

Tencent (700 HK)

3Q23 earnings beat on strong operating leverage and business innovation

Tencent reported 3Q23 financial results on 15 Nov: total revenue grew 10% YoY to RMB154.6bn, inline with our/consensus estimate. Non-IFRS net income grew by 39% YoY to RMB44.9bn in 3Q23, beating our/consensus estimate by 11/12%, mainly due to the solid GPM expansion across business lines. 3Q23 GPM expanded by 5.2ppt YoY to 49.5% (vs. consensus' 47.5%) on the strong operating leverage and incremental revenue from higher-margin innovative businesses (i.e. Mini Games and Video Accounts etc). The record-high GPM since 2019 proved Tencent's operating leverage in its consumer internet business model and its competitive edges. We lift FY23-25E earnings forecast by 2-4% due to the strong GPM improvement and operating leverage. We raise our SOTP-derived TP to HK\$465.0 (previous: HK\$460.0). Maintain BUY.

- **Domestic games revenue returned to positive growth track.** Domestic games revenue was up 5% YoY to RMB32.7bn in 3Q23, mainly driven by the launches of *Lost Ark* and *Valorant*. Notably, legacy titles such as *Honour of Kings* and *DnF* recorded positive YoY growth in 3Q23. International games revenue grew by 14% YoY to RMB13.3bn in 3Q23 (7% YoY on a constant currency basis). Key titles in the pipeline include *Dream Stars*, *HoK World* and *Valorant Mobile*. Looking ahead, Tencent plans to step up investment in high-potential genres like content-driven and casual games. Games performance and pipeline plans are better-than-feared.
- **Solid ad revenue growth on strong demand for Weixin ad properties.** Online ad revenue grew by 20% YoY to RMB25.7bn in 3Q23 (17% of total revenue), fuelled by strong demand for Weixin ad properties such as Video Accounts (VA) and Mini Programs. Weixin's closed-loop ad revenue (incl. Mini Programs/VA/Official Accounts/Wecom) grew by over 30% YoY in 3Q23. VA ad revenue grew notably QoQ in 3Q23, propelled by solid growth in video views (>50% YoY). Management remains upbeat on VA ads' long-term growth potential, given the growing user traffic, improving click-through rate through AI, and relatively low ad load rate (<3%) vs. peers (>10%).
- **FBS revenue growth further accelerated.** Fintech and Business Services (FBS) revenue increased by 16% YoY to RMB52.0bn in 3Q23 (34% of total revenue). Fintech revenue growth was driven by increases in commercial payment activities and wealth management service revenue. Business Services revenue growth improved vs 2Q23, mainly due to recovery of cloud revenue and incremental live streaming e-commerce revenue.
- **GPM expansion across business lines.** Overall GPM rose by 5.2ppt YoY to 49.5% in 3Q23, mainly due to incremental revenue from higher-margin businesses including Mini Games, VA ads and e-commerce. VAS/ads/FBS GPM was up 3.8/6.0/7.6ppt YoY in 3Q23. Management expects further room for GPM improvement in the future, given the favourable revenue mix shift. For the capital management policy, management believes share buyback is more favourable for shareholders under the current market situation, but Tencent may adopt different tools dynamically in the future.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	611,875	664,724	716,952
Adjusted net profit (RMB mn)	123,788.0	115,649.0	156,028.8	184,530.6	201,484.0
YoY growth (%)	0.9	(6.6)	34.9	18.3	9.2
EPS (Adjusted) (RMB)	12.99	12.13	16.11	19.05	20.81
Consensus EPS (RMB)	12.99	12.13	15.48	18.16	20.58
P/E (x)	18.1	14.1	23.7	19.3	16.6
ROE (%)	29.8	24.6	15.5	16.4	16.5

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$465.00

(Previous TP) HK\$460.00

Up/Downside 44.1%

Current Price HK\$322.60

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Stock Data

Mkt Cap (HK\$ mn)	3,053,892.9
Avg 3 mths t/o (HK\$ mn)	5,012.4
52w High/Low (HK\$)	415.00/256.44
Total Issued Shares (mn)	9466.5

