COMPANY RESULTS

Tencent Holdings (700 HK)

4Q23: In-Line Results; Lifting Shareholder Returns

Tencent's 4Q23 results came in slightly below our expectation. Revenue grew 7.1% yoy to Rmb155.2b, in line with consensus estimate. Gross margin expanded 3ppt yoy to 50%, better than consensus forecast. Non-GAAP operating margin recovered to Rmb52b, while non-GAAP operating margin rose to 34.2%, beating our estimate. Non-IFRS net profit increased 43.7% yoy, 3% above consensus estimate on a positive revenue mix shift. Maintain BUY with a lower target price of HK$382.00.

4Q23 RESULTS

Year to 31 Dec (Rmbm)	4Q22A	3Q23A	4Q23A	UOBKHE	QoQ	YoY	Var	Cons	Var
Revenue	144,954	154,625	155,196	159,243	0.4%	7.1%	-2.5%	157,364	-1.4%
Social networking	28,617	29,748	28,179	30,459	-5.3%	-1.5%	-7.5%		
Online games	41,800	46,000	40,900	43,742	-11.1%	-2.2%	-6.5%		
Online ads	24,660	25,721	29,794	29,623	15.8%	20.8%	0.6%		
Fintech and Cloud	47,244	52,048	54,379	55,419	4.5%	15.1%	-1.9%		
Others	2,633	1,108	1,944	1,944	75.5%	-26.2%	0.0%		
Gross profit	61,822	76,523	77,564	75,051	1.4%	25.5%	3.3%	76,252	1.7%
Non-GAAP OP	-45,672	55,483	53,051	51,130	-4.4%	216.2%	3.8%		
Non-GAAP Net Profit	29,711	44,921	42,708	42,299	-4.9%	43.7%	1.0%	41,469	3.0%
GPM	*42.6%*	*49.5%*	*50.0%*	*47.1%*	*0.5 ppt*	*7.3 ppt*	*2.8 ppt*	*48.5%*	*1.5 ppts*
Non-GAAP OPM	*-31.5%*	*35.9%*	*34.2%*	*32.1%*	*-1.7 ppt*	*65.7 ppt*	*2.1 ppt*		

Source: Tencent, UOB Kay Hian

RESULTS

- **Lacklustre momentum in online games revenue.** Tencent Holdings' (Tencent) online games revenue growth came in at Rmb41b in 4Q23 (-2% yoy, -11% qoq), dampened by the 3% yoy decline in domestic game revenue and soft international games (34% of game revenue) growth of 1% yoy (or -1% yoy, excluding the impact of currency fluctuations), primarily supported by the strong performance of PUBG Mobile and Valorant, but partially offset by impact from Supercell's game repositioning. The weak domestic game revenue growth was due to decreased contributions from HoKs and Peacekeeper Elite, partially offset by contributions from recently-launched games including VALORANT and Lost Ark. The company saw a 50% surge in mini games' gross receipts in 2023.

- **Resilient growth trajectory in online ad revenue.** Online advertising revenue saw solid growth of 21% and came in at Rmb29.8b, bolstered by strong ad demand for video accounts, coupled with the continuous upgrade of its AI-powered advertising technology platform. The monetisation of WeCom and Tencent Meeting was heightened by leveraging on generative AI-powered functionalities. The internet services, healthcare and FMCG categories also delivered notable demand growth in advertising.

KEY FINANCIALS

Year to 31 Dec (Rmbm)	2022	2023	2024F	2025F	2026F
Net turnover	554,552	609,015	669,935	744,731	808,071
EBITDA	188,554	187,543	210,910	243,846	260,729
Operating profit	150,622	174,522	197,289	229,625	245,908
Net profit (rep./act.)	103,159	121,946	158,612	176,167	181,603
Net profit (adj.)	30,565	164,445	185,410	205,956	213,926
EPS (Fen)	312.8	1,702.3	1,924.2	2,133.1	2,211.3
PE (x)	85.0	15.6	13.8	12.5	12.0
P/B (x)	3.5	3.1	2.5	2.1	1.9
EV/EBITDA (x)	11.8	11.9	10.5	9.1	8.5
Dividend yield (%)	0.8	1.1	1.8	2.0	2.2
Net margin (%)	18.6	20.0	23.7	23.7	22.5
Net debt/(cash) to equity (%)	(12.3)	(20.4)	(34.3)	(36.6)	(37.6)
Interest cover (x)	20.2	15.3	19.7	22.8	24.4
ROE (%)	13.5	15.9	17.4	16.1	14.5
Consensus net profit	-	-	183,609	208,409	241,329
UOBKH/Consensus (x)	-	-	1.01	0.99	0.89

Source: Tencent Holdings, Bloomberg, UOB Kay Hian

BUY

(Maintained)

