

Tencent (700 HK)

Solid recovery across all business lines

Tencent reported 1Q23 financial results on 17 May. Total revenue was up by 11% YoY to RMB150.0bn in 1Q23, in line with consensus/CMBI estimates of RMB146/148bn. Non-IFRS operating income grew by 32% YoY to RMB48.4bn in 1Q23 and beat consensus estimate by 13%, boosted by the reaccelerating top-line growth, expanding GPM and operating leverage. We lifted FY23-25E non-IFRS net income forecast by 1-3% due to: 1) stronger-than-expected growth of higher-margin game business; and 2) stringent opex control. Our SOTP-derived target price is unchanged at HK\$455.0 (decline in investment portfolio value largely offset earnings revision). Maintain BUY.

■ **Game & ads: resumed solid growth in 1Q23.** Games revenue increased by 11% YoY to RMB48.3bn in 1Q23 (32% of total revenue) and was ahead of our estimate, with domestic/international games revenue up by 6/25% YoY. 12 of Tencent's top 15 games delivered positive YoY revenue growth in 1Q23, including legacy games like *Honour of Kings*, *DnF* and *Cross Fire Mobile*. International game business was driven by strong growth of *Valorant* (>30% YoY), *NIKKE* and *Triple Match 3D* in 1Q23. Online ad revenue grew by 17% YoY to RMB21.0bn in 1Q23 (14% of total revenue), despite several percentage-point revenue contribution from Beijing Winter Olympics in 1Q22. Weixin already accounted for over 50% of total ad revenue and outpaced overall ad revenue growth in 1Q23, driven by incremental revenue from Video Accounts and solid growth of Mini Program ads.

■ **FBS: quality growth amid normalized macro and policy environment.** Fintech and Business Services (FBS) revenue grew by 14% YoY to RMB48.7bn in 1Q23 (32% of total revenue). Fintech revenue resumed double-digit YoY growth in 1Q23. Business services revenue recovered to positive YoY growth with notable GPM expansion, thanks to the successful strategic adjustment and initial revenue contribution from Video Accounts e-commerce. Management believes that the recent price cut in the cloud sector has limited impact on Tencent, given that Cloud revenue only accounted for mid-single digit % of total revenue, and the price discounts are mainly offered to SME instead of KA customers. For fintech regulations, management expects the PBoC inspection of Tenpay (launched in FY21) is approaching a conclusion, after which the regulations shall be more normalized.

■ **Margin improvement across business lines.** GPM rose by 3.3ppt YoY to 45.5% in 1Q23, supported by GPM improvement in all three business lines (VAS/ads/FBS: +3.4/5.0/2.9ppts YoY). S&M/G&A expenses both declined by 13/8% YoY in 1Q23, equivalent to 4.7/16.4% of total revenue (1Q22: 5.9/19.7%). Solid GPM improvement and opex control support non-IFRS operating margin to increase by 5.3ppts YoY to 32.3% in 1Q23. Looking ahead, Tencent will maintain prudent expenses control, but we expect milder margin expansion on the tougher comps.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	613,195	668,542	720,198
YoY growth (%)	16.2	(1.0)	10.6	9.0	7.7
Gross margin (%)	43.9	43.1	44.7	45.4	46.3
Adjusted net profit (RMB mn)	123,788.0	115,649.0	142,333.0	165,655.3	185,752.3
YoY growth (%)	0.9	(6.6)	23.1	16.4	12.1
EPS (Adjusted) (RMB)	12.99	12.13	14.70	17.11	19.18
Consensus EPS (RMB)	12.99	12.13	14.89	17.54	20.17
P/S (x)	5.2	5.2	4.7	4.3	4.0
P/E (x)	18.1	14.1	21.8	19.5	16.5

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$455.00
(Previous TP)	HK\$455.00)
Up/Downside	32.7%
Current Price	HK\$342.80

