

Tencent (700 HK)

2Q23 preview: expecting strong recovery ahead

Tencent will report 2Q23 results on 16 Aug. We expect a strong quarter with total revenue/non-IFRS net income up by 12/25% YoY to RMB149.9/35.2bn, driven by solid recovery of ads/fintech businesses and operating leverage. Several developing catalysts will support Tencent's business growth and valuation recovery: 1) solid consumer internet revenue growth provides room for operating leverage improvement; 2) Tencent's MaaS solutions and AI deployment will not only capture the rising enterprise demand for model training and AI applications, but also become growth multipliers for its own business lines. We are positive on the earnings recovery trajectory in FY23 and maintain our full-year forecast largely unchanged. Our SOTP-derived TP is maintained at HK\$455.0. Reiterate BUY.

- **Consumer internet revenue growth reaccelerating.** We forecast total revenue to increase by 12% YoY in 2Q23E, with growth further accelerating (1Q23: +11% YoY). We estimate games revenue to grow by 9% YoY to RMB46.3bn in 2Q23E (31% of total revenue), mainly driven by the strong international game business. The launch of several popular PC titles including Valorant and Lost Ark in July will further support games revenue growth and GPM improvement in 2H23. We forecast ad revenue to increase by 22% YoY to RMB22.7bn (22% of total revenue) in 2Q23E, driven by solid recovery of ad demand from key ad categories like gaming and e-commerce. We expect Tencent to gain ad market share by more collaboration with e-commerce platforms like Alibaba and incremental revenue contribution from Video Account.
- **FBS is on track of solid recovery.** We project fintech and business service (FBS) revenue to grow by 17% YoY to RMB49.3bn in 2Q23E (33% of total revenue), as both fintech and cloud revenue recovered on low base. PBoC on 7 July imposed a fine of RMB2.99bn (c.2% of cash) on Tenpay and ended its inspection started since FY21. With more normalized fintech regulations, we are positive on the healthy growth of fintech business in the long term. For cloud business, we expect its revenue growth to gradually reaccelerate driven by rising demand for model training and AI applications. To capture the opportunities, Tencent recently launched the one-stop MaaS offering based on its strong cloud infrastructure ([see detail](#)).
- **Increase in higher-margin segment revenue contribution and operating leverage boost 2Q23E earnings.** Tencent continues to unleash its operating leverage on expenses optimization. We forecast non-IFRS net income to increase by 25% YoY to RMB35.2bn in 2Q23E, with NPM up by 2.5pct YoY to 23.5%. Tencent currently trades at 21x 2023E non-IFRS PE (or 18x 2023E PE if excluding strategic investment). We see its current valuation attractive given its strong earnings growth outlook (FY23/24: +24/21% YoY) and ROE.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	616,035	671,342	723,336
YoY growth (%)	16.2	(1.0)	11.1	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	142,908.0	173,513.6	193,497.7
YoY growth (%)	0.9	(6.6)	23.6	21.4	11.5
EPS (Adjusted) (RMB)	12.99	12.13	14.76	17.92	19.98
Consensus EPS (RMB)	12.99	12.13	15.12	17.96	20.37
P/E (x)	18.1	14.1	23.0	19.6	16.7
ROE (%)	29.8	24.6	17.0	17.1	17.2

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$455.00
 (Previous TP HK\$455.00)
Up/Downside 29.0%
Current Price HK\$352.60

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Stock Data

Mkt Cap (HK\$ mn)	3,343,970.3
Avg 3 mths t/o (HK\$ mn)	6,314.5
52w High/Low (HK\$)	415.00/190.72
Total Issued Shares (mn)	9483.8

Source: FactSet

Shareholding Structure

MIH TC	26.9%
Advance Data Services Limited	8.4%

Source: HKEx

Share Performance

	Absolute	Relative
1-mth	2.0%	2.0%
3-mth	-3.5%	1.6%
6-mth	-5.1%	6.3%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business and valuation update

