



April 12, 2019

China/Asia • Target Price Change

Internet &amp; Media • Multi-business

## Tencent Holdings Limited (SEHK: 700)

### PUBG monetization might be around the corner

- We believe Tencent will try to transfer users from <PUBG Mobile> (刺激战场) to <Peaceful Elite> (和平精英), a game that recently received code approval;
- We therefore estimate the annual gross billing of <Peaceful Elite> may be more than RMB 10 bn. If it can be launched in July, it will bring RMB 6 bn gross billing in 2019, and its net profit maybe more than RMB 2 bn.
- We maintain BUY rating, and raise our TP from HK\$406 to HK\$427

### PUBGm's game code issue might be solved

We estimate that <PUBG Mobile>'s game code issue might be solved. Previously this game cannot be monetized because it didn't have game code approval. Tencent acquired the game code of <Peaceful Elite> on April 10, whose gameplay mode is very similar to <PUBG Mobile>, in our view. We believe the user traffic of <PUBGm> will be transferred to the <Peaceful Elite> in various ways. Monetization will be realized in the new game.

### PUBG mobile has large traffic but limited monetization

According to QuestMobile, <PUBGm> was China's No.1 game with MAU of 186 mn (vs HOK's 185mn) and No.2 game with DAU of 69.2mn (vs HOK's 81.5mn) in February. Yet it generates no revenue so far because it doesn't have game code approval.

### <Peaceful Elite>'s annual gross billing will be >RMB 10 bn

<Peaceful Elite>'s monetization method might include skins, Battle Pass, and other items. We estimate first-month gross billing might reach RMB 1.5bn and steady state gross billing will be ~RMB800 mn, with annual gross billing reaching over RMB 10 bn. If it can be launched in July, it will bring RMB 6bn to Tencent's top line in 2019. After considering the amortization, we believe the game might add Rmb2bn to Tencent's bottom line. The monetization of PUBG mobile will greatly enhance Tencent's medium and long-term profitability. We maintain the BUY rating and raise the target price from HK \$406 to HK \$427.

### Summary financial data

Highlights (RMB)	2015A	2016A	2017A	2018A	2019E	2020E
Revenues (RMB mn)	102,863	151,938	237,760	312,694	426,234	531,804
non-IFRS op. profit (RMB mn)	43,468	58,154	96,555	105,211	122,901	148,331
non-IFRS EPS (RMB)	3.34	4.79	8.14	8.98	10.12	12.10
IFRS EPS (RMB)	3.04	4.32	7.49	8.19	9.14	10.92
EBITDA margin	49%	45%	47%	41%	36%	35%
P/E (non-IFRS)	94.6	66.0	38.8	35.2	31.2	26.1
Free cash flow yield (%)	3.13	0.35	3.19	2.97	4.32	3.12

Source: Bloomberg, Blue Lotus (as of April 11, 2019)

**BUY** **HOLD** **SELL**

<b>Target Price: HK\$427</b>	<b>Current Price: HK\$391</b>
RIC: (SEHK: 700)	BBG: 700 HK
Market cap (HK\$ bn)	3760
Average daily volume (HK\$ mn)	8917.07
Shares out/float (m)	9,520.4/5,707.0

Source: Bloomberg, Blue Lotus (as of April 11, 2019)

### Key Changes

	New	Old	Diff
BLRI Recommendation	BUY	BUY	N/A
BLRI Target Price (HK\$)	427	406	5.17%
2018A EPS (RMB)	8.98	8.98	-
2019E EPS (RMB)	10.12	9.42	7.4%
2020E EPS (RMB)	12.1	11.13	8.7%

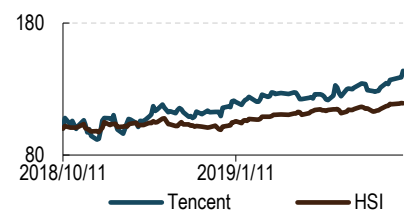
Source: Blue Lotus (as of April 11, 2019)

### BLRI vs. The Street

No. of Bloomberg Recommendations	64
Target price vs. Bloomberg mean	2.89%
1-year-fwd EPS vs. Bloomberg mean	2.60%
Bloomberg recommendation	4.81

Source: Bloomberg Recommendation, Blue Lotus(5=BUY,1=SELL) (as of March 25, 2019)

### Price performance and volume data



Source: Bloomberg (as of April 11, 2019)

### Research team



**Tianli Wen**

Head of Research

[research@blue-lotus.cn](mailto:research@blue-lotus.cn)

