

Tencent (700 HK)

Unleashing business model advantages

Tencent announced its 4Q23 results on 20 Mar: total revenue grew by 7% YoY to RMB155.2bn in 4Q23, largely in line with our/consensus estimate of RMB156.1/157.4bn. Non-IFRS net income was up by 44% YoY to RMB42.7bn in 4Q23, ahead of our/consensus estimate of RMB40.0/42.0bn, mainly due to solid GPM expansion (+7.3ppt YoY). FY23 total revenue grew by 10% YoY to RMB609.0bn, and non-IFRS net income increased by 36% YoY to RMB157.7bn. Tencent's business model has ample room for operating leverage improvement and we expect its consumer internet business will drive for continuous profit growth in near term. It also has strong cash generation to assure capital return to investors. The company proposed to at least double the size of share repurchase from HK\$49bn in 2023 to over HK\$100bn in 2024 (c.4% of current mkt cap). We raise FY24/25E earnings forecast by 4-5% given the strong GPM improvement. We fine-tuned our SOTP-derived TP to HK\$450.5 (previous: HK\$458.5). Maintain BUY.

■ **Expect games revenue growth to recover from 2Q24 onwards.** Games revenue dropped 2% YoY to RMB40.9bn in 4Q23, 7% below consensus estimate, primarily due to slowdown in monetization of certain legacy titles. Domestic games revenue declined by 3% YoY to RMB27.0bn in 4Q23, mainly due to drop in revenue from *Honor of Kings* and *Peacekeeper Elite*. International games revenue grew by 1% YoY to RMB13.9bn in 4Q23 (-1% YoY on constant currency), driven by growth in *PUBG Mobile* and *Valorant*. Management expects domestic games revenue to recover from 2Q24 onwards, mainly on monetization recovery of legacy games and launch of new titles such as *DnF Mobile*, *Honor of Fight*, and *Need for Speed Mobile*.

■ **Solid ad revenue growth on robust demand for VA ads.** Online ad revenue increased by 21% YoY to RMB29.8bn in 4Q23, with all verticals except for automotive increasing their ad spending, supported by the strong ad demand for Video Accounts (VA) and improvement in ad tech. Total time spent on VA grew over 80% YoY, and the ad revenue from VA more than doubled YoY on higher click through rate and impressions in 4Q23, while its ad load rate remains significantly lower than the peers.

■ **Resilient FBS business on business innovation.** Fintech and Business Services (FBS) revenue grew by 15% YoY to RMB54.4bn in 4Q23. Fintech revenue recorded double-digit YoY growth in 4Q23, backed by solid growth in commercial payment, wealth management, and consumer loan businesses. Business services revenue delivered c.20% YoY growth in 4Q23, mainly driven by strong growth in service fee revenue from VA e-commerce. Total GMV from VA e-commerce surpassed RMB100bn in 2023.

■ **Continuous GPM expansion.** GPM expanded by 7.3ppt YoY to 50.0% in 4Q23, with VAS/ads/FBS GPM up by 3.9/12.5/10.3ppt YoY, benefitting from incremental revenue from high-margin businesses such as Mini Games/VA ad/VA e-commerce. We expect further room for GPM expansion in FY24/25E, and forecast non-IFRS net income to grow 23/10% in FY24/25E. Current valuation of 13x FY24 non-IFRS PE offers attractive value. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	554,552	609,015	663,725	717,483	762,698
Adjusted net profit (RMB mn)	115,649.0	157,688.0	193,194.9	212,767.0	229,501.3
EPS (Adjusted) (RMB)	12.13	16.66	19.95	21.97	23.70
Consensus EPS (RMB)	12.13	16.66	18.87	21.35	24.73
P/E (x)	41.9	26.8	18.2	16.4	15.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	HK\$450.50
(Previous TP)	HK\$458.50
Up/Downside	56.0%
Current Price	HK\$288.80

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Stock Data

Mkt Cap (HK\$ mn)	2,734,069.6
Avg 3 mths t/o (HK\$ mn)	6,789.7
52w High/Low (HK\$)	388.20/262.20
Total Issued Shares (mn)	9467.0