Source: FactSet

Shareholding Structure

MIH TC	26.9%
Advance Data Services Limited	8.4%

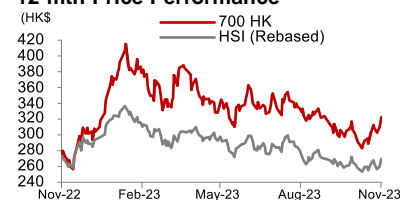
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	5.1%	3.6%
3-mth	-3.0%	-0.3%
6-mth	-5.4%	4.5%

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	611.9	664.7	717.0	609.9	662.0	713.5	0.3%	0.4%	0.5%
Gross Profit	292.7	324.3	351.4	283.1	311.3	340.8	3.4%	4.2%	3.1%
Adjusted net profit	156.0	184.5	201.5	149.9	179.1	196.8	4.1%	3.0%	2.4%
Adjusted EPS (RMB)	16.1	19.1	20.8	15.5	18.5	20.3	4.1%	3.0%	2.4%
Gross Margin	47.8%	48.8%	49.0%	46.4%	47.0%	47.8%	1.4 ppt	1.8 ppt	1.2 ppt
Adjusted net margin	25.5%	27.8%	28.1%	24.6%	27.1%	27.6%	0.9 ppt	0.7 ppt	0.5 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	611.9	664.7	717.0	617.6	689.8	764.0	-0.9%	-3.6%	-6.2%
Gross Profit	292.7	324.3	351.4	285.9	323.1	360.3	2.4%	0.4%	-2.5%
Adjusted net profit	156.0	184.5	201.5	149.2	176.2	200.8	4.6%	4.8%	0.3%
Adjusted EPS (RMB)	16.1	19.1	20.8	15.5	18.2	20.6	4.1%	4.9%	1.1%
Gross Margin	47.8%	48.8%	49.0%	46.3%	46.8%	47.2%	1.5 ppt	1.9 ppt	1.8 ppt
Adjusted net margin	25.5%	27.8%	28.1%	24.2%	25.5%	26.3%	1.3 ppt	2.2 ppt	1.8 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financial

(RMB bn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	Cons.	Diff%	CMBI	Diff%
SNS revenue	29.1	29.2	29.9	28.6	31.0	29.7	29.7	30.7	-3.2%	29.9	-0.5%
YoY %	1.0%	0.6%	-1.4%	-1.7%	6.4%	1.8%	-0.4%				
Games revenue	43.6	42.5	42.9	41.8	48.3	44.5	46.0	46.7	-1.6%	45.9	0.2%
YoY %	0.0%	-1.2%	-4.6%	-2.3%	10.8%	4.7%	7.4%				
Online ad revenue	18.0	18.6	21.4	24.7	21.0	25.0	25.7	26.2	-2.0%	26.3	-2.3%
YoY %	-17.6%	-18.4%	-4.7%	14.6%	16.5%	34.2%	20.0%				
FBS revenue	42.8	42.2	44.8	47.2	48.7	48.6	52.0	50.7	2.6%	50.3	3.5%
YoY %	9.6%	0.8%	3.5%	-1.5%	13.9%	15.2%	16.1%				
Total revenue	135.5	134.0	140.1	145.0	150.0	149.2	154.6	154.8	-0.1%	153.5	0.7%
YoY %	0.1%	-3.1%	-1.6%	0.5%	10.7%	11.3%	10.4%				
Gross profit margin	42.1%	43.2%	44.2%	42.6%	45.5%	47.5%	49.5%	47.5%	2.0 ppt	46.9%	2.6 ppt
G&A%	19.7%	19.6%	18.9%	18.8%	16.4%	17.0%	17.0%				
S&M%	5.9%	5.9%	5.1%	4.2%	4.7%	5.6%	5.1%				
Non-IFRS net margin	18.9%	21.0%	23.0%	20.5%	21.7%	25.2%	29.1%				
Non-IFRS net profit	25.5	28.1	32.3	29.7	32.5	37.5	44.9	40.0	12.4%	40.6	10.6%
YoY %	-22.9%	-17.3%	1.6%	19.4%	27.4%	33.4%	39.3%				

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$465.0 comprises, per share:

