

COMPANY RESULTS

Tencent Holdings (700 HK)

2Q23: Robust Ad Growth Momentum Offsets Tempered Online Game Revenue

Tencent's 2Q23 results are slightly below our expectations. Revenue grew 11.3% yoy to Rmb149.2b, 2% below consensus estimates. Gross margin expanded 2ppt yoy to 45.5%, better than the street's expectations. Non-GAAP operating profit surged 36.7% yoy, and non-GAAP OPM expanded 6ppt yoy to 33.6%, better than our estimates. Non-IFRS net profit increased 33.4% yoy, 4% above consensus estimates, given a positive revenue mix shift. Maintain BUY with a slightly lower target price of HK\$433.00.

2023 RESULTS

Year to 31 Dec (Rmbm)	2022A	1Q23A	2Q23A	UOBKHE	QoQ	YoY	Var	Cons	Var
Revenue	134,034	149,986	149,208	153,208	-0.5%	11.3%	-2.6%	151,955	-1.8%
Social networking	29,183	31,037	29,711	30,426	-4.3%	1.8%	-2.3%		
Online games	42,500	48,300	44,500	47,845	-7.9%	4.7%	-7.0%		
Online ads	18,638	20,964	25,003	22,500	19.3%	34.2%	11.1%		
Fintech and Cloud	43,713	49,685	49,994	52,437	0.6%	14.4%	-4.7%		
Gross profit	57,867	68,182	70,840	69,716	3.9%	22.4%	1.6%	68,203	3.9%
Non-GAAP Operating profit	36,667	48,389	50,122	42,447	3.6%	36.7%	18.1%		
Net income	18,619	25,838	26,171	29,834	1.3%	40.6%		32,342	-19.1%
Non-GAAP net income	28,139	32,538	37,548	35,962	15.4%	33.4%	4.4%	36,255	3.6%
GPM	43.2%	45.5%	47.5%	45.5%	2.0 ppts	4.3 ppts	2.0 ppts	44.9%	2.6 ppts
Non-GAAP OPM	27.4%	32.3%	33.6%	27.7%	1.3 ppts	6.2 ppts	5.9 ppts		
Non-GAAP NPM	21.0%	21.7%	25.2%	23.5%	3.5 ppts	4.2 ppts	1.7 ppts	23.9%	1.3 ppts

Source: Tencent, UOB Kay Hian

RESULTS

- **Alleviated momentum in domestic game; international games remain intact.** Tencent Holdings' (Tencent) online games revenue growth came in at Rmb44.5b in 2Q23, +4.7% yoy/-7.9% qoq, dragged by the flattish growth of domestic game revenue, but offset by the solid international games (28.5% of game revenue) growth of 19% yoy (or up 12% yoy, excluding the impact of currency fluctuations), primarily propelled by the strong performance of Triple Match 3D and the expansion pack from Valorant and Nikke. Management stated that the soft domestic game revenue growth was mainly due to lesser commercial content released in 2Q23 after a strong 1Q23 rather than lack of licences released, and expects domestic games revenue to resume yoy growth in 3Q23. The company is confident on its mini-game development and expects the upcoming new game licence approval to stimulate further innovation.
- **Robust growth trajectory in online ad revenue.** Online advertising revenue saw accelerated growth of 34% and came in at Rmb25b, 11% above our estimates. The strong rebound in demand for Video Accounts advertisements generated around Rmb3b in advertising revenue in 2Q23, and boosted continuous advancements in machine learning within the advertising platform. Advertising spending on the platforms grew at a double-digit yoy from every major advertiser category, with the exception of transportation. Tencent also gained market share in e-commerce, apparels and luxury brands during the 618 shopping event.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2021	2022	2023F	2024F	2025F
Net turnover	560,118	554,552	628,170	701,659	785,108
EBITDA	324,617	272,470	200,236	222,866	254,750
Operating profit	271,620	235,706	162,872	184,902	216,186
Net profit (rep./act.)	224,822	188,243	118,311	148,761	166,306
Net profit (adj.)	123,788	115,649	149,547	176,827	197,711
EPS (Fen)	1,269.8	1,183.5	1,539.7	1,820.6	2,031.6
PE (x)	24.1	25.9	19.9	16.8	15.1
P/B (x)	3.6	4.0	3.3	2.8	2.5
EV/EBITDA (x)	9.3	11.0	15.0	13.5	11.8
Dividend yield (%)	0.5	0.5	0.6	0.7	0.8
Net margin (%)	40.1	33.9	18.8	21.2	21.2
Net debt/(cash) to equity (%)	(12.2)	2.6	2.0	(6.3)	(13.3)
Interest cover (x)	45.6	29.1	18.2	22.5	25.8
ROE (%)	29.8	24.6	14.7	15.5	15.1
Consensus net profit	-	-	145,823	172,258	195,363
UOBKH/Consensus (x)	-	-	1.03	1.03	1.01

Source: Tencent Holdings Limited, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK\$328.80
Target Price	HK\$433.00
Upside	+31.7%
(Previous TP)	HK\$435.00

COMPANY DESCRIPTION

The company is one of the largest comprehensive internet service providers.

