Tencent (700 HK)

3Q26 results: early signs of positive AI progress but margin pressure persists

BUY (Maintain)

Target Price	**HK$670.00**
(Previous TP	HK$705.00)
Up/Downside	**79.7%**
Current Price	**HK$372.80**

Tencent reported 3Q26 results: total revenue grew by 8% YoY to RMB207.3bn, 2% below the consensus estimate of Visible Alpha, mainly due to the lower-than-expected games revenue growth. Non-IFRS operating profit was down by 6% YoY to RMB68.1bn, 6% below the consensus estimate, primarily due to the increase in AI investment. If excluding new AI products investment of RMB15.2bn, non-IFRS operating profit grew by 8% YoY to RMB83.3bn. Free cash flow was negative RMB69.1bn in 3Q26, down from positive RMB58.5bn in 3Q25, reflecting significant prepayment for compute procurement (RMB86bn) and cash capex (RMB65bn). We expect the front-loaded AI investment continues to drag margin in FY26/27E, and lower our FY26-28 earnings forecasts by 3-9%. We roll over our valuation window to FY27 and trim our SOTP-derived target price to HK$670.0 (previous: HK$705.0). Despite short-term earnings drag, we remain constructive on the solid progress and long-term monetization potential of Tencent's productivity AI and personal agents. Maintain BUY.

- **Game revenue below expectation; ad & FBS businesses in line.** By segment in 3Q26: 1) Games revenue grew by 5% YoY to RMB66.5bn, 3% below VA consensus. International games revenue declined by 9% YoY (-4% on a constant currency basis), primarily due to the high base in 3Q25 arising from Supercell games and *Dying Light: The Beast*. Domestic games revenue was up by 11% YoY to RMB47.6bn, driven by the solid performance of evergreen titles. 2) Marketing services revenue was up by 19% YoY to RMB43.0bn, driven by growth in both impressions and eCPM. Video Accounts' ad impressions increased by over 50% YoY in 3Q26. 3) Fintech and Business Services revenue grew by 9% YoY to RMB63.7bn. Cloud revenue growth accelerated to 35% YoY in 3Q26 (low-20% YoY in 2Q26), supported by strong demand for AI services like WorkBuddy and Model-as-a-Service, revenue of which more than tripled QoQ.
- **Solid progress on model, productivity and personal AI.** 1) Foundational model: Hy4 ranked the top Chinese model on Agent Arena leaderboard at its launch in Nov, showing strong capabilities for real-world tasks. 2) Productivity AI: WorkBuddy achieved over 10mn DAUs with over 100tn daily token usage collectively. WorkBuddy's revenue also increased more than five-fold QoQ in 3Q26, with annualized gross revenue over the last seven days exceeding US$500mn, supported by increasing paying users and strong enterprise adoption. 3) Personal AI assistant: Xiaowei achieved 30mn DAUs as Weixin expanded user testing pool. Inference cost of Xiaowei continued to decline, and management expects quarterly cost of Xiaowei at full availability will be less than that of Yuanbao.
- **Rising AI investment drags margin.** Non-IFRS OPM dropped by 4.8ppts YoY and 4.1ppts QoQ to 32.8% in 3Q26, mainly due to the increased AI investment. R&D expenses were up by 42% YoY and 19% QoQ to RMB32.4bn in 3Q26. Cash capex increased by 10% QoQ and 225% YoY to RMB65bn in 3Q26. Management believes cash capex is nearing its peak and expects quarterly cash capex to hover around this level in FY26/27E, before a gradual decline thereafter.

