VF Invest

Tencent: We're Buying Another Tranche at the Low Level!

The indication that we're purchasing this China stock again is not without reason. Just as with the recent purchase of JD.com, we want to alert you to the theoretical possibility of a potential total loss, in the event that contrary to our expectations, any form of direct or indirect military conflict between the USA and China would alter the world. Such a negative surprise would massively pressure the stock market worldwide, especially given that we're talking about the two largest trading partners currently, but Chinese stocks would be particularly affected, there's no doubt about it.

Counter-cyclical, yes, but let's not overdo it! In a long-term portfolio, it's not a sensible strategy to continually buy those assets that are currently underperforming. Doing so would succumb to the misconception that all stocks will eventually perform similarly, which is not the case. Rather, base your strategy on the tranches deployed, which should develop roughly equally. Currently, the China component in our LTP is low, so we can justify buying Tencent to somewhat maintain the China component in the portfolio.

The last known quarterly figures: The next quarterly earnings presentation is expected on March 30. Looking at the latest quarterly results: Although the reported numbers are not breathtaking, we see a solid business. Revenue increased from 140.093 billion RMB to 154.625 billion RMB (approximately 21.6 billion USD) in year-on-year comparison, representing an annual growth of 10.4 percent. Despite Tencent being able to increase its revenue, operating profit fell by 6.0 percent from 51.593 billion RMB in the previous year's quarter to 48.475 billion RMB (approximately 6.8 billion USD) in this quarter. Finally, diluted earnings per share also decreased from 4.104 RMB in the same quarter of the previous year to 3.752 RMB in Q3/2023, representing an annual decline of 8.6 percent. However, Tencent generated a free cash flow of 51.1 billion RMB (approximately 7.2 billion USD) – an increase of 85 percent compared to the previous year's 27.6 billion RMB in the same quarter.

The China discount: According to its own statements, China aims to become the world's most significant financial center in the coming years, making it difficult to imagine that we will continuously face investor-unfriendly policies. Of course, this is not certain. At the moment, however, a China discount is justified, as the plans of the government in Beijing are too opaque. In addition to the challenges facing the Chinese economy, state leaders exerted immense pressure on several technology companies – including Tencent. In December, some regulations hit several online gaming companies hard, leading to panic among investors and a double-digit sell-off of many stocks – including Tencent. The National Press and Publication Administration (NPPA) released a draft of rules for online games, such as pop-up warnings for irrational consumption behavior and control of the time and duration minors can spend on online games.

What's next? It's likely that Beijing will continue to regulate its largest companies in the future, but China won't destroy its international flagships. We should also not overlook the fact that many politicians in the USA are now also calling for more regulation in the gaming and social media sectors. On average, teenagers in the USA spend four hours daily consuming digital content (excluding computer or laptop work), with this trend increasing. Regardless of discussions about an individual's freedom of choice, it's foreseeable that this issue will be more loudly debated in the West, which might cast some of the regulations in China in a less dramatic light. Investors could also reassess the situation then.

Tencent In Our Stock Check:

Profit Growth:	Positive Outlook After a Slump	+ -
Debt:	Healthy Balance Sheet	+
P/E Ratio Evaluation:	Now Comparatively Low	+
Industry Outlook:	Good, but Risk of Overregulation	+ -
Technical Analysis:	Chart Shows a Downtrend	-
Market Leader:	Yes, in Many Areas	+
Management Quality:	Determined, Talented, Future-Oriented	+
Dividend Yield:	Low, Normal for a Growth Stock	+ -
Business Model:	Very Good, but Political Risks	+ -
Insider Buys/Sells:	No Anomalies	+

Tencent in USD (5 years)

Tencent https://www.tencent.com/

ISIN	KYG875721634
Current Price	$36.53
Market Capitalization	$351.66 billion
Profit Growth 2023 to 2025e	+45.1%
Dividend 2023e	1.752 CNY
Dividend Yield 2023e	0.6 %
Earnings Per Share 2023e	13.14 CNY
P/E Ratio 2023e	20.0

Buy-Order

ISIN	KYG875721634
Transaction	Buy
Exchange	OTC/HKEX
Quantity	27/25
Current Price	$36.53 / 285HKD
Buy-Limit	$37.70 / 290HKD

Our conclusion: Considering the revenue and earnings growth, it can be concluded that Tencent, as a non-Chinese company on the stock market, would likely be valued at least twice as high. We believe this discount is exaggerated, and therefore, in our Long-Term Portfolio, which is geared towards very long-term investments, we are ordering another monthly tranche.