

Tencent (700 HK)

FUNDAMENTAL VIEW ¹

As of 28 May 2024

- We maintain our Outperform recommendation on Tencent (A1/A+/A+) post its strong 1Q24 results; Topline growth in 1Q24 was ahead of our expectations, while EBITDA margin and debt metrics improved. Tencent also turned to a net cash position in 1Q24 on the back of stable FOCF. We see positive earnings catalysts over the next 12 month as the company delivers better domestic gaming revenues, further improve EBITDA margin, and maintain a rock solid balance sheet.
- We continue to see value in Tencent compared to other A-rated China tech, Asia quasi-sovereigns and US tech. We like the 7-20Y part of Tencent curve (38,41) as a core holding for investors looking to add duration in the Asia credit space.

RISKS & CATALYSTS

As of 28 May 2024

- While Chinese regulators have adopted a more friendly stance towards tech companies, any regulatory clampdowns abroad and domestically (e.g. antitrust rules, data security, personal information protection laws) may affect Tencent's business. Tencent's gaming, music streaming, and online payment units are among those that have come under regulatory scrutiny in the past.
- Tencent uses variable interest entities (VIEs) to circumvent China's restrictions on foreign ownership of Internet Content Providers, which poses regulatory risks. Specifically, VIE transactions involving "change in control" will be subject to antitrust regulatory processes.

CREDIT QUALITY SCORE (CQS)²

As of 21 Jun 2024

CURRENT CQS

82

CQS OUTLOOK ³HISTORICAL RATINGS: AVERAGE AGENCY RATING (ACR)⁴ VS CQS

KEY METRICS

As of 28 May 2024

| RMB BN | FY20 | FY21 | FY22 | FY23 | LTM 1Q24 |
|----------------------|-------|-------|-------|-------|----------|
| Debt to Book Cap | 25.2% | 27.0% | 31.4% | 29.8% | 29.0% |
| Net Debt to Book Cap | 4.0% | 6.0% | 8.5% | 1.0% | n/m |
| Debt/Total Equity | 33.7% | 36.9% | 45.9% | 42.5% | 40.8% |
| Debt/Total Assets | 19.7% | 20.1% | 22.8% | 23.5% | 22.7% |
| Gross Leverage | 1.4x | 1.7x | 1.9x | 1.6x | 1.5x |
| Net Leverage | 0.2x | 0.4x | 0.5x | 0.1x | n/m |
| Interest Coverage | 24.8x | 24.7x | 19.0x | 19.9x | 20.5x |
| EBITDA Margin | 38.3% | 34.9% | 34.3% | 38.9% | 40.2% |

Tencent turned into a net cash position in 1Q24. Year-end: 31 December.

BUSINESS DESCRIPTION

As of 28 May 2024

- Founded in November 1998, Tencent is a leading provider of Internet value added services in China. Since its establishment, Tencent has ventured into instant messaging, social networking, online payments, digital entertainment, and PC and smartphone gaming. Most recently, it has also forayed into high-tech areas such as artificial intelligence, and cloud computing.
- Tencent's leading Internet platforms in China include Weixin/WeChat (online messaging), QQ Instant Messenger (online messaging), Tencent Games (gaming), Tencent Video/Weixin Video Accounts (video platforms), WeChat Pay (payments), and Tencent Cloud. The combined monthly average users (MAU) of Weixin and Wechat reached 1.36 bn as of 31 March 2023.
- In 1Q24, 49% of revenues came from Value Added Services (which consist of Domestic Games, International Games, and Social Networks), 33% came from FinTech and Business Services (e.g. commercial payments and cloud), 17% from Online Advertising and 1% from Others.
- Tencent is currently primarily listed on the Hong Kong Stock Exchange, with a market capitalization of HKD 3.6 tn as of 28 May 2024.

GLOSSARY

¹ The **Fundamental View** is our current assessment of credit quality and our expectation of how credit quality will trend over the next year or longer.

² The **Credit Quality Score (CQS)** is a number between 5 and 100. It is a medium-term credit score for corporates and financial institutions that utilizes a combination of sector fundamental scores and equity market signals. Values of CQS above 50 generally indicate investment grade credit quality.

³ The **Credit Quality Score (CQS) Outlook** is the near-term (3 month) outlook for the CQS, based on its trend, volatility and distance from the adjacent CQS risk bucket.

⁴ The **Agency Composite Rating (ACR)** is the average senior unsecured rating from one or more major rating agencies.

Quantitative scores provided by CreditSights Analytics, LLC. Scores are shown are for the lesser of (1) 2 years and (2) date of CreditSights inception of quantitative coverage.

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