STOCK DATA

GICS sector	Communication Services
Bloomberg ticker:	700 HK
Shares issued (m):	9,556.2
Market cap (HK\$m):	3,142,091.5
Market cap (US\$m):	401,345.2
3-mth avg daily t'over (US\$m):	830.8

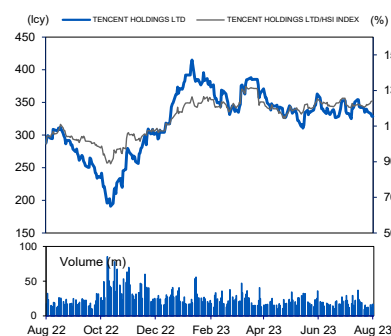
Price Performance (%)

52-week high/low HK\$415.00/HK\$190.72

1mth	3mth	6mth	1yr	YTD
(6.7)	(4.6)	(14.1)	14.3	3.6

Major Shareholders	%
Naspers	26
Ma Hu	7.4
BlackRock Inc	2.5
FY23 NAV/Share (Rmb)	94.01
FY23 Net Debt/Share (Rmb)	1.84

PRICE CHART



Source: Bloomberg

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STOCK IMPACT

- FBS segment.** The fintech and business services' (FBS) segment delivered accelerated revenue growth of 15% yoy, (2Q22: +1% yoy; 1Q23: +14%) to Rmb48.6b. Fintech services recorded double-digit yoy growth in 2Q23, driven by the recovery in: a) both offline and online commercial payment activities, and b) wealth management business with expanded user base and customer assets. Cloud services revenue improved to a low double-digit yoy growth, propelled by the fees generated from live streaming e-commerce transactions on video accounts and modest growth in cloud services.
- Social network revenue** grew 2% yoy to Rmb29.7b, supported by mini games and music subscription services, partially offset by a decline in revenues from music- and games-related live-streaming services.
- Margins expansion across the board.** Gross profit was Rmb70.8b, up 22% yoy with gross margin expanding 4.3ppt yoy to 47.5%. By segment, VAS gross margin grew 3.4ppt yoy to 54.0%, on reduced content costs/bandwidth/server costs. Online advertising gross margins was 48.9% vs 40.6% in 2Q22, supported by the robust advertising revenue growth, offsetting the incremental channel and distribution costs. FinTech and business services gross margin increased 5.1ppt yoy to 38.4% due to increased commercial payment activities. Adjusted operating margin improved by 6.2ppt yoy to 33.6%, thanks to optimisation of operating costs.
- The latest upgrade of Tencent Cloud's MaaS was unveiled** on 16 August during the 2023 China Digital Economy Innovation and Development Conference. Tencent Cloud's TI platform has fully integrated more than 20 mainstream models such as Llama 2, Falcon, Vicuna, Bloom, Alpaca, etc. It facilitates the direct implementation and utilisation of a range of models, featuring a straightforward application procedure and the capacity for complete low-code operation throughout the process. These models can cover various scenarios such as intelligent dialogue, text generation, and writing, providing enterprises and developers with multiple model choices. This advancement has positioned it among the pioneer domestic providers supporting open-source models.

12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

EARNINGS REVISION/RISK

- We have kept our 3Q23 revenue estimates unchanged and trimmed 2023 revenue estimates by 1%. We model revenue growth of 13% in 2023, driven by yoy growth of 8%/27%/16%/6% in online game/advertising/FBS/social network revenue. We raise our non-GAAP net profit forecasts marginally for 3Q23/2023 by 1%/1%, implying a 23%/29% yoy growth with net margin of 25%/24% respectively.
- Risks:** Regulatory risks and slowing growth from game revenue.

VALUATION/RECOMMENDATION

- We maintain BUY on Tencent with a slightly lower target price of HK\$433.00.** Our target price implies 25x PE based on 2023 EPS. The company currently trades at 19.5x 12-month forward PE, 1.4SD below its historical mean of 27.5x.

SHARE PRICE CATALYST

- a) Improving online advertising from Wechat video account, b) game licence approval, and c) collaboration with various internet platform operators on Tencent's WeChat ecosystem.

