

## Tencent Gains \$18 Billion as Record Profit Eases Margin Fear (2)

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By Lulu Yilun Chen

(Bloomberg) -- Tencent Holdings Ltd. climbed after delivering record profit that topped analyst estimates, calming investors who'd braced for a big hit to margins.

The stock jumped 3.7 percent in Hong Kong, conceding some of its earlier gains. China's largest social media and gaming company posted a faster than expected 61 percent jump in net income last quarter as growth on mobile bounced back, outstripping estimates by almost a third. But Thursday's near-\$18 billion increase in market value merely helped Tencent recoup a slice of the more than \$90 billion lost since peaking in January.

Its latest results soothed fears that outsized spending would hammer profitability. The owner of the giant WeChat messaging platform opened its wallet to sustain growth as PC gaming slows, investing in cloud computing, entertainment and physical retail to lock horns with Alibaba Group Holding Ltd. It's also secured Chinese distribution rights to some of the world's hottest games, from PlayerUnknown's Battlegrounds to Fortnite, adapting them to draw in smartphone users.

The gross profit margin in the quarter was more than 50 percent, higher than the 47 percent expected by analysts.

"Analysts were expecting a drag on margins because of increasing contribution from cloud and payments, but it looks like Tencent was pretty good at controlling costs," said Julia Pan, a Shanghai-based analyst at UOB Kay Hian.

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Tencent continues to draw the lion's share of its business from gaming, while counting on advertising and newer areas such as finance to drive future growth. WeChat had 1.04 billion monthly active users -- crossing the billion mark for the first time. But QQ, the older of its two social networks, saw users drop 6.4 percent to 805.5 million at the end of the quarter.

Revenue from Value Added Services, which includes online games and messaging, rose 34 percent to 46.9 billion yuan. The company has however been leery of barraging its users with ads - on Wednesday, it declared it had raised the maximum number of ads that customers see on WeChat Moments, a function similar to Facebook's newsfeed, to just two a day from one previously.

"The results were good even without the one-time gains, but the gains made it even better," said Bhavtosh Vajpayee, a Hong Kong-based research analyst at Bernstein.

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But overall costs surged 51 percent. Tencent executives have signaled a willingness to sacrifice margins in favor of longer term growth in new businesses, though that would depend on growing and engaging a massive user base now primarily confined to China.

Profit was also helped by one-time gains of almost 7.6 billion yuan from its investments in arenas like video and news.

"The reason why analysts had been modeling down was because they did mention about subsidies on payments and also continued investments in content costs," Citigroup Global Markets's Head of Pan-Asia Internet Research Alicia Yap told Bloomberg Television. "All these years of investments in digital content, for example music and video, actually started to show some leverage" this quarter.

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