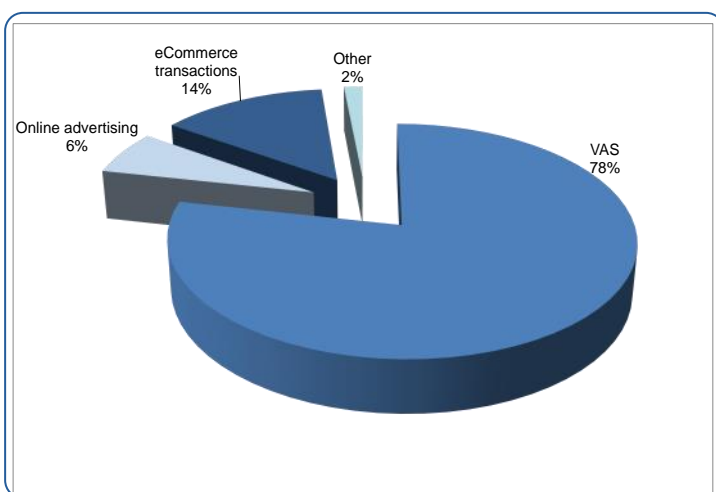


Tencent 1Q14 results: Well-above expectations

Tencent released 1Q14 results on Wednesday which came in well above analyst expectations on the back of strong growth in the sale of smartphone games. The company posted total revenue of CNY18.4bn (\$2.99bn), an 8% QoQ increase and a 36% YoY jump. Operating profit came in at CNY7.8bn (\$1.23bn), up 64% QoQ and 54% YoY, while on a non-GAAP basis the operating profit rose 28% YoY (vs a 35% revenue gain). The operating margin increased to 42% (or c. 31% excluding the one-off gain on the partial sale of JD.com) from 37% in the same period last year and vs 28% in 4Q13. Net income was CNY6.46bn (\$1.05bn), up 60% YoY, from CNY4.04bn, and 65% higher QoQ, while on a non-GAAP basis net income rose 29% YoY. This was well ahead of consensus analyst forecasts of CNY4.93bn. Basic earnings per share were CNY3.50 (and CNY2.78 on a non-GAAP basis), while diluted EPS were CNY3.449.

Tencent revenue by segment, 1Q14:



Source: Company data, Anchor Capital

By segment Tencent's value-added service (**VAS**) segment (the biggest contributor at 78%) revenues increased 21% QoQ and 35.1% YoY to CNY14.4bn with online games revenue up 23% QoQ to CNY10.4bn. This was mainly driven by increased revenue from smart phone games integrated with its instant messaging (IM) services QQ and WeChat (known as Weixin in Chinese) and increased revenue from

Tencent's major PC titles. Social networks revenue was up 16% QoQ to CNY4.02bn, reflecting an increase in platform revenues from smart phone games integrated with QQ and WeChat.

Online advertising (6% contribution to total) revenue was down 21% QoQ to CNY1.18bn but up 38.5% YoY and represented 6% of total revenues. The company's WeChat IM platform nearly doubled the number of monthly unique users YoY, helping boost online advertising sales 38.5% higher YoY. However, the weaker QoQ growth mainly reflected the impact of weaker advertisers' spending around the Chinese New Year holidays in addition to the change in the company's eCommerce strategy which affected eCommerce-related advertising revenue.

The **eCommerce transactions** (14% contribution to total) segment saw revenue decrease 24% QoQ to CNY2.5bn but up 31.9% YoY. The weaker QoQ growth was mainly driven by seasonality in the eCommerce industry and the change in the company's business strategy. We highlight that subsequent to the completion of the transaction with JD.com in March, Tencent no longer recognises fee income generated from physical goods transactions on its marketplaces.

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We scan the globe looking for good opportunities. We provide our model portfolios, as well as news and views on our watch-list, which is continually reviewed and updated.



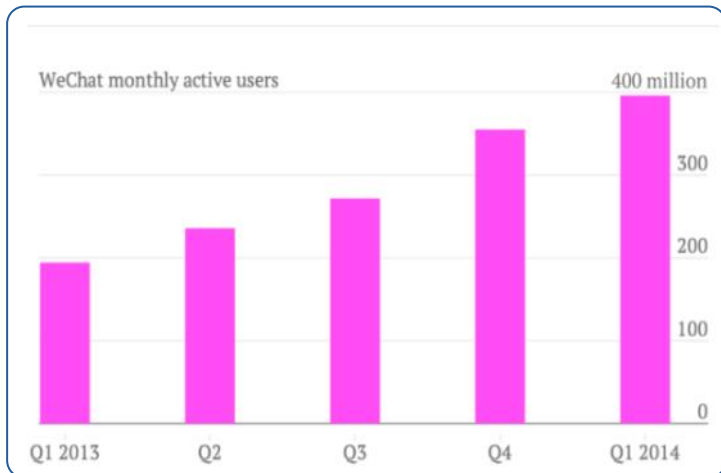
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The company's **other** segment (2% contribution to total revenue), saw a 142.4% YoY gain to CNY286mn.