Earnings Summary

(YE 31 Dec)	FY24A	FY25A	FY26E	FY27E	FY28E
Revenue (RMB mn)	660,257	751,766	818,593	884,043	942,988
Adjusted net profit (RMB mn)	222,703.0	259,626.0	262,919.6	260,533.2	274,268.9
EPS (Adjusted) (RMB)	23.96	28.55	28.79	28.96	30.95
Consensus EPS (RMB)	23.96	28.55	28.72	29.68	32.40
P/E (x)	15.2	12.8	12.1	11.7	11.5

Source: Company data, Bloomberg, CMBIGM estimates

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Stock Data

Mkt Cap (HK$ mn)	3,358,456.9
Avg 3 mths t/o (HK$ mn)	8,941.5
52w High/Low (HK$)	633.00/372.80
Total Issued Shares (mn)	9008.7

Source: FactSet

Shareholding Structure

MIH TC	22.8%
Advance Data Services Limited	7.8%

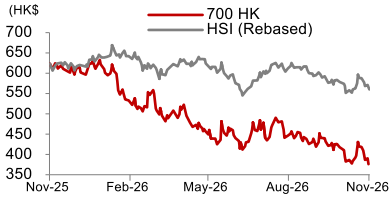
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-10.8%	-7.4%
3-mth	-15.7%	-7.9%
6-mth	-17.0%	-8.5%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: Tencent: forecast revision

	Current			Previous			Change (%)		
(RMB bn)	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	818.0	884.0	943.0	816.5	873.8	925.2	0.2%	1.2%	1.9%
Gross profit	463.6	502.5	535.6	469.9	507.4	537.8	-1.3%	-1.0%	-0.4%
Operating profit	249.7	247.4	258.8	260.5	275.4	289.3	-4.2%	-10.2%	-10.5%
Adjusted net profit	263.0	260.5	274.3	272.2	286.5	302.5	-3.4%	-9.1%	-9.3%
Adjusted EPS (RMB)	28.8	29.0	31.0	29.8	31.9	34.2	-3.5%	-9.2%	-9.4%
Gross margin	56.7%	56.8%	56.8%	57.5%	58.1%	58.1%	-0.9 ppt	-1.2 ppt	-1.3 ppt
Operating margin	30.5%	28.0%	27.4%	31.9%	31.5%	31.3%	-1.4 ppt	-3.5 ppt	-3.8 ppt
Adjusted net margin	32.2%	29.5%	29.1%	33.3%	32.8%	32.7%	-1.2 ppt	-3.3 ppt	-3.6 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

	CMBIGM			Consensus			Diff (%)		
(RMB bn)	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	818.0	884.0	943.0	825.2	903.6	986.2	-0.9%	-2.2%	-4.4%
Gross profit	463.6	502.5	535.6	469.2	513.8	562.8	-1.2%	-2.2%	-4.8%
Operating profit	249.7	247.4	258.8	260.2	271.2	297.4	-4.0%	-8.8%	-13.0%
Adjusted net profit	263.0	260.5	274.3	269.4	273.4	297.3	-2.4%	-4.7%	-7.7%
Adjusted EPS (RMB)	28.8	29.0	31.0	28.7	29.7	32.4	0.3%	-2.4%	-4.5%
Gross margin	56.7%	56.8%	56.8%	56.9%	56.9%	57.1%	-0.2 ppt	0.0 ppt	-0.3 ppt
Operating margin	30.5%	28.0%	27.4%	31.5%	30.0%	30.2%	-1.0 ppt	-2.0 ppt	-2.7 ppt
Adjusted net margin	32.2%	29.5%	29.1%	32.6%	30.3%	30.1%	-0.5 ppt	-0.8 ppt	-1.1 ppt

