese industry regulators reestablish approvals of license numbers, Tencent, which is one of the industry leaders, will be the first to benefit from it. We adjusted the growth of game business in 2019/2020, the whole increasing of game business has raised from 4.59%/3.29% to 10.91%/11.62%. We adjusted DFC model to the price of 345.8HKD with a Non-GAAP PE ratio 27.17x in 2019, and maintained the outperform rating.

Risk tips: 1) game policies; 2) less than expected advertising revenues; 3) margin worsen; 4) less than expected effect of structure adjusts;

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Attachment

Balance sheet		RMB in millions			
Fiscal year	2017A	2018E	2019E	2020E	
Current assets	178,446	189,558	202,905	222,913	
Inventories	295	414	566	723	
Accounts receivable	33,659	39,841	47,392	53,714	
Cash and cash equivalents	105,697	110,508	116,152	129,681	
Other current assets	38,795	38,795	38,795	38,795	
Non-current assets	376,226	533,037	721,091	944,041	
Property, plant and equipment	23,597	34,442	44,589	54,975	
Construction in progress	3,163	4,163	5,263	6,263	
Investment properties	800	801	802	803	
Land use rights	5,111	5,058	5,006	4,955	
Intangible assets	40,266	52,700	68,025	84,768	
Investments in associates	144,581	209,444	290,983	392,359	
Available-for-sale financial assets	127,218	194,940	274,934	368,427	
Other Non-current assets	31,490	31,490	31,490	31,490	
Total assets	554,672	722,595	923,996	1,166,954	
Current liabilities	151,740	185,484	227,475	272,593	
Accounts payable	79,518	108,262	144,253	182,371	
Borrowings	15,696	20,696	26,696	33,696	
Other current liabilities	56,526	56,526	56,526	56,526	
Non-current liabilities	125,839	155,839	185,839	215,839	
Long-term payables	82,094	112,094	142,094	172,094	
Other Non-current liabilities	43,745	43,745	43,745	43,745	
Total liabilities	277,579	341,323	413,314	488,432	
Equity attributable to equity holders of the Company	256,074	358,178	483,716	645,651	
Share capital and Share premium	22,204	22,204	22,204	22,204	
Shares held for share award schemes	-3,970	-3,970	-3,970	-3,970	
Treasury shares	35,158	35,640	35,929	35,078	
Retained earnings	202,682	304,304	429,553	592,339	
Non-controlling interests	21,019	23,093	26,967	32,871	
Total equity	277,093	327,397	456,520	625,210	
Total equity and liabilities	554,672	668,720	869,833	1,113,642	
Cash Flow					
Fiscal year	2017A	2018E	2019E	2020E	
Profit before tax	88,215	102,351	123,962	160,949	
Depreciation and amortization	23,611	26,854	34,659	43,000	
Interest expense	2,908	4,834	5,160	5,573	
Change of working capital	-6,400	-6,182	-7,552	-6,322	
Others	-2,194	-14,119	-16,841	-36,055	
CF from operating	106,140	113,737	139,389	167,145	
CF from investing	-96,392	-136,957	-161,389	-179,823	
CF from financing	26,598	28,030	27,645	26,208	
Net change in cash and cash equivalents	36,346	4,811	5,644	13,529	
Cash and cash equivalents beginning of the year	71,902	105,697	110,508	116,152	
Cash and cash equivalents end of the year	105,697	110,508	116,152	129,681	

Income statement		RMB in millions			
Fiscal year	2017A	2018E	2019E	2020E	
Revenues	237,760	312,695	413,296	520,477	
Cost of revenues	120,835	169,603	231,779	295,987	
Gross profit	116,925	143,092	181,517	224,490	
Interest income	3,940	4,413	5,295	8,473	
Other gains, net	20,140	25,086	28,495	40,784	
Selling and marketing expenses	17,652	25,719	34,097	42,939	
General and administrative expenses	-33,051	-41,648	-54,555	-67,662	
Operating profit	90,302	105,223	126,656	163,145	
Finance costs, net	-2,908	-4,834	-5,160	-5,573	
Share of profit of associates and joint ventures	821	1,961	2,467	3,376	
Profit before income tax	88,215	102,351	123,962	160,949	
Income tax expense	15,744	16,376	19,834	25,752	
Profit for the period	72,471	85,974	104,128	135,197	
Profit attributable to Non-controlling interests	961	1,719	3,124	4,732	
Profit attributable to equity holders of the Company	71,510	84,255	101,005	130,465	
Non-GAAP profit attributable to equity holders of the Company	65,126	76,205	91,789	120,854	
EPS(RMB)	7.60	8.85	10.61	13.70	
Non-GAAP EPS(RMB)	6.96	8.30	10.09	13.37	

Key Financials		2017A	2018E	2019E	2020E
Growth(%)					
Revenue	56.5%	31.5%	32.2%	25.9%	
Operating profit	38.4%	22.4%	26.9%	23.7%	
Net income	74.9%	18.6%	21.1%	29.8%	
Net income attributable to equity holders of the Company	74.0%	17.8%	19.9%	29.2%	
Profit Margin (%)					
Gross Margin	49.2%	45.8%	43.9%	43.1%	
Non-GAAP Net Margin	27.9%	25.3%	23.3%	24.5%	
Non-GAAP Net Margin attributable to equity holders of the Company	27.4%	24.4%	22.2%	23.2%	
ROE	171.9%	31.0%	20.4%	19.9%	
ROA	13.1%	11.9%	11.3%	11.6%	
Solvency test (%)					
Net asset ratio	100.2%	89.5%	80.9%	72.0%	
Debt ratio	50.0%	47.2%	44.7%	41.9%	
Current ratio	1.18	1.02	0.89	0.82	
Quick ratio	1.17	1.02	0.89	0.82	
Operation(times)					
Assets turnover	42.9%	43.3%	44.7%	44.6%	
Accounts payable turnover	0.14	0.13	0.11	0.10	
Per share (RMB)					
Non-GAAP EPS	7.0	8.3	10.1	13.4	
EPS	7.6	8.8	10.6	13.7	
BPS	27.2	37.6	50.8	67.8	
Multiple(x)					
PE(Non-GAAP)	39.4	33.0	27.2	20.5	
PB	10.1	7.3	5.4	4.0	

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- Neutral: Industry performs about the same as that of the whole market;
- Underweight: Industry performs worse than that of the whole market

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