Share Price	HK$288.80
Target Price	HK$382.00
Upside	+32.3%
(Previous TP	*HK$425.00)*

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):	9,431.8
Market cap (HK$m):	2,723,899.0
Market cap (US$m):	348,195.6
3-mth avg daily t'over (US$m):	871.2

Price Performance (%)

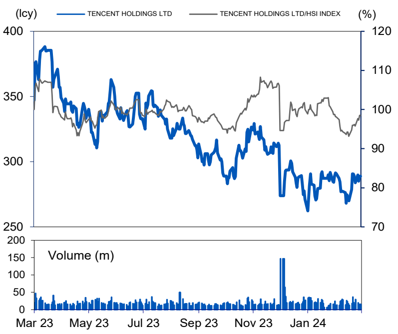
52-week high/low HK$388.20/HK$262.20

1mth	3mth	6mth	1yr	YTD
1.6	(8.1)	(6.6)	(13.7)	(1.6)

Major Shareholders	%
Naspers	25.2
Ma Huateng	7.5
Vanguard Group Inc	3.1

FY24 NAV/Share (Rmb)	107.76
FY24 Net Cash/Share (Rmb)	37.00

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 (4Q22: -1% yoy, 3Q23: +16%) to Rmb54.4b. This is mainly anchored by the growth in commercial payment activities, as well as the expansion of wealth management services and consumer loan services. Business services revenue grew 20% yoy, underpinned by increased e-commerce technology service fees within video accounts, alongside moderate growth in cloud services.
- **Social network revenue down 2% yoy to Rmb28.2b,** resulting from lower revenues from music-related and games-related live streaming services, and partially mitigated by revenue growth from music subscriptions and Mini Games platform service fees.
- **Margin expansion across the board.** Gross profit was Rmb77.6b, up 7.3% yoy with gross margin expanding 7ppt yoy to 50%. By segment, value-added services (VAS) gross margin grew 4ppt yoy to 53.7%, on higher contribution of high-margin game revenues and Mini Games platform service fees. Online advertising gross margin was 56.8% vs 44.2% in 4Q22, resulting from robust growth in high-quality revenue streams, especially from video accounts advertising. FBS gross margin increased 10ppt yoy to 41.8%, benefitting from the cloud business' restructuring. Operating margin improved by 7ppt yoy to 29.2%, thanks to optimisation of operating costs.
- **Continuous returns to shareholders.** Tencent paid final dividends of HK$22,762m (vs 2022: HK$15,260m) during the year ended 31 Dec 23. It also proposed to increase its annual dividend by 42% for the year to HK$3.40 per share (equivalent to HK$32b). Management intends to at least double the size of share repurchases, from HK$49b in 2023 to over HK$100b in 2024. In total, the shareholder return comes to about 5%.
- **Highly anticipated blockbuster in 2Q24.** DNF Mobile has made new progress and started its pre-emptive closed beta test on 29 Feb 24. It is scheduled to accelerate its launch date to 2Q24.
- **DreamStar reached 129m registered users in the first three months.** Data showed that DreamStar garnered a total of 129m new registered users across all channels in 1Q24. In addition, Tencent's new frontline line-up of games is gaining momentum, with titles such as Battle of Golden Shovels, League of Legends and Arena Breakout witnessing significant yoy growth in revenue and daily active users in January and February.

EARNINGS REVISION/RISK

- We keep our 1Q24 revenue estimate largely unchanged but trimmed 2024 revenue estimate by 1% after factoring in the lack of growth drivers for online game revenue. We model revenue growth of 8%/10% in 1Q24/2024 respectively. We also raise our non-GAAP net profit forecasts for 1Q24/2024 by 4%/3%, implying a 40%/18% yoy growth with net margin of 28%/28% respectively.
- **Risks:** Regulatory risks and slowing growth from game revenue.

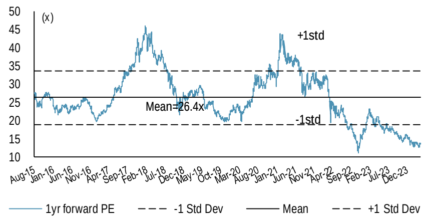
VALUATION/RECOMMENDATION

- **We maintain BUY on Tencent with a lower target price of HK$382.00** based on our 2024 SOTP valuation. Our target price implies 18x 2024F PE. The company currently trades at 13.7x 12-month forward PE, 1.7SD below its historical mean of 26.4x.

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.