Source: Visible Alpha, CMBIGM estimates

Figure 3: Tencent: quarterly financials

(RMB bn)	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	Cons.	Diff%
SNS revenue	32.6	32.2	32.3	30.6	31.9	32.5	31.8	33.0	-3.5%
YoY%	*2.5%*	*6.9%*	*6.1%*	*4.4%*	*2.7%*	*5.0%*	*-2.2%*	*2.2%*	
QoQ%	*9.4%*	*-1.4%*	*0.3%*	*-5.1%*	*4.2%*	*1.8%*	*-2.0%*		
Games revenue	59.5	59.2	63.6	59.3	64.2	65.9	66.5	68.5	-2.9%
YoY%	*23.7%*	*22.1%*	*22.8%*	*20.5%*	*7.9%*	*11.4%*	*4.6%*	*7.7%*	
QoQ%	*20.9%*	*-0.5%*	*7.4%*	*-6.8%*	*8.3%*	*2.7%*	*0.8%*		
Marketing revenue	31.9	35.8	36.2	41.1	38.2	43.6	43.0	43.0	0.0%
YoY%	*20.2%*	*19.7%*	*20.8%*	*17.5%*	*19.8%*	*21.8%*	*18.8%*	*18.7%*	
QoQ%	*-9.0%*	*12.3%*	*1.3%*	*13.4%*	*-7.2%*	*14.1%*	*-1.2%*		
FBS revenue	54.9	55.5	58.2	60.8	59.9	60.3	63.7	63.4	0.3%
YoY%	*5.0%*	*10.1%*	*9.6%*	*8.4%*	*9.1%*	*8.6%*	*9.4%*	*9.1%*	
QoQ%	*-2.2%*	*1.1%*	*4.8%*	*4.5%*	*-1.5%*	*0.7%*	*5.6%*		
Total revenue	**180.0**	**184.5**	**192.9**	**194.4**	**196.5**	**204.8**	**207.3**	**210.8**	**-1.7%**
YoY%	*12.9%*	*14.5%*	*15.4%*	*12.7%*	*9.1%*	*11.0%*	*7.5%*	*9.3%*	
QoQ%	*4.4%*	*2.5%*	*4.5%*	*0.8%*	*1.1%*	*4.2%*	*1.2%*		
Gross profit	**100.5**	**105.0**	**108.8**	**108.3**	**111.3**	**118.4**	**115.9**	**119.6**	**-3.1%**
YoY%	*19.8%*	*22.3%*	*22.5%*	*19.5%*	*10.7%*	*12.8%*	*6.5%*	*9.9%*	
GPM (%)	*55.8%*	*56.9%*	*56.4%*	*55.7%*	*56.6%*	*57.8%*	*55.9%*	*56.7%*	
Non-IFRS operating profit	**69.3**	**69.2**	**72.6**	**69.5**	**75.6**	**75.6**	**68.1**	**72.5**	**-6.2%**
YoY%	*18.3%*	*18.5%*	*18.4%*	*16.9%*	*9.1%*	*9.2%*	*-6.2%*	*0.0%*	
Non-IFRS OPM (%)	*38.5%*	*37.5%*	*37.6%*	*35.8%*	*38.5%*	*36.9%*	*32.8%*	*34.4%*	

Source: Company data, Visible Alpha, CMBIGM

Our SOTP-derived target price of HK$670.0 comprises, per share:

1) HK$307.4 for the games business, based on an 20x 2027E PE, which is at a premium to the average PE for its global gaming peers (17x), mainly due to Tencent's strong leadership in China's games industry and diversified games portfolio.

2) HK$29.8 for the SNS business, including the market cap of Tencent's stake in its subsidiaries, the valuation of Tencent Video (based on a 3.5x 2027E PS, at a premium to the 1.9x average PS of its peers given its content and user traffic leadership), and the valuation of other membership services (based on a 3.5x 2026E PS).

3) HK$118.0 for the marketing services business, based on an 20x 2027E PE, which is at a premium to the industry average (17x). This reflects Tencent's more resilient ad revenue growth outlook, supported by the solid performance of Weixin Video Account and Mini Program.

4) HK$100.0 for the fintech business, based on a 4.0x 2027E PS, at a premium to the peer average (1.5x). This mainly reflects Tencent's strong leadership in China's digital payment market and its potential to capture other fintech business opportunities.

5) HK$44.0 for the cloud business, based on a 4.0x 2027E PS, at a discount to the industry average (4.4x) as Tencent's current offerings mainly involve the lower-margin IaaS business.

