

Investment Analysis about China's IT Company—The Tencent Holdings Limited

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Abstract

As one of the most huge and potential markets in the world, China has a series of powerful IT companies, such as Tencent, Alibaba, and Xiaomi and so on. Based on such a market and huge population, these companies have very good future in developing and making profits. As a result, studying on them becomes more and more important for the market to know how these companies develop and how their stocks change. This paper focuses on the developing trend of Tencent and tries to provide a valuable investment suggestion for the market. At last, this paper finds that Tencent, as one of the biggest IT companies in China, has very great developing potential with its achievements in the game industry. The main contributions of this paper are that it has found future developing points of Tencent in the game industry and that it points out a new developing power in IT industry, the Entertainment power. The main limitation of this paper is that it has only checked one IT company, the Tencent, instead of comparing different companies to show how Tencent gets benefits from game industry.

Keywords

High Technology Company, Investment Suggestion, Tencent Performance

1. Introduction

The objective of this research is to help investors develop basic skills necessary to be an equity analyst or do research on specific stocks or sectors. We can easily get overwhelmed when learn about a company, analyze its financials, and forecast a stock's investment potential. While this research will use Tencent stock as an example to demonstrate the process of analyzing available information and building a stock analysis report. This true of professional equity research will discuss how to connect incomplete information together to figure the likely fu-

ture trend and draw a conclusion. Though the market is the ultimate factor that decides if an analyst and his or her investment thesis are right, we have little chance to win without doing any research.

This paper is organized as follows: it introduces the general condition of the company and then taking the company's main products, such as Wechat, to show the main developing figure of this company. Then it analyzes the profit points of Tencent before getting a conclusion.

We generally start with key facts, business overview of the company, and important operating statistics, for example profitability, leverage, and other comparisons with industry average. We can analyze how economic developments will impact the industry with major economic indicators. Examples include fed policy, inflation, GDP growth rate, etc. It is also important to pay close attention to the company's recent movements and policy decisions. The most critical portion of stock analysis is comparing the company's financials to those of its competitors and estimating the trends of ratios and comparisons to competitors.

2. Corporation Description

Tencent Holdings Limited is a Chinese multinational investment holding conglomerate, founded in November 1998. It is one of the largest internet integrated service providers and one of the internet companies with the most service users in China. Tencent specializes in various internet-related services and products, entertainment, and technology both in China and globally. Tencent also invests in AI by jointly establishing an innovation lab with MediaTek. Its many services include social network, music, e-commerce, smartphones, mobile games, and it started to buy large video game companies, making it also become the largest and most valuable gaming and social media company in the world.

Tencent became Asia's first technology company with \$500 billion valuation in November 2017, and its stock price grew 115% in 2017 [1]. The massive user base and investments allow Tencent to maintain its bullish outlook and surpass Facebook in market value. Tencent aims to become the most respected Internet enterprise in the world through enhancing its development and innovation capabilities while expanding its worldwide branding.