12-MONTH FORWARD PE BAND



Source: Bloomberg, UOB Kay Hian

SOTP DETAILS

(Rmb m)	2024F revenue	2024F non-GAAP earnings	Valuation (2024)	Value (LC bn)	% Tencent holding	Est. fair value to Tencent (RMB bn)	Fair value to Tencent (US$ b)	Fair value/ share (HK$)
Online game (PC + Mobile game)	191,847	67,917	15x PE	1,019	100%	1,019	141	116
Social networking (QQ + Wexin VAS)	125,204	44,324	17x PE	754	100%	754	105	86
Online ads (Portal + Video + Social ads)	118,711	33,443	15x PE	502	100%	502	70	57
Payment	184,079	39,025	15x PE	585	100%	585	81	67
Cloud	50,093		3x PS	150	100%	150	21	17
Total EV	435,763	184,708	12x PE	2,274	100%	2,274	255	342
Total (10% discount)						241.3	35.1	28.3
2024F cash per share (HK$)								11
Target price (HK$)								382

Source: UOB Kay Hian

PROFIT & LOSS

Year to 31 Dec (Rmbm)	2023	2024F	2025F	2026F
Net turnover	609,015	669,935	744,731	808,071
EBITDA	187,543	210,910	243,846	260,729
Deprec. & amort.	13,021	13,621	14,221	14,821
EBIT	174,522	197,289	229,625	245,908
Associate contributions	5,800	0	6,917	6,917
Net interest income/(expense)	(12,268)	(10,687)	(10,687)	(10,687)
Pre-tax profit	168,054	186,603	225,855	242,138
Tax	(43,276)	(27,990)	(49,688)	(60,534)
Minorities	(2,832)	0	0	0
Net profit	121,946	158,612	176,167	181,603
Net profit (adj.)	164,445	185,410	205,956	213,926

BALANCE SHEET

Year to 31 Dec (Rmbm)	2023	2024F	2025F	2026F
Fixed assets	87,279	114,141	144,129	176,688
Other LT assets	971,521	1,051,798	1,140,784	1,239,475
Cash/ST investment	362,121	542,191	618,864	688,126
Other current assets	156,325	188,409	208,022	227,674
Total assets	1,577,246	1,896,539	2,111,798	2,331,962
ST debt	41,537	37,383	33,645	30,280
Other current liabilities	310,620	426,363	488,241	551,444
LT debt	155,819	155,819	155,819	155,819
Other LT liabilities	195,589	195,589	195,589	195,589
Shareholders' equity	808,591	1,016,294	1,173,415	1,333,740
Minority interest	65,090	65,090	65,090	65,090
Total liabilities & equity	1,577,246	1,896,539	2,111,798	2,331,962

CASH FLOW

Year to 31 Dec (Rmbm)	2023	2024F	2025F	2026F
Operating	221,962	500,097	221,965	229,290
Pre-tax profit	168,054	186,603	225,855	242,138
Tax	(43,276)	(27,990)	(49,688)	(60,534)
Deprec. & amort.	13,021	13,621	14,221	14,821
Working capital changes	33,362	338,550	42,264	43,552
Other operating cashflows	50,801	(10,687)	(10,687)	(10,687)
Investing	(125,161)	(120,760)	(133,195)	(146,071)
Capex (growth)	(7,524)	(32,479)	(36,105)	(39,176)
Others	(117,637)	(88,281)	(97,090)	(106,895)
Financing	(82,573)	(9,465)	(12,098)	(13,956)
Dividend payments	(13,125)	(17,898)	(21,041)	(23,373)
Issue of shares	(13,488)	1,899	1,994	2,094
Proceeds from borrowings	12,268	10,687	10,687	10,687
Others/interest paid	(68,228)	(4,154)	(3,738)	(3,364)
Net cash inflow (outflow)	14,228	369,871	76,672	69,263
Beginning cash & cash equivalent	156,739	172,320	542,191	618,864
Changes due to forex impact	1,353	0	0	0
Ending cash & cash equivalent	362,121	542,191	618,864	688,126

KEY METRICS

Year to 31 Dec (%)	2023	2024F	2025F	2026F
Profitability				
EBITDA margin	30.8	31.5	32.7	32.3
Pre-tax margin	27.6	27.9	30.3	30.0
Net margin	20.0	23.7	23.7	22.5
ROA	7.7	9.1	8.8	8.2
ROE	15.9	17.4	16.1	14.5
Growth				
Turnover	9.8	10.0	11.2	8.5
EBITDA	(0.5)	12.5	15.6	6.9
Pre-tax profit	34.3	11.0	21.0	7.2
Net profit	18.2	30.1	11.1	3.1
Net profit (adj.)	438.0	12.7	11.1	3.9
EPS	444.3	13.0	10.9	3.7
Leverage				
Debt to total capital	18.4	15.2	13.3	11.7
Debt to equity	24.4	19.0	16.1	14.0
Net debt/(cash) to equity	(20.4)	(34.3)	(36.6)	(37.6)
Interest cover (x)	15.3	19.7	22.8	24.4

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