



April 15 2022

Non US Internet | China New Economy • Target Price Change

Internet & Media • Multi-business

Tencent Holdings Limited (SEHK: 700)

COVID hits online ads and fintech, cut TP to HK\$399

- We estimate that Tencent 1Q22's rev./non-IFRS net profit will have 0.9%/(15.2%) YoY change, and are (4.4%)/3.8% vs cons.
- Our 2Q22's rev./non-IFRS net profit missed cons by 8.2%/4.6%. We cut our estimation of online ads and fintech because of current lockdown measures.
- We forecast 2022's EPS will have 5% YoY decline vs 2021, and cut TP to HK\$399, which implies 27.6X PE in 2022.

PC and mobile games show flattish growth

We estimate that Tencent PC games have 0.4% YoY growth, and mobile games have 2.7% YoY decline in 1Q22: 1) <DNF PC> and <Crossfire PC> have about 2%-6% YoY growth because of content update, but <LOL> China and <LOL> overseas have seen 10%-15% YoY decline because of cannibalization from <LOL Mobile>; 2) <HOK> and <PUBG Mobile> gross billings experienced about 15%-20% YoY decline in 1Q22, and the decline will be deferred to the next two quarters; 3) Supercell growth slowed to about 10%-15% YoY in 1Q22, vs 45% YoY in 2021. Supercell implemented more optimization work in 2021, following some key management change. But the growth will also experience slowdown in 2022. 4) Other Tencent overseas games, like <PUBG> and <CODM>, have seen about 15%-20% YoY decline because more people went back to work after COVID. In general, Tencent games are facing some common issues in 1Q22, lack of new games and protection of minors. The re-approve of game code could help save the new-game issue, but Tencent is facing challenges in building its 3A game development capability.

Positive signs in online ads are offset by COVID

We estimate that Tencent online ads will record about 17% YoY decline in 1Q22, with media/social declines about 27%/16% YoY, respectively. Wechat-related ads, including moments, official accounts, and mini programs have more resilience, and other ads, like ads network, QQ/Qzone, Tencent News, and Tencent Video have all seen more than 20% YoY declines. **(To be continued)**

Summary financial data

Highlights (RMB)	2019A	2020A	2021E	2022E	2023E
Revenues (RMB mn)	377,289	482,064	560,118	575,851	647,945
Non-IFRS op. profit (RMB mn)	128,822	149,404	159,539	176,062	197,630
Non-IFRS EPS (RMB)	10.7	12.7	12.8	12.1	12.2
IFRS EPS (RMB)	9.7	16.6	23.2	16.2	17.5
EBITDA margin	46.0%	41.5%	35.8%	39.4%	40.0%
P/E (non-IFRS)	29.3	24.7	24.6	25.9	25.7
Free cash flow yield (%)	4.24	5.61	7.92	5.61	7.46

Source: Tencent Holdings Limited, Blue Lotus (as of Apr 15, 2022)

BUY

HOLD

SELL

Target Price: HK\$399

Current Price: HK\$374

RIC: (SEHK: 700)

BBG: 700 HK

Market cap (HK\$ bn)

3,599

Average daily volume (HK\$ mn)

12,902

Shares out/float (m)

9,613/6,002

Source: Bloomberg, Blue Lotus (as of Apr 15, 2022)

Key Changes

	New	Old	Diff
BLRI Recommendation	HOLD	HOLD	-
BLRI Target Price (HK\$)	399	416	(4.1%)
2021A EPS (RMB)	12.8	12.8	-
2022E EPS (RMB)	12.1	12.4	(2.4%)
2023E EPS (RMB)	12.2	13.3	(8.3%)

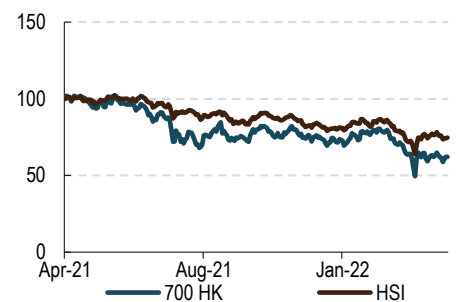
Source: Blue Lotus (as of Apr 15, 2022)

BLRI vs. The Street

No. of Bloomberg Recommendations	71
Target price vs. Bloomberg mean	(22.8%)
1-year-fwd EPS vs. Bloomberg mean	(9.6%)
Bloomberg recommendation	4.65

Source: Bloomberg Recommendation, Blue Lotus (5=BUY, 1=SELL) (as of Apr 15, 2022)

Price performance and volume data



Source: Bloomberg (as of Apr 15, 2022)

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Blue Lotus Capital Advisors Limited

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Tencent Holdings Limited: Financial Summary

