招银国际 CMB INTERNATIONAL
招商银行全资附属机构
A Wholly Owned Subsidiary Of China Merchants Bank

Tencent (700 HK)

Solid core business growth; investing to accelerate AI development

BUY (Maintain)

Target Price	**HK$735.00**
(Previous TP	HK$750.00)
Up/Downside	**59.7%**
Current Price	**HK$460.20**

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Stock Data

Mkt Cap (HK$ mn)	4,125,913.0
Avg 3 mths t/o (HK$ mn)	14,437.6
52w High/Low (HK$)	677.50/411.80
Total Issued Shares (mn)	8965.5

Source: FactSet

Shareholding Structure

MIH TC	22.8%
Advance Data Services Limited	7.8%

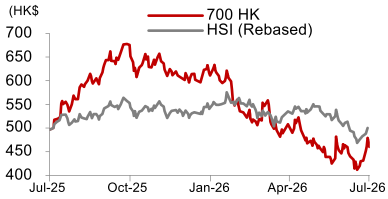
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-1.2%	-0.2%
3-mth	-8.8%	-2.3%
6-mth	-24.7%	-18.3%

Source: FactSet

12-mth Price Performance



Source: FactSet

Tencent will report 2Q26E results on 12 Aug: we expect total revenue to increase by 9% YoY to RMB201.3bn, driven by the solid growth of games and marketing businesses; we estimate non-IFRS net income to grow by 7% YoY to RMB67.3bn, with non-IFRS NPM down by 0.7ppts YoY mainly due to AI-related investment. Overall, we slightly trim our FY26 non-IFRS net income forecast by 1% in view of the AI investment. That said, we remain upbeat on the ROI of Tencent's AI spend, proven by its enhancing HY model performance, accelerating cloud revenue growth and improving ad solutions. We fine-tuned our SOTP-derived target price to HK$735.0 (previous: HK$750.0). The company's current valuation at 13x FY26E non-IFRS PE offers attractive risk-reward with multiple catalysts ahead, including the launch of Weixin AI agents and upgrade of HY model. Maintain BUY.

- **Expect solid top-line growth in 2Q26E.** For 2Q26E, we forecast: 1) games revenue to grow by 9% YoY to RMB64.8bn, with domestic/international games revenue up by 11%/6% YoY respectively. We expect international games revenue growth to slightly decelerate due to the high-base effect; 2) marketing revenue to rise by 18% YoY to RMB42.2bn, mainly attributable to the increase in ad inventory of Video Account and AI empowerment; 3) fintech and business services (FBS) revenue to increase by 9% YoY to RMB60.7bn, primarily fuelled by the accelerating cloud revenue growth amid strong demand for AI compute.
- **OPM dragged by AI investment.** We expect overall GPM to improve by 0.3ppts YoY to 57.2% in 2Q26E, mainly supported by the strength in games and marketing businesses; but we estimate non-IFRS OPM to decline by 0.9ppts YoY to 36.6% in 2Q26E, as the company steps up investment in AI. We forecast S&M/G&A expenses to increase by 37%/17% YoY to RMB12.9/37.2bn in 2Q26E, due to increase in marketing spend for AI products, AI talent expenses and depreciation expenses.
- **Solid progress on AI front, with more catalysts ahead.** Tencent's AI agentic platform WorkBuddy maintained its leadership in China's productivity AI agent market, in terms of average DAU in 2Q26. The official HY3 model, launched on 6 Jul, achieved significant improvement in reasoning and agentic capabilities compared to HY3 preview, thanks to the enhanced dataset quality and the scaling RL. Looking into 2H26E, we expect several catalysts to support Tencent's fundamental and valuation recovery: 1) launch of Weixin AI agent "Xiaowei" & iteration of WorkBuddy, which enable Tencent to tap into the enormous AI agent market; 2) upgrade of HY model, with larger parameters, more quality datasets and higher-value use cases; 3) acceleration in cloud revenue growth underpinned by the increase in total AI compute power.