- 1) HK\$192.9 for the online games business, based on a 20x 2024E PE, which is on par with the average PE for its global gaming peers.
- 2) HK\$18.8 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 2.0x 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\$57.5 for the advertising business, based on a 16x 2024E PE, on par with the industry average.
- 4) HK\$107.6 for the fintech business, based on a 5.0x 2024E PS, at a premium to the peer average (1.6x). This mainly reflects 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\$18.9 for the cloud business, based on a 4.0x 2024E PS, at a discount to the industry average (5.1x) as Tencent's current offerings come mainly from the lower-margin IaaS Business
- 6) HK\$62.5 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\$6.8 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	84,272		20x			1,685,438	41.5	192.9
Social network services (SNS)		124,524				164,021	4.0	18.8
Tencent Music (TME)					94,340	51,981	1.3	5.9
China Literature					27,651	16,364	0.4	1.9
Huya					6,357	3,013	0.1	0.3
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	31,406		16x			502,500	12.4	57.5
Fintech		188,116		5.0x		940,582	23.1	107.6
Cloud (business services)		41,339		4.0x		165,356	4.1	18.9
Net cash						59,189	1.5	6.8
Valuation of core business						3,517,086		
RMB/HK\$						0.92		
Valuation of core business (HK\$mn)						3,809,668		
Valuation per share – core business (HK\$)						402.4		
Valuation per share – investments (HK\$)						62.5	13.5	
Valuation per share – Tencent (HK\$)						465.0		

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	114.3	22	3	3	18	18	17
Activision Blizzard	ATVI US	94.4	39	2	9	22	22	20
Electronic Arts	EA US	134.4	(14)	13	11	22	20	18
Take Two Interactive	TTWO US	153.4	(27)	(11)	148	43	48	19
IGG	799 HK	3.4	6	NA	53	NA	7	5
Nexon	3659 JP	2,958.0	6	7	10	22	20	19
Nintendo	7974 JP	7,008.0	(9)	7	(17)	21	20	24
Bandai Namco	7832 JP	3,053.0	18	6	10	22	20	18
Perfect World	002624 CH	13.5	(19)	33	16	20	15	13
37 Interactive	002555 CH	24.1	11	15	13	16	14	12
Average PE						23	20	17
Online advertising								
Focus Media	002027 CH	6.7	61	22	14	20	16	14
Baidu	BIDU US	109.5	28	6	11	11	11	10
Meta	Meta US	336.3	28	24	15	24	19	17
Google	GOOG US	135.4	18	16	23	22	19	16
Average PE						19	16	14

Source: Bloomberg, CMBIGM estimates

Note: data as of market close on 14 Nov

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	5.0	4.5	7.1	6.8	1.1	1.0	0.9
Mango Excellent Media	300413 CH	28.5	3.1	13.3	10.6	3.4	3.0	2.7
Average PS						2.3	2.0	1.8
Cloud								
Microsoft	MSFT US	370.3	11.9	13.1	14.7	11.6	10.3	9.0
Google	GOOG US	135.4	13.9	6.6	15.8	6.4	6.0	5.2
Salesforce	CRM US	221.2	12.3	11.0	11.3	6.2	5.6	5.0
Kingsoft Cloud	KC US	5.5	(10.3)	12.4	15.0	1.3	1.2	1.0
Amazon	AMZN US	145.8	11.6	12.0	12.5	2.6	2.4	2.1
Average PS						5.6	5.1	4.5
Fintech								
PayPal	PYPL US	56.7	7.8	9.1	9.1	2.1	1.9	1.8
Square	SQ US	55.1	23.8	14.0	13.9	1.6	1.4	1.2
Average PS						1.8	1.6	1.5