Figure 1: Tencent: forecast revision

RMB bn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	616.0	671.3	723.3	613.2	668.5	720.2	0.5%	0.4%	0.4%
Gross Profit	275.5	304.7	334.6	274.3	303.6	333.3	0.4%	0.4%	0.4%
Adjusted net profit	142.9	173.5	193.5	142.3	165.7	185.8	0.4%	4.7%	4.1%
Adjusted EPS (RMB)	14.8	17.9	20.0	14.7	17.1	19.2	0.4%	4.8%	4.2%
Gross Margin	44.7%	45.4%	46.3%	44.7%	45.4%	46.3%	0.0 ppt	0.0 ppt	0.0 ppt
Adjusted net margin	23.2%	25.8%	26.8%	23.2%	24.8%	25.8%	0.0 ppt	1.1 ppt	1.0 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	616.0	671.3	723.3	625.1	699.2	774.4	-1.5%	-4.0%	-6.6%
Gross Profit	275.5	304.7	334.6	281.5	318.8	355.6	-2.1%	-4.4%	-5.9%
Adjusted net profit	142.9	173.5	193.5	144.5	174.4	195.1	-1.1%	-0.5%	-0.8%
Adjusted EPS (RMB)	14.8	17.9	20.0	15.1	18.0	20.4	-2.4%	-0.2%	-1.9%
Gross Margin	44.7%	45.4%	46.3%	45.0%	45.6%	45.9%	-0.3 ppt	-0.2 ppt	0.3 ppt
Adjusted net margin	23.2%	25.8%	26.8%	23.1%	24.9%	25.2%	0.1 ppt	0.9 ppt	1.6 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: key financial forecasts

(RMB bn)	2022	2023E	2024E	2025E	2Q23E
SNS revenue	116.8	123.8	129.4	134.6	30.3
YoY %	0%	6%	5%	4%	4%
As % of total revenue	21%	20%	19%	19%	20%
Games revenue	170.7	187.6	199.9	210.2	46.3
YoY %	-2%	10%	7%	5%	9%
As % of total revenue	31%	30%	30%	29%	31%
Online ad revenue	82.7	95.2	105.5	115.9	22.7
YoY %	-7%	15%	11%	10%	22%
As % of total revenue	15%	15%	16%	16%	15%
FBS revenue	177.1	205.5	230.8	256.8	49.3
YoY %	3%	16%	12%	11%	17%
As % of total revenue	32%	33%	34%	36%	33%
Total revenue	554.6	616.0	671.3	723.3	149.9
YoY %	-1%	11%	9%	8%	12%
Gross profit margin (%)	43.1%	44.7%	45.4%	46.3%	44.4%
G&A expenses as % of total revenue (%)	19.2%	17.2%	17.0%	16.8%	17.5%
S&M expenses as % of total revenue (%)	5.3%	5.0%	5.3%	5.2%	5.2%
Non-IFRS net profit margin (%)	20.9%	23.2%	25.8%	26.8%	23.5%
Non-IFRS net profit	115.6	142.9	173.5	193.5	35.2
YoY %	-7%	24%	21%	12%	25%

Source: Company data, CMBIGM estimates

SOTP valuation

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

1) HK\$186.1 for the online games business, based on a 20x 2023E PE, which is at discount to average PE for its global gaming peers (23x). The discount reflects Tencent's gaming business has entered mature stage with more stable growth outlook versus peers.

2) HK\$28.6 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 2.6x 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\$47.7 for the advertising business, based on 18x 2023E PE, at a discount to the industry average (21x) as its advertising business entered mature phase.

4) HK\$99.2 for the fintech business, based on a 5.0x 2023E PS, at a premium to the peer average (2.5x). 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\$21.7 for the cloud business, based on a 5.0x 2023E PS, at a discount to the industry average (5.5x) as Tencent's current offerings come mainly from the lower-margin IaaS Business.

6) HK\$60.3 for strategic investments, 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.