Fiscal year ends-31-Dec

Exhibit 1 . Income statement

RMB mn	2021A	2022E	2023E
Revenues	560,118	575,851	647,945
Cost of revenues	(314,174)	(332,999)	(374,689)
Gross profit	245,944	242,852	273,256
G&A cost	(89,847)	(81,523)	(94,482)
Marketing cost	(40,594)	(35,945)	(41,659)
Operating profit IFRS	271,620	220,432	232,587
Share based compensation	(28,946)	(34,152)	(38,428)
Operating profit non-IFRS	159,539	176,062	197,630
Finance cost/income	(7,114)	(6,794)	(6,412)
Other income/cost	156,117	95,049	95,472
Share of profits of asso. and JVs	(16,444)	(16,904)	(17,750)
Pre-tax profit, IFRS	248,062	196,734	208,426
Income tax	(20,252)	(35,121)	(33,348)
Net income, IFRS	227,810	161,613	175,078
Non-controlling interests	2,988	3,365	3,471
EPS, IFRS (RMB)	23.2	16.2	17.5
EPS, non-IFRS(RMB)	12.8	12.1	12.2
Gross margin	43.9%	42.2%	42.2%
Operating margin, non-IFRS	28.5%	30.6%	30.5%

Source: Tencent Holdings Limited, Blue Lotus (as of Apr 15, 2022)

Exhibit 2 . Balance sheet

RMB mn	2021A	2022E	2023E
Cash and cash equivalent	117,930	194,243	305,736
Restricted cash and ST investment	3,024	3,629	4,355
Term deposits over three months	82,184	98,621	118,346
Accounts receivable	58,357	46,025	68,398
Prepayments and others	33,704	46,581	45,808
Inventory	2,470	1,235	617
Total current asset	297,669	390,334	543,259
Property and equipment	25,558	28,777	32,104
Construction in progress	2,470	1,235	617
Invest. in a jointly controlled entity	312,489	328,114	344,520
Intangibles, goodwill and others	20,587	24,373	22,983
Available-for-sale financial assets	444,036	488,439	563,968
Total non-current assets	903,557	978,316	1,081,738
Total assets	1,201,226	1,368,650	1,624,997
Account payables	108,590	111,645	142,322
Accrued expense and others	75,104	79,139	94,944
Deferred revenues	89,045	90,810	115,112
Short-term debt	14,954	15,702	16,487
Total current liabilities	287,693	297,295	368,865
Long-term debt	112,145	112,145	112,145
Other long-term liability	35,513	35,513	35,513
Total non-current liability	147,658	147,658	147,658
Total equity	689,315	844,561	1,026,686
Total liabilities and equity	1,201,226	1,368,650	1,624,997

Source: Tencent Holdings Limited, Blue Lotus (as of Apr 15, 2022)

Company Description

Tencent is China's 2nd largest internet company by revenue and profits and the largest by traffic measures. Founded in 1998, Tencent dominates China's online game industry with nearly 55% of market share in 2021. Apart from online games, the company also has online advertising, fintech, and company services, and other revenue streams.

Industry View

China's entertainment market has continued to grow in recent years. The online game market remains one of the most promising subsectors in the entertainment market. By Dec 2020, the number of mobile game players reached 654mn. In 2021, the total China mobile game market is expected to exceed RMB 240bn.

Exhibit 3 . Cash flow statement

RMB mn	2021A	2022E	2023E
Net income	227,810	161,613	175,078
Adjusted for:			
Depreciation & amortization	40,924	50,631	61,238
Taxation	18,142	20,969	23,014
Net Interest	2,491	(937)	(1,338)
Changes in			
Account receivable	(13,376)	12,332	(22,373)
Inventory	814	2,470	1,235
Account payables	14,560	3,055	30,677
Short term deposit	(14,201)	(17,042)	(20,450)
Other assets	0	0	0
Accrued liabilities and deferred revenues	12,731	5,800	40,107
Cash from operations	174,860	194,146	268,235
Capex, PPE	(15,200)	(15,627)	(17,584)
Capex, land and bldg.	0	0	0
Purchase of intangibles	(37,913)	(42,008)	(45,591)
(Increase) /decrease in term deposits	(6,336)	(7,603)	(9,124)
Cash paid for equity investment	(40,367)	(44,404)	(75,529)
Payment for business combinations	0	0	0
Cash from investing	(109,599)	(119,314)	(157,527)
Cash from financing	(100,129)	1,480	785
Change in cash	(34,868)	76,313	111,493
Cash at beginning	152,798	117,930	194,243
Cash at end	117,930	194,243	305,736

Source: Tencent Holdings Limited, Blue Lotus (as of Apr 15, 2022)

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Pressures on the non-gaming business