3. Macroeconomic Condition

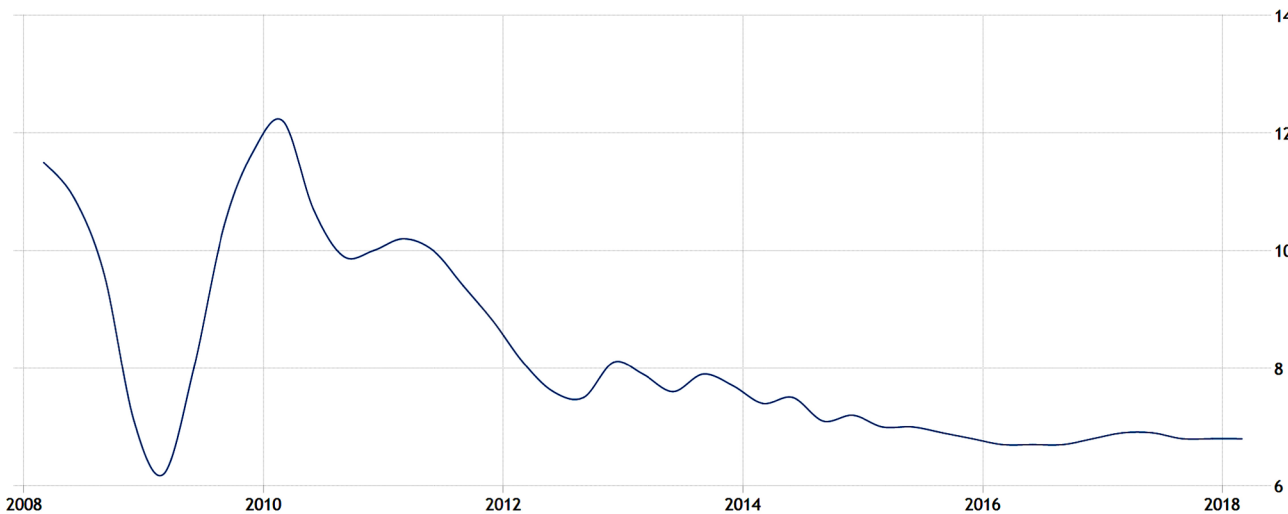
China's extraordinary growth over the past few decades attracted worldwide investors. Three comparisons, GDP growth rate, unemployment rate, and inflation rate, between China and United States valid the common statement that China currently have a great macroeconomic condition. The GDP growth rate is the most important indicator of a country's economic health, and China is able to maintain GDP growth rate at 7% annually for the past 20 years, which clearly explains how fast the China's economy is growing. In addition, the growing economy allows China to keep unemployment rate very low, around 4.6%. It is important to know that nominal GDP should be adjusted with inflation to illu-

strate a country’s economy power, and the third graph below shows that China is capable of controlling its inflation at very low level, which is 4.6% and showed in **Figure 1** and **Figure 2**.

4. Company Outlook: WeChat

The main strength of the company is the mobile chat service WeChat. Almost

CHINA GDP ANNUAL GROWTH RATE

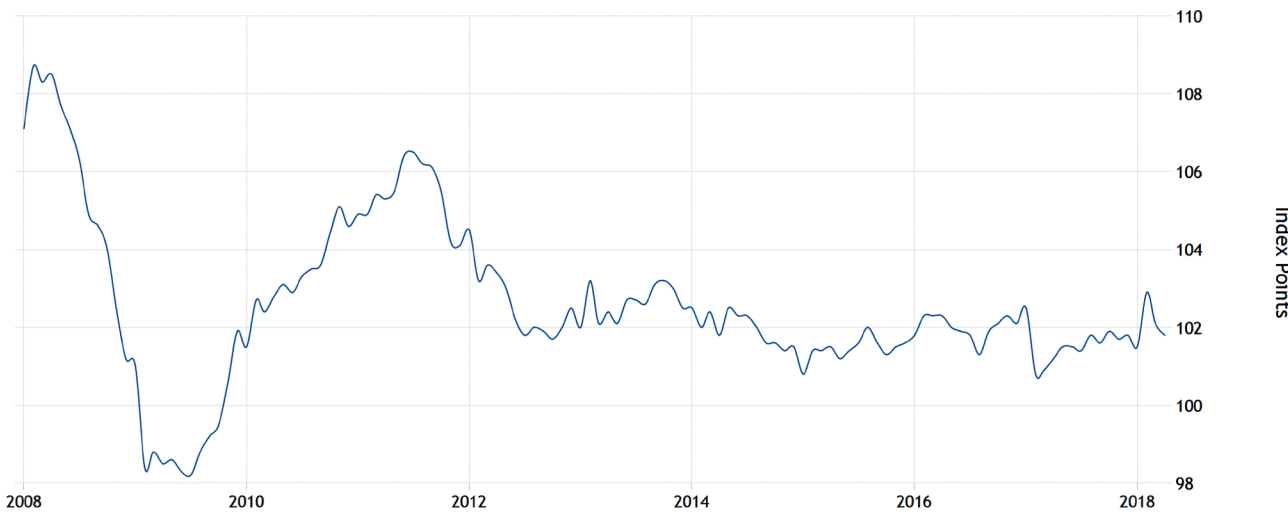


SOURCE: TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

The historical data shows that China has lower GDP growth rate than United States, which benefits the business expansions and investments in the China.