Earnings Summary

(YE 31 Dec)	FY24A	FY25A	FY26E	FY27E	FY28E
Revenue (RMB mn)	660,257	751,766	817,806	878,578	926,280
Adjusted net profit (RMB mn)	222,703.0	259,626.0	272,643.2	287,512.3	306,655.4
EPS (Adjusted) (RMB)	23.96	28.55	29.95	32.06	34.72
Consensus EPS (RMB)	23.96	28.55	30.04	33.30	36.85
P/E (x)	19.1	16.1	15.2	14.3	13.5

Source: Company data, Bloomberg, CMBIGM estimates

Business forecasts update and valuation

Figure 1: Tencent: forecast revision

	Current			Previous			Change (%)		
(RMB bn)	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Revenue	817.8	878.6	926.3	823.8	886.4	930.0	-0.7%	-0.9%	-0.4%
Gross profit	467.5	506.6	536.7	471.2	512.1	540.4	-0.8%	-1.1%	-0.7%
Operating profit	261.9	277.7	292.6	266.5	290.9	311.1	-1.8%	-4.5%	-6.0%
Adjusted net profit	272.6	287.5	306.7	276.5	300.0	323.8	-1.4%	-4.2%	-5.3%
Adjusted EPS (RMB)	29.9	32.1	34.7	30.4	33.5	36.7	-1.4%	-4.2%	-5.3%
Gross margin	57.2%	57.7%	57.9%	57.2%	57.8%	58.1%	0.0 ppt	-0.1 ppt	-0.2 ppt
Operating margin	32.0%	31.6%	31.6%	32.4%	32.8%	33.5%	-0.3 ppt	-1.2 ppt	-1.9 ppt
Adjusted net margin	33.3%	32.7%	33.1%	33.6%	33.8%	34.8%	-0.2 ppt	-1.1 ppt	-1.7 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

	CMBIGM			Consensus			Diff (%)		
(RMB bn)	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E	FY25E	FY26E	FY27E
Revenue	817.8	878.6	926.3	828.7	907.1	994.2	-1.3%	-3.1%	-6.8%
Gross profit	467.5	506.6	536.7	470.9	520.9	576.3	-0.7%	-2.7%	-6.9%
Operating profit	261.9	277.7	292.6	272.4	302.9	336.7	-3.9%	-8.3%	-13.1%
Adjusted net profit	272.6	287.5	306.7	275.4	302.5	335.0	-1.0%	-5.0%	-8.5%
Adjusted EPS (RMB)	29.9	32.1	34.7	30.0	33.3	36.9	-0.3%	-3.7%	-5.8%
Gross margin	57.2%	57.7%	57.9%	56.8%	57.4%	58.0%	0.3 ppt	0.2 ppt	0.0 ppt
Operating margin	32.0%	31.6%	31.6%	32.9%	33.4%	33.9%	-0.8 ppt	-1.8 ppt	-2.3 ppt
Adjusted net margin	33.3%	32.7%	33.1%	33.2%	33.3%	33.7%	0.1 ppt	-0.6 ppt	-0.6 ppt

Source: Bloomberg, CMBIGM estimates

Our SOTP-derived target price of HK$735.0 comprises, per share:

1) HK$345.7 for the games business, based on a 24x 2026E 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$30.6 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 2026E PS, at a premium to the 1.1x average PS of peers given its content and user traffic leadership), and the valuation of other membership services (based on a 3.5x 2026E PS).

3) HK$144.4 for the marketing services business, based on a 22x 2026E 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$105.6 for the fintech business, based on a 4.5x 2026E 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$35.4 for the cloud business, based on a 4.5x 2026E PS, at a discount to the industry average (5.2x) as Tencent's current offerings mainly involve the lower-margin IaaS business.

6) HK$71.1 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$2.2 for net cash.

