

Tencent (700 HK)

Earnings growth stability continues

Underpinned by the recovering games business and solid ad performance, we expect Tencent to continue to deliver solid revenue and earnings growth, with total revenue/non-IFRS net income up by 8%/33% YoY to RMB160.9bn/49.2bn in 2Q24E (vs. consensus of RMB161.8bn/48.1bn). *DnF Mobile*'s performance was ahead of market expectation after its launch in May, but we expect it to mainly drive 2H24E games revenue growth given its relatively long deferral period. Ad business was resilient on strong Weixin ad performance, while fintech business remained under pressure in 2Q24 amid macro uncertainty, in our view. We slightly lower 2Q24E games/FBS revenue forecast but maintain FY24E forecast largely unchanged. We maintain our SOTP-derived target price of HK\$480.0. Overall, we are upbeat on Tencent's FY24E earnings growth (+26% YoY) and commitment to shareholder return (>HK\$100bn share buyback). Current valuation of 15x FY24E PE (excl. strategic investments) remains attractive in our view. BUY.

- **Strong performance of *DnF Mobile* to drive games revenue growth.** We forecast games revenue to grow by 7% YoY to RMB47.7bn in 2Q24E, driven by the *DnF Mobile* launch, steady legacy game titles, and international games business recovery. *DnF Mobile* ranked among the top 2 in China iOS grossing chart since its launch on 21 May, with total iOS grossing already exceeding US\$400mn per Sensor Tower. Given the relatively long deferral period of both *DnF Mobile* and Supercell's titles, the strong grossing performance of *DnF Mobile* and international business will mainly be recognized into games revenue from 2H24E onwards. Thus, We are more positive on games business in 2H24E, and expect games revenue to grow by 12% YoY.
- **Expect inline ad business performance; FBS growth to decelerate in 2Q24E.** We estimate advertising revenue to grow by 18% YoY to RMB29.4bn in 2Q24E, mainly attributable to the solid performance of Weixin ad properties (e.g. Video Account and Mini Program). We forecast FBS revenue to grow by 7% YoY in 2Q24E (4Q23: +15% YoY; 1Q24: +7% YoY), slowing down as the soft consumption sentiment impacted total payment volume of fintech business. Based on NBS data, 5M24 total retail sales were up 4.1% YoY, vs. +7.2% YoY in 2023.
- **Margin expansion to continue.** For 2Q24E, we expect overall GPM to rise by 5.9ppt YoY to 53.4%, driven by the incremental revenue of higher-margin business (e.g. Video Account and Mini Games) and recovery of games business, partially offset by an increase in *DnF Mobile* revenue sharing with Nexon. We forecast non-IFRS net income to grow by 33% YoY to RMB49.2bn, with net margin up by 5.9ppt YoY to 30.6% in 2Q24E.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	554,552	609,015	658,280	712,260	764,432
Gross margin (%)	43.1	48.1	53.1	53.8	54.3
Adjusted net profit (RMB mn)	115,649.0	157,688.0	198,794.6	218,584.6	238,904.4
YoY growth (%)	(6.6)	36.4	26.1	10.0	9.3
EPS (Adjusted) (RMB)	12.13	16.66	20.53	22.57	24.67
Consensus EPS (RMB)	12.13	16.66	20.65	23.23	26.18
P/E (x)	55.6	32.5	24.0	20.4	19.0

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$480.00
Up/Downside	20.9%
Current Price	HK\$397.00

China Internet

Saiyi HE, CFA
 (852) 3916 1739
 hesaiyi@cmbi.com.hk

Wentao LU, CFA
 luwentao@cmbi.com.hk

Ye TAO
 franktao@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	3,754,627.5
Avg 3 mths t/o (HK\$ mn)	8,107.1
52w High/Low (HK\$)	397.00/262.20
Total Issued Shares (mn)	9457.5

Source: FactSet

Shareholding Structure

MIH TC	25.6%
Advance Data Services Limited	8.4%

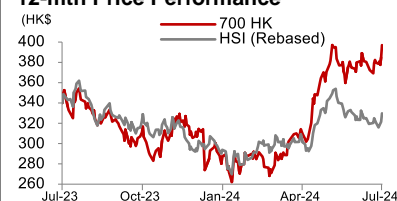
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	7.1%	5.0%
3-mth	28.2%	17.2%
6-mth	37.7%	22.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: Tencent: forecast revision