Figure 1. GDP growth rate.

CHINA CONSUMER PRICE INDEX (CPI)



SOURCE: TRADINGECONOMICS.COM | NATIONAL BUREAU OF STATISTICS OF CHINA

The low inflation-consumer prices allow business to experience lower risk of inflation. Historically, China had lower inflation-consumer prices than United States in the past 15 years.

Figure 2. Inflation-consumer prices.

every smartphone user in China has a WeChat account, for the WeChat meets the various needs of Internet users for example communication, information, entertainment, financial services and other online services powered with third parties. As a communication tool, WeChat offers everything from free video calls and group chats to subscriptions updates and easy sharing of large multimedia files. WeChat also has the same functions as Instagram, for the users can also post their daily photos on the moments to share moods with friends. Tencent has the largest Internet community, to be more specific, the combined users of QQ and WeChat is almost a billion. WeChat not only promotes people to communicate with playful stickers but also change people's lifestyles with a wide range of applications, like food delivery, travel bookings, online shopping, and even public services. In addition to the conveniences that WeChat has dedicated to providing, WeChat plays a significant role in financial services in China, and e-commerce is one of the most important drivers of the economy. Over half of WeChat users have been convinced to link their bank cards to the app and save their fingerprint as password, and this unique approach promotes people to use one app that offers them an effortless way to integrate multiple services into a single digital identity. A remarkable innovation based on this financial service is a "red packet", inspired by the Chinese tradition that friends and family usually give cash in a red envelope to young children as greeting gifts. It is brilliant to even add "red packet" with gaming functions that people can bind together into groups to send and get money from each other randomly. The data shows that over 400 m users sent over 50 billion packets of digital cash during Chinese New Year [2].

5. Company Outlook: Tencent Games

As the world's largest video games company by revenue, Tencent makes great achievements in gaming industry and release popular games every year. Video games impact the economy more than we think, especially when we are in the technology era. The entertainment side of the software world is expanding remarkably faster than other segments of the economy, because people nowadays place much more value on entertainment. Global eSports industry is growing at the rate of 30% in 2017 [3]. The entertainment software industry generates \$108.9 billion in game revenues in 2017, which represents a 7.8% increase from the year before (Emma, 2017). Now Tencent aims to introduce Chinese games globally, and Tencent has invested to form a special team specifically dedicated to expanding local games in foreign markets. Tencent is also famous for being the world's biggest investment corporation, and it has made several big movements in expanding its gaming markets worldwide through acquisition. In 2015, Tencent acquire the Blizzard Studio to own League of Legends, which has 100 million monthly players, developer Riot Games. Furthermore, Tencent also owns companies like Super cell (producer of game Clash of Clans), Epic Games (producer of Gears of War), and Activision Blizzard (producer of Overwatch

and Destiny). These overseas gaming expansions bring Tencent Games \$4 billion revenue annually.

China became the world's leading publisher and distributor in the gaming market after Chinese Tencent acquired the Finnish video game developer Supercell in 2016. China not only generates great revenue but also exports culture through video games. Recently, Chinese game developers mostly focused on the rapidly growing domestic market as well as expanding overseas game business.

In 2017, Tencent's quarterly profit got a huge boost from the success of its game Honor of Kings and an assist from advertising revenues. China's largest corporation reported a 70% surge in net income to a record \$2.7 billion for the three months ended June, and sales rose 59% to \$8.5 billion.

Tencent's market valuation grows at remarkable rates every year. Strong growth potential in advertising and e-commerce has contributed to the surging revenue growth.

Though Tencent will release its Q4 and annual report on 21 March 16, 2018, its stock price is expected to continue to rise based on its historical performances. As we mentioned before, mobile game growth and digital payment is strong, which lead to no signs of slow down or deterioration in 2018.

