

Tencent Holdings (700 HK)

3Q26 Preview: Clear AI Strategy; Investment Pressure On Margins

Highlights

- Tencent will report its 3Q26 results in mid-November. We expect Tencent's revenue growth to remain solid at 9% yoy in 3Q26 despite macro headwinds, supported by stable gaming and resilient advertising driven by higher ad loads and improved eCPM. Operating profit is likely to remain flattish due to increased AI-related investment. We maintain overweight on Tencent, supported by resilient core franchises, attractive valuation and potential upside from Weixin AI agents.
- Maintain BUY with a lower target price of HK\$537.00.

Analysis

- Moderating 3Q26 game revenue growth due to high base effect.** We forecast 3Q26 games revenue growing moderately to 6.7% yoy to Rmb67.8b due to the high base effect from international games in 3Q25, but supported by resilient evergreen titles and a solid new-game pipeline. For instance, Battle of Golden Shovel's Mainland China iOS revenue rose 45% mom in September, driven by anniversary events, with the title ranking second on the iOS grossing chart on 30 September. Social network revenue could expand 5% to Rmb33.8b amid softer digital content demand. We expect Tencent's 3Q26 revenue to rise 9% yoy to Rmb210.8b, while adjusted operating profit should be flattish yoy at Rmb73.1b.
- Online marketing services to remain resilient.** Advertising should remain a key growth driver; we project that 3Q26 marketing services revenue will increase 18% yoy to Rmb42.7b, moderating from 22% in 2Q26. Overall momentum remains resilient, underpinned by continued enhancements in AI-driven ad targeting precision, which is expected to support both monetisation efficiency and margin expansion.
- Tencent Cloud likely to continue its solid momentum.** Fintech and business services revenue is expected to grow 9% yoy to Rmb63.4b, as improving cloud demand partly offsets softer consumption-related fintech activity. We forecast cloud revenue expanding 23% yoy to Rmb15.7b, to reflect incremental AI cloud and enterprise application monetisation.
- Clearer AI strategy, although rising AI investment could weigh on near-term earnings.** We expect Tencent Holdings (Tencent) to prioritise monetisation through enterprise AI tools and cloud services, supported by faster iteration of its in-house models, before scaling AI agents within Weixin. While we remain positive on Tencent's AI ecosystem and distribution advantages, higher depreciation and inference costs are likely to precede meaningful revenue contribution. We foresee 3Q26/2026 adjusted net profit dropping 5% yoy and 2% yoy.

Key Financials

Year to 31 Dec (Rmbm)	2024	2025	2026F	2027F	2028F
Net turnover	660,257	751,766	825,230	906,890	987,199
EBITDA	221,456	258,027	276,548	289,708	322,622
Operating profit	208,099	241,562	260,098	272,658	304,972
Net profit (rep./act.)	194,073	224,842	215,118	230,998	253,215
Net profit (adj.)	222,703	259,626	254,283	274,530	299,959
EPS	2,350.7	2,790.9	2,791.7	3,007.9	3,280.0
PE	14.0	11.8	11.8	11.0	10.0
P/B	3.1	2.6	2.6	2.1	1.9
EV/EBITDA	13.3	11.4	10.7	10.2	9.2
Dividend yield	1.3	1.6	1.6	1.7	1.8
Net margin	29.4	29.9	26.1	25.5	25.6
Net debt/(cash) to equity	(13.3)	(11.6)	(11.4)	9.7	12.8
ROE	21.8	21.1	18.8	18.3	17.0
Consensus net profit	-	-	265,075.0	274,327.9	298,858.7
UOBKH/Consensus (x)	-	-	0.96	1.00	1.00

Source: Tencent, Bloomberg, UOB Kay Hian

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BUY (Maintained)

Share Price	HK\$387.60
Target Price	HK\$537.00
Upside	38.5%
Previous TP	HK\$608.00

Stock Data

Sector	Communication Services
Bloomberg ticker	700 HK
Shares issued (m)	9,092.6
Market cap (US\$m)	3,524,309.2
Market cap (US\$m)	449,265.6
3-mth avg daily t'over (US\$m)	1,235.5

Price Performance (%)

52-week high/low			HK\$664.00/HK\$378.00	
1mth	3mth	6mth	1yr	YTD
(11.2)	(13.3)	(19.0)	(40.9)	(35.3)

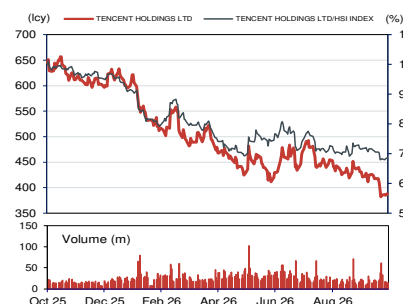
Major Shareholders (%)

Naspers	22.60
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Balance Sheet Metrics

FY26 NAV/Share (Rmb)	126.78
FY26 Net Cash/ Share (Rmb)	14.51

Price Chart



Source: Bloomberg

Company Description

The company is one of the largest comprehensive internet service providers.