6) HK$69.6 for strategic investments, based on the current market value of Tencent's listed investments and the book value of its unlisted investments. We apply a 30% holding company discount to the fair value of Tencent's equity investments.

7) HK$1.2 for net cash.

Figure 4:Tencent: SOTP valuation

	2027E net profit (RMBmn)	2027E revenue (RMBmn)	2027E PE (x)	2027E PS (x)	Market cap (RMBmn)	Valuation to Tencent (RMBmn)	As % of total valuation	Per share valuation (HK$)
Games	118,893		20x			2,377,850	45.9	307.4
Social network services (SNS)		125,267				230,814	4.5	29.8
Tencent Music (TME)					100,059	55,133	1.1	7.1
China Literature					19,222	11,376	0.2	1.5
Huya					3,158	1,497	0.0	0.2
Online video – subscription		18,100		3.5x		63,348	1.2	8.2
Others		28,417		3.5x		99,461	1.9	12.9
Marketing services	45,647		20x			912,943	17.6	118.0
Fintech		193,322		4.0x		773,290	14.9	100.0
Cloud (business services)		85,097		4.0x		340,387	6.6	44.0
Net cash						9,252	0.2	1.2
Valuation of core business						**4,644,537**		
RMB/HK$						0.86		
Valuation of core business (HK$mn)						**5,400,624**		
Valuation per share – core business (HK$)						**600.4**		
Valuation per share – investments (HK$)						69.6	10.4	
Valuation per share – Tencent (HK$)						**670.0**		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

Companies	Ticker	Price (Local)	Earnings growth (YoY %) FY27E	Earnings growth (YoY %) FY28E	PE (x) FY27E	PE (x) FY28E
Online games						
NetEase	NTES US	119.6	16%	8%	11.8	11.0
Nexon	3659 JP	3,124.0	-11%	3%	21.5	20.8
Bandai Namco	7832 JP	7,034.0	21%	9%	26.5	24.4
Perfect World	002624 CH	9.9	80%	28%	12.6	9.8
37 Interactive	002555 CH	15.0	44%	11%	10.9	9.8
Average PE					**16.7**	**15.2**
Marketing services						
Focus Media	002027 CH	5.7	0%	6%	14.4	13.6
Meta	Meta US	618.9	18%	19%	18.0	15.1
Google	GOOG US	280.2	-22%	22%	18.4	15.1
Average PE					**16.9**	**14.6**

Source: Visible Alpha, Bloomberg, CMBIGM
Note: data as of market close on 17 Nov

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

Companies	Ticker	Price (Local)	Revenue growth (YoY %) FY27E	Revenue growth (YoY %) FY28E	PS (x) FY27E	PS (x) FY28E
Online video						
iQiyi	IQ US	0.7	-1%	1%	0.2	0.2
Mango Excellent Media	300413 CH	29.1	5%	5%	3.7	3.5
Average PS					**1.9**	**1.9**
Cloud						
Microsoft	MSFT US	506.2	19%	21%	9.5	7.8
Google	GOOG US	280.2	29%	23%	5.3	4.3
Salesforce	CRM US	194.5	11%	10%	3.5	3.1
Kingsoft Cloud	KC US	6.3	28%	26%	0.8	0.6
Amazon	AMZN US	257.9	16%	17%	2.9	2.5
Average PS					**4.4**	**3.7**
Fintech						
PayPal	PYPL US	58.1	4%	4%	1.3	1.3
Block	XYZ US	79.3	11%	11%	1.6	1.5
Average PS					**1.5**	**1.4**

Source: Visible Alpha, Bloomberg, CMBIGM
Note: data as of market close on 17 Nov

Risks

Increased AI investment impacts margin; a slowdown in games revenue growth; slower-than-expected AI monetization.

