

Tencent (700 HK)

Eyes on efficiency and video accounts upside

Tencent delivered its 2Q22 results, with topline/bottom line -3%/-17% YoY (topline largely in line while bottom line beat 15%). We view this result as relatively positive, given better-than-feared ads and margin improvement. Game softness may linger in 2H22E, but has been partly priced in. We believe the worst quarter is behind, and suggest to move into 2H22E ads recovery and LT upside from video accounts. We are impressed by video accounts' faster-than-expected monetization (in-feed ads/bidding ads in Jul/Aug). Mgmt guided video accounts to contribute >RMB1bn rev quarterly within five quarters. Efficiency improvement would continue in 2H22E, boosting earnings to resume YoY growth. As such, we lifted our earnings by 1-4% in FY22-24E, with TP at **HK\$480**.

- 2Q22 beat on margin.** 2Q22 rev was RMB134.0bn, down 3.1% YoY, 1%/1% below consensus/ our estimate, mainly on moderate games and softer FBS. By segment, VAS/ ads/ others +0%/-18%/+1% YoY (vs. our estimates of +2%/-25%/+3% YoY). Non-GAAP net profit declined 17% YoY to RMB28.1bn, 15% above consensus, on effective opex control.
- Looking into 2H22E ads recovery, with video accounts to bring LT upside.** Games -1% YoY in 2Q22 (3% below our estimate), in which domestic game -1% YoY (largely in line) and international games decelerated to -1% YoY (vs. +4% in 1Q22). Domestic mobile grossing in Jun and Jul still declined YoY (according to third-party channels), but partly priced in recent weak price. We suggest to look beyond soft game, and eye on ads recovery and video accounts upside. Ads -18% YoY in 2Q22 (9% above our estimate), on solid ecommerce ads recovery. We expect 2Q22 to be ads trough, and 2H22E would see gradual recovery with lockdown relaxation and macro recovery. Additionally, Tencent launched video accounts in-feed ads in Jul, and plans to launch bidding ads in Aug. Mgmt guided video accounts to contribute >RMB1bn rev quarterly with five quarters, backed by strong video views growth and better targeting. We are impressed by its faster-than-expected monetization, and expect it to be a LT ads driver, with higher ad loads and better user experience.
- Efficiency improvement to continue.** 2Q22E non-GAAP net profit +10% QoQ, with margin at 21% (+2ppts QoQ). Mgmt guided 2H22E earnings to resume YoY growth, backed by continuous cost optimization (e.g. non-core biz closure, disciplined S&M, long form video spending control).
- Maintain BUY.** We slightly raised our earnings by 1-4% in FY22-24E to reflect better cost control, with TP at **HK\$480** (31x FY23E P/E).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	482,064	560,118	566,719	645,098	725,536
YoY growth (%)	27.8	16.2	1.2	13.8	12.5
Net income (RMB mn)	122,742	123,788	110,871	129,599	150,115
Adj. EPS (RMB)	12.7	12.8	11.4	13.2	15.1
YoY growth (%)	30.1	0.9	(10.4)	16.9	15.8
Consensus EPS (RMB)	NA	NA	11.6	14.3	17.1
P/E (x)	20.3	20.2	22.6	19.6	17.1
P/S (x)	5.2	4.5	4.4	3.9	3.5
Yield (%)	0.5	0.5	0.5	0.6	0.6
ROE (%)	21.8	17.4	15.4	12.0	12.4
Net gearing (%)	Net cash	Net cash	Net cash	Net cash	Net cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$480
(Previous TP)	HK\$480)
Up/Downside	58.4%
Current Price	HK\$303

China Internet Sector

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Stock Data

Mkt Cap (HK\$ mn)	2,891,232
Avg 3 mths t/o (HK\$ mn)	8,440.22
52w High/Low (HK\$)	513.6/ 288.0
Total Issued Shares (mn)	9,618

Source: Bloomberg

Shareholding Structure

Naspers	28.81%
Ma Huateng	7.38%
Vanguard	2.18%

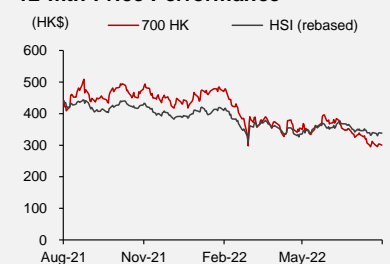
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-9.2%	-6.6%
3-mth	-14.2%	-15.3%
6-mth	-35.6%	-21.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: PwC

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Figure 1: 2Q22 financial review