7) HK\$9.3 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	79,089		20x			1,581,771	40.9	186.1
Social network services (SNS)		123,835				242,985	6.3	28.6
Tencent Music (TME)					92,892	51,183	1.3	6.0
China Literature					31,293	18,519	0.5	2.2
Huya					5,612	2,660	0.1	0.3
Online video – subscription		27,300		3.0x		81,900	2.1	9.6
Others		44,361		2.0x		88,722	2.3	10.4
Online advertising	22,504		18x			405,071	10.5	47.7
Fintech		168,618		5.0x		843,091	21.8	99.2
Cloud (business services)		36,901		5.0x		184,503	4.8	21.7
Net cash						78,825	2.0	9.3
Valuation of core business						3,336,246		
RMB/HK\$						0.89		
Valuation of core business (HK\$mn)						3,743,543		
Valuation per share – core business (HK\$)						394.7		
Valuation per share – investment (HK\$)						60.3		
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	105.3	6	6	2	19	18	18
Activision Blizzard	ATVI US	90.1	32	5	8	23	22	20
Electronic Arts	EA US	137.3	(14)	14	11	23	20	18
Take Two Interactive	TTWO US	150.0	(27)	(7)	138	42	45	19
IGG	799 HK	4.1	(22)	(385)	30	na	7	6
Nexon	3659 JP	2,786.0	2	13	10	22	19	17
Nintendo	7974 JP	6,389.0	(9)	(4)	(9)	19	20	22
Bandai Namco	7832 JP	3,210.0	18	4	10	23	22	20
Perfect World	002624 CH	15.3	(4)	22	15	19	16	14
37 Interactive	002555 CH	29.7	14	14	13	19	17	15
Average PE						23	21	17
Online advertising								
Focus Media	002027 CH	7.3	59	22	13	22	18	16
Baidu	BIDU US	149.2	18	12	14	17	15	13
Meta	Meta US	308.9	20	23	14	23	19	17
Google	GOOG US	125.7	13	18	18	22	18	16
Average PE						21	18	15

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 14 Jul

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	5.4	6.4	7.6	7.1	1.1	1.1	1.0
Mango Excellent Media	300413 CH	34.8	7.7	12.5	10.2	4.1	3.7	3.3
Average PS						2.6	2.4	2.2
Cloud								
Microsoft	MSFT US	345.2	11.4	12.0	14.2	10.9	9.7	8.5
Google	GOOG US	125.7	6.1	10.7	11.4	6.4	5.8	5.2
Salesforce	CRM US	229.3	11.8	10.9	10.9	6.4	5.8	5.2
Kingsoft Cloud	KC US	6.3	(2.6)	11.3	16.7	1.4	1.3	1.1
Amazon	AMZN US	134.7	9.9	11.8	12.4	2.5	2.2	2.0
Average PS						5.5	5.0	4.4
Fintech								
PayPal	PYPL US	72.1	7.3	9.2	9.1	2.7	2.5	2.3
Square	SQ US	75.5	18.9	13.2	14.4	2.2	1.9	1.7
Average PS						2.5	2.2	2.0