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Stock Data

Mkt Cap (HK\$ mn)	3,251,286.6
Avg 3 mths t/o (HK\$ mn)	7,448.2
52w High/Low (HK\$)	415.00/190.72
Total Issued Shares (mn)	9484.5

Source: FactSet

Shareholding Structure

MIH TC	26.9%
Advance Data Services Limited	8.4%

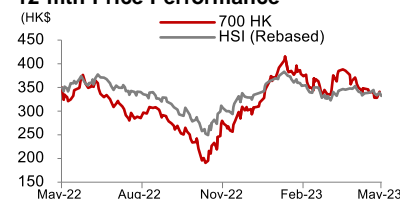
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-7.6%	-1.8%
3-mth	-8.3%	-2.1%
6-mth	23.6%	14.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: Tencent: forecast revision

RMB bn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	613.2	668.5	720.2	615.4	669.0	721.2	-0.4%	-0.1%	-0.1%
Gross Profit	274.3	303.6	333.3	268.8	298.0	327.8	2.1%	1.9%	1.7%
Adjusted net profit	142.3	165.7	185.8	138.5	162.5	184.6	2.7%	2.0%	0.6%
Adjusted EPS (RMB)	14.7	17.1	19.2	14.3	16.8	19.1	2.7%	2.0%	0.6%
Gross Margin	44.7%	45.4%	46.3%	43.7%	44.5%	45.5%	1.1 ppt	0.9 ppt	0.8 ppt
Adjusted net margin	23.2%	24.8%	25.8%	22.5%	24.3%	25.6%	0.7 ppt	0.5 ppt	0.2 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	613.2	668.5	720.2	620.8	694.8	770.1	-1.2%	-3.8%	-6.5%
Gross Profit	274.3	303.6	333.3	274.7	311.9	350.8	-0.1%	-2.7%	-5.0%
Adjusted net profit	142.3	165.7	185.8	145.2	169.6	194.4	-2.0%	-2.3%	-4.4%
Adjusted EPS (RMB)	14.7	17.1	19.2	14.9	17.5	20.2	-1.3%	-2.5%	-4.9%
Gross Margin	44.7%	45.4%	46.3%	44.2%	44.9%	45.6%	0.5 ppt	0.5 ppt	0.7 ppt
Adjusted net margin	23.2%	24.8%	25.8%	23.4%	24.4%	25.2%	-0.2 ppt	0.4 ppt	0.6 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financial

(RMB bn)	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	Cons.	Diff%	CMBI	Diff%
SNS revenue	30.3	29.1	29.1	29.2	29.9	28.6	31.0	29.1	6.5%	30.1	3.2%
YoY %	6.8%	4.4%	1.0%	0.6%	-1.4%	-1.7%	6.4%				
Games revenue	44.9	42.8	43.6	42.5	42.9	41.8	48.3	45.5	6.3%	46.1	4.8%
YoY %	8.4%	9.5%	0.0%	-1.2%	-4.6%	-2.3%	10.8%				
Online ad revenue	22.5	21.5	18.0	18.6	21.4	24.7	21.0	21.4	-2.0%	21.9	-4.3%
YoY %	5.4%	-12.7%	-17.6%	-18.4%	-4.7%	14.6%	16.5%				
FBS revenue	43.3	48.0	42.8	42.2	44.8	47.2	48.7	47.4	2.8%	47.9	1.6%
YoY %	30.3%	24.6%	9.6%	0.8%	3.5%	-1.5%	13.9%				
Total revenue	142.4	144.2	135.5	134.0	140.1	145.0	150.0	146.3	2.5%	148.0	1.3%
YoY %	13.5%	7.9%	0.1%	-3.1%	-1.6%	0.5%	10.7%				
Gross profit margin	44.1%	40.1%	42.1%	43.2%	44.2%	42.6%	45.5%	43.7%	1.8 ppt	43.6%	1.8 ppt
G&A%	16.8%	16.9%	19.7%	19.6%	18.9%	18.8%	16.4%				
S&M%	7.3%	8.1%	5.9%	5.9%	5.1%	4.2%	4.7%				
Non-IFRS net margin	22.3%	17.3%	18.9%	21.0%	23.0%	20.5%	21.7%				
Non-IFRS net profit	31.8	24.9	25.5	28.1	32.3	29.7	32.5	33.2	-2.1%	32.8	-0.8%
YoY %	-1.7%	-25.1%	-22.9%	-17.3%	1.6%	19.4%	27.4%				