Source: FactSet

Shareholding Structure

MIH TC	25.6%
Advance Data Services Limited	8.4%

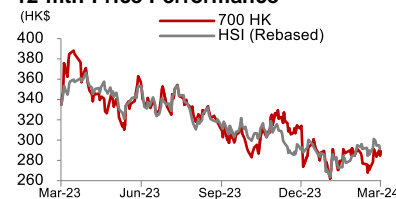
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	1.6%	-0.2%
3-mth	-8.1%	-7.7%
6-mth	-6.6%	1.0%

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	663.7	717.5	762.7	662.7	714.9	NA	0.2%	0.4%	NA
Gross Profit	327.9	358.4	385.7	323.3	350.3	NA	1.4%	2.3%	NA
Adjusted net profit	193.2	212.8	229.5	185.1	202.1	NA	4.4%	5.3%	NA
Adjusted EPS (RMB)	19.9	22.0	23.7	19.1	20.9	NA	4.4%	5.3%	NA
Gross Margin	49.4%	49.9%	50.6%	48.8%	49.0%	NA	0.6 ppt	0.9 ppt	NA
Adjusted net margin	29.1%	29.7%	30.1%	27.9%	28.3%	NA	1.2 ppt	1.4 ppt	NA

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB bn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	663.7	717.5	762.7	681.2	753.1	839.3	-2.6%	-4.7%	-9.1%
Gross Profit	327.9	358.4	385.7	332.6	370.3	417.3	-1.4%	-3.2%	-7.6%
Adjusted net profit	193.2	212.8	229.5	183.6	208.4	241.3	5.2%	2.1%	-4.9%
Adjusted EPS (RMB)	19.9	22.0	23.7	18.9	21.4	24.7	5.7%	2.9%	-4.2%
Gross Margin	49.4%	49.9%	50.6%	48.8%	49.2%	49.7%	0.6 ppt	0.8 ppt	0.8 ppt
Adjusted net margin	29.1%	29.7%	30.1%	27.0%	27.7%	28.8%	2.2 ppt	2.0 ppt	1.3 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financial

(RMB bn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	Cons.	Diff%	CMBI	Diff%
SNS revenue	29.1	29.2	29.9	28.6	31.0	29.7	29.7	28.2	28.8	-2.1%	28.7	-1.8%
YoY %	1.0%	0.6%	-1.4%	-1.7%	6.3%	1.6%	-0.4%	-1.5%				
Games revenue	43.6	42.5	42.9	41.8	48.4	44.5	46.0	40.9	43.9	-6.8%	42.6	-3.9%
YoY %	0.0%	-1.2%	-4.6%	-2.3%	10.9%	4.8%	7.4%	-2.2%				
Online ad revenue	18.0	18.6	21.4	24.7	21.0	25.0	25.7	29.8	28.8	3.5%	28.3	5.4%
YoY %	-17.6%	-18.4%	-4.7%	14.6%	16.5%	34.2%	20.0%	20.8%				
FBS revenue	42.8	42.2	44.8	47.2	48.7	48.6	52.0	54.4	54.8	-0.8%	54.3	0.1%
YoY %	9.6%	0.8%	3.5%	-1.5%	13.9%	15.2%	16.1%	15.1%				
Total revenue	135.5	134.0	140.1	145.0	150.0	149.2	154.6	155.2	157.4	-1.4%	156.1	-0.6%
YoY %	0.1%	-3.1%	-1.6%	0.5%	10.7%	11.3%	10.4%	7.1%				
Gross profit margin	42.1%	43.2%	44.2%	42.6%	45.5%	47.5%	49.5%	50.0%	48.5%	1.5 ppt	48.8%	1.2 ppt
G&A%	19.7%	19.6%	18.9%	18.8%	16.4%	17.0%	17.0%	17.5%				
S&M%	5.9%	5.9%	5.1%	4.2%	4.7%	5.6%	5.1%	7.1%				
Non-IFRS net margin	16.6%	21.6%	24.7%	20.5%	22.0%	24.7%	29.2%	27.5%				
Non-IFRS net profit	22.5	28.9	34.6	29.7	32.9	36.9	45.2	42.7	42.0	1.7%	40.0	6.8%
YoY %	-32.2%	-15.1%	8.9%	19.4%	46.6%	27.6%	30.8%	43.7%				

