

# Tencent (00700.HK)

Core business makes steady progress, and the ecosystem continues to be stable  
China | Gaming | Internet

16 Dec 2024

## Company profile

Tencent was founded in November 1998 and is currently one of China's largest comprehensive internet service providers. It is also one of the most widely used internet companies by Chinese service users. Tencent's communication and social services connect over 1 billion people worldwide, helping them stay in touch with family and friends and enjoy convenient travel, payment, and entertainment. Tencent has released a variety of globally popular electronic games and other high-quality digital content, providing rich interactive entertainment experiences for global users. Tencent also offers a range of enterprise services including cloud computing, advertising, and financial technology, supporting partners in achieving digital transformation and promoting business development.

## Core business is making steady progress, and the ecosystem continues to be stable

In the third quarter of 2024, the company achieved a total revenue of 167 billion yuan. Compared to the same period last year, this represents an 8.1% increase. In terms of profitability, the unadjusted operating profit was 61 billion yuan, showing a growth of 18.6% year-on-year. The operating profit margin increased from 33.0% in the same period last year to 37.0%. The unadjusted profit for the period was 54 billion yuan, marking a 46.8% year-on-year growth.

Regarding departmental revenues, in Q3 2024, the gaming business revenue experienced strong growth, increasing by 12.6% year-on-year to 52 billion yuan. This growth was mainly driven by the steady performance of evergreen games globally and the contribution of new games with evergreen potential. Marketing services revenue grew by 16.7% year-on-year to 30 billion yuan, primarily due to strong demand from video accounts, mini-programs, and WeChat search. Fintech and business services business revenue increased by 2.1% year-on-year to 53 billion yuan, with a slight decrease in payment service revenue due to weak consumer spending.

## Value-added services business: Evergreen games performed strongly, and social networks experienced healthy growth

**Gaming business:** In the third quarter of 2024, the company's gaming revenue increased by 12.6% year-on-year to 52 billion yuan. Among these, international market gaming revenue reached 15 billion yuan, up by 9.0% year-on-year, primarily driven by strong performances from games including "PUBG MOBILE" and "Wild Rift." "VALORANT" expanded from PC to PlayStation and Xbox, launching console versions in five key international markets, driving a revenue increase of over 30% year-on-year for the game. Domestic market gaming revenue grew by 14.1% year-on-year to 37 billion yuan, benefiting from healthy growth of flagship evergreen games like "Honor of Kings" and "Peacekeeper Elite," as well as game drivers including evergreen games like "Naruto" and "Fearless Agreement." Notably, with the introduction of new content and characters, "Naruto" surpassed 10 million monthly DAUs. We predict that the gaming revenue growth rate in the fourth quarter could reach 17.3%, mainly due to the strong user daily average usage time and retention rate performance of "Delta Operations," launched in September, and the income deferral cycle extension of some international market games will be reflected in the revenue of the coming quarters. Additionally, the company will launch Chinese New Year activities to further enhance user experience and game revenue.

## Buy

CMP HKD 410  
(Closing price as of 11 Dec)  
Target HKD 540 (+31.7%)

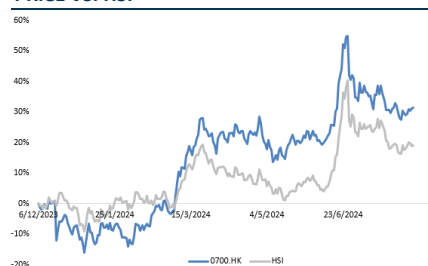
### COMPANY DATA

O/S SHARES (MN) :	9,267.0
MARKET CAP (HKD BN) :	38.0
52 - WK HI/LO (HKD):	482.4/260.2

### SHARE HOLDING PATTERN, %

MIH Internet Holdings B.V.	24.43%
Advance Data Services Limited	7.59%
Ma Huateng Global Foundation	1.02%

### PRICE VS. HSI



Source: Phillip Securities (HK) Research

### KEY FINANCIALS

CNY mn	FY22	FY23	FY24E	FY25E
Revenue	547,358	603,620	654,669	707,362
Net profit	188,709	118,048	208,017	236,489
EPS	19.76	12.19	21.69	24.66
P/E ratio, x	15.2	21.9	22.9	20.1
Dividend Yield, %	0.25%	0.31%	0.59%	0.85%

Source: Company reports, Phillip Securities Est.

### Research Analyst

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**Social network business:** In the third quarter of 2024, the company's social network business revenue increased by 4.0% year-on-year to 31 billion yuan, mainly driven by the growth in virtual goods sales for mobile games, music subscription member revenue, and small game platform service fees, partially offset by declines in revenue from music live streaming and game live streaming services. Music subscription revenue increased by 20.0% year-on-year, primarily due to a 16.0% year-on-year growth in subscription numbers, reaching 119 million. During this period, the company improved its recommendation algorithms, expanded content supply, and upgraded audio quality.