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$455.0 comprises, per share:

- 1) HK\$188.0 for the online games business, based on a 20x 2023E PE, which is at discount to average PE for its global gaming peers (22x). The discount reflects Tencent's gaming business has entered a mature stage with more stable growth outlook versus peers.
- 2) HK\$29.2 for the SNS business, including the market cap of Tencent's stake in its subsidiaries, the valuation of Tencent Video (based on a 3.0x 2023E PS, at a premium to the 2.3x average PS of its peers given its content and user traffic leadership), and the valuation of other membership services (based on a 2.0x 2023E PS).
- 3) HK\$39.8 for the advertising business, based on a 18x 2023E PE, on par with the industry average.
- 4) HK\$100.2 for the fintech business, based on a 5.0x 2023E PS, at a premium to the peer average (2.0x). This mainly reflected our positive view on the recovery of China's digital payment volume in FY23/24E, and Tencent, as one of the largest digital payment platforms in China, is well-positioned to benefit from the recovery
- 5) HK\$23.1 for the cloud business, based on a 5.0x 2023E PS, on par with the industry average.
- 6) HK\$58.1 for strategic investments, based on the market value of Tencent's listed investment and the book value of its unlisted investment. We applied a 30% holding company discount to the fair value of Tencent's equity investment.
- 7) HK\$14.5 for net cash.

Figure 4: Tencent: SOTP valuation

	2023E net profit (RMBmn)	2023E revenue (RMBmn)	2023E PE (x)	2023E PS (x)	Market cap (RMBmn)	Valuation to Tencent (RMBmn)	As % of total valuation	Per share valuation (HK\$)
Online games	77,763		20x			1,555,262	41.3	188.0
Social network services (SNS)		123,835				241,366	6.4	29.2
Tencent Music (TME)					91,486	50,409	1.3	6.1
China Literature					30,074	17,798	0.5	2.2
Huya					5,353	2,537	0.1	0.3
Online video – subscription		27,300		3.0x		81,900	2.2	9.9
Others		44,361		2.0x		88,722	2.4	10.7
Online advertising	18,307		18x			329,527	8.8	39.8
Fintech		165,760		5.0x		828,801	22.0	100.2
Cloud (business services)		38,267		5.0x		191,337	5.1	23.1
Net cash						119,633	3.2	14.5
Valuation of core business						3,265,926		
RMB/HK\$						0.87		
Valuation of core business (HK\$mn)						3,764,756		
Valuation per share – core business (HK\$)						396.9		
Valuation per share – investment (HK\$)						58.1	12.8	
Valuation per share – Tencent (HK\$)						455.0		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

Companies	Ticker	Price	EPS growth (YoY %)			PE (x)		
		(Local)	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Online games								
NetEase	NTES US	89.6	(5)	11	12	18	17	15
Activision Blizzard	ATVI US	77.8	31	6	6	20	19	18
Electronic Arts	EA US	125.1	(14)	11	14	21	19	16
Take Two Interactive	TTWO US	124.1	(28)	39	57	35	25	16
IGG	799 HK	4.8	(36)	(516)	43	N/A	7	5
Nexon	3659 JP	3,010.0	(1)	17	9	24	20	19
Nintendo	7974 JP	5,913.0	(9)	(11)	(5)	18	20	21
Bandai Namco	7832 JP	3,300.0	18	6	11	23	22	20
Perfect World	002624 CH	18.4	5	18	11	21	18	16
37 games	002555 CH	28.0	14	14	14	18	16	14
Average PE						22	18	16
Online advertising								
Focus Media	002027 CH	6.8	61	22	9	20	16	15
Baidu	BIDU US	132.7	22	15	50	14	12	8
Meta	Meta US	238.8	21	23	13	18	15	13
Google	GOOG US	120.1	13	19	21	21	18	14
Average PE						18	15	13