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	QoQ	YoY	Consensus	Diff %	CMBI	Diff %
Revenue	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	135,471	134,034	-1.1%	-3.1%	135,598	-1%	135,718	-1%
Operating Profit	37,260	39,311	43,953	63,713	56,273	52,487	53,137	109,723	37,217	30,067	-19.2%	-42.7%	37,451	-20%	30,836	-2%
Net profit	28,896	33,107	38,542	59,302	47,767	42,587	39,510	94,958	23,413	19,230	-17.9%	-54.8%	25,030	-23%	23,632	-19%
Adj. net profit	27,079	30,153	32,303	33,207	33,118	34,039	31,751	24,880	25,545	28,139	10.2%	-17.3%	24,388	15%	28,864	-3%
Adj. EPS	2.82	3.13	3.31	3.41	3.42	3.51	3.33	2.55	2.62	2.89	10.3%	-17.7%	2.51	15%	2.96	-2%
Margin (%)																
Gross Margin	48.9%	46.3%	45.2%	44.0%	46.3%	45.4%	44.1%	40.1%	42.1%	43.0%			41.7%		43.5%	
Operating Margin	34.5%	34.2%	35.0%	47.7%	41.6%	38.0%	37.3%	76.1%	27.5%	22.4%			27.6%		22.7%	
Adj. net margin	25.1%	26.2%	25.8%	24.8%	24.5%	24.6%	22.3%	17.3%	18.9%	21.0%			18.0%		21.3%	
Growth (%)																
Revenue (YoY)	26.4%	29.3%	29.0%	26.4%	25.2%	20.3%	13.5%	7.9%	0.1%	-3.1%			-1.9%		-1.8%	
Revenue (QoQ)	2.2%	6.3%	9.2%	6.6%	1.2%	2.2%	3.0%	1.3%	-6.0%	-1.1%			0.1%		0.2%	
Operating Profit	1.4%	42.8%	51.0%	122.7%	51.0%	33.5%	20.9%	72.2%	-33.9%	-42.7%			-28.6%		-41.3%	
Adj. net profit	29.4%	28.2%	32.3%	30.3%	22.3%	12.9%	-1.7%	-25.1%	-22.9%	-17.3%			-28.4%		-15.2%	

Source: Company data, Bloomberg, CMBIGM estimates

Figure 2: Revenue breakdown

RMB mn	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	QoQ	YoY
Total revenue	108,065	114,883	125,447	133,669	135,303	138,259	142,368	144,188	135,471	134,034	-1%	-3%
VAS	62,429	65,002	69,802	66,979	72,443	72,013	75,203	71,913	72,738	71,683	-1%	0%
- Online games	37,298	38,288	41,422	39,100	43,600	43,000	44,903	42,813	43,494	42,483	-2%	-1%
- Social network	25,131	26,714	28,380	27,879	28,843	29,013	30,300	29,100	29,244	29,200	0%	1%
Online advertisin	17,713	18,552	21,351	24,655	21,820	22,833	22,495	21,518	17,988	18,638	4%	-18%
Others	27,923	31,329	34,294	42,035	41,040	43,413	44,670	50,757	44,745	43,713	-2%	1%

Source: Company data

Figure 3: CMBIGM estimates vs. consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	566,719	645,098	725,536	578,442	660,887	745,358	-2.0%	-2.4%	-2.7%
Gross profit	242,557	280,244	318,662	242,746	280,416	318,658	-0.1%	-0.1%	0.0%
Operating profit	136,253	137,619	158,850	159,058	187,237	213,596	-14.3%	-26.5%	-25.6%
Net profit	110,871	129,599	150,115	113,307	141,209	166,507	-2.2%	-8.2%	-9.8%
Adj. EPS (RMB)	11.39	13.18	15.12	11.58	14.34	17.07	-1.6%	-8.1%	-11.4%
Gross margin	42.8%	43.4%	43.9%	42.0%	42.4%	42.8%	+0.8ppts	+1.0ppts	+1.2ppts
Operating margin	24.0%	21.3%	21.9%	27.5%	28.3%	28.7%	-3.5ppts	-7.0ppts	-6.8ppts
Net margin	19.6%	20.1%	20.7%	19.6%	21.4%	22.3%	-0.0ppts	-1.3ppts	-1.6ppts

Source: CMBIGM estimates, Bloomberg

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	566,719	645,098	725,536	573,431	654,665	738,871	-1.2%	-1.5%	-1.8%
Gross profit	242,557	280,244	318,662	245,389	283,645	323,003	-1.2%	-1.2%	-1.3%
Operating profit	136,253	137,619	158,850	135,224	160,447	181,591	0.8%	-14.2%	-12.5%
Adj. net profit	110,871	129,599	150,115	106,882	127,571	148,197	3.7%	1.6%	1.3%
EPS (RMB)	11.39	13.18	15.12	10.95	12.94	14.88	4.0%	1.9%	1.6%
Gross margin	42.8%	43.4%	43.9%	42.8%	43.3%	43.7%	+0.0ppts	+0.1ppts	+0.2ppts
Operating margin	24.0%	21.3%	21.9%	23.6%	24.5%	24.6%	+0.4ppts	-3.2ppts	-2.7ppts
Net margin	19.6%	20.1%	20.7%	18.6%	19.5%	20.1%	+1.0ppts	+0.6ppts	+0.6ppts