Financial Summary

INCOME STATEMENT	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Revenue	**609,015**	**660,257**	**751,766**	**818,593**	**884,043**	**942,988**
Cost of goods sold	(315,906)	(311,011)	(329,173)	(355,032)	(381,516)	(407,366)
Gross profit	**293,109**	**349,246**	**422,593**	**463,561**	**502,527**	**535,622**
Operating expenses	**(133,035)**	**(141,147)**	**(181,031)**	**(214,037)**	**(255,082)**	**(276,852)**
Selling expense	(34,211)	(36,388)	(41,727)	(49,116)	(53,043)	(56,579)
Admin expense	(103,525)	(112,761)	(136,127)	(166,174)	(203,330)	(221,602)
Others	4,701	8,002	(3,177)	1,253	1,291	1,329
Operating profit	**160,074**	**208,099**	**241,562**	**249,524**	**247,445**	**258,770**
Gain/loss on financial assets at FVTPL	(6,090)	4,187	10,168	33,226	26,581	21,265
Share of (losses)/profits of associates/JV	5,800	25,176	23,740	2,591	17,928	16,135
Interest income	13,808	16,004	16,909	16,355	14,309	15,315
Interest expense	(12,268)	(11,981)	(15,130)	(13,029)	(11,968)	(10,795)
Pre-tax profit	**161,324**	**241,485**	**277,249**	**288,667**	**294,296**	**300,690**
Income tax	(43,276)	(45,018)	(47,448)	(46,187)	(47,087)	(48,110)
After tax profit	**118,048**	**196,467**	**229,801**	**242,480**	**247,209**	**252,579**
Minority interest	(2,832)	(2,394)	(4,959)	(6,062)	(6,180)	(6,314)
Net profit	**115,216**	**194,073**	**224,842**	**236,418**	**241,028**	**246,265**
Adjusted net profit	**157,688**	**222,703**	**259,626**	**262,920**	**260,533**	**274,269**
Gross dividends	28,485	27,965	42,645	48,939	49,893	50,977

BALANCE SHEET	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Current assets	**518,446**	**496,180**	**595,460**	**576,130**	**742,144**	**982,960**
Cash & equivalents	172,320	132,519	141,041	125,100	288,136	533,764
Account receivables	46,606	48,203	49,930	51,825	54,290	56,172
Inventories	456	440	530	1,292	1,367	1,429
Prepayment	88,411	101,044	111,270	112,982	121,935	121,128
ST bank deposits	185,983	192,977	236,801	224,961	213,938	203,665
Financial assets at FVTPL	14,903	12,913	44,710	46,946	49,293	51,757
Other current assets	9,767	8,084	11,178	13,025	13,185	15,045
Non-current assets	**1,058,800**	**1,284,815**	**1,443,526**	**1,747,190**	**1,854,328**	**1,896,740**
PP&E	53,232	80,185	149,905	314,365	467,588	534,769
Deferred income tax	29,017	28,325	28,618	38,554	33,989	43,391
Investment in JVs & assos	261,665	297,415	348,712	319,254	293,873	270,990
Intangibles	177,727	196,127	205,999	205,729	207,901	211,603
Financial assets at FVTPL	211,145	204,999	207,157	207,157	207,157	207,157
Other non-current assets	326,014	477,764	503,135	662,131	643,820	628,830
Total assets	**1,577,246**	**1,780,995**	**2,038,986**	**2,323,320**	**2,596,472**	**2,879,700**
Current liabilities	**352,157**	**396,909**	**412,751**	**448,592**	**476,187**	**510,331**
Short-term borrowings	55,698	61,508	53,160	57,109	61,129	65,021
Account payables	100,948	118,712	121,127	134,837	140,221	153,473
Tax payable	17,664	16,586	18,558	19,616	20,657	21,616
Other current liabilities	171,693	194,503	214,520	231,645	248,794	264,836
Lease liabilities	6,154	5,600	5,386	5,386	5,386	5,386
Non-current liabilities	**351,408**	**330,190**	**385,170**	**477,197**	**504,467**	**521,905**
Long-term borrowings	155,819	146,521	208,369	214,620	216,552	217,136
Bond payables	137,101	130,586	126,204	195,616	215,178	225,937
Deferred income	3,435	6,236	2,210	14,201	15,261	16,295
Other non-current liabilities	55,053	46,847	48,387	52,759	57,477	62,537
Total liabilities	**703,565**	**727,099**	**797,921**	**925,788**	**980,655**	**1,032,236**
Retained earnings	813,911	892,030	1,010,436	1,205,481	1,417,586	1,642,918
Other reserves	(5,320)	81,518	143,716	99,076	99,076	99,076
Total shareholders equity	**808,591**	**973,548**	**1,154,152**	**1,304,557**	**1,516,662**	**1,741,994**
Minority interest	65,090	80,348	86,913	92,975	99,155	105,470
Total equity and liabilities	**1,577,246**	**1,780,995**	**2,038,986**	**2,323,320**	**2,596,472**	**2,879,700**