RMB bn	Current			Previous			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	658.3	712.3	764.4	661.9	718.9	771.7	-0.5%	-0.9%	-0.9%
Gross profit	349.4	383.0	415.1	351.0	386.5	418.9	-0.5%	-0.9%	-0.9%
Adjusted net profit	198.8	218.6	238.9	199.5	219.1	238.2	-0.4%	-0.2%	0.3%
Adjusted EPS (RMB)	20.5	22.6	24.7	20.6	22.6	24.6	-0.4%	-0.2%	0.3%
Gross margin	53.1%	53.8%	54.3%	53.0%	53.8%	54.3%	0.0 ppt	0.0 ppt	0.0 ppt
Adjusted net margin	30.2%	30.7%	31.3%	30.1%	30.5%	30.9%	0.1 ppt	0.2 ppt	0.4 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	658.3	712.3	764.4	665.0	730.0	796.6	-1.0%	-2.4%	-4.0%
Gross profit	349.4	383.0	415.1	350.1	390.2	430.7	-0.2%	-1.8%	-3.6%
Adjusted net profit	198.8	218.6	238.9	198.0	222.7	249.9	0.4%	-1.9%	-4.4%
Adjusted EPS (RMB)	20.5	22.6	24.7	20.6	23.2	26.2	-0.6%	-2.8%	-5.8%
Gross margin	53.1%	53.8%	54.3%	52.6%	53.5%	54.1%	0.4 ppt	0.3 ppt	0.2 ppt
Adjusted net margin	30.2%	30.7%	31.3%	29.8%	30.5%	31.4%	0.4 ppt	0.2 ppt	-0.1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financials

(RMB bn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24E
SNS revenue	29.1	29.2	29.9	28.6	31.0	29.7	29.7	28.2	30.5	30.2
YoY %	1.0%	0.6%	-1.4%	-1.7%	6.3%	1.6%	-0.4%	-1.5%	-1.4%	1.7%
Games revenue	43.6	42.5	42.9	41.8	48.4	44.5	46.0	40.9	48.1	47.7
YoY %	0.0%	-1.2%	-4.6%	-2.3%	10.9%	4.8%	7.4%	-2.2%	-0.5%	7.0%
Online ad revenue	18.0	18.6	21.4	24.7	21.0	25.0	25.7	29.8	26.5	29.4
YoY %	-17.6%	-18.4%	-4.7%	14.6%	16.5%	34.2%	20.0%	20.8%	26.4%	17.5%
FBS revenue	42.8	42.2	44.8	47.2	48.7	48.6	52.0	54.4	52.3	52.1
YoY %	9.6%	0.8%	3.5%	-1.5%	13.9%	15.2%	16.1%	15.1%	7.4%	7.0%
Total revenue	135.5	134.0	140.1	145.0	150.0	149.2	154.6	155.2	159.5	160.9
YoY %	0.1%	-3.1%	-1.6%	0.5%	10.7%	11.3%	10.4%	7.1%	6.3%	7.8%
Gross profit margin	42.1%	43.2%	44.2%	42.6%	45.5%	47.5%	49.5%	50.0%	52.6%	53.4%
G&A%	19.7%	19.6%	18.9%	18.8%	16.4%	17.0%	17.0%	17.5%	15.6%	16.0%
S&M%	5.9%	5.9%	5.1%	4.2%	4.7%	5.6%	5.1%	7.1%	4.7%	6.0%
Non-IFRS net margin	16.6%	21.6%	24.7%	20.5%	21.7%	24.7%	29.5%	27.5%	31.5%	30.6%
Non-IFRS net profit	22.5	28.9	34.6	29.7	32.5	36.9	45.6	42.7	50.3	49.2
YoY %	-32.2%	-15.1%	8.9%	19.4%	44.9%	27.6%	31.9%	43.7%	54.5%	33.4%

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$480.0 comprises, per share:

- 1) HK\$186.4 for the online games business, based on a 19x 2024E PE, which is on par with the average PE for its global gaming peers.
- 2) HK\$32.5 for the SNS business, including the market cap of Tencent's stake in its subsidiaries, the valuation of Tencent Video (based on a 2.5x 2024E PS, at a premium to the 1.6x average PS of its peers given its content and user traffic leadership), and the valuation of other membership services (based on a 2.0x 2024E PS).
- 3) HK\$85.8 for the advertising business, based on an 18x 2024E PE, on par with the industry average.
- 4) HK\$79.7 for the fintech business, based on a 4.0x 2024E PS, at a premium to the peer average (1.8x). This mainly reflects Tencent's strong leadership in China's digital payment market and its potential to capture other fintech business opportunities.
- 5) HK\$20.8 for the cloud business, based on a 4.0x 2024E PS, at a discount to the industry average (6.0x) as Tencent's current offerings come mainly from the lower-margin IaaS Business
- 6) HK\$68.6 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.