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 14 Jul

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	100,506	121,433
Sea Ltd	SE US	20.2	35,422	55,812
Kuaishou Technology	1024 HK	19.0	33,071	49,037
Snap Inc	SNAP US	17.5	21,156	28,927
NU Holdings Ltd/Cayman Islands	NU US	7.9	36,394	22,454
Spotify Technology SA	SPOT US	8.6	33,299	22,363
KE Holdings Inc	BEKE US	11.3	18,872	16,633
China International Capital Co	3908 HK	11.4	18,478	16,373
Meituan	3690 HK	1.7	105,845	14,283
JD.com Inc	9618 HK	2.7	60,627	12,579
Futu Holdings Ltd	FUTU US	21.6	6,558	11,055
Vipshop Holdings Ltd	VIPS US	11.5	9,679	8,697
Tongcheng Travel Holdings Ltd	780 HK	21.4	5,193	8,660
Krafton Inc	259960 KS	13.5	7,422	7,810
Bilibili Inc	9626 HK	13.4	7,095	7,421
Warner Music Group Corp	WMG US	4.9	14,896	5,717
Kanzhun Ltd	BZ US	9.9	7,086	5,455
Netmarble Corp	251270 KS	17.5	3,298	4,506
Yixin Group Ltd	2858 HK	53.9	676	2,842
ZhongAn Online P&C Insurance C	6060 HK	8.1	4,401	2,777
Paradox Interactive AB	PDX SS	9.1	2,818	2,002
Kadokawa Corp	9468 JP	6.9	3,497	1,871
Waterdrop Inc	WDH US	26.5	818	1,691
Ubisoft Entertainment SA	UBI FP	5.5	3,668	1,562
Oxford Nanopore Technologies P	ONT LN	7.7	2,424	1,446
Maoyan Entertainment	1896 HK	13.7	1,239	1,328
DHC Software Co Ltd	002065 CH	4.9	3,104	1,186
Lilium NV	LILM US	27.6	533	1,149
Linklogis Inc	9959 HK	15.6	833	1,016
Other listed entities as a whole			52,753	10,375
Listed investment (Current value)				448,462
Unlisted investment (Book Value)				369,196
Total investment value				817,658
Holdco discount				30%
Valuation of strategic investment				572,360
Valuation of strategic investment per share				60.3

Source: Bloomberg, Company data, CMBIGM estimates

Note: data as of the market close on 14 Jul

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	482,064	560,118	554,552	616,035	671,342	723,336
Cost of goods sold	(260,532)	(314,174)	(315,806)	(340,518)	(366,606)	(388,697)
Gross profit	221,532	245,944	238,746	275,517	304,736	334,639
Operating expenses	(37,295)	25,676	(3,040)	(102,565)	(113,048)	(121,667)
Selling expense	(33,758)	(40,594)	(29,229)	(30,802)	(35,581)	(37,613)
Admin expense	(67,625)	(89,847)	(106,696)	(105,958)	(114,128)	(121,520)
Others	64,088	156,117	132,885	34,195	36,661	37,467
Operating profit	184,237	271,620	235,706	172,952	191,688	212,972
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	9,607	9,601
Interest expense	(7,887)	(7,114)	(9,352)	(10,968)	(11,068)	(2,692)
Pre-tax profit	180,022	248,062	210,225	162,304	180,940	210,599
Income tax	(19,897)	(20,252)	(21,516)	(29,215)	(24,427)	(27,290)
After tax profit	160,125	227,810	188,709	133,089	156,513	183,309
Minority interest	(278)	(2,988)	(466)	(329)	(386)	(432)
Net profit	159,847	224,822	188,243	132,760	156,126	182,878
Adjusted net profit	122,742	123,788	115,649	142,908	173,514	193,498
Gross dividends	12,653	12,704	20,256	16,429	19,320	21,585
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	317,647	484,812	565,989	561,036	669,349	819,800
Cash & equivalents	152,798	167,966	156,739	270,255	343,257	453,736
Account receivables	44,981	49,331	45,467	48,798	51,584	53,912
Inventories	814	1,063	2,333	1,881	1,948	2,056
Prepayment	40,321	65,390	76,685	78,943	83,450	87,216
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	4,503	4,176	4,596
Non-current assets	1,015,778	1,127,552	1,012,142	1,059,691	1,133,408	1,179,578
PP&E	59,843	61,914	53,978	71,983	86,194	97,634
Deferred income tax	21,348	26,068	29,882	20,668	34,420	24,935
Investment in JVs & assos	305,258	323,188	252,715	264,094	275,842	287,948
Intangibles	159,437	171,376	161,802	190,752	217,631	242,365
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	306,108	313,235	320,611
Total assets	1,333,425	1,612,364	1,578,131	1,620,727	1,802,757	1,999,378
Current liabilities	269,079	403,098	434,204	332,710	360,223	385,678
Short-term borrowings	14,242	19,003	22,026	18,242	19,640	20,823
Account payables	94,030	109,470	92,381	105,239	112,169	117,738
Tax payable	12,134	12,506	13,488	14,927	15,749	16,364
Other current liabilities	144,851	256,673	299,955	187,949	206,312	224,398
Lease liabilities	3,822	5,446	6,354	6,354	6,354	6,354
Non-current liabilities	286,303	332,573	361,067	383,352	394,628	405,762
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	13,621	14,664	15,548
Other non-current liabilities	45,423	45,521	45,227	50,927	57,999	66,695
Total liabilities	555,382	735,671	795,271	716,062	754,851	791,440
Retained earnings	538,464	669,911	705,981	827,457	970,312	1,129,912
Other reserves	165,520	136,388	15,410	15,410	15,410	15,410
Total shareholders equity	703,984	806,299	721,391	842,867	985,722	1,145,322
Minority interest	74,059	70,394	61,469	61,798	62,184	62,616
Total equity and liabilities	1,333,425	1,612,364	1,578,131	1,620,727	1,802,757	1,999,378

