

Tencent (700 HK)

Expect solid earnings growth and enhancing shareholder return in FY24

Tencent remains on track of margins expansion, underpinned by increased revenue contribution from high-margin businesses and operating leverage. The company is also committed to enhancing shareholder return, with daily share repurchase amount reaching HK\$1bn (c.13% of average daily turnover) since 4Q23 earning release in March. For 1Q24E, we forecast total revenue to increase by 6% YoY to RMB158.6bn, while non-IFRS net income to grow by 31% YoY to RMB43.1bn, primarily driven by the solid GPM expansion (+c.3ppt YoY). We slightly lower our FY24-26 total revenue forecast by 1-2%, mainly to factor in the relatively soft gaming business. We fine-tune our SOTP-derived target price to HK\$445.0 (previous: HK\$450.5). Maintain BUY.

- Games business to navigate short-term headwinds.** Games business remains under short-term pressure and we forecast its revenue to decline by 2% YoY in 1Q24E, mainly due to: 1) prudent monetization of key titles like *Honor of Kings* and *Peacekeeper Elite* compared to the same period last year; 2) soft performance of certain PC titles like *DnF* on tough comps. Nonetheless, we expect games revenue to recover to positive YoY growth in 2Q24E, driven by the revamp of certain games' monetization and launch of new titles like *DnF Mobile* in 2Q24. For SNS business, we forecast its revenue to decrease by 2% YoY in 1Q24E, primarily due to adjustment of Huya and TME's live streaming businesses, but partially offset by solid growth of mini-games revenue.
- Driving quality growth of ads/FBS businesses.** We forecast advertising revenue to grow by 16% YoY in 1Q24E, driven by strong demand for Video Account (VA) ads and improved ad tech. We expect ad GPM to expand by c.7ppts YoY due to the enhanced monetization of high-margin Weixin ad properties like VA and Moment ads. For FBS business, we also expect continued high-quality growth, with revenue and GPM up by 14% YoY and 6ppt YoY respectively in 1Q24E, mainly supported by incremental revenue from high-margin VA e-commerce, wealth management and consumer loan businesses.
- Maintain BUY.** We are positive on Tencent's earnings growth in 1Q24/2024E (+31%/18% YoY). In addition, the increase in shareholder return (FY24E share repurchases + cash dividends equivalent to ~5% of current market cap) should further support Tencent's valuation. We see Tencent's current valuation of 15x FY24E PE (12x FY24E PE excl. strategic investment value) remains attractive. Key catalysts: 1) launch of *DnF Mobile* in 2Q24 supporting games business recovery; 2) better-than-expected expansion of ad/FBS GPM; 3) increasing shareholder return.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	554,552	609,015	655,548	707,635	751,260
YoY growth (%)	(1.0)	9.8	7.6	7.9	6.2
Gross margin (%)	43.1	48.1	49.9	51.1	52.1
Adjusted net profit (RMB mn)	115,649.0	157,688.0	185,358.3	206,436.4	225,145.4
YoY growth (%)	(6.6)	36.4	17.5	11.4	9.1
EPS (Adjusted) (RMB)	12.13	16.66	19.14	21.32	23.25
Consensus EPS (RMB)	12.13	16.66	19.31	21.54	24.09
P/S (x)	4.9	4.4	4.1	3.8	3.6
P/E (x)	43.0	25.2	20.7	17.3	16.1
ROE (%)	8.3	14.1	14.9	15.4	14.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$445.00**
 (Previous TP) HK\$450.50
Up/Downside **43.7%**
Current Price **HK\$309.60**

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Stock Data

Mkt Cap (HK\$ mn)	2,930,983.2
Avg 3 mths t/o (HK\$ mn)	6,472.1
52w High/Low (HK\$)	371.00/262.20
Total Issued Shares (mn)	9467.0

Source: FactSet

Shareholding Structure

MIH TC	25.6%
Advance Data Services Limited	8.4%

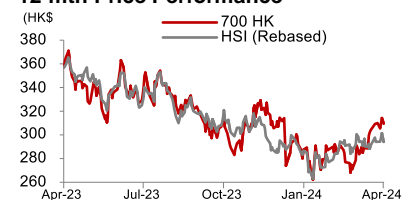
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	6.5%	8.8%
3-mth	7.4%	4.1%
6-mth	-2.2%	6.7%