Figure 4: Tencent: SOTP valuation

	2024E net profit (RMBmn)	2024E revenue (RMBmn)	2024E PE (x)	2024E PS (x)	Market cap (RMBmn)	Valuation to Tencent (RMBmn)	As % of total valuation	Per share valuation (HK\$)
Online games	85,434		19x			1,623,252	38.8	186.4
Social network services (SNS)		119,761				283,084	6.8	32.5
Tencent Music (TME)					183,390	101,048	2.4	11.6
China Literature					24,311	14,387	0.3	1.7
Huya					7,163	3,395	0.1	0.4
Online video – subscription		20,700		2.5x		51,750	1.2	5.9
Others		56,251		2.0x		112,503	2.7	12.9
Online advertising	41,500		18x			746,994	17.9	85.8
Fintech		173,517		4.0x		694,066	16.6	79.7
Cloud (business services)		45,186		4.0x		180,745	4.3	20.8
Net cash						55,577	1.3	6.4
Valuation of core business						3,583,718		
RMB/HK\$						0.92	14.3	
Valuation of core business (HK\$mn)						3,891,116		
Valuation per share – core business (HK\$)						411.4		
Valuation per share – investments (HK\$)						68.6		
Valuation per share – Tencent (HK\$)						480.0		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

		Price	EPS growth (YoY %)			PE (x)		
Companies	Ticker	(Local)	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Online games								
NetEase	NTES US	92.9	4	7	5	13	12	12
Electronic Arts	EA US	145.7	19	4	12	20	20	18
Take Two Interactive	TTWO US	153.4	(37)	12	189	NA	NA	21
Nexon	3659 JP	3,291.0	(4)	10	6	24	22	20
Nintendo	7974 JP	8,916.0	16	(24)	22	23	30	25
Bandai Namco	7832 JP	3,255.0	(14)	23	6	27	22	20
Perfect World	002624 CH	7.2	(0)	27	16	16	13	11
37 Interactive	002555 CH	12.7	(8)	12	14	9	8	7
Average PE						19	18	17
Online advertising								
Focus Media	002027 CH	6.1	12	12	15	16	14	12
Baidu	BIDU US	99.1	3	5	10	9	9	8
Meta	Meta US	498.9	40	15	13	24	21	18
Google	GOOG US	186.8	26	13	13	25	22	19
Average PE						18	16	14

Source: Bloomberg, CMBIGM estimates

Note: data as of market close on 12 Jul

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

		Price	Revenue growth (YoY %)			PS (x)		
Companies	Ticker	(Local)	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Online video								
iQiyi	IQ US	4.0	1.8	6.2	6.0	0.9	0.8	0.8
Mango Excellent Media	300413 CH	20.1	11.6	9.3	7.9	2.3	2.1	2.0
Average PS						1.6	1.5	1.4
Cloud								
Microsoft	MSFT US	453.6	14.6	14.7	15.0	12.0	10.5	9.1
Google	GOOG US	186.8	19.0	10.3	9.2	7.6	6.9	6.3
Salesforce	CRM US	254.0	8.7	9.2	0.0	6.5	6.0	6.0
Kingsoft Cloud	KC US	2.8	2.8	8.5	10.3	0.7	0.6	0.6
Amazon	AMZN US	194.5	12.0	11.3	11.4	3.2	2.8	2.6
Average PS						6.0	5.4	4.9
Fintech								
PayPal	PYPL US	60.3	8.2	8.4	7.9	2.0	1.8	1.7
Square	SQ US	68.7	15.1	11.6	9.7	1.7	1.5	1.4
Average PS						1.8	1.7	1.5

Source: Bloomberg, CMBIGM estimates

Note: data as of market close on 12 Jul

Our calculation of the valuation of Tencent's strategic investments is 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.

