ANCHOR CAPITAL
INVESTOR CAMPUS

GLOBAL IDEAS

14 November 2014

WWW.ANCHORCAPITAL.CO.ZA
WWW.INVESTORCAMPUS.COM

Tencent 3Q14 results miss expectations as mobile gaming growth slows

Tencent (34.3% held by Naspers) released its 3Q14 results on Wednesday. The Company posted a 28% YoY increase in revenue to CNY19,808mn ($1=CNY6.13) - below market expectations of 32% YoY growth to CNY20,499mn. Excluding the eCommerce transactions business, revenue increased by 47% YoY to CNY19,349mn. Earnings growth QoQ came in at 39% to CNY1.870/share from the CNY1.343/share achieved in 2Q14. This was also below market expectations of 50% growth for the period. The earnings miss was driven primarily by the market underestimating the quantum of deceleration in its mobile gaming segment revenue growth. Mobile gaming comes from an explosive growth of 67% in the previous quarter (2Q14 QoQ growth), hence the 3Q14 QoQ decline itself was not a surprise but at a 2% QoQ increase it was nevertheless below market expectations of 10% QoQ growth. YoY mobile gaming grew 34%, which we believe is a decent number.

The company said that costs grew by 2% YoY to CNY7,167mn primarily reflecting increases in sharing and content costs, staff costs, and bandwidth and server custody fees. This was partly offset by a significant decline in cost of merchandise sold due to decreased revenues from principal eCommerce transactions. Other net gains increased to CNY118mn QoQ vs CNY442mn which the market had expected. A deemed disposal gain, related to an investee company, as well as impairment provisions for selected investee companies and certain intangible assets arising from acquisitions, was also recognised in the current quarter.

The Group's selling and marketing expenses increased by 30% QoQ to CNY1,906mn vs market expectation of CNY2,252mn. This was primarily driven by an increase in advertising spending on products and platforms such as online games and online media. Tencent's general and administrative expenses increased by 45% QoQ to CNY3,790mn vs market expectations of CNY3,642mn, mainly due to development expenses and staff costs. Net finance costs increased to CNY317mn due to an increase in interest expenses driven by a higher amount of notes payable, and the recognition of foreign exchange losses (due to comparative exchange rate movements in 3Q14). This was higher than the CNY132mn the market had expected.

Tencent financial highlights:

in billion RMB	3Q2014	3Q2013	YoY	2Q2014	QoQ
Total Revenue	19.8	15.5	+28%	19.7	stable
Value Added Services	16.0	11.6	+38%	15.7	+2%
Social Networks	4.7	3.2	+47%	4.6	+2%
Online Games	11.3	8.4	+34%	11.1	+2%
Online Advertising	2.4	1.4	+76%	2.1	+18%
eCommerce Transactions	0.5	2.4	-81%	1.3	-65%
Gross Profit	12.6	8.5	+49%	12.2	+4%
Operating Profit	7.5	4.8	+56%	7.8	-4%
Net Profit Attributable to Shareholders	5.7	3.9	+46%	5.8	-3%
*Non-GAAP **					
Operating Profit	8.3	5.3	+55%	7.7	+7%
Operating Margin	*42%*	*34%*	*8 ppt*	*39%*	*3 ppt*
Net Profit Attributable to Shareholders	6.4	4.4	+47%	5.9	+10%

	Unaudited Three months ended 30 September 2014 Amount	% of total revenues	30 September 2013 Amount	% of total revenues
	(RMB in millions, unless specified)			
VAS	16,047	82%	11,635	75%
Online advertising	2,440	12%	1,390	9%
eCommerce transactions	459	2%	2,359	15%
Others	862	4%	151	1%
Total revenues	19,808	100%	15,535	100%

Source: Company data

Global Ideas is a newsletter published three times a week (Monday, Wednesday and Friday) and available only to clients of Investor Campus and Anchor Capital. The key objective of this newsletter is to provide ideas for investment in the global investment universe.

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.

Contacts

Anchor Capital reception	**011 591 0677**	**Trading Desk**	**012 665 3461**
Investment/ Sales	mnyoung@anchorcapital.co.za	General Enquiries	info@anchorcapital.co.za
Brokerage/ Trading	fswart@anchorcapital.co.za	Newsletter Enquiries	newsletters@anchorcapital.co.za

In terms of reporting segments we highlight the following:

Value Added Services (VAS — mobile gaming, social networks):

Revenue in this division increased by 38% YoY (+2% QoQ) toCNY16,047mn, with online gaming revenue growing 2% YoY to CNY11,324mn. The deceleration (from the 67% QoQ growth achieved in 2Q14) in online gaming revenue was expected but nevertheless below market expectations (+10% QoQ consensus estimate). This disappointment was on the back of reduced revenues from smartphone games integrated with Mobile QQ and Weixin, driven by delayed launches of expansion packs. The 34% YoY online gaming growth primarily reflected higher revenues from PC client games, which benefited from positive seasonality for Anime, Comic and Games (ACGs) in China, contributions from recently launched titles and increased revenue from international markets which partly offset the above. Social networks revenue increased by 2% YoY to CNY4,723mn driven by healthy sequential growth in subscription revenues, which in turn benefited from enhanced mobile privileges and improved mobile-user experience for QQ Membership, Super VIP and the Qzone subscription service.

Online advertising:

Revenue increased 76% YoY to CNY2,440mn - better than the 51% YoY growth (to CNY2,095mn) which the market had expected. This was primarily driven by growth in revenues from video advertising and mobile advertising. Video advertising benefited from underlying viewer growth and the non-recurring impact of the Voice of China 3 and FIFA World Cup. Mobile Qzone contributed to the revenue growth of mobile performance-based social advertising.

eCommerce transactions:

Revenue from Tencent's eCommerce transactions business decreased 81% YoY to CNY459mn - worse than the 50% YoY decline (to CNY1,180mn) the market had expected. This primarily reflected a traffic shift to JD.com following Tencent's strategic transaction with JD.com in March 2014, and the repositioning of the Group's Yixun business from principal to marketplace operations, which resulted in a significant decline in revenue from principal eCommerce transactions.

Prospects:

The integration of guest access options was largely completed in October 2014 and looking ahead, Tencent said it aims to enrich its PC and mobile game portfolios with new titles in different genres. The growth in video advertising, underpinned by viewer growth, is gaining momentum whilst the Group said that growth in performance-based advertising revenue generated on mobile platforms in 3Q14 was expected to continue into 4Q14 and 2015. Key focus areas for the medium-term include revenue maximisation through an increased app store offering, increased licenced gaming, improving the mobile game infrastructure for the current portfolio, maintaining its mobile game leadership position, the monetisation of We Chat and an improvement in the Group's Lifestyle services offering. The drive to reposition eCommerce (JD.com traffic shift and Yixun) is also continuing.

Conclusion:

We remain cognisant of the potential impact these quarterly updates have on Tencent, as the group implements the strategy that will yield the earnings that we (and the market) expect in the long term. The market will react negatively to any delays or challenges in that implementation (as evidenced in this update) or variables that influence the environment within which Tencent operates. We expect 42% growth for the full-year (vs consensus' 47% growth forecast) and our view of Naspers as a long-term hold (which is currently undervalued) remains intact.

Khanyisa Ngesi

The business of money: Global asset management and stockbroking

The business of knowledge: Financial education, information and valuation services