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	655.5	707.6	751.3	663.7	717.5	762.7	-1.2%	-1.4%	-1.5%
Gross profit	327.2	361.4	391.6	327.9	358.4	385.7	-0.2%	0.8%	1.5%
Adjusted net profit	185.4	206.4	225.1	193.2	212.8	229.5	-4.1%	-3.0%	-1.9%
Adjusted EPS (RMB)	19.1	21.3	23.2	19.9	22.0	23.7	-4.1%	-3.0%	-1.9%
Gross margin	49.9%	51.1%	52.1%	49.4%	49.9%	50.6%	0.5 ppt	1.1 ppt	1.6 ppt
Adjusted net margin	28.3%	29.2%	30.0%	29.1%	29.7%	30.1%	-0.8 ppt	-0.5 ppt	-0.1 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	655.5	707.6	751.3	666.4	733.0	798.6	-1.6%	-3.5%	-5.9%
Gross p	327.2	361.4	391.6	336.6	375.0	410.6	-2.8%	-3.6%	-4.6%
Adjusted net profit	185.4	206.4	225.1	185.8	211.6	235.5	-0.2%	-2.5%	-4.4%
Adjusted EPS (RMB)	19.1	21.3	23.2	19.3	21.5	24.1	-0.9%	-1.0%	-3.5%
Gross margin	49.9%	51.1%	52.1%	50.5%	51.2%	51.4%	-0.6 ppt	-0.1 ppt	0.7 ppt
Adjusted net margin	28.3%	29.2%	30.0%	27.9%	28.9%	29.5%	0.4 ppt	0.3 ppt	0.5 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: Tencent: quarterly financials

(RMB bn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24E
SNS revenue	29.1	29.2	29.9	28.6	31.0	29.7	29.7	28.2	30.4
YoY %	1.0%	0.6%	-1.4%	-1.7%	6.3%	1.6%	-0.4%	-1.5%	-1.8%
Games revenue	43.6	42.5	42.9	41.8	48.4	44.5	46.0	40.9	47.4
YoY %	0.0%	-1.2%	-4.6%	-2.3%	10.9%	4.8%	7.4%	-2.2%	-1.9%
Online ad revenue	18.0	18.6	21.4	24.7	21.0	25.0	25.7	29.8	24.3
YoY %	-17.6%	-18.4%	-4.7%	14.6%	16.5%	34.2%	20.0%	20.8%	16.0%
FBS revenue	42.8	42.2	44.8	47.2	48.7	48.6	52.0	54.4	55.4
YoY %	9.6%	0.8%	3.5%	-1.5%	13.9%	15.2%	16.1%	15.1%	13.9%
Total revenue	135.5	134.0	140.1	145.0	150.0	149.2	154.6	155.2	158.6
YoY %	0.1%	-3.1%	-1.6%	0.5%	10.7%	11.3%	10.4%	7.1%	5.8%
Gross profit margin	42.1%	43.2%	44.2%	42.6%	45.5%	47.5%	49.5%	50.0%	48.8%
G&A%	19.7%	19.6%	18.9%	18.8%	16.4%	17.0%	17.0%	17.5%	17.5%
S&M%	5.9%	5.9%	5.1%	4.2%	4.7%	5.6%	5.1%	7.1%	6.0%
Non-IFRS net margin	16.6%	21.6%	24.7%	20.5%	22.0%	24.7%	29.2%	27.5%	27.2%
Non-IFRS net profit	22.5	28.9	34.6	29.7	32.9	36.9	45.2	42.7	43.1
YoY %	-32.2%	-15.1%	8.9%	19.4%	46.6%	27.6%	30.8%	43.7%	31.0%

Source: Company data, CMBIGM estimates

Our SOTP-derived target price of HK\$445.0 comprises, per share:

- 1) HK\$160.3 for the online games business, based on a 17x 2024E PE, which is on par with the average PE for its global gaming peers.
- 2) HK\$29.7 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 1.7x 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\$79.4 for the advertising business, based on a 19x 2024E PE, on par with the industry average.
- 4) HK\$85.4 for the fintech business, based on a 4.0x 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 come mainly from the lower-margin IaaS Business
- 6) HK\$62.0 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	82,116		17x			1,395,980	36.0	160.3
Social network services (SNS)		119,761				258,858	6.7	29.7
Tencent Music (TME)					138,469	76,297	2.0	8.8
China Literature					24,881	14,725	0.4	1.7
Huya					7,559	3,583	0.1	0.4
Online video – subscription		20,700		2.5x		51,750	1.3	5.9
Others		56,251		2.0x		112,503	2.9	12.9
Online advertising	36,376		19x			691,136	17.8	79.4
Fintech		185,852		4.0x		743,407	19.2	85.4
Cloud (business services)		45,186		4.0x		180,745	4.7	20.8
Net cash						65,383	1.7	7.5
Valuation of core business						3,335,509		
RMB/HK\$						0.92		
Valuation of core business (HK\$mn)						3,625,553		
Valuation per share – core business (HK\$)						383.0		
Valuation per share – investments (HK\$)						62.0	13.9	
Valuation per share – Tencent (HK\$)						445.0		

Source: Company data, CMBIGM estimates

Figure 5: Peer comparison: online games and advertising sector

Company	Ticker	Price (Local)	EPS growth (YoY %)		PE (x)	
			FY24E	FY25E	FY24E	FY25E
Online games						
NetEase	NTES US	92.2	5	1	13	13
Electronic Arts	EA US	127.9	19	5	18	17
Take Two Interactive	TTWO US	147.3	(37)	158	NA	25
Nexon	3659 JP	2,429.5	(16)	19	20	17
Nintendo	7974 JP	7,735.0	17	(16)	20	24
Bandai Namco	7832 JP	2,888.0	(13)	21	23	19
Perfect World	002624 CH	10.1	53	20	15	12
37 Interactive	002555 CH	16.5	18	12	10	9
Average PE					17	17
Online advertising						
Focus Media	002027 CH	6.9	19	14	17	15
Baidu	BIDU US	97.5	(7)	15	10	9
Meta	Meta US	511.9	37	16	25	22
Google	GOOG US	159.2	16	15	23	20
Average PE					19	16

Source: Bloomberg, CMBIGM estimates

Note: data as of market close on 12 Apr

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

Companies	Ticker	Price (Local)	Revenue growth (YoY %)		PS (x)	
			FY24E	FY25E	FY24E	FY25E
Online video						
iQiyi	IQ US	4.1	7.1	6.9	0.8	0.8
Mango Excellent Media	300413 CH	22.9	11.7	10.6	2.7	2.4
Average PS					1.7	1.6
Cloud						
Microsoft	MSFT US	421.9	14.5	14.5	11.2	9.8
Google	GOOG US	159.2	12.8	17.7	6.8	5.8
Salesforce	CRM US	294.3	9.2	10.3	7.5	6.8
Kingsoft Cloud	KC US	2.7	3.7	10.1	0.7	0.6
Amazon	AMZN US	186.1	12.5	11.8	3.0	2.7
Average PS					5.8	5.1
Fintech						
PayPal	PYPL US	64.6	7.7	7.7	2.2	2.0
Square	SQ US	77.0	14.7	11.6	1.9	1.7
Average PS					2.0	1.9