Figure 3: Tencent: SOTP valuation

	2026E net profit (RMBmn)	2026E revenue (RMBmn)	2026E PE (x)	2026E PS (x)	Market cap (RMBmn)	Valuation to Tencent (RMBmn)	As % of total valuation	Per share valuation (HK$)
Games	115,417		24x			2,770,010	47.0	345.7
Social network services (SNS)		125,127				245,233	4.2	30.6
Tencent Music (TME)					94,768	52,217	0.9	6.5
China Literature					18,316	10,839	0.2	1.4
Huya					3,924	1,860	0.0	0.2
Online video – subscription		20,700		3.5x		72,450	1.2	9.0
Others		30,819		3.5x		107,867	1.8	13.5
Marketing services	52,590		22x			1,156,989	19.6	144.4
Fintech		188,036		4.5x		846,162	14.4	105.6
Cloud (business services)		62,941		4.5x		283,237	4.8	35.4
Net cash						17,983	0.3	2.2
Valuation of core business						**5,319,613**		
RMB/HK$						0.88		
Valuation of core business (HK$mn)						**6,045,015**		
Valuation per share – core business (HK$)						**664.0**		
Valuation per share – investments (HK$)						71.1	9.7	
Valuation per share – Tencent (HK$)						**735.0**		

Source: Company data, CMBIGM estimates

Figure 4: Peer comparison: online games and advertising sector

		Price	EPS growth (YoY %)		PE (x)	
Companies	**Ticker**	**(LC)**	**FY26E**	**FY27E**	**FY26E**	**FY27E**
Online games						
NetEase	NTES US	133.9	8	10	14	13
Electronic Arts	EA US	206.6	31	3	24	23
Nexon	3659 JP	2,284.0	(1)	3	17	16
Bandai Namco	7832 JP	4,024.0	0	8	20	18
Perfect World	002624 CH	11.4	124	22	13	11
37 Interactive	002555 CH	19.2	2	10	13	12
Average PE					**17**	**16**
Marketing services						
Focus Media	002027 CH	4.8	36	4	12	11
Meta	Meta US	631.5	26	13	16	14
Google	GOOG US	356.2	31	8	25	23
Average PE					**17**	**15**

Source: Bloomberg, CMBIGM
Note: data as of market close on 10 Jul

Figure 5: Peer comparison: online video, fintech, and cloud sectors

		Price	Revenue growth (YoY %)		PS (x)	
Companies	**Ticker**	**(LC)**	**FY26E**	**FY27E**	**FY26E**	**FY27E**
Online video						
iQiyi	IQ US	1.1	(3.4)	2.6	0.3	0.3
Mango Excellent Media	300413 CH	15.4	12.9	5.7	2.0	1.9
Average PS					**1.1**	**1.1**
Cloud						
Microsoft	MSFT US	384.4	16.8	18.1	7.4	6.3
Google	GOOG US	356.2	24.0	20.9	10.3	8.5
Salesforce	CRM US	162.5	0.0	11.1	3.2	2.9
Kingsoft Cloud	KC US	10.5	35.3	24.2	1.7	1.4
Amazon	AMZN US	247.0	15.4	13.2	3.2	2.8
Average PS					**5.2**	**4.4**
Fintech						

		Price	Revenue growth (YoY %)		PS (x)	
PayPal	PYPL US	45.3	3.1	4.1	1.2	1.1
Block	SQ US	77.4	7.9	10.2	1.8	1.6
Average PS					**1.5**	**1.4**