Long video subscription revenue increased by 4% year-on-year. Benefiting from popular animations and TV dramas, video subscription numbers grew by 6.0% year-on-year, reaching 116 million. The QQ team comprehensively upgraded the platform's backend infrastructure and added and promoted new features such as Tencent Channel, AI Sketch, and Album Memories, driving a year-on-year increase in monthly active accounts for QQ's mobile terminals in the third quarter of 2024.

#### **Marketing services business: Enhanced features bring different monetization opportunities and revenue growth**

In the third quarter of 2024, the company's marketing services revenue increased by 16.7% year-on-year to 30 billion yuan, mainly driven by strong demand from advertisers for video accounts, mini-programs, and WeChat search inventory, as well as a modest one-time contribution from brand advertisements related to the Paris Olympics. Advertising spending in the gaming and e-commerce industries increased year-on-year, surpassing the reductions in spending in the real estate and food and beverage industries. By business type: 1) Video account advertising revenue in the third quarter increased by 60% year-on-year, mainly due to the systematic enhancement of WeChat's transactional capabilities, although the ad loading rate remained at 3-4%. 2) Mini-program marketing service revenue showed strong year-on-year growth, with mini-program GMV exceeding 2 trillion yuan in the third quarter, a growth of over 10% year-on-year. Game mini-programs and short video mini-programs provided high-value incentivized video ad inventory, generating incremental closed-loop demand. 3) WeChat search revenue more than doubled year-on-year, benefiting from increased commercial queries and improved click-through rates. The company leveraged LLM capabilities to enhance understanding of complex queries and content, improving the relevance of search results.

#### **Fintech and Business services business: Macro environment remains a major influencing factor**

In the third quarter of 2024, the company's fintech and business services revenue reached 53 billion yuan, a year-on-year increase of 2.1%. Management stated that the number of commercial payment transactions continued to grow at a healthy pace, increasing by approximately 10% year-on-year, although the average amount per transaction decreased. The decline in payment revenue was offset by the growth in wealth management service revenue. The number of users for wealth management and aggregated customer assets both increased year-on-year. Business services revenue in the third quarter grew year-on-year, benefiting from the growth in cloud service revenue and increased technology service fees due to the rise in e-commerce transaction volume. Due to increased contribution from higher-profit revenue streams and improved efficiency, gross profit margin for business services significantly increased within a year. Management indicated that the economic stimulus policies announced in October will take some time to impact the Chinese market, and they expect financial technology business revenue to remain stable in the fourth quarter.

## Company valuation

In terms of e-commerce business, management stated that since the end of September, Taobao has fully integrated with WeChat Pay, leading to an overall increase in e-commerce transaction volume and growth in payment revenue. Additionally, considering Tencent's strong user base in social networking services, the e-commerce business is expected to become a new growth node.

Regarding marketing services business, management mentioned that the ad loading for video accounts is still far below single-digit levels compared to peers. With the advancement of advertising technology and increased ad loading in the future, the company's advertising business is expected to continue outpacing industry growth.

Overall, we are optimistic about the company's medium to long-term growth prospects. We expect the company's operating revenue for the years 2024 to 2026 to be 655/707/768 billion yuan respectively, and the unadjusted profits for the same periods to be 208/237/263 billion yuan, corresponding to EPS of 21.7/24.7/27.5 yuan, and PE ratios of 22.9/20.1/18.1x. Based on the SOTP valuation method using the latest market values or valuations of subsidiaries and investee companies with a 10.0% discount, we assign a 2025 Tencent total target market value of 4.6 trillion yuan, corresponding to a target price of 496 yuan/540 HKD, and rate it as a "Buy".

	% owned	PE/PS	2025E x	Valuation to Tencent, RMB mn
<b>Core business</b>				4,115,638
Game	100%	PE	18x	1,671,619
Social Network	100%	PE	15x	401,207
Marketing services	100%	PE	18x	871,837
FBS	100%	PS	5x	1,170,976
<b>Investments</b>				950,000
<b>Net cash</b>				96,221
<b>Less: holdco discount</b>			10%	4,645,673

## Risk factors

1) Strict gaming regulations; 2) Weak macroeconomic environment; 3) Potential competitive threats from existing and emerging social platforms.

## Financials

### Key Financial Data

Dec Y/E	FY21	FY22	FY23	FY24E	FY25E
<b>Valuation Ratio</b>					
P/E ratio	16.0	15.2	21.9	22.9	20.1
Dividend Yield, %	0.23%	0.25%	0.31%	0.59%	0.85%
<b>Per share data(RMB)</b>					
EPS	23.60	19.76	12.19	21.69	24.66
BVPS	83.92	75.39	85.27	76.79	78.88
<b>Growth &amp; Margin</b>					
<b>Growth</b>					
Net Revenue Growth	16.19%	-0.99%	9.82%	7.50%	8.05%
Gross Profit Growth	11.02%	-2.93%	22.77%	15.05%	13.14%
EBIT Growth	47.43%	-59.20%	44.44%	48.69%	12.81%
Net Profit Growth	42.27%	-17.16%	-37.44%	76.21%	13.69%
<b>Margin</b>					
Gross Profit Margin	43.91%	43.05%	48.13%	51.51%	53.94%
EBIT Margin	48.49%	19.98%	26.28%	36.36%	37.96%
Net Profit Margin	40.67%	34.03%	19.38%	31.77%	33.43%
<b>Key Ratios</b>					
ROE	25.99%	24.11%	13.51%	21.69%	24.66%
ROA	14.13%	11.96%	7.48%	12.40%	13.93%