Source: Bloomberg, CMBIGM estimates

Note: data as of the market close on 14 Nov

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	147,473	178,180
Kuaishou Technology	1024 HK	18.9	31,452	46,366
Sea Ltd	SE US	20.2	20,258	31,918
Snap Inc	SNAP US	17.5	20,004	27,352
NU Holdings Ltd/Cayman Islands	NU US	7.9	41,455	25,577
Spotify Technology SA	SPOT US	8.6	33,734	22,603
China International Capital Co	3908 HK	11.4	20,626	18,276
KE Holdings Inc	BEKE US	11.3	18,172	16,017
Futu Holdings Ltd	FUTU US	21.6	8,927	15,047
Meituan	3690 HK	1.7	86,596	11,618
NIO Inc	NIO US	9.8	12,167	9,329
JD.com Inc	9618 HK	2.7	40,534	8,410
Krafton Inc	259960 KS	13.5	7,217	7,594
Vipshop Holdings Ltd	VIPS US	11.5	8,018	7,205
Tongcheng Travel Holdings Ltd	780 HK	21.4	4,164	6,944
Warner Music Group Corp	WMG US	4.9	17,043	6,541
Bilibili Inc	9626 HK	13.4	5,913	6,185
Kanzhun Ltd	BZ US	9.9	6,606	5,085
Netmarble Corp	251270 KS	17.5	3,157	4,314
ZhongAn Online P&C Insurance C	6060 HK	8.1	3,990	2,518
Yixin Group Ltd	2858 HK	53.9	535	2,247
Ubisoft Entertainment SA	UBI FP	5.5	3,896	1,659
Paradox Interactive AB	PDX SS	9.1	2,206	1,567
Maoyan Entertainment	1896 HK	13.7	1,408	1,509
Kadokawa Corp	9468 JP	6.9	2,524	1,351
Oxford Nanopore Technologies P	ONT LN	7.7	2,128	1,270
DHC Software Co Ltd	002065 CH	4.9	3,015	1,152
Other listed entities as a whole			27,703	10,618
Listed investments (current value)				478,450
Unlisted investments (book value)				374,010
Total investment value				852,460
Holdco discount				30%
Valuation of strategic investments				596,722
Valuation of strategic investments per share				62.5

Source: Bloomberg, company data, CMBIGM estimates

Note: data as of market close on 14 Nov

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	482,064	560,118	554,552	611,875	664,724	716,952
Cost of goods sold	(260,532)	(314,174)	(315,806)	(319,173)	(340,424)	(365,557)
Gross profit	221,532	245,944	238,746	292,702	324,300	351,396
Operating expenses	(37,295)	25,676	(3,040)	(117,274)	(127,717)	(135,868)
Selling expense	(33,758)	(40,594)	(29,229)	(31,206)	(35,230)	(37,282)
Admin expense	(67,625)	(89,847)	(106,696)	(102,795)	(111,674)	(119,731)
Others	64,088	156,117	132,885	16,727	19,187	21,145
Operating profit	184,237	271,620	235,706	175,428	196,583	215,528
Share of (losses)/profits of associates/JV	3,672	(16,444)	(16,129)	4,200	4,200	4,200
Interest income	6,957	6,650	8,592	12,951	15,298	17,139
Interest expense	(7,887)	(7,114)	(9,352)	(11,808)	(11,899)	(2,691)
Pre-tax profit	180,022	248,062	210,225	167,820	188,883	217,036
Income tax	(19,897)	(20,252)	(21,516)	(44,472)	(37,777)	(41,547)
After tax profit	160,125	227,810	188,709	123,348	151,107	175,489
Minority interest	(278)	(2,988)	(466)	(2,960)	(3,627)	(3,989)
Net profit	159,847	224,822	188,243	120,387	147,480	171,501
Adjusted net profit	122,742	123,788	115,649	156,029	184,531	201,484
Gross dividends	12,653	12,704	20,256	14,898	18,250	20,072
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	317,647	484,812	565,989	540,584	641,874	787,213
Cash & equivalents	152,798	167,966	156,739	250,699	317,144	422,431
Account receivables	44,981	49,331	45,467	48,469	51,076	53,436
Inventories	814	1,063	2,333	1,868	1,928	2,038
Prepayment	40,321	65,390	76,685	78,410	82,627	86,446
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	4,482	4,165	4,577
Non-current assets	1,015,778	1,127,552	1,012,142	1,056,760	1,129,342	1,175,105
PP&E	59,843	61,914	53,978	71,734	85,644	96,909
Deferred income tax	21,348	26,068	29,882	20,327	34,219	24,613
Investment in JVs & assos	305,258	323,188	252,715	264,094	275,842	287,948
Intangibles	159,437	171,376	161,802	190,311	216,601	240,916
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	304,209	310,952	318,634
Total assets	1,333,425	1,612,364	1,578,131	1,597,343	1,771,216	1,962,318
Current liabilities	269,079	403,098	434,204	318,870	343,090	370,534
Short-term borrowings	14,242	19,003	22,026	17,099	18,237	19,584
Account payables	94,030	109,470	92,381	98,642	104,158	110,729
Tax payable	12,134	12,506	13,488	13,991	14,624	15,390
Other current liabilities	144,851	256,673	299,955	182,784	199,717	218,478
Lease liabilities	3,822	5,446	6,354	6,354	6,354	6,354
Non-current liabilities	286,303	332,573	361,067	382,498	393,580	404,836
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	12,767	13,617	14,622
Other non-current liabilities	45,423	45,521	45,227	50,927	57,999	66,695
Total liabilities	555,382	735,671	795,271	701,368	736,670	775,370
Retained earnings	538,464	669,911	705,981	816,136	951,080	1,099,493
Other reserves	165,520	136,388	15,410	15,410	15,410	15,410
Total shareholders equity	703,984	806,299	721,391	831,546	966,490	1,114,903
Minority interest	74,059	70,394	61,469	64,429	68,056	72,044
Total equity and liabilities	1,333,425	1,612,364	1,578,131	1,597,343	1,771,216	1,962,318