- **(Continued)** There have been some positive signs within Tencent ads mainly because some heavily regulated sectors are recovering. For example, online gaming, which takes about 20%-25% of total ads, has seen a stable trend, and will increase after game code re-approval. Internet finance and online education, which take about 5%-10% of total ads, are seeing some growth because loan and non-K12 education advertisers are slightly increasing budgets. However, top major eCommerce advertisers, like PDD, Meituan, and Kuaishou, are trimming their budgets to about RMB 2-4 mn per day vs about 5-8 mn per day in the peak times. Some other sectors, like FMCG and auto, are heavily hit by COVID and macro economy in 2Q22.
- **Social network, cloud, and fintech are also weak:** We estimate that social network will be flattish in 1Q22. Wechat Video Account live-streaming revenue reached about RMB 2bn in 1Q22, which is similar to 4Q21's level. Other live-streaming and membership services have generally experienced declines. We estimate that Tencent cloud revenue to reach about RMB 7 bn in 1Q22, which has about 0%-5% YoY decline. There has been a general slowing of growth of the China cloud market, and more telecom companies, like China Unicom, China Mobile, and China Telecom, have seen much faster growth in cloud businesses because they take more government and state-owned enterprise clients. We estimate that Fintech revenue will reach about RMB 36 bn, and the growth slows to about 16% YoY growth vs +30% YoY growth in 2021. Revenue of online payments will be more impacted by the current lock-down measures in China.
- **Margin is better than 4Q21, but worse than 1Q21:** We estimate that non-IFRS net margin is about 20.6% in 1Q22, which is better than 17.3% in 4Q21. Tencent conducted a series of measures to layoff staffs, close long-term unprofitable businesses, and save cost. But the margin is still lower compared with 24.5% in 1Q21, mainly because the high-margin businesses like online gaming and online ads have seen a very weak trend, and some new businesses, like overseas gaming publishing and Video Account live streaming, have low gross margins.

Exhibit 4 . Tencent's C1Q22E Earnings Preview Table

RMB mn	1Q22E	1Q22C	Diff	4Q21A	QoQ	1Q21A	YoY	2Q22E	2Q22C	Diff
Revenues	136,498	142,781	(4.40%)	144,188	(5.3%)	135,303	0.9%	136,070	148,256	(8.22%)
VAS	73,343			71,913	2.0%	72,443	1.2%	70,086		
Online games	44,663			42,800	4.4%	43,600	2.4%	43,258		
PC games	11,945			10,600	12.7%	11,900	0.4%	10,535		
Mobile games	40,393			40,000	1.0%	41,500	(2.7%)	40,399		
Social networks	28,680			29,100	(1.4%)	28,800	(0.4%)	26,829		
Online advertising	17,980			21,518	(16.4%)	21,820	(17.6%)	19,274		
Fintech and company svcs	45,175			47,958	(5.8%)	39,028	15.8%	45,159		
Cost of revenues	(76,802)			(86,371)	11.1%	(72,668)	(5.7%)	(78,344)		
Gross profit	59,695	60,215	(0.86%)	57,817	3.2%	62,635	(4.7%)	57,727	63,142	(8.58%)
Gross margin	43.7%	42.2%	1.56ppt	40.1%	3.6ppt	46.3%	(2.6ppt)	42.4%	42.6%	(0.17ppt)
S&M expenses	(8,349)			(11,616)	28.1%	(8,530)	2.1%	(8,408)		
G&A expenses	(19,639)			(24,380)	19.4%	(18,967)	(3.5%)	(20,049)		
SBC	(8,463)			(10,063)	15.9%	(4,855)	(74.3%)	(8,513)		
Operating profit	55,469	40,431	37.2%	109,723	(49.4%)	56,273	(1.4%)	53,032	40,784	30.03%
Operating margin	40.6%	28.3%	12.32ppt	76.1%	(35 ppt)	41.6%	(1.0ppt)	39.0%	27.5%	11.47ppt
Operating profit, non-IFRS	63,932			119,786	(46.6%)	61,128	4.6%	61,545		
Pre-SBC operating margin	46.8%			83.1%	(36 ppt)	45.2%	1.7ppt	45.2%		
Profit before taxation	46,742	33,023	41.54%	99,593	(53.1%)	56,254	(16.9%)	46,706	36,135	29.25%
Profit for the quarter	38,397	29,894	28.45%	95,705	(59.9%)	49,008	(21.7%)	38,368	31,826	20.56%
Net margin	28.1%	20.9%	7.19ppt	66.4%	(38 ppt)	36.2%	(8.1ppt)	28.2%	21.5%	6.73ppt
Net income, non-IFRS	28,096	27,058	3.84%	24,880	12.93%	33,118	(15.2%)	28,066	29,411	(4.57%)
Operating matrices										
Mobile gaming gross billing										
HoK (est.)	14,025			15,000	(6.5%)	16,500	(15.0%)	15,750		
Peacekeeper Elite (est.)	6,750			3,600	87.5%	9,000	(25.0%)	4,590		
Fintech and company svcs										
Wexin pay take rate (est.)	0.42%			0.42%		0.42%		0.42%		

Source: Tencent, Bloomberg, Blue Lotus Estimates (as of Apr 15, 2022)

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