Source: Company data, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue	482,064	560,118	566,719	645,098	725,536
VAS	264,212	291,572	296,256	321,533	344,644
Ads	82,271	88,666	78,139	90,827	104,736
E-commerce	-	-	-	-	-
Others	135,581	179,880	192,323	232,738	276,156
COGS	(260,532)	(314,174)	(324,162)	(364,853)	(406,874)
Gross profit	221,532	245,944	242,557	280,244	318,662
S&M	(33,758)	(40,594)	(34,003)	(47,092)	(54,415)
Admin.Exp.	(67,625)	(89,847)	(104,629)	(117,124)	(129,209)
Interest income	6,957	6,650	6,933	7,745	9,853
Others	57,131	149,467	25,395	13,846	13,959
Operating profit	184,237	271,620	136,253	137,619	158,850
Financial cost	(7,887)	(7,114)	(6,052)	(7,624)	(7,624)
Associates	3,672	(16,444)	(14,671)	(2,646)	(765)
Pre-tax Income	180,022	248,062	115,530	127,350	150,460
Income Tax	(19,897)	(20,252)	(20,832)	(19,499)	(22,684)
MI	(278)	(2,988)	(1,987)	(2,186)	(2,404)
Net profit	159,847	224,822	92,710	105,665	125,372
Adj. net profit	122,742	123,788	110,871	129,599	150,115

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	160,125	227,810	94,698	107,850	127,776
D&A	50,774	55,895	69,796	90,338	113,034
Change in WC	27,423	(15,391)	(5,656)	7,649	5,122
Income tax paid	(20,322)	(20,252)	(20,832)	(19,499)	(22,684)
Others	(23,881)	(72,876)	54,265	35,113	39,711
Operating CF	194,119	175,186	192,270	221,451	262,959
Capex	(66,599)	(96,943)	(93,175)	(105,716)	(118,586)
Associates	(30,533)	(48,050)	(31,810)	(51,288)	(51,288)
Others	(84,823)	(33,556)	(28,583)	(6,140)	(6,828)
Investing CF	(181,955)	(178,549)	(153,567)	(163,144)	(176,702)
Equity raised	1,716	0	0	0	0
Change of Debts	5,090	12,000	(12,000)	0	0
Others	6,841	9,620	(16,850)	(12,134)	(14,156)
Financing CF	13,647	21,620	(28,850)	(12,134)	(14,156)
Net change in cash	25,811	18,257	9,853	46,173	72,101
Cash (beg of yr)	132,991	152,798	167,966	177,819	223,992
FX	(6,004)	(3,089)	0	0	0
Cash (end of yr)	152,798	167,966	177,819	223,992	296,093

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	1,015,778	1,127,552	1,225,312	1,305,048	1,377,625
Fixed asset	59,843	61,914	77,913	83,257	86,361
Associates	297,609	316,574	333,713	382,355	432,878
Intangible assets	159,437	171,376	195,969	203,503	203,452
Others	498,889	577,688	617,717	635,933	654,934
Current assets	317,647	484,812	393,284	455,217	543,534
Cash	152,798	167,966	177,819	223,992	296,093
Deposit over 3 months	68,487	83,813	83,813	83,813	83,813
Account receivable	44,981	49,331	50,445	56,797	63,244
Others	51,381	183,702	81,207	90,615	100,384
Current liabilities	269,079	403,098	292,476	316,495	340,913
Borrowings	14,242	19,003	14,242	14,242	14,242
Account payable	148,338	170,052	166,460	183,039	198,604
Tax payable	82,827	87,846	87,581	95,775	103,151
Other	23,672	126,197	24,192	23,439	24,916
Non-current liabilities	286,303	332,573	329,040	329,040	329,040
Borrowings	112,145	136,936	136,936	136,936	136,936
Deferred taxation	16,061	13,142	13,142	13,142	13,142
Others	158,097	182,495	178,962	178,962	178,962
MI	74,059	70,394	70,394	70,394	70,394
Total net assets	778,043	876,693	997,081	1,114,730	1,251,205
Shareholders' equity	703,984	806,299	926,687	1,044,336	1,180,811

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
VAS	54.8	52.1	52.3	49.8	47.5
Ads	17.1	15.8	13.8	14.1	14.4
E-commerce	0.0	0.0	0.0	0.0	0.0
Others	28.1	32.1	33.9	36.1	38.1
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	27.8	16.2	1.2	13.8	12.5
Gross profit	32.2	11.0	-1.4	15.5	13.7
EBIT	55.2	47.4	-49.8	1.0	15.4
Net profit	30.1	0.9	-10.4	16.9	15.8
P&L ratios (%)					
Operating margin	38.2	48.5	24.0	21.3	21.9
Pre-tax margin	37.3	44.3	20.4	19.7	20.7
Adj. net margin	25.5	22.1	19.6	20.1	20.7
Effective tax rate	(11.1)	(8.2)	(18.0)	(15.3)	(15.1)
Returns (%)					
ROE	21.8	17.4	15.4	12.0	12.4
ROA	9.9	9.2	7.7	6.8	7.4
Per share					
EPS (RMB)	12.7	12.8	11.4	13.2	15.1
DPS (RMB)	1.3	1.4	1.2	1.4	1.7
BVPS (RMB)	73.1	83.2	95.2	106.2	118.9

Source: Company data, CMBIGM estimates

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