Source: Bloomberg, CMBIGM estimates
Note: data as of market close on 10 Jul

Financial Summary

INCOME STATEMENT	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Revenue	**609,015**	**660,257**	**751,766**	**817,806**	**878,578**	**926,280**
Cost of goods sold	(315,906)	(311,011)	(329,173)	(350,299)	(371,987)	(389,530)
Gross profit	**293,109**	**349,246**	**422,593**	**467,507**	**506,591**	**536,750**
Operating expenses	**(133,035)**	**(141,147)**	**(181,031)**	**(205,652)**	**(228,897)**	**(244,135)**
Selling expense	(34,211)	(36,388)	(41,727)	(51,522)	(54,472)	(55,577)
Admin expense	(103,525)	(112,761)	(136,127)	(155,383)	(175,716)	(189,887)
Others	4,701	8,002	(3,177)	1,253	1,291	1,329
Operating profit	**160,074**	**208,099**	**241,562**	**261,855**	**277,694**	**292,615**
Gain/loss on financial assets at FVTPL	(6,090)	4,187	10,168	7,712	6,170	4,936
Share of (losses)/profits of associates/JV	5,800	25,176	23,740	18,992	21,841	25,117
Interest income	13,808	16,004	16,909	17,317	13,721	15,458
Interest expense	(12,268)	(11,981)	(15,130)	(13,034)	(11,946)	(10,734)
Pre-tax profit	**161,324**	**241,485**	**277,249**	**292,842**	**307,480**	**327,392**
Income tax	(43,276)	(45,018)	(47,448)	(52,712)	(55,346)	(58,930)
After tax profit	**118,048**	**196,467**	**229,801**	**240,130**	**252,133**	**268,461**
Minority interest	(2,832)	(2,394)	(4,959)	(4,803)	(5,043)	(5,369)
Net profit	**115,216**	**194,073**	**224,842**	**235,328**	**247,091**	**263,092**
Adjusted net profit	**157,688**	**222,703**	**259,626**	**272,643**	**287,512**	**306,655**
Gross dividends	28,485	27,965	42,645	48,713	51,148	54,460

BALANCE SHEET	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Current assets	**518,446**	**496,180**	**595,460**	**561,139**	**745,287**	**891,484**
Cash & equivalents	172,320	132,519	141,041	79,930	224,843	326,002
Account receivables	46,606	48,203	49,930	51,776	53,954	55,177
Inventories	456	440	530	1,290	1,359	1,404
Prepayment	88,411	101,044	111,270	112,766	120,698	118,058
ST bank deposits	185,983	192,977	236,801	248,641	260,824	273,349
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	19,790	34,315	65,737
Non-current assets	**1,058,800**	**1,284,815**	**1,443,526**	**1,622,028**	**1,733,297**	**1,816,962**
PP&E	53,232	80,185	149,905	252,139	308,284	326,952
Deferred income tax	29,017	28,325	28,618	38,489	33,605	42,403
Investment in JVs & assos	261,665	297,415	348,712	363,834	379,369	395,307
Intangibles	177,727	196,127	205,999	246,458	283,140	315,339
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	513,951	521,743	529,802
Total assets	**1,577,246**	**1,780,995**	**2,038,986**	**2,183,167**	**2,478,583**	**2,708,446**
Current liabilities	**352,157**	**396,909**	**412,751**	**379,607**	**444,727**	**421,996**
Short-term borrowings	55,698	61,508	53,160	60,838	64,291	67,001
Account payables	100,948	118,712	121,127	86,778	133,999	97,190
Tax payable	17,664	16,586	18,558	18,435	19,185	19,688
Other current liabilities	171,693	194,503	214,520	208,170	221,866	232,731
Lease liabilities	6,154	5,600	5,386	5,386	5,386	5,386
Non-current liabilities	**351,408**	**330,190**	**385,170**	**408,187**	**416,001**	**422,496**
Long-term borrowings	155,819	146,521	208,369	214,620	216,552	217,136
Bond payables	137,101	130,586	126,204	126,796	127,093	127,242
Deferred income	3,435	6,236	2,210	14,012	14,879	15,581
Other non-current liabilities	55,053	46,847	48,387	52,759	57,477	62,537
Total liabilities	**703,565**	**727,099**	**797,921**	**787,794**	**860,728**	**844,492**
Retained earnings	813,911	892,030	1,010,436	1,204,581	1,422,021	1,662,750
Other reserves	(5,320)	81,518	143,716	99,076	99,076	99,076
Total shareholders equity	**808,591**	**973,548**	**1,154,152**	**1,303,657**	**1,521,097**	**1,761,826**
Minority interest	65,090	80,348	86,913	91,716	96,758	102,127
Total equity and liabilities	**1,577,246**	**1,780,995**	**2,038,986**	**2,183,167**	**2,478,583**	**2,708,446**