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 16 May

Figure 6: Peer comparison: online video, fintech, and cloud sectors

Companies	Ticker	Price	Revenue growth (YoY %)			PS (x)		
		(Local)	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Online video								
iQiyi	IQ US	5.5	8.6	8.2	7.6	1.1	1.1	1.0
Mango Excellent Media	300413 CH	30.1	14.4	13.1	8.2	3.4	3.0	2.8
Average PS						2.3	2.0	1.9
Cloud								
Microsoft	MSFT US	311.7	11.5	12.1	14.4	9.8	8.8	7.7
Google	GOOG US	120.1	6.4	13.3	11.9	6.1	5.4	4.8
Salesforce	CRM US	204.6	11.7	11.2	12.5	5.9	5.3	4.7
Kingsoft Cloud	KC US	5.0	3.8	11.1	12.3	1.0	0.9	0.8
Amazon	AMZN US	113.4	9.7	11.9	12.7	2.1	1.9	1.6
Average PS						5.0	4.5	3.9
Fintech								
PayPal	PYPL US	60.8	7.3	9.6	8.7	2.3	2.1	1.9
Square	SQ US	55.5	18.1	13.4	10.7	1.6	1.4	1.3
Average PS						2.0	1.8	1.6

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 16 May

Our calculation for the valuation of Tencent's strategic investments is based on the current market value of Tencent's listed investment and the book value of its unlisted investment. We applied a 30% holding company discount to the fair value of Tencent's equity investment.

Figure 7: Tencent: valuation of strategic investment

Name	Ticker	Tencent's stake %	Mkt cap (US\$mn)	Value to Tencent (HK\$bn)
PDD Holdings Inc	PDD US	15.5	83,462	100,841
Sea Ltd	SE US	20.2	41,062	64,697
Kuaishou Technology	1024 HK	19.0	29,321	43,476
China International Capital Co	3690 HK	11.4	22,611	20,035
Spotify Technology SA	SNAP US	8.6	28,301	19,006
Snap Inc	BEKE US	17.5	13,791	18,857
KE Holdings Inc	3908 HK	11.3	21,268	18,746
NU Holdings Ltd/Cayman Islands	SPOT US	7.9	28,638	17,669
Meituan	9618 HK	1.7	109,442	14,768
JD.com Inc	NU US	2.7	58,967	12,234
Futu Holdings Ltd	FUTU US	21.6	5,758	9,706
Bilibili Inc	9626 HK	13.4	7,901	8,264
Vipshop Holdings Ltd	780 HK	11.5	9,127	8,201
Krafton Inc	VIPS US	13.5	7,384	7,770
Tongcheng Travel Holdings Ltd	259960 KS	21.4	4,400	7,337
Kanzhun Ltd	BZ US	9.9	8,136	6,264
Netmarble Corp	WMG US	17.5	3,726	5,092
Warner Music Group Corp	251270 KS	4.9	13,157	5,049
Yixin Group Ltd	2858 HK	53.9	724	3,044
ZhongAn Online P&C Insurance C	6060 HK	8.1	4,680	2,953
Waterdrop Inc	WDH US	26.5	1,142	2,362
Paradox Interactive AB	PDX SS	9.1	2,680	1,904
Kadokawa Corp	9468 JP	6.9	3,326	1,780
Oxford Nanopore Technologies P	1896 HK	7.7	2,479	1,479
Ubisoft Entertainment SA	UBI FP	5.5	3,466	1,476
DHC Software Co Ltd	002065 CH	4.9	3,248	1,241
Maoyan Entertainment	ONT LN	13.7	1,158	1,241
Tuya Inc	9959 HK	11.7	1,102	1,004
Other listed entities as a whole			47,816	11,015
Listed investment (Current value)				417,513
Unlisted investment (Book Value)				369,196
Total investment value				786,709
Holdco discount				30%
Valuation of strategic investment				550,696
Valuation of strategic investment per share				58.1