6. Company Outlook: Online Advertisement

Starting in 2017, Tencent experience robust expansion in advertising business through WeChat, QQ, and mobile games. In order to more precisely target customers with their interests, Tencent upgraded advertising systems in WeChat moments to post different advertisements based on individual's interest. With a billion users, Tencent can easily dominate Chinese digital advertising. Tencent is one of the pioneers in social advertising, for it is patient enough to first build a giant media business with QQ and WeChat before focusing on the advertising role. Although Tencent's slice of the online advertisement pie is small (showed in **Figure 3**), comparing to Google, Facebook and Alibaba, it is growing at the fastest rate. According to researches, Tencent's revenue can achieve doubling to \$11.5 billion by 2019.

7. Recent Moves

7.1. Local Investments

To expand its WeChat embedded services, Tencent invest in e-commerce and corporate with other companies in different domains. For example, WeChat is planning to invest \$4 billion in Meituan-Dianping app, a Yelp-like platform that offers food delivery, ticket booking and other businesses. The wide range of different services benefits WeChat's own super payment system, which has helped WeChat pay made considerable gains. Tencent announced its \$1.6 billion investment in NextEV, one of China's rising electric car startups. Tencent's cooperation with automobile and technology companies aims to build more platforms for entertainment, content, and consumer-oriented services [4]. To further

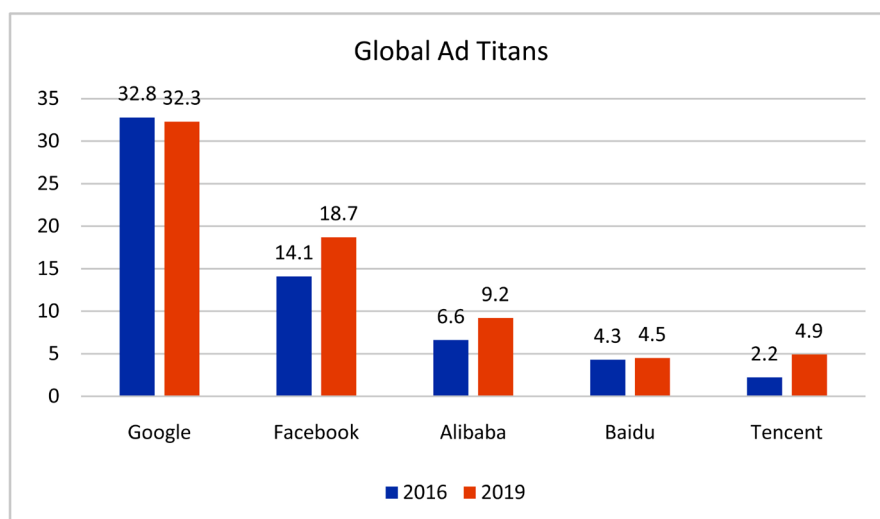


Figure 3. Global AF Titans (Data from Tencent Holdings Ltd.).

compete with Alibaba's online payment platform, Tencent and JD jointly invest \$863 million in Vipshop, which mainly target young female shoppers and expand business [5] [6].

7.2. Overseas Investments

Tencent's foreign media expansion is significant. First, the latest announcement that Spotify will partner with Tencent's music in a deal that two companies buy minority in each other. Second, Tencent also purchased roundly 10% stake in Snap at the end of 2017. Many social media platforms are blocked in China; hence the cooperation with Tencent will bring Snapchat great opportunity with the growing base of smart phones and advanced 4G and 5G networks in China. Many noticeable investments occur in 2017, including a 5% stake in Tesla, a 5% stake in Activision Blizzard, and a 15% stake in Glu Mobile. These investments are all very new, and the long-term profits will gradually increase Tencent's market value, which will be reflected on the stock price.

8. Company's Historical Performance

8.1. Growth Rate

Though growth rates vary each year, Tencent's sales revenue continues to grow annually at a positive rate. Sales for the third quarter in 2017 reached \$9.8 billion (The revenues in graph is in yuan value), and the revenue in 2018 Q1 is predicted to grow as showed in **Figure 4**. During 2015, there is a huge jump in growth rate because of the success of Honor of Kings, which has an estimated 200 million monthly players.