Figure 7: Tencent: valuation of strategic investments

Name	Ticker	Tencent's stake %	Mkt cap (US\$mn)	Value to Tencent (HK\$mn)
PDD Holdings Inc	PDD US	15.5	197,789	238,972
Sea Ltd	SE US	18.5	42,256	60,942
Spotify Technology SA	SPOT US	8.4	60,168	39,375
Snap Inc	SNAP US	17.5	26,663	36,458
Kuaishou Technology	1024 HK	15.7	27,475	33,560
NU Holdings Ltd/Cayman Islands	NU US	5.2	64,114	26,055
KE Holdings Inc	BEKE US	11.3	19,157	16,885
Futu Holdings Ltd	FUTU US	21.6	9,663	16,287
Meituan	3690 HK	1.7	95,970	12,875
Krafton Inc	259960 KS	13.5	9,748	10,258
JD.com Inc	9618 HK	2.7	43,901	9,109
Bilibili Inc	9626 HK	13.4	7,365	7,703
Tongcheng Travel Holdings Ltd	780 HK	21.1	4,586	7,533
Vipshop Holdings Ltd	VIPS US	11.5	7,652	6,876
Kanzhun Ltd	BZ US	9.9	8,529	6,566
Warner Music Group Corp	WMG US	4.9	16,009	6,144
Netmarble Corp	251270 KS	17.5	3,956	5,405
Tuhu Car Inc	9690 HK	18.7	2,074	3,025
Yixin Group Ltd	2858 HK	53.9	568	2,388
ZhongAn Online P&C Insurance C	6060 HK	8.1	2,534	1,599
Kadokawa Corp	9468 JP	6.9	2,578	1,380
Lilium NV	LILM US	29.3	601	1,374
Ubisoft Entertainment SA	UBI FP	5.5	3,150	1,342
Maoyan Entertainment	1896 HK	13.7	1,156	1,239
Paradox Interactive AB	PDX SS	9.1	1,489	1,058
Other listed entities as a whole			47,382	21,354
Listed investments (current value)				575,762
Unlisted investments (book value)				351,861
Total investment value				927,623
Holdco discount				30%
Valuation of strategic investments				649,336
Valuation of strategic investments per share				575,762

Source: Bloomberg, company data, CMBIGM estimates

Note: data as of the market close on 12 Jul

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	560,118	554,552	609,015	658,280	712,260	764,432
Cost of goods sold	(314,174)	(315,806)	(315,906)	(308,888)	(329,213)	(349,329)
Gross profit	245,944	238,746	293,109	349,392	383,048	415,102
Operating expenses	19,026	(127,919)	(133,035)	(140,967)	(152,422)	(163,038)
Selling expense	(40,594)	(29,229)	(34,211)	(37,851)	(40,599)	(42,808)
Admin expense	(89,847)	(106,696)	(103,525)	(107,958)	(116,811)	(125,367)
Others	149,467	8,006	4,701	4,842	4,987	5,137
Operating profit	264,970	110,827	160,074	208,425	230,625	252,064
Share of (losses)/profits of associates/JV	(16,444)	(16,129)	5,800	5,800	5,800	1,523
Interest income	6,650	8,592	13,808	14,550	12,840	3,961
Interest expense	(7,114)	(9,352)	(12,268)	(10,357)	(2,845)	(2,797)
Pre-tax profit	241,412	85,346	153,606	203,867	233,580	250,790
Income tax	(20,252)	(21,516)	(43,276)	(55,260)	(59,030)	(63,097)
After tax profit	221,160	63,830	110,330	148,607	174,551	187,692
Minority interest	(2,988)	(466)	(2,832)	(2,984)	(3,274)	(3,597)
Net profit	218,172	63,364	107,498	145,623	171,276	184,096
Adjusted net profit	123,788	115,649	157,688	198,795	218,585	238,904
Gross dividends	12,704	20,256	28,485	37,443	41,086	45,129