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$450.5 comprises, per share:

- 1) HK\$171.9 for the online games business, based on a 18x 2024E PE, which is on par with the average PE for its global gaming peers.
- 2) HK\$21.2 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 1.9x 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\$70.8 for the advertising business, based on a 18x 2024E PE, on par with the industry average.
- 4) HK\$96.0 for the fintech business, based on a 4.5x 2024E PS, at a premium to the peer average (2.0x). 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 (5.8x) as Tencent's current offerings mainly come from the lower-margin IaaS business.
- 6) HK\$62.4 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\$7.5 for net cash.

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	83,157		18x			1,496,835	38.2	171.9
Social network services (SNS)		123,911				184,223	4.7	21.2
Tencent Music (TME)					134,485	74,101	1.9	8.5
China Literature					23,549	13,936	0.4	1.6
Huya					7,431	3,522	0.1	0.4
Online video – subscription		20,700		2.5x		51,750	1.3	5.9
Others		20,456		2.0x		40,913	1.0	4.7
Online advertising	34,244		18x			616,396	15.7	70.8
Fintech		185,852		4.5x		836,333	21.3	96.0
Cloud (business services)		45,186		4.0x		180,745	4.6	20.8
Net cash						65,383	1.7	7.5
Valuation of core business						3,379,914		
RMB/HK\$						0.92		
Valuation of core business (HK\$mn)						3,673,820		
Valuation per share – core business (HK\$)						388.1		
Valuation per share – investments (HK\$)						62.4	13.9	
Valuation per share – Tencent (HK\$)						450.5		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

Companies	Ticker	Price	EPS growth (YoY %)		PE (x)	
		(Local)	FY24E	FY25E	FY24E	FY25E
Online games						
NetEase	NTES US	105.5	7	2	14	14
Electronic Arts	EA US	133.0	19	5	19	18
Take Two Interactive	TTWO US	145.2	(37)	166	NA	24
Nexon	3659 JP	2,590.5	(12)	17	20	17
Nintendo	7974 JP	8,358.0	16	(17)	22	26
Bandai Namco	7832 JP	2,891.0	(14)	23	24	19
Perfect World	002624 CH	12.2	65	20	17	15
37 Interactive	002555 CH	18.9	19	13	11	10
Average PE					18	18
Online advertising						
Focus Media	002027 CH	6.4	19	14	16	14
Baidu	BIDU US	104.2	(1)	10	10	9
Meta	Meta US	496.2	37	16	24	21
Google	GOOG US	147.9	17	15	21	18
Average PE					18	15

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 19 Mar

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

Companies	Ticker	Price	Revenue growth (YoY %)		PS (x)	
		(LC)	FY24E	FY25E	FY24E	FY25E
Online video						
*iQiyi	IQ US	4.0	7.1	6.9	0.8	0.7
Mango Excellent Media	300413 CH	25.0	11.7	10.6	2.9	2.6
Average PS					1.9	1.7
Cloud						
Microsoft	MSFT US	421.4	14.3	14.7	11.2	9.8
Google	GOOG US	147.9	12.8	17.6	6.4	5.4
Salesforce	CRM US	301.5	9.3	10.3	7.7	7.0
Kingsoft Cloud	KC US	3.2	8.2	12.7	0.8	0.7
Amazon	AMZN US	175.9	12.5	11.8	2.8	2.5
Average PS					5.8	5.1
Fintech						
PayPal	PYPL US	63.0	7.7	7.7	2.1	2.0
Square	SQ US	79.3	14.6	11.8	1.9	1.7
Average PS					2.0	1.9

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 19 Mar; *Covered by Sophie Huang