Source: Bloomberg, CMBIGM estimates

Note: data as of market close on 12 Apr

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	153,452	176,427
Sea Ltd	SE US	18.5	30,197	43,551
Spotify Technology SA	SPOT US	8.4	59,587	38,995
Kuaishou Technology	1024 HK	15.7	27,242	33,276
Snap Inc	SNAP US	17.5	17,909	24,488
NU Holdings Ltd/Cayman Islands	NU US	5.2	53,807	21,866
KE Holdings Inc	BEKE US	11.3	16,348	14,409
Futu Holdings Ltd	FUTU US	21.6	8,027	13,531
China International Capital Co	3908 HK	11.4	14,311	12,680
Meituan	3690 HK	1.7	81,233	10,898
Tongcheng Travel Holdings Ltd	780 HK	21.1	6,401	10,516
Krafton Inc	259960 KS	13.5	8,325	8,760
JD.com Inc	9618 HK	2.7	41,086	8,525
Vipshop Holdings Ltd	VIPS US	11.5	8,812	7,918
Warner Music Group Corp	WMG US	4.9	17,318	6,646
Kanzhun Ltd	BZ US	9.9	8,319	6,404
Bilibili Inc	9626 HK	13.4	5,085	5,319
Netmarble Corp	251270 KS	17.5	3,524	4,815
Tuhu Car Inc	9690 HK	18.7	1,881	2,744
Yixin Group Ltd	2858 HK	53.9	524	2,204
Maoyan Entertainment	1896 HK	13.7	1,460	1,565
ZhongAn Online P&C Insurance C	6060 HK	8.1	2,352	1,484
Kadokawa Corp	9468 JP	6.9	2,570	1,375
Paradox Interactive AB	PDX SS	9.1	1,764	1,254
Ubisoft Entertainment SA	UBI FP	5.5	2,779	1,184
Lilium NV	LILM US	29.3	470	1,075
Other listed entities as a whole			32,983	10,195
Listed investments (current value)				472,103
Unlisted investments (book value)				366,630
Total investment value				838,734
Holdco discount				30%
Valuation of strategic investments				587,114
Valuation of strategic investments per share				62.0

Source: Bloomberg, company data, CMBIGM estimates

Note: data as of market close on 12 Apr

Risks

1) Slower-than-expected growth of games revenue; 2) slower-than-expected monetization of Video Account; 3) intensifying competition of the social media sector.

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	560,118	554,552	609,015	655,548	707,635	751,260
Cost of goods sold	(314,174)	(315,806)	(315,906)	(328,380)	(346,222)	(359,677)
Gross profit	245,944	238,746	293,109	327,168	361,413	391,584
Operating expenses	19,026	(127,919)	(133,035)	(144,623)	(154,938)	(162,394)
Selling expense	(40,594)	(29,229)	(34,211)	(38,022)	(41,043)	(43,573)
Admin expense	(89,847)	(106,696)	(103,525)	(111,443)	(118,883)	(123,958)
Others	149,467	8,006	4,701	4,842	4,987	5,137
Operating profit	264,970	110,827	160,074	182,545	206,475	229,190
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	16,070	3,384
Interest expense	(7,114)	(9,352)	(12,268)	(10,420)	(2,264)	(2,812)
Pre-tax profit	241,412	85,346	153,606	177,925	210,010	227,900
Income tax	(20,252)	(21,516)	(43,276)	(45,025)	(51,352)	(56,977)
After tax profit	221,160	63,830	110,330	132,900	158,659	170,923
Minority interest	(2,988)	(466)	(2,832)	(2,139)	(2,439)	(2,706)
Net profit	218,172	63,364	107,498	130,762	156,220	168,216
Adjusted net profit	123,788	115,649	157,688	185,358	206,436	225,145
Gross dividends	12,704	20,256	28,485	32,301	36,840	0
BALANCE SHEET						
YE 31 Dec (RMB mn)						
Current assets	484,812	565,989	518,446	591,025	707,770	859,748
Cash & equivalents	167,966	156,739	172,320	215,483	269,808	368,111
Account receivables	49,331	45,467	46,606	50,371	52,742	54,313
Inventories	1,063	2,333	456	1,902	2,012	2,093
Prepayment	65,390	76,685	88,411	81,487	85,322	90,408
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	981	9,827	998
Non-current assets	1,127,552	1,012,142	1,058,800	1,119,866	1,188,462	1,237,904
PP&E	61,914	53,978	53,232	73,079	88,206	99,684
Deferred income tax	26,068	29,882	29,017	24,776	33,291	28,356
Investment in JVs & assos	323,188	252,715	261,665	273,109	284,919	297,084
Intangibles	171,376	161,802	177,727	205,895	231,669	254,558
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	331,862	339,232	347,076
Total assets	1,612,364	1,578,131	1,577,246	1,710,891	1,896,232	2,097,652
Current liabilities	403,098	434,204	352,157	330,424	351,684	372,391
Short-term borrowings	19,003	22,026	55,698	17,592	18,548	19,269
Account payables	109,470	92,381	100,948	100,473	104,872	110,736
Tax payable	12,506	13,488	17,664	14,107	14,576	14,839
Other current liabilities	256,673	299,955	171,693	192,098	207,534	221,394
Lease liabilities	5,446	6,354	6,154	6,154	6,154	6,154
Non-current liabilities	332,573	361,067	351,408	371,688	383,203	395,742
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	13,135	13,849	14,387
Other non-current liabilities	45,521	45,227	55,053	62,807	72,223	83,539
Total liabilities	735,671	795,271	703,565	702,112	734,887	768,132
Retained earnings	669,911	705,981	813,911	946,871	1,096,997	1,262,465
Other reserves	136,388	15,410	(5,320)	(5,320)	(5,320)	(5,320)
Total shareholders equity	806,299	721,391	808,591	941,551	1,091,677	1,257,145
Minority interest	70,394	61,469	65,090	67,229	69,668	72,374
Total equity and liabilities	1,612,364	1,578,131	1,577,246	1,710,891	1,896,232	2,097,652