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	484,812	565,989	518,446	502,281	632,478	802,616
Cash & equivalents	167,966	156,739	172,320	137,442	219,899	353,326
Account receivables	49,331	45,467	46,606	50,581	53,086	55,266
Inventories	1,063	2,333	456	1,910	2,025	2,130
Prepayment	65,390	76,685	88,411	81,826	85,880	92,931
ST bank deposits	83,813	104,776	185,983	213,880	245,321	280,662
Financial assets at FVTPL	10,573	27,963	14,903	15,648	16,431	17,252
Other current assets	106,676	152,026	9,767	994	9,836	1,050
Non-current assets	1,127,552	1,012,142	1,058,800	1,118,835	1,188,226	1,240,797
PP&E	61,914	53,978	53,232	73,240	88,577	100,668
Deferred income tax	26,068	29,882	29,017	25,000	33,446	29,281
Investment in JVs & assos	323,188	252,715	261,665	273,109	284,919	297,084
Intangibles	171,376	161,802	177,727	206,179	232,360	256,409
Financial assets at FVTPL	192,184	206,085	211,145	211,145	211,145	211,145
Other non-current assets	352,822	307,680	326,014	330,162	337,778	346,210
Total assets	1,612,364	1,578,131	1,577,246	1,621,116	1,820,703	2,043,413
Current liabilities	403,098	434,204	352,157	318,985	342,154	370,465
Short-term borrowings	19,003	22,026	55,698	16,548	17,637	18,714
Account payables	109,470	92,381	100,948	94,509	99,720	109,685
Tax payable	12,506	13,488	17,664	13,269	13,860	14,412
Other current liabilities	256,673	299,955	171,693	188,505	204,784	221,500
Lease liabilities	5,446	6,354	6,154	6,154	6,154	6,154
Non-current liabilities	332,573	361,067	351,408	370,908	382,523	395,328
Long-term borrowings	136,936	163,668	155,819	156,074	156,150	156,173
Bond payables	145,590	148,669	137,101	139,672	140,981	141,642
Deferred income	4,526	3,503	3,435	12,356	13,169	13,973
Other non-current liabilities	45,521	45,227	55,053	62,807	72,223	83,539
Total liabilities	735,671	795,271	703,565	689,893	724,677	765,793
Retained earnings	669,911	705,981	813,911	960,469	1,121,998	1,299,996
Other reserves	136,388	15,410	(5,320)	(97,320)	(97,320)	(97,320)
Total shareholders equity	806,299	721,391	808,591	863,149	1,024,678	1,202,676
Minority interest	70,394	61,469	65,090	68,074	71,348	74,945
Total equity and liabilities	1,612,364	1,578,131	1,577,246	1,621,116	1,820,703	2,043,413

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	241,412	85,346	153,606	203,867	233,580	250,790
Depreciation & amortization	56,818	60,230	55,298	58,620	72,024	83,283
Tax paid	(20,252)	(21,516)	(43,276)	(55,260)	(59,030)	(63,097)
Change in working capital	(2,844)	(28,405)	16,661	11,529	14,815	17,346
Others	(99,948)	50,437	39,673	14,550	5,258	10,437
Net cash from operations	175,186	146,091	221,962	233,306	266,648	298,758
Investing						
Capital expenditure	(34,931)	(33,892)	(36,477)	(38,639)	(40,971)	(43,093)
Acquisition of subsidiaries/ investments	(117,642)	59,711	(105,332)	(31,445)	(68,937)	(43,808)
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	(25,976)	(130,690)	16,648	(68,441)	(72,572)	(76,330)
Net cash from investing	(178,549)	(104,871)	(125,161)	(138,524)	(182,480)	(163,231)
Financing						
Net borrowings	45,239	31,982	30,834	(32,965)	12,481	13,631
Proceeds from share issues	0	0	0	0	0	0
Others	(23,619)	(91,935)	(113,407)	(96,694)	(14,192)	(15,731)
Net cash from financing	21,620	(59,953)	(82,573)	(129,660)	(1,712)	(2,100)
Net change in cash						
Cash at the beginning of the year	152,798	167,966	156,739	172,320	137,442	219,899
Exchange difference	(3,089)	7,506	1,353	0	0	0
Cash at the end of the year	167,966	156,739	172,320	137,442	219,899	353,326
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	16.2%	(1.0%)	9.8%	8.1%	8.2%	7.3%
Gross profit	11.0%	(2.9%)	22.8%	19.2%	9.6%	8.4%
Operating profit	49.5%	(58.2%)	44.4%	30.2%	10.7%	9.3%
Net profit	42.7%	(71.0%)	69.7%	35.5%	17.6%	7.5%
Adj. net profit	0.9%	(6.6%)	36.4%	26.1%	10.0%	9.3%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	43.9%	43.1%	48.1%	53.1%	53.8%	54.3%
Operating margin	47.3%	20.0%	26.3%	31.7%	32.4%	33.0%
Adj. net profit margin	22.1%	20.9%	25.9%	30.2%	30.7%	31.3%
Return on equity (ROE)	28.9%	8.3%	14.1%	17.4%	18.1%	16.5%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	0.2	0.2	0.2	0.2	0.1	(0.0)
Current ratio (x)	1.2	1.3	1.5	1.6	1.8	2.2
Receivable turnover days	32.1	29.9	27.9	28.0	27.2	26.4
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	16.1	55.6	32.5	24.0	20.4	19.0
P/E (diluted)	16.4	56.4	33.0	24.4	20.7	19.3
P/B	4.4	4.9	4.3	4.0	3.4	2.9

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

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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