

11 May 2018

Technology | Software & Services

Tencent

Buy (Maintained)

Target Price: HKD540
 Price: HKD406
 Market Cap: USD491,783m
 Bloomberg Ticker: 700 HK

Strong Mobile Game And Advertising Revenue In 1Q18

Reiterate BUY call with unchanged SOP-based TP of HKD540, offering 33% upside and implying 2018F-2019F P/Es of 49x and 36x respectively. Tencent is expected to release its 1Q18 results on 16 May after market close. We expect Tencent to post revenue of CNY72.3bn (+46% YoY) and non-GAAP net profit of CNY19.2bn (+35% YoY) for 1Q18, both of which are slightly higher than consensus, mainly driven by QoQ recovery at its mobile game business and a strong online advertising business. We believe the share price pullback over the past couple of months reflects investors' concerns over its online gaming business (especially PC games), margin pressure (as Tencent is to increase investment from 2018), and competition for user traffic from some emerging platforms. We think these concerns are more short-term focused and are largely priced in at these levels. Tencent's key competitive advantages remain intact, and the potential monetisation of *Weixin* should support strong growth for Tencent going forward.

1Q18 results preview. We expect Tencent to post revenue of CNY72.3bn (+46% YoY) and non-GAAP net profit of CNY19.2bn (+35% YoY) for 1Q18, both of which are slightly higher than consensus. In terms of revenue, we see a 36% YoY growth from social network, 26% YoY growth from online games (mobile games +65% YoY while PC game likely to be flattish), 57% YoY growth from online advertising, and more than doubling of growth from its other businesses including cloud and payment. Overall, we see growth coming from the strong mobile game, social advertising, and payment businesses. Tencent is expected to release its 1Q18 results on 16 May after market close.

Mobile game to resume sequential growth. We expect mobile game revenue to grow by 65% YoY and 26% QoQ to CNY21.3bn, while PC game revenue is likely to remain flattish YoY – these together are likely to contribute 26% YoY growth for its online gaming business. We see strong revenue from its mobile game, *Honor of Kings* (partially due to its promotions during the Lunar New Year in February) with monthly gross billings close to CNY4bn, and *QQspeed* with monthly gross billings close to CNY2bn.

Tencent launched nine new mobile games in 1Q18 (vs seven new mobile games in 1Q17), four of which are ranked top two during the respective periods in terms of the number of downloads. We also see high monetisation potential for the two *Players Unknown Battleground (PUBG)* games launched in 1Q18. Overall, we believe that the nine new game launches in 1Q18, the potential for *PUBG* games, and strong *SpeedQQ* revenue should lay a good foundation for high mobile gaming revenue growth for the full year.

Strong social advertising and large potential from monetisation of *Weixin*. We expect online advertising to grow by 58% YoY and decline by 12% QoQ due to seasonality. We note that Tencent recently stepped up its social advertising inventory in *Weixin Moment* and *Weixin* mini programmes and mini games. In March, it had upgraded its *Weixin* advertising capabilities to increase mini-programme exposure. We think the mini-programmes would play an important role in *Weixin's* monetisation.

Maintain BUY with unchanged TP of HKD540. Our SOP-based TP implies 2018F-2019F P/Es of 49x and 36x respectively. Key risks include intensifying competition for user engagement such as from short videos, regulatory risks such as content controls, and competition in the mobile payment and online video segments.

Forecasts and Valuations	Dec-16	Dec-17	Dec-18F	Dec-19F	Dec-20F
Total turnover (CNYm)	151,938	237,760	334,199	440,173	563,874
Reported net profit (CNYm)	41,095	71,510	75,731	104,017	132,924
Recurring net profit (CNYm)	45,420	65,126	88,102	118,485	150,812
Recurring net profit growth (%)	40.1	43.4	35.3	34.5	27.3
Recurring EPS (CNY)	4.8	6.8	9.2	12.4	15.8
DPS (CNY)	0.12	0.18	0.19	0.26	0.33
Recurring P/E (x)	68.7	48.1	35.6	26.4	20.8
P/B (x)	17.5	12.0	11.6	9.7	8.2
P/CF (x)	122	23	31	19	25
Dividend Yield (%)	0.0	0.1	0.1	0.1	0.1
EV/EBITDA (x)	(4.59)	(7.54)	(7.84)	(4.57)	(2.88)
Return on average equity (%)	27.4	32.7	28.5	35.1	37.8
Net debt to equity (%)	netcash	netcash	11.6	4.9	netcash
Our vs consensus EPS (adjusted) (%)			2.5	5.2	5.3

Source: Company data, RHB

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