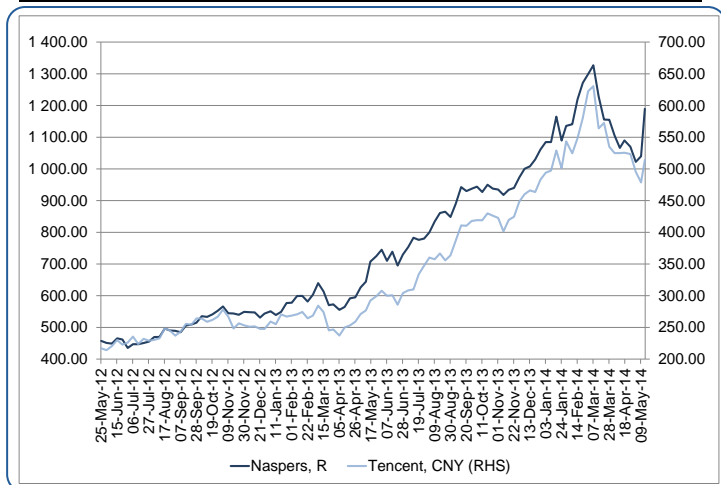
WeChat monthly active users, 1Q13 to 1Q14:



Source: qz.com, Company data

Since the start of this year Tencent has spent over \$1.2bn in areas such as e-commerce, real estate and digital mapping as it looks towards developing WeChat into a gateway for all users' needs on a smartphone. Another one of Tencent's many recent investments is a tie-up with JD.com (in March) as well as investments in mobile commerce (this includes an app or service which allows the user to hail a taxi and make bookings at a restaurant or cinema from their smartphone). Currently Tencent is ranked far behind Alibaba (with a c. 80% market share) in China's online retail market and through its investment/tie-up with JD.com the company has divested control of its e-commerce assets to JD. Tencent has also said that it intends capitalising on WeChat's reach. WeChat's global monthly active user numbers rose 11.5% to 396mn in 1Q14. Tencent's total revenue for smartphone games tripled in 1Q14 to over CNY1.8bn from the previous quarter.

Tencent and Naspers share price trajectories, weekly:



Source: qz.com, Company data

Following the results Tencent's market cap now stands at over \$133bn, making it China's largest listed technology company and the biggest potential rival to China e-commerce behemoth Alibaba, which is readying itself for a US listing. These results will also likely allay concerns among investors that Tencent's profit margins are shrinking as the company's surge in net income helped boost margins. Revenue trends also remain strong across the group. In our view what also remains very impressive about these results is that Tencent is clearly **extracting significantly more monetisation from each user** – for example, VAS revenue grew by 35% YoY despite fee-based VAS subscriptions declining 16% YoY. Thus from a valuation perspective, Tencent undoubtedly remains richly valued – as is the whole "new tech" sector - at a forward P/E multiple of about 35x. However, growth has surprised on the upside which will likely be enough to stem and even reverse the recent sell-off we have seen in the shares as the market gains confidence that the group's growth path is sustainable.

Naspers, which owns around a one-third stake in Tencent has in recent years seen its share price closely tracking that of Tencent (see chart on left). Naspers' share of Tencent's market cap comprises virtually all of the current Naspers share price (see table below) and therefore we believe investors should expect the share price to track the fortunes of Tencent until such time as Naspers' own nascent eCommerce assets begin to show evidence of full monetisation and become a greater part of the overall value equation for Naspers shareholders. Naspers' 10.8% share price gain on Wednesday (14 May) led to a somewhat smaller gain in Tencent yesterday, which has resulted in our estimate of Naspers' discount to its sum of the parts (SoTP) valuation narrowing from c. 26% to the current 22%. Still, we expect further gains from Tencent on the back of this well-above consensus result which should lead Naspers higher as well.

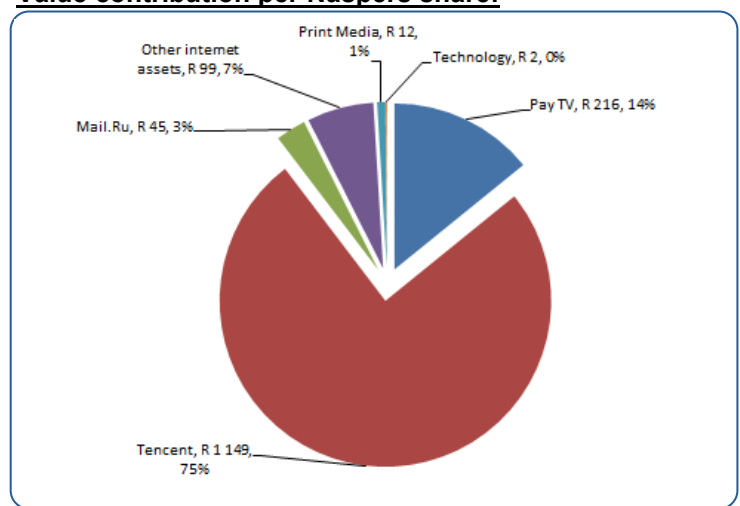
Nasper SoTP valuation:

Company / asset:	% held:	EBITDA applied:	EV/EBITDA:	Fair value / market cap (R'm)	Attributable value:	Per share:	Comments:
Pay TV		10 273	10.0	102 730	87 320	R 216	~20% minorities included in Pay TV SA
Tencent	34.3%			1 356 465	465 267	R 1 149	At current share price
Mail.Ru	29.1%			62 062	18 060	R 45	At current share price
Other internet assets	Various			40 000	40 000	R 99	eCommerce assets; currently loss-making
Print Media	Various	1 000	5.0	5 000	5 000	R 12	
Technology	Various	100	8.0	800	800	R 2	
Corporate overheads					-2 500	-R 6	
Value of enterprise:					613 948	R 1 516	
less: net debt					-14 732	-R 36	
Equity value					599 216	R 1 480	
Fully diluted shares in issue					404.9		
Per share value					R 1 479.92		
Current share price					R 1 150.05		
Discount to SOTP value					-22%		

Source: Anchor Capital, Company data

/continued...

Value contribution per Naspers share:



Source: Company data, Anchor Capital

Sean Ashton
Marco de Matos



The business of money: Global asset management and stockbroking



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