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	14.7	169,634	194,502
Sea Ltd	SE US	18.5	31,733	45,766
*Kuaishou Technology	1024 HK	15.7	28,417	34,711
Spotify Technology SA	SPOT US	8.6	50,129	33,588
NU Holdings Ltd/Cayman Islands	NU US	5.2	56,476	22,951
Snap Inc	SNAP US	14.7	18,239	20,942
KE Holdings Inc	BEKE US	11.0	17,603	15,048
Futu Holdings Ltd	FUTU US	22.1	7,893	13,607
Meituan	3690 HK	1.7	69,971	9,387
Krafton Inc	259960 KS	13.5	8,527	8,972
JD.com Inc	9618 HK	2.7	42,666	8,852
*Tongcheng Travel Holdings Ltd	780 HK	20.9	5,376	8,776
Vipshop Holdings Ltd	VIPS US	11.5	9,284	8,342
Warner Music Group Corp	WMG US	4.9	17,126	6,572
Kanzhun Ltd	BZ US	9.9	8,501	6,545
China International Capital Co	3908 HK	4.5	16,413	5,735
Netmarble Corp	251270 KS	17.5	3,718	5,081
Bilibili Inc	9626 HK	10.4	4,861	3,940
Yixin Group Ltd	2858 HK	53.9	617	2,593
*Tuhu Car Inc	9690 HK	18.7	1,382	2,015
Maoyan Entertainment	1896 HK	13.7	1,528	1,637
ZhongAn Online P&C Insurance C	6060 HK	8.1	2,356	1,487
Kadokawa Corp	9468 JP	6.9	2,742	1,467
Paradox Interactive AB	PDX SS	9.1	1,866	1,326
Lilium NV	LILM US	29.3	533	1,219
Ubisoft Entertainment SA	UBI FP	5.5	2,613	1,113
DHC Software Co Ltd	002065 CH	4.9	2,649	1,013
Other listed entities as a whole			35,104	9,694
Listed investments (current value)				476,881
Unlisted investments (book value)				366,630
Total investment value				843,511
Holdco discount				30%
Valuation of strategic investments				590,458
Valuation of strategic investments per share				62.4

Source: Bloomberg, company data, CMBIGM estimates

Note: data as of the market close on 19 Mar; *Covered by Sophie Huang

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	560,118	554,552	609,015	663,725	717,483	762,698
Cost of goods sold	(314,174)	(315,806)	(315,906)	(335,842)	(359,115)	(377,024)
Gross profit	245,944	238,746	293,109	327,883	358,368	385,674
Operating expenses	19,026	(127,919)	(133,035)	(147,815)	(157,164)	(164,945)
Selling expense	(40,594)	(29,229)	(34,211)	(38,496)	(41,614)	(44,236)
Admin expense	(89,847)	(106,696)	(103,525)	(114,161)	(120,537)	(125,845)
Others	149,467	8,006	4,701	4,842	4,987	5,137
Operating profit	264,970	110,827	160,074	180,068	201,204	220,729
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	16,440	3,506
Interest expense	(7,114)	(9,352)	(12,268)	0	0	0
Pre-tax profit	241,412	85,346	153,606	185,868	207,004	222,252
Income tax	(20,252)	(21,516)	(43,276)	(43,998)	(49,398)	(54,009)
After tax profit	221,160	63,830	110,330	141,870	157,606	168,243
Minority interest	(2,988)	(466)	(2,832)	(3,636)	(4,082)	(4,463)
Net profit	218,172	63,364	107,498	138,234	153,524	163,780
Adjusted net profit	123,788	115,649	157,688	193,195	212,767	229,501
Gross dividends	12,704	20,256	28,485	34,020	38,195	0
BALANCE SHEET						
YE 31 Dec (RMB mn)						
Current assets	484,812	565,989	518,446	602,971	729,394	888,907
Cash & equivalents	167,966	156,739	172,320	225,720	289,475	394,877
Account receivables	49,331	45,467	46,606	50,999	53,476	55,140
Inventories	1,063	2,333	456	1,925	2,040	2,125
Prepayment	65,390	76,685	88,411	82,503	86,510	91,896
ST bank deposits	83,813	104,776	185,983	225,155	271,628	326,573
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	1,021	9,835	1,044
Non-current assets	1,127,552	1,012,142	1,058,800	1,122,518	1,192,242	1,243,804
PP&E	61,914	53,978	53,232	73,559	89,085	100,900
Deferred income tax	26,068	29,882	29,017	25,447	33,428	29,157
Investment in JVs & assos	323,188	252,715	261,665	273,109	284,919	297,084
Intangibles	171,376	161,802	177,727	206,745	233,331	256,988
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	332,513	340,333	348,529
Total assets	1,612,364	1,578,131	1,577,246	1,725,488	1,921,636	2,132,711
Current liabilities	403,098	434,204	352,157	336,388	361,203	386,110
Short-term borrowings	19,003	22,026	55,698	17,992	19,238	20,198
Account payables	109,470	92,381	100,948	102,756	108,778	117,229
Tax payable	12,506	13,488	17,664	14,427	15,118	15,555
Other current liabilities	256,673	299,955	171,693	195,059	211,914	226,975
Lease liabilities	5,446	6,354	6,154	6,154	6,154	6,154
Non-current liabilities	332,573	361,067	351,408	371,986	383,719	396,435
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	13,434	14,365	15,081
Other non-current liabilities	45,521	45,227	55,053	62,807	72,223	83,539
Total liabilities	735,671	795,271	703,565	708,374	744,922	782,546
Retained earnings	669,911	705,981	813,911	953,709	1,109,226	1,278,214
Other reserves	136,388	15,410	(5,320)	(5,320)	(5,320)	(5,320)
Total shareholders equity	806,299	721,391	808,591	948,389	1,103,906	1,272,894
Minority interest	70,394	61,469	65,090	68,726	72,808	77,271
Total equity and liabilities	1,612,364	1,578,131	1,577,246	1,725,488	1,921,636	2,132,711