CASH FLOW	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	**161,324**	**241,485**	**277,249**	**292,842**	**307,480**	**327,392**
Depreciation & amortization	59,008	56,213	63,281	86,171	124,933	149,113
Tax paid	(43,276)	(45,018)	(47,448)	(52,712)	(55,346)	(58,930)
Change in working capital	19,233	21,881	12,733	(44,801)	50,738	(24,572)
Others	25,673	(16,040)	(2,763)	0	0	0
Net cash from operations	**221,962**	**258,521**	**303,052**	**281,500**	**427,805**	**393,002**
Investing						
Capital expenditure	(23,893)	(76,760)	(79,198)	(147,205)	(131,787)	(111,154)
Acquisition of subsidiaries/ investments	(105,332)	(183,983)	(157,834)	(58,497)	(47,499)	(79,208)
Net proceeds from disposal of short-term investments	0	0	0	0	0	0
Others	4,064	138,556	31,300	(81,659)	(85,973)	(88,828)
Net cash from investing	**(125,161)**	**(122,187)**	**(205,732)**	**(287,361)**	**(265,258)**	**(279,189)**
Financing						
Net borrowings	19,445	(107)	50,903	18,770	11,150	9,007
Proceeds from share issues	1,070	1,932	0	0	0	0
Others	(103,088)	(178,319)	(138,058)	(74,020)	(28,783)	(21,661)
Net cash from financing	**(82,573)**	**(176,494)**	**(87,155)**	**(55,250)**	**(17,634)**	**(12,654)**
Net change in cash						
Cash at the beginning of the year	156,739	172,320	132,519	141,041	79,930	224,843
Exchange difference	1,353	359	(1,643)	0	0	0
Cash at the end of the year	**172,320**	**132,519**	**141,041**	**79,930**	**224,843**	**326,002**
GROWTH	**2023A**	**2024A**	**2025A**	**2026E**	**2027E**	**2028E**
YE 31 Dec						
Revenue	9.8%	8.4%	13.9%	8.8%	7.4%	5.4%
Gross profit	22.8%	19.2%	21.0%	10.6%	8.4%	6.0%
Operating profit	44.4%	30.0%	16.1%	8.4%	6.0%	5.4%
Net profit	(38.8%)	68.4%	15.9%	4.7%	5.0%	6.5%
Adj. net profit	36.4%	41.2%	16.6%	5.0%	5.5%	6.7%
PROFITABILITY	**2023A**	**2024A**	**2025A**	**2026E**	**2027E**	**2028E**
YE 31 Dec						
Gross profit margin	48.1%	52.9%	56.2%	57.2%	57.7%	57.9%
Operating margin	26.3%	31.5%	32.1%	32.0%	31.6%	31.6%
Adj. net profit margin	25.9%	33.7%	34.5%	33.3%	32.7%	33.1%
Return on equity (ROE)	15.1%	21.8%	21.1%	19.1%	17.5%	16.0%
GEARING/LIQUIDITY/ACTIVITIES	**2023A**	**2024A**	**2025A**	**2026E**	**2027E**	**2028E**
YE 31 Dec						
Net debt to equity (x)	0.2	0.2	0.2	0.2	0.1	0.0
Current ratio (x)	1.5	1.3	1.4	1.5	1.7	2.1
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	32.8	19.1	16.1	15.2	14.3	13.5
P/E (diluted)	33.3	19.4	16.4	15.4	14.5	13.7
P/B	4.7	3.8	3.1	2.7	2.3	2.0

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

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BUY	: Stock with potential return of over 15% over next 12 months
HOLD	: Stock with potential return of +15% to -10% over next 12 months
SELL	: Stock with potential loss of over 10% over next 12 months
NOT RATED	: Stock is not rated by CMBIGM
OUTPERFORM	: Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM	: Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM	: Industry expected to underperform the relevant broad market benchmark over next 12 months

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