

Tencent (700 HK)

FUNDAMENTAL VIEW ¹

As of 08 Dec 2022

- We affirm our O/P recommendation on Tencent. We continue to view Tencent as attractive compared to other Single-A rated Chinese companies and US A-rated tech peers. We see value in extending duration to the belly of Tencent's curve as it provides a good pickup against its short-end (<5Y).
- Tencent's near-term growth recovery may be volatile, but we expect its balance sheet to remain strong in the next 6-12 months. We expect near-term growth recovery to remain constrained by potential COVID-19 flareups, but we think that its growth has already bottomed in 2Q. We think Tencent's margins will continue to improve, and its EBITDA generation will be supported by its effective cost control measures, an improving product mix, monetization of its in-feed ads and disciplined marketing expenditures.

RISKS & CATALYSTS

As of 03 Oct 2022

- Any regulatory clampdowns abroad and domestically (e.g. US SEC delisting, 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. In addition, 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.
- Tencent operates in a competitive market alongside other Chinese tech giants. Failure to continually innovate may result in loss of market share and profitability. Monetization of its social-network base may take time and heavy investment in payments, cloud, AI and retail businesses may weigh on margins.
- The potential restructuring and spin-off of Tencent's finance-related business into a financial holding company as ordered by the Chinese government could be a credit negative event depending on the final structural reorganization.

CREDIT QUALITY SCORE (CQS) ²

As of 27 Feb 2023

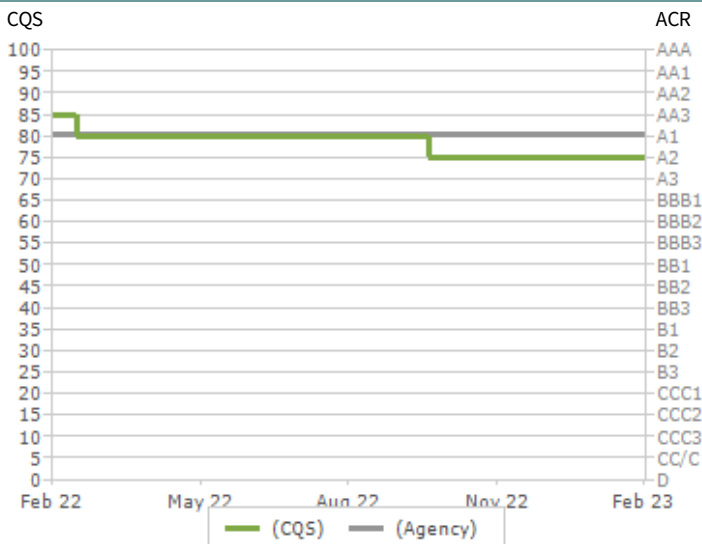
CURRENT CQS

75

CQS OUTLOOK ³

NEGATIVE STABLE POSITIVE

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



KEY METRICS

As of 16 Sep 2022

RMB BN	LTM 2Q22	FY21	FY20	FY19	FY18
Debt to Book Cap	31.0%	27.0%	25.2%	32.2%	33.5%
Net Debt to Book Cap	7.3%	6.0%	4.0%	7.3%	3.5%
Debt/Total Equity	44.9%	36.9%	33.7%	47.6%	50.3%
Debt/Total Assets	24.7%	20.1%	19.7%	24.4%	24.8%
Gross Leverage	2.3x	1.9x	1.5x	1.7x	1.6x
Net Leverage	0.5x	0.4x	0.2x	0.4x	0.2x
Interest Coverage	17.9x	21.9x	22.9x	17.9x	22.5x
EBITDA Margin	28.1%	30.9%	35.4%	36.4%	35.3%

Year-end: 31 December.

BUSINESS DESCRIPTION

As of 08 Dec 2022

- 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 QQ Instant Messenger (online messaging), Weixin/WeChat (online messaging), QQ Games (gaming), Qzone (social networking), and Tenpay (payments). The combined monthly average users (MAU) of Weixin and Wechat reached 1,309 mn in 3Q22.
- In 3Q22, 52% of revenues came from Value Added Services (which consist of Domestic Games, International Games, and Social Networks), 32% came from FinTech and Business Services (e.g. commercial payments and cloud), 15% from Online Advertising and 1% from Others.
- Tencent is currently primarily listed on the Hong Kong Stock Exchange, with a market capitalization of HKD 2.7 tn as of 8 December 2022.

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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