**Adam C. Xie**

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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)	2018A	2019E	2020E
Revenues	312,694	426,234	531,804
Cost of revenues	(170,574)	(244,148)	(304,619)
Gross profit	142,120	182,086	227,186
G&A cost	(41,522)	(55,839)	(70,198)
Marketing cost	(24,233)	(34,979)	(43,608)
Operating profit IFRS	97,648	113,524	136,748
Share based compensation	(7,309)	(9,377)	(11,583)
Operating profit non-IFRS	104,957	122,901	148,331
Finance cost/income	(4,669)	(5,995)	(5,816)
Other income/cost	21,283	22,256	23,369
Share of (losses)/profits of JV	1,487	2,000	2,200
Pre-tax profit, IFRS	94,466	109,529	133,132
Income tax	(14,482)	(19,715)	(23,964)
Net income, IFRS	79,984	89,814	109,168
Non-controlling interests	1,265	1,938	2,035
EPS, IFRS	8.2	9.1	10.9
EPS, IFRS	8.9	10.1	12.1
Gross margin	45%	43%	43%
Operating margin, non-IFRS	34%	29%	28%

Source: Tencent Holdings Limited, Blue Lotus (as of April 11, 2019)

## Exhibit 2. Balance sheet

(RMB mn)	2018A	2019E	2020E
Cash and cash equivalent	97,814	187,700	269,469
Restricted cash and ST investment	2,590	3,108	3,730
Term deposits over three months	62,918	75,502	90,602
Accounts receivable	28,427	17,105	38,247
Prepayments and others	18,493	44,603	34,121
Inventory	324	2,440	1,220
Total current asset	217,080	330,457	437,389
Property and equipment	35,091	42,040	55,912
Construction in progress	4,879	2,440	1,220
Investment in a JV	219,215	230,176	241,685
Intangibles, goodwill and others	56,650	45,629	49,790
Available-for-sale financial assets	0	0	0
Total non-current assets	506,441	528,154	575,140
Total assets	723,521	858,611	1,012,529
Account payables	73,735	86,864	115,181
Accrued expense and others	59,491	79,591	69,746
Deferred revenues	42,375	74,402	71,298
Short term debt	26,834	28,176	29,584
Total current liabilities	202,435	269,031	285,810
Long term debt	138,735	87,437	87,437
Other Long-term liability	26,144	14,270	14,270
Total non-current liability	164,879	101,707	101,707
Total equity	323,510	448,222	554,422
Total liabilities and equity	723,521	858,611	1,012,529

Source: Tencent Holdings Limited, Blue Lotus (as of April 11, 2019)

## 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 42% market share in 2015. We expect it to grow beyond the 50% level by 2019. Its other revenues include advertising and e-commerce.

## Industry View

We hold the view that the total revenue of the Chinese game market will increase 6.7% YoY to RMB 229 bn and the mobile game market will increase 15% YoY to RMB 155 bn in 2019. However, PC client game market revenue will decrease 5% YoY to RMB 58.9 bn in 2019.

## Exhibit 3. Cash flow statement

(RMB mn)	2018A	2019E	2020E
Net income	79,984	89,814	109,168
Adjusted for:			
Depreciation & amortization	22,769	29,812	38,944
Taxation	14,482	19,715	23,964
Net Interest	100	1,289	874
Changes in			
Account receivable	(11,878)	11,322	(21,143)
Inventory	(1,745)	324	2,440
Account payables	23,650	13,129	28,318
Short term deposit	(27,178)	(13,102)	(15,722)
Other asset	0	0	0
Accrued liabilities and deferred revenues	4,122	67,046	(12,948)
Cash from operations	116,489	177,369	163,504
Capex, PPE	(17,867)	(24,354)	(30,386)
Capex, land and bldg.	(1,995)	0	0
Purchase of intangibles	(15,635)	(21,312)	(26,590)
(Increase) /decrease in term deposits (>3mths)	5,365	0	0
Cash paid for equity investment	127,218	0	0
Payment for business combinations	0	0	0
Cash from investing	(134,411)	(63,008)	(82,209)
Cash from financing	(1,317)	(13,119)	474
Change in cash	(19,239)	101,241	81,770
Cash at beginning	105,697	97,814	187,700
Cash at end	97,814	187,700	269,469

Source: Tencent Holdings Limited, Blue Lotus (as of April 11, 2019)

See the last page of the report for important disclosures

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### Equity rating allocation as of 4 April, 2019

Buy	51%	Hold	37%	Sell	12%
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### Blue Lotus rating system:

Buy : The stock is expected to have an absolute return of more than 15-20% within 12 months

Hold: The stock is expected to have an absolute return of between 0-15% within 12 months

Sell: The stock is expected to have negative absolute return within 12 months

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