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	241,412	85,346	153,606	185,868	207,004	222,252
Depreciation & amortization	56,818	60,230	55,298	58,620	72,263	83,679
Tax paid	(20,252)	(21,516)	(43,276)	(43,998)	(49,398)	(54,009)
Change in working capital	(2,844)	(28,405)	16,661	25,219	16,279	16,376
Others	(99,948)	50,437	39,673	14,550	16,440	20,907
Net cash from operations	175,186	146,091	221,962	240,259	262,589	289,205
Investing						
Capital expenditure	(34,931)	(33,892)	(36,477)	(38,958)	(41,271)	(42,995)
Acquisition of subsidiaries/ investments	(117,642)	59,711	(105,332)	(45,543)	(83,682)	(63,065)
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	(25,976)	(130,690)	16,648	(69,007)	(73,104)	(76,157)
Net cash from investing	(178,549)	(104,871)	(125,161)	(153,508)	(198,058)	(182,217)
Financing						
Net borrowings	45,239	31,982	30,834	(30,364)	12,740	13,396
Proceeds from share issues	0	0	0	0	0	0
Others	(23,619)	(91,935)	(113,407)	(2,988)	(13,516)	(14,982)
Net cash from financing	21,620	(59,953)	(82,573)	(33,351)	(776)	(1,586)
Net change in cash						
Cash at the beginning of the year	152,798	167,966	156,739	172,320	225,720	289,475
Exchange difference	(3,089)	7,506	1,353	0	0	0
Cash at the end of the year	167,966	156,739	172,320	225,720	289,475	394,877
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	16.2%	(1.0%)	9.8%	9.0%	8.1%	6.3%
Gross profit	11.0%	(2.9%)	22.8%	11.9%	9.3%	7.6%
Operating profit	49.5%	(58.2%)	44.4%	12.5%	11.7%	9.7%
Net profit	42.7%	(71.0%)	69.7%	28.6%	11.1%	6.7%
Adj. net profit	0.9%	(6.6%)	36.4%	22.5%	10.1%	7.9%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	43.9%	43.1%	48.1%	49.4%	49.9%	50.6%
Operating margin	47.3%	20.0%	26.3%	27.1%	28.0%	28.9%
Adj. net profit margin	22.1%	20.9%	25.9%	29.1%	29.7%	30.1%
Return on equity (ROE)	28.9%	8.3%	14.1%	15.7%	15.0%	13.8%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	0.2	0.2	0.2	0.1	0.0	(0.1)
Current ratio (x)	1.2	1.3	1.5	1.8	2.0	2.3
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	18.7	41.9	26.8	18.2	16.4	15.3
P/E (diluted)	19.0	42.5	27.2	18.5	16.6	15.6
P/B	5.0	3.7	3.6	2.7	2.3	2.0

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

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