

Analyst: Sam Ho

Main Board Listing- Research

騰訊控股有限公司

Tencent Holdings Limited - [Stock Code: 0700]

Global Coordinator, Bookrunner, Lead Manager and Sponsor : Goldman Sachs (Asia) L.L.C.

Sector : Internet-related

Business : Provision of Internet services and mobile value-added services

Total share offer: <u>420,160,500 shares</u> (25% of the enlarged share capital)	<u>Business of Tencent</u>
Placement: 378,144,500 shares (90%)	<p>The Company is a leading provider of Internet services and mobile value-added services in China. At present, the Company has 3 principal lines of business, namely Internet value-added services, mobile and telecommunications value-added services and online advertizing.</p> <p>Its instant messaging (IM) platform branded "QQ " allows users to communicate in real-time across the Internet, as well as mobile and fixed-line telecommunications networks using various terminal devices. As of 31st March 2004, the Company had the largest IM community, with 291.3 million registered user accounts, in China.</p>
IPO: 42,016,000 shares (10%)	
Greenshoe: 63,024,000 shares	
Price: HK\$2.77-HK\$3.70 per share Market cap: HK\$4,655 mln-HK\$6,218 mln	
Staffing: 700	
Prospective 2004 P/E: 11.1x-14.8x Adjusted NAV per share: HK\$0.95-HK\$1.17	
Book opens: 31 st May 2004 Book closes: 10 th June 2004 IPO commences: 7 th June 2004 IPO ends: 10 th June 2004	
Share registrar: Computershare Hong Kong Investor Services Receiving bank: Bank of China (Hong Kong)	
Listing date: 16 th June 2004	

Major Shareholders after Listing

(Assuming the over-allotment option is not exercised)

MIH, a wholly-owned subsidiary of Nasdaq-listed Naspers	37.50%
Ma Huateng (age: 32), chairman and an executive director of the Company	14.43%
Zhang Zhidong (age: 32), an executive director of the Company	6.43%
Other core founders, who are the senior management of the Company	9.87%
Other founders, who are independent 3 rd parties	6.77%
	<u>75.00%</u>

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Use of Proceeds

Net proceeds from the offer are estimated to be HK\$1,258 million

(Assuming the over-allotment option is not exercised, and at an issue price of HK\$3.235 each, which is the mid-point of the indicative price range)

	HK\$ million
To finance new strategic initiatives in the real-time communications, entertainment and Internet sectors	818
To grow and expand existing business	252
To serve as general working capital	Balance

Financial Highlights

	3 months ended 31 st March 2004 RMB'000	2003 RMB'000	2002 RMB'000	2001 RMB'000
Turnover				
Internet value-added services	104,586	229,690	40,819	944
Mobile and telecommunications value-added services	142,817	467,369	198,818	37,960
Online advertizing	8,215	32,841	19,188	7,735
Others	<u>1,935</u>	<u>5,057</u>	<u>4,282</u>	<u>2,437</u>
	<u>257,553</u>	<u>734,957</u>	<u>263,107</u>	<u>49,076</u>
Operating profit	113,085	336,205	142,894	10,341
Net profit	<u>107,304</u>	<u>322,196</u>	<u>140,707</u>	<u>10,216</u>
Dividend	-	28,935	10,334	-
EPS- basic	<u>RMB0.085</u>	<u>RMB0.244</u>	<u>RMB0.104</u>	<u>RMB0.009</u>

Selected Operation Data

	For the 16-day period ended 31 st March 2004 (Millions)	2003 (Millions)	For the 16-day period ended 31 st December 2002 (Millions)	2001 (Millions)
Registered IM user accounts	291.3	256.1	151.3	93.2
Active user accounts	97.1	81.5	54.4	43.8
Average daily messages	848.8	681.8	386.4	413.9
Fee-based Internet value-added service registered subscriptions	7.3	6.9	1.5	-
Fee-based mobile and telecommunications value-added service registered subscriptions	12.8	13.1	5.6	1.4

	Portion of fees shared with operator	* Imbalance fee per message RMB
SMS (China Mobile)	15%	0.05-0.08
SMS (China Unicom)	12%	0.04-0.08
MMS (China Mobile)	15%	0.20-0.25

* - a fee resulted from the number of SMS/ MMS messages sent from the Internet to mobile phones exceeding the number of SMS/ MMS messages sent from mobile phones to the Internet

Strengths/ Opportunities

- ✓ China has experienced rapid growth in Internet use in recent years. According to China Internet Network Information Centre, the number of Internet users in China increased from 9 million in 1999 to over 80 million in 2003, making China the 2nd-largest Internet market in the world. In addition, China is also the largest mobile market globally. According to Pyramid Research, value-added service and SMS revenues are expected to grow at a CAGR of 43.3% and GPRS revenues are expected to grow at 141.8% from 2002 to 2007. This should create an opportunity for Internet companies to deliver their Internet-portal products and services to users through mobile phones.
- ✓ The Company has strong brand recognition of its QQ brand for instant message (IM) service. In addition, it has the largest IM registered user base in China. Its large user base provides the Company with the opportunity to market and deliver its value-added services and products.
- ✓ Currently, the Company works with 13 mobile-phone manufacturers, including Motorola, Nokia and TCL (parent company of TCL International (*stock code: 1070*)), to pre-load its QQ client software on their handsets. Moreover, PDA manufacturers, such as Lenovo (*stock code: 0992*) and Samsung, also pre-load its client software. This has enhanced the ease for subscribers to use the Company's QQ service.
- ✓ Owing to its small capital outlays and minimal fixed costs, the Company enjoys high profitability, with a gross-profit margin of 68.8% and a net-profit margin of 43.8% in 2003. However, margins will be on a downtrend going forward as development and marketing expenses continue to rise.
- ✓ With shares priced at 2004E P/E of 15.1x-19.0x, valuation of Tencent is undemanding, when compared with Tom Online (*stock code: 8282*)'s 2004E P/E of 20.5x, Sina's 2004E P/E of 38.79x, Netease's 2004E P/E of 26.6x and Sohu's 2004E P/E of 23x.

Weaknesses/ Threats

- × Competition in China's wireless value-added-services market has intensified with an increasing number of new entrants due to its low entry barrier. The primary competitors include Sina.com, Sohu.com, Netease.com and Tom Online. In addition, other competitors in the China IM market include Microsoft, Yahoo! and AOL.
- × Policy risk is huge for the Internet and telecommunication industry in China as it is highly regulated by the central government. Should there be an adverse change in policy towards the provision of value-added telecommunications services, profitability of the Company will be badly affected.
- × Technology changes quickly and there would be other new Chinese-style ICQ programmes to challenge the leadership status of QQ.
- × The Company had strong financials, with cash on hand of RMB329.3 million as at 31/04/2004 and no major debts. After the IPO, the Company would have an even-stronger war chest for M&As. Nevertheless, no potential investments and new businesses were yet identified, and it is disappointing to know that the Company only plans to distribute 10% of its profit as dividends in future.

Recommendation: Hit and Run