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	180,022	248,062	210,225	162,304	180,940	210,599
Depreciation & amortization	50,774	56,818	60,230	55,298	68,113	79,135
Tax paid	(19,897)	(20,252)	(21,516)	(29,215)	(24,427)	(27,290)
Change in working capital	27,423	(2,844)	(28,405)	43,679	17,934	17,454
Others	(44,203)	(106,598)	(74,443)	0	0	(8,451)
Net cash from operations	194,119	175,186	146,091	232,065	242,560	271,447
Investing						
Capital expenditure	(33,906)	(34,931)	(33,892)	(36,897)	(39,405)	(41,608)
Acquisition of subsidiaries/ investments	(108,665)	(117,642)	59,711	(24,952)	(60,579)	(43,767)
Net proceeds from disposal of short-term investments	15,376	0	0	0	0	0
Others	(54,760)	(25,976)	(130,690)	(65,355)	(69,799)	(73,700)
Net cash from investing	(181,955)	(178,549)	(104,871)	(127,204)	(169,783)	(159,075)
Financing						
Net borrowings	44,490	45,239	31,982	9,822	12,452	12,049
Proceeds from share issues	1,716	0	0	0	0	0
Others	(32,559)	(23,619)	(91,935)	(1,167)	(12,227)	(13,943)
Net cash from financing	13,647	21,620	(59,953)	8,655	225	(1,894)
Net change in cash						
Cash at the beginning of the year	132,991	152,798	167,966	156,739	270,255	343,257
Exchange difference	(6,004)	(3,089)	7,506	0	0	0
Cash at the end of the year	152,798	167,966	156,739	270,255	343,257	453,736
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	27.8%	16.2%	(1.0%)	11.1%	9.0%	7.7%
Gross profit	32.2%	11.0%	(2.9%)	15.4%	10.6%	9.8%
Operating profit	55.2%	47.4%	(13.2%)	(26.6%)	10.8%	11.1%
Net profit	71.3%	40.6%	(16.3%)	(29.5%)	17.6%	17.1%
Adj. net profit	30.1%	0.9%	(6.6%)	23.6%	21.4%	11.5%
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%	28.6%	29.4%
Adj. net profit margin	25.5%	22.1%	20.9%	23.2%	25.8%	26.8%
Return on equity (ROE)	28.1%	29.8%	24.6%	17.0%	17.1%	17.2%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	0.1	0.2	0.2	0.1	(0.0)	(0.1)
Current ratio (x)	1.2	1.2	1.3	1.7	1.9	2.1
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	23.0	19.6	16.7
P/E (diluted)	23.6	18.4	14.3	23.4	19.9	17.0
P/B	5.3	5.0	3.7	3.6	3.1	2.7

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

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