SOTP-BASED VALUATION

(Rmb m)	2023-24F revenue	2023-24F non-GAAP earnings	Valuation (2023)	Value (LC bn)	% Tencent holding	Est. fair value to Tencent (RMB bn)	Fair value to Tencent (US\$ b)	Fair value/ share (HK\$)
Online game (PC + Mobile game)	194,807	63,683	16x PE	1,019	100%	1,019	146	117
Social networking (QQ + Weixin VAS)	127,824	41,787	16x PE	669	100%	669	96	76
Online ads (Portal + Video + Social ads)	111,684	27,256	18x PE	491	100%	491	70	56
Payment	175,535	35,107	20x PE	702	100%	702	101	80
Cloud	55,064	5x PS	5x PS	275	100%	275	39	31
Total EV	434,316	167,833	13x PE	2,178	100%	2,178	267	361
2023F cash per share (HK\$)								6
Target price (HK\$)								433

Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Net turnover	554,552	628,170	701,659	785,108
EBITDA	272,470	200,236	222,866	254,750
Deprec. & amort.	36,764	37,364	37,964	38,564
EBIT	235,706	162,872	184,902	216,186
Associate contributions	(16,129)	1,239	0	6,917
Net interest income/(expense)	(9,352)	(10,988)	(9,889)	(9,889)
Pre-tax profit	210,225	153,123	175,013	213,213
Tax	(21,516)	(33,403)	(26,252)	(46,907)
Minorities	(466)	(1,408)	0	0
Net profit	188,243	118,311	148,761	166,306
Net profit (adj.)	115,649	149,547	176,827	197,711

CASH FLOW

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Operating	146,091	85,546	180,277	201,446
Pre-tax profit	210,225	153,123	175,013	213,213
Tax	(21,516)	(33,403)	(26,252)	(46,907)
Deprec. & amort.	36,764	37,364	37,964	38,564
Working capital changes	(32,605)	(59,141)	3,441	6,465
Other operating cashflows	(46,777)	(12,396)	(9,889)	(9,889)
Investing	(104,871)	(85,449)	(93,992)	(103,508)
Capex (growth)	0	0	0	0
Others	(104,871)	(85,449)	(93,992)	(103,508)
Financing	(59,953)	(174)	(4,847)	(7,675)
Dividend payments	(14,048)	(13,125)	(16,971)	(20,067)
Issue of shares	(138,828)	3,121	3,277	3,441
Proceeds from borrowings	9,352	10,988	9,889	9,889
Others/interest paid	83,571	(1,158)	(1,042)	(938)
Net cash inflow (outflow)	(18,733)	(77)	81,438	90,263
Beginning cash & cash equivalent	167,966	156,739	156,662	238,100
Changes due to forex impact	7,506	0	0	0
Ending cash & cash equivalent	156,739	156,662	238,100	328,363

BALANCE SHEET

Year to 31 Dec (Rmbm)	2022	2023F	2024F	2025F
Fixed assets	85,731	80,071	73,911	67,251
Other LT assets	926,411	980,156	1,042,344	1,113,948
Cash/ST investment	156,739	156,662	238,100	328,363
Other current assets	409,250	334,805	369,205	407,275
Total assets	1,578,131	1,551,694	1,723,560	1,916,837
ST debt	11,580	10,422	9,380	8,442
Other current liabilities	422,624	396,596	434,438	478,973
LT debt	163,668	163,668	163,668	163,668
Other LT liabilities	197,399	197,399	197,399	197,399
Shareholders' equity	721,391	891,168	1,026,234	1,175,914
Minority interest	61,469	61,469	61,469	61,469
Total liabilities & equity	1,578,131	1,551,694	1,723,560	1,916,837

KEY METRICS

Year to 31 Dec (%)	2022	2023F	2024F	2025F
Profitability				
EBITDA margin	49.1	31.9	31.8	32.4
Pre-tax margin	37.9	24.4	24.9	27.2
Net margin	33.9	18.8	21.2	21.2
ROA	11.8	7.6	9.1	9.1
ROE	24.6	14.7	15.5	15.1
Growth				
Turnover	(1.0)	13.3	11.7	11.9
EBITDA	(16.1)	(26.5)	11.3	14.3
Pre-tax profit	(15.3)	(27.2)	14.3	21.8
Net profit	(16.3)	(37.1)	25.7	11.8
Net profit (adj.)	(6.6)	29.3	18.2	11.8
EPS	(6.8)	30.1	18.2	11.6
Leverage				
Debt to total capital	18.3	15.5	13.7	12.2
Debt to equity	24.3	19.5	16.9	14.6
Net debt/(cash) to equity	2.6	2.0	(6.3)	(13.3)
Interest cover (x)	29.1	18.2	22.5	25.8

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