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	241,412	85,346	153,606	177,925	210,010	227,900
Depreciation & amortization	56,818	60,230	55,298	58,620	71,904	82,998
Tax paid	(20,252)	(21,516)	(43,276)	(45,025)	(51,352)	(56,977)
Change in working capital	(2,844)	(28,405)	16,661	21,644	13,519	12,984
Others	(99,948)	50,437	39,673	14,550	7,852	12,623
Net cash from operations	175,186	146,091	221,962	227,714	251,934	279,528
Investing						
Capital expenditure	(34,931)	(33,892)	(36,477)	(38,478)	(40,705)	(42,350)
Acquisition of subsidiaries/ investments	(117,642)	59,711	(105,332)	(44,182)	(83,797)	(62,011)
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	(25,976)	(130,690)	16,648	(68,157)	(72,100)	(75,015)
Net cash from investing	(178,549)	(104,871)	(125,161)	(150,817)	(196,603)	(179,376)
Financing						
Net borrowings	45,239	31,982	30,834	(31,084)	12,227	12,985
Proceeds from share issues	0	0	0	0	0	0
Others	(23,619)	(91,935)	(113,407)	(2,651)	(13,232)	(14,833)
Net cash from financing	21,620	(59,953)	(82,573)	(33,735)	(1,006)	(1,849)
Net change in cash						
Cash at the beginning of the year	152,798	167,966	156,739	172,320	215,483	269,808
Exchange difference	(3,089)	7,506	1,353	0	0	0
Cash at the end of the year	167,966	156,739	172,320	215,483	269,808	368,111
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	16.2%	(1.0%)	9.8%	7.6%	7.9%	6.2%
Gross profit	11.0%	(2.9%)	22.8%	11.6%	10.5%	8.3%
Operating profit	49.5%	(58.2%)	44.4%	14.0%	13.1%	11.0%
Net profit	42.7%	(71.0%)	69.7%	21.6%	19.5%	7.7%
Adj. net profit	0.9%	(6.6%)	36.4%	17.5%	11.4%	9.1%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	43.9%	43.1%	48.1%	49.9%	51.1%	52.1%
Operating margin	47.3%	20.0%	26.3%	27.8%	29.2%	30.5%
Adj. net profit margin	22.1%	20.9%	25.9%	28.3%	29.2%	30.0%
Return on equity (ROE)	28.9%	8.3%	14.1%	14.9%	15.4%	14.3%
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	(0.0)
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	12.5	43.0	25.2	20.7	17.3	16.1
P/E (diluted)	12.7	43.7	25.6	21.0	17.6	16.3
P/B	3.4	3.8	3.3	2.9	2.5	2.2

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

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