### Consolidated Statement of Profit or Loss

Dec Y/E, RMB mn	2021	2022	2023	2024E	2025E
<b>REVENUE</b>	552433	547358	603620	654669	707362
Cost of services	-260532	-314174	-315806	-315906	-317435
Gross profit	291901	233184	287814	338763	389927
Sales and marketing expenses	-40594	-29229	-34211	-39576	-41341
General and administrative expenses	-67625	-89847	-106696	-103525	-110813
Other gains/losses	149467	8006	4701	42350	30728
Operating profit	271620	110827	160074	238012	268501
Finance income	6650	124879	7718	16570	19884
Finance costs	-7114	-9352	-12268	-12268	-12268
Profit before income tax and share of results of equity investees	248062	210225	161324	263313	295611
Income tax expenses	-20252	-21516	-43276	-55296	-59122
<b>Profit for the year</b>	227810	188709	118048	208017	236489
<b>Net profit, IFRS</b>					
- Equity holders of the Company	224822	188243	115216	203027	230815
- Non-controlling interests	2988	466	2832	4990	5673

### Consolidated Statement of Financial Position

Dec Y/E, RMB mn	FY21	FY22	FY23	FY24E	FY25E
<b>Current assets</b>					
Accounts receivable	44981	49331	45467	46606	51842
Cash and cash equivalents	167966	156739	172320	199696	255038
Others	271865	359919	300659	312369	321178
<b>Total current assets</b>	484812	565989	518446	558672	628057
<b>Non-current assets</b>					
PPE	61914	53978	53232	69161	79324
Others	1065638	958164	1005568	1049500	1097753
<b>Total non-current assets</b>	1127552	1012142	1058800	1118661	1177078
<b>Total Assets</b>	1612364	1578131	1577246	1677758	1697329
<b>Current liabilities</b>					
Accounts payable	109470	92381	100948	111043	122147
Others	159609	310717	333256	241114	245176
<b>Total current liabilities</b>	269079	403098	434204	352157	367323
<b>Non-current liabilities</b>					
Long-term debt	292492	321404	305089	305089	305089
Others	40081	39663	46319	46319	46319
<b>Total non-current liabilities</b>	332573	361067	351408	351408	351408
<b>Total liabilities</b>	735671	795271	703565	718731	738302
Equity attributable to equity holders of the Company	806299	721391	808591	893937	893937
Non-controlling interests	70394	61469	65090	65090	65090
<b>Total equity</b>	876693	782860	873681	959027	959027
<b>Total liabilities and equity</b>	1612364	1578131	1577246	1677758	1697329

**Consolidated Statement of Cash Flow**

Dec Y/E, RMB mn	2021	2022	2023	2024E	2025E
<b>CFO</b>	175186	146091	221962	277242	316422
Net profit	227810	188709	118048	208017	236489
Depreciation and Amortization	57670	61216	59008	59254	68118
Change in working capital	891	-18472	19233	2317	5526
Others	-111185	-85362	25673	7653	6289
<b>CFI</b>	-178549	-104871	-125161	-112630	-112462
Short term and long term investment,net	-149247	-82192	-104153	-73258	-73091
Purchase of property, equipment and intangible assets	-29302	-22679	-21008	-39372	-39371
<b>CFF</b>	21620	-59953	-82573	-137236	-148617
Cash paid for distribution of dividends	-11418	-13906	-15117	-21788	-27236
Cash received from financing	33038	-46047	-67456	-115448	-121382
<b>Effect of exchange rate changes on cash</b>	-3089	7506	1353	0	0
<b>Net Change in Cash</b>	18257	-18733	14228	27376	55342
Cash, CE and Restricted cash at Beg	152798	167966	156739	172320	199696
<b>Cash, CE and Restricted cash at Y/E</b>	167966	156739	172320	199696	255038

Current Price as of: Dec 11

Exchange rate: HKD/RMB = 0.92

Source: PSHK Est.

### PHILLIP RESEARCH STOCK SELECTION SYSTEMS

Total Return	Recommendation	Rating	Remarks
>+20%	Buy	1	>20% upside from the current price
+5% to +20%	Accumulate	2	+5% to +20% upside from the current price
-5% to +5%	Neutral	3	Trade within $\pm$ 5% from the current price
-5% to -20%	Reduce	4	-5% to -20% downside from the current price
<-20%	Sell	5	>20% downside from the current price

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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