Source: Bloomberg, Company data, CMBIGM estimates

Note: data as of the market close on 16 May

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	482,064	560,118	554,552	613,195	668,542	720,198
Cost of goods sold	(260,532)	(314,174)	(315,806)	(338,851)	(364,967)	(386,900)
Gross profit	221,532	245,944	238,746	274,345	303,575	333,298
Operating expenses	(37,295)	25,676	(3,040)	(101,934)	(120,844)	(129,133)
Selling expense	(33,758)	(40,594)	(29,229)	(30,660)	(35,433)	(36,730)
Admin expense	(67,625)	(89,847)	(106,696)	(105,470)	(123,680)	(129,636)
Others	64,088	156,117	132,885	34,195	38,269	37,233
Operating profit	184,237	271,620	235,706	172,410	182,731	204,164
Share of (losses)/profits of associates/JV	3,672	(16,444)	(16,129)	320	320	320
Interest income	6,957	6,650	8,592	7,929	11,215	9,367
Interest expense	(7,887)	(7,114)	(9,352)	(10,963)	(11,063)	(2,692)
Pre-tax profit	180,022	248,062	210,225	161,767	171,988	201,792
Income tax	(19,897)	(20,252)	(21,516)	(29,118)	(23,218)	(26,102)
After tax profit	160,125	227,810	188,709	132,649	148,770	175,690
Minority interest	(278)	(2,988)	(466)	(328)	(367)	(413)
Net profit	159,847	224,822	188,243	132,322	148,402	175,277
Adjusted net profit	122,742	123,788	115,649	142,333	165,655	185,752
Gross dividends	12,653	12,704	20,256	16,374	18,364	20,645
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	317,647	484,812	565,989	581,068	656,437	825,351
Cash & equivalents	152,798	167,966	156,739	337,274	331,066	509,381
Account receivables	44,981	49,331	45,467	48,574	51,369	53,678
Inventories	814	1,063	2,333	1,872	1,939	2,047
Prepayment	40,321	65,390	76,685	32,204	82,952	37,380
ST bank deposits	68,487	83,813	104,776	127,294	154,105	185,913
Financial assets at FVTPL	6,593	10,573	27,963	29,361	30,829	32,371
Other current assets	3,653	106,676	152,026	4,488	4,177	4,581
Non-current assets	1,015,778	1,127,552	1,012,142	1,058,838	1,132,469	1,178,078
PP&E	59,843	61,914	53,978	71,813	85,919	97,275
Deferred income tax	21,348	26,068	29,882	20,435	34,424	24,674
Investment in JVs & assos	305,258	323,188	252,715	264,094	275,842	287,948
Intangibles	159,437	171,376	161,802	190,451	217,107	241,638
Financial assets at FVTPL	165,944	192,184	206,085	206,085	206,085	206,085
Other non-current assets	303,948	352,822	307,680	305,960	313,092	320,458
Total assets	1,333,425	1,612,364	1,578,131	1,639,906	1,788,906	2,003,430
Current liabilities	269,079	403,098	434,204	352,359	353,927	404,259
Short-term borrowings	14,242	19,003	22,026	18,153	19,552	20,727
Account payables	94,030	109,470	92,381	125,885	106,853	137,405
Tax payable	12,134	12,506	13,488	14,854	15,678	16,288
Other current liabilities	144,851	256,673	299,955	187,113	205,489	223,485
Lease liabilities	3,822	5,446	6,354	6,354	6,354	6,354
Non-current liabilities	286,303	332,573	361,067	383,285	394,562	405,690
Long-term borrowings	112,145	136,936	163,668	164,560	164,829	164,909
Bond payables	122,057	145,590	148,669	154,244	157,136	158,609
Deferred income	6,678	4,526	3,503	13,554	14,599	15,476
Other non-current liabilities	45,423	45,521	45,227	50,927	57,999	66,695
Total liabilities	555,382	735,671	795,271	735,644	748,489	809,948
Retained earnings	538,464	669,911	705,981	827,055	962,843	1,115,494
Other reserves	165,520	136,388	15,410	15,410	15,410	15,410
Total shareholders equity	703,984	806,299	721,391	842,465	978,253	1,130,904
Minority interest	74,059	70,394	61,469	61,797	62,164	62,577
Total equity and liabilities	1,333,425	1,612,364	1,578,131	1,639,906	1,788,906	2,003,430