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	180,022	248,062	210,225	167,820	188,883	217,036
Depreciation & amortization	50,774	56,818	60,230	55,298	67,927	78,711
Tax paid	(19,897)	(20,252)	(21,516)	(44,472)	(37,777)	(41,547)
Change in working capital	27,423	(2,844)	(28,405)	32,793	15,565	19,043
Others	(44,203)	(106,598)	(74,443)	0	0	(9,301)
Net cash from operations	194,119	175,186	146,091	211,439	234,598	263,942
Investing						
Capital expenditure	(33,906)	(34,931)	(33,892)	(36,648)	(39,017)	(41,241)
Acquisition of subsidiaries/ investments	(108,665)	(117,642)	59,711	(22,691)	(60,344)	(43,945)
Net proceeds from disposal of short-term investments	15,376	0	0	0	0	0
Others	(54,760)	(25,976)	(130,690)	(64,914)	(69,110)	(73,050)
Net cash from investing	(181,955)	(178,549)	(104,871)	(124,253)	(168,471)	(158,235)
Financing						
Net borrowings	44,490	45,239	31,982	7,743	12,004	12,363
Proceeds from share issues	1,716	0	0	0	0	0
Others	(32,559)	(23,619)	(91,935)	(969)	(11,686)	(12,782)
Net cash from financing	13,647	21,620	(59,953)	6,774	318	(419)
Net change in cash						
Cash at the beginning of the year	132,991	152,798	167,966	156,739	250,699	317,144
Exchange difference	(6,004)	(3,089)	7,506	0	0	0
Cash at the end of the year	152,798	167,966	156,739	250,699	317,144	422,431
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	27.8%	16.2%	(1.0%)	10.3%	8.6%	7.9%
Gross profit	32.2%	11.0%	(2.9%)	22.6%	10.8%	8.4%
Operating profit	55.2%	47.4%	(13.2%)	(25.6%)	12.1%	9.6%
Net profit	71.3%	40.6%	(16.3%)	(36.0%)	22.5%	16.3%
Adj. net profit	30.1%	0.9%	(6.6%)	34.9%	18.3%	9.2%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	46.0%	43.9%	43.1%	47.8%	48.8%	49.0%
Operating margin	38.2%	48.5%	42.5%	28.7%	29.6%	30.1%
Adj. net profit margin	25.5%	22.1%	20.9%	25.5%	27.8%	28.1%
Return on equity (ROE)	28.1%	29.8%	24.6%	15.5%	16.4%	16.5%
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	23.7	19.3	16.6
P/E (diluted)	23.6	18.4	14.3	24.1	19.6	16.9
P/B	5.3	5.0	3.7	3.4	2.9	2.6

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

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