CASH FLOW	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	**161,324**	**241,485**	**277,249**	**288,667**	**294,296**	**300,690**
Depreciation & amortization	59,008	56,213	66,028	93,667	135,455	181,857
Tax paid	(43,276)	(45,018)	(47,448)	(46,187)	(47,087)	(48,110)
Change in working capital	19,233	21,881	16,484	26,466	11,040	28,157
Others	25,673	(16,040)	(9,261)	0	0	0
Net cash from operations	**221,962**	**258,521**	**303,052**	**362,612**	**393,704**	**462,593**
Investing						
Capital expenditure	(23,893)	(76,760)	(79,198)	(216,927)	(247,532)	(207,457)
Acquisition of subsidiaries/ investments	(105,332)	(183,983)	(157,834)	(131,717)	56,773	34,419
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	4,064	138,556	31,300	(40,930)	(43,318)	(45,282)
Net cash from investing	**(125,161)**	**(122,187)**	**(205,732)**	**(389,573)**	**(234,077)**	**(218,320)**
Financing						
Net borrowings	19,445	(107)	52,706	85,041	31,274	21,253
Proceeds from share issues	1,070	1,932	2,721	0	0	0
Others	(103,088)	(178,319)	(142,582)	(74,022)	(27,864)	(19,899)
Net cash from financing	**(82,573)**	**(176,494)**	**(87,155)**	**11,020**	**3,410**	**1,355**
Net change in cash						
Cash at the beginning of the year	156,739	172,320	132,519	141,041	125,100	288,136
Exchange difference	1,353	359	(1,643)	0	0	0
Cash at the end of the year	**172,320**	**132,519**	**141,041**	**125,100**	**288,136**	**533,764**

GROWTH	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Revenue	9.8%	8.4%	13.9%	8.9%	8.0%	6.7%
Gross profit	22.8%	19.2%	21.0%	9.7%	8.4%	6.6%
Operating profit	44.4%	30.0%	16.1%	3.3%	(0.8%)	4.6%
Net profit	(38.8%)	68.4%	15.9%	5.1%	2.0%	2.2%
Adj. net profit	36.4%	41.2%	16.6%	1.3%	(0.9%)	5.3%

PROFITABILITY	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Gross profit margin	48.1%	52.9%	56.2%	56.6%	56.8%	56.8%
Operating margin	26.3%	31.5%	32.1%	30.5%	28.0%	27.4%
Adj. net profit margin	25.9%	33.7%	34.5%	32.1%	29.5%	29.1%
Return on equity (ROE)	15.1%	21.8%	21.1%	19.2%	17.1%	15.1%

GEARING/LIQUIDITY/ACTIVITIES	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Net debt to equity (x)	0.2	0.2	0.2	0.3	0.1	(0.0)
Current ratio (x)	1.5	1.3	1.4	1.3	1.6	1.9
Receivable turnover days	27.9	26.6	24.2	23.1	22.4	21.7

VALUATION	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
P/E	26.0	15.2	12.8	12.1	11.7	11.5
P/E (diluted)	26.4	15.4	13.0	12.2	11.8	11.7
P/B	3.7	3.0	2.5	2.2	1.9	1.6

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

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