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	180,022	248,062	210,225	161,767	171,988	201,792
Depreciation & amortization	50,774	56,818	60,230	55,298	67,986	78,921
Tax paid	(19,897)	(20,252)	(21,516)	(29,118)	(23,218)	(26,102)
Change in working capital	27,423	(2,844)	(28,405)	110,463	(54,266)	91,702
Others	(44,203)	(106,598)	(74,443)	0	0	(8,446)
Net cash from operations	194,119	175,186	146,091	298,410	162,489	337,867
Investing						
Capital expenditure	(33,906)	(34,931)	(33,892)	(36,727)	(39,241)	(41,428)
Acquisition of subsidiaries/ investments	(108,665)	(117,642)	59,711	(24,556)	(60,835)	(43,476)
Net proceeds from disposal of short-term investments	15,376	0	0	0	0	0
Others	(54,760)	(25,976)	(130,690)	(65,054)	(69,507)	(73,380)
Net cash from investing	(181,955)	(178,549)	(104,871)	(126,338)	(169,584)	(158,284)
Financing						
Net borrowings	44,490	45,239	31,982	9,659	12,456	12,035
Proceeds from share issues	1,716	0	0	0	0	0
Others	(32,559)	(23,619)	(91,935)	(1,196)	(11,570)	(13,303)
Net cash from financing	13,647	21,620	(59,953)	8,463	887	(1,268)
Net change in cash						
Cash at the beginning of the year	132,991	152,798	167,966	156,739	337,274	331,066
Exchange difference	(6,004)	(3,089)	7,506	0	0	0
Cash at the end of the year	152,798	167,966	156,739	337,274	331,066	509,381
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	27.8%	16.2%	(1.0%)	10.6%	9.0%	7.7%
Gross profit	32.2%	11.0%	(2.9%)	14.9%	10.7%	9.8%
Operating profit	55.2%	47.4%	(13.2%)	(26.9%)	6.0%	11.7%
Net profit	71.3%	40.6%	(16.3%)	(29.7%)	12.2%	18.1%
Adj. net profit	30.1%	0.9%	(6.6%)	23.1%	16.4%	12.1%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	46.0%	43.9%	43.1%	44.7%	45.4%	46.3%
Operating margin	38.2%	48.5%	42.5%	28.1%	27.3%	28.3%
Adj. net profit margin	25.5%	22.1%	20.9%	23.2%	24.8%	25.8%
Return on equity (ROE)	28.1%	29.8%	24.6%	16.9%	16.3%	16.6%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	0.1	0.2	0.2	(0.0)	0.0	(0.1)
Current ratio (x)	1.2	1.2	1.3	1.6	1.9	2.0
Receivable turnover days	34.1	32.1	29.9	28.9	28.0	27.2
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	23.2	18.1	14.1	21.8	19.5	16.5
P/E (diluted)	23.6	18.4	14.3	22.2	19.8	16.8
P/B	5.3	5.0	3.7	3.4	3.0	2.6

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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