8.2. Stock Price

Over the past five years, Tencent stock price has been doubled from 200 to 400 Hong Kong dollars, which now has immense potential to become the leading



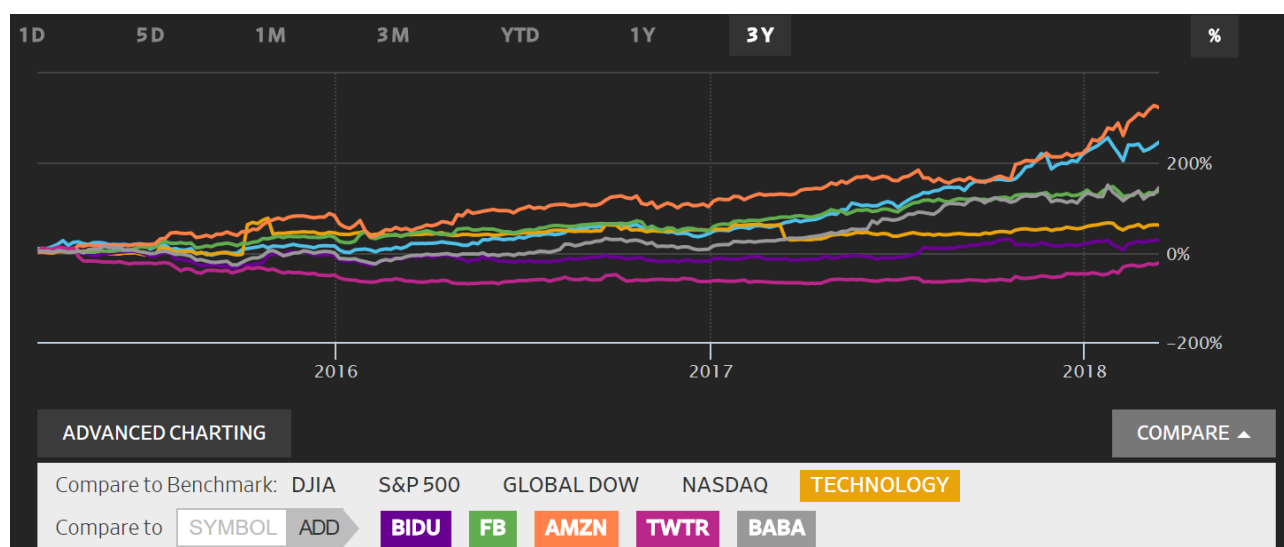


Figure 5. Advanced charting (Data from Tencent Holdings Ltd.).

Table 1. Ticker Information (Data from Tencent Holdings Ltd.).

Name	Share price (\$)	Market cap (\$bn)	P/E	P/S	P/CF	P/B
Tencent	59.72	536.48	58.34	16.57	36.6	15.16
Facebook	185.09	537.69	34.34	13.23	22.6	7.23
Twitter	35.85	26.62	50.83	10.89	31.4	5.25
Sina	116.80	8.35	55.89	5.27	16.9	2.93
Baidu	262.39	91.35	31.62	6.8	17.6	5
		Median	50.83	10.89	22.6	5.25
		Industry Avg	54.6	6.6	13.3	3.2

Table 2. Stock Trading Information (Data from Tencent Holdings Ltd.).

	3 month ago	1 month ago	Current
Buy	40	39	39
Overweight	4	4	4
Hold	1	3	3
Underweight	0	0	0
Sell	0	0	0
consensus	buy	buy	buy

The data from Bloomberg estimates Tencent's 5-year trend. Though the growth in net income, sales and revenue varies, it is always a growth sign. More importantly, earnings before interest, taxes, depreciation, and amortization increase every year, which is a positive sign of investing.

As showed above, it is clean that focusing on game industry will bring more profit potential for this company and bring it more advantage in the future.

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