- **Looking ahead, we expect Tencent's gaming business to remain resilient**, supported by evergreen titles, with Honor of Kings, Peacekeeper Elite and Delta Force ranking among China's top three iOS games by revenue in 3Q26. Upcoming launches include Monster Hunter Outlanders (overseas, 29 October) and The Hidden Ones (domestic, December; final test on 4 November), while Supercell's acquisition of Metacore expands its overseas casual-game portfolio. We forecast 3Q26 domestic/international game revenue at Rmb48.1b/Rmb19.8b respectively (+12%/-5% yoy) and 2026 revenue at Rmb184.0b/Rmb77.7b (+12%/+0.5% yoy), with a high base weighing on overseas growth.
- **Task economics matter more than benchmarks.** Tencent launched the Hy4 preview on 28 August, a 770B-parameter open-weight MoE model and its third major release in six months. While still under training, Hy4 demonstrates improving capabilities, although demand exceeded compute supply at launch. We believe cost per completed task, reliability and retention matter more than benchmark rankings. However, Hy4's free promotions could raise 3Q26 inference costs without matching revenue. Paid conversion and retention in 4Q26 will be key indicators of commercialisation progress.
- **WorkBuddy and cloud drive near-term monetisation.** WorkBuddy offers subscription tiers of Rmb99/Rmb199/Rmb999 per month, making it Tencent's clearest AI monetisation opportunity. However, free model access during 3Q26 likely inflated usage and inference costs, making 4Q26 paid conversion, retention and profitability key indicators. Tencent prioritises internal AI products for compute allocation, with spare capacity deployed through cloud to improve utilisation. We raise our 2027 fintech and business services revenue estimate by 2% on cloud AI services and paid productivity tools, while fintech remains soft.
- **Xiaowei offers optionality, but monetisation remains unproven.** Tencent is gradually rolling out Xiaowei, powered by its Weixin-developed WeLM model, initially connecting users with merchant services through Mini Programs. Potential monetisation includes intent-based advertising, merchant fees and payment volume, although incremental value remains uncertain given the possible cannibalisation of existing traffic. We exclude Xiaowei from forecasts pending evidence of retention, completed transactions, merchant ROI and inference economics. Initial commercial disclosures could become a key re-rating catalyst.

Valuation/Recommendation

- **Maintain BUY on Tencent with a lower target price of HK\$537.00**, based on our 2027F SOTP valuation. Our target price implies 16x 2027F PE, while Tencent currently trades at 13x 2026F PE and 12x 2027F PE, around 1SD below its historical mean of 24x.

Earnings Revision/Risk

- We cut our 3Q26 revenue forecast by 1% while keeping our 2026 revenue estimate unchanged. We cut our 2026/27 non-IFRS EPS estimates by 4%/3%, with 2027 EPS lowered from Rmb31.1 to Rmb30.1, to reflect higher AI-related costs.
- **Key risks:** slower AI monetisation, weaker advertising and consumption demand, regulatory risks and slowing growth from game revenue.

Share Price Catalyst

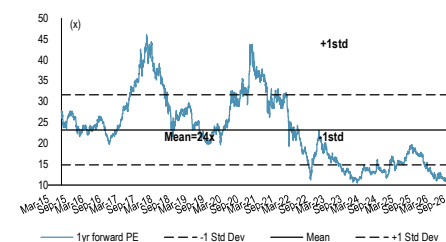
- a) Faster enterprise AI adoption and early Xiaowei monetisation could offer upside, b) game licence approval, and c) monetisation of new game launches.

Sotp-Based Valuation

(Rmb m)	2027F revenue	2027F non-GAAP earnings	Valuation 2027 (x)	Value (LC bn)	Tencent holding (%)	Est. fair value to Tencent (RMB bn)	Fair value to Tencent (US\$ b)	Fair value/ share (HK\$)
Online game (PC + Mobile game)	285,124	102,785	15x PE	1,542	100	1,542	228	184
Social networking (QQ + Weixin VAS)	135,724	48,927	13x PE	636	100	636	94	76
Online ads	198,658	58,421	18x PE	1,052	100	1,052	156	125
Payment	193,329	28,999	12x PE	348	100	348	52	41
Cloud	94,054		5x PS	470	100	470	70	56
Total EV	906,890	239,133	14x PE	3,229	100	3,229	302	482
Investees	% owned		Rmb/sh.			Valuation		
Total (15% discount)						523	79	64
2027F Net cash per share (HK\$)								-9
Target price (HK\$)								537

Source: UOB Kay Hian

12-Month Forward PE Band



Source: Bloomberg UOB Kay Hian

Key Milestones In HunYuan And Agentic AI Development

Date	Product launch / development
28 Jan 26	Open-sourced Hunyuan-Image 3.0-Instruct
30 Jan 26	CodeBuddy Code 2.0
9 Mar 26	WorkBuddy all-scenario AI agent
1 Apr 26	ADP Agent Portal for enterprise agents
2 Apr 26	ClawPro enterprise-grade OpenClaw
3 Apr 26	TencentDB Agent Memory for OpenClaw
8 Apr 26	QBotClaw on QQ Browser
9 Apr 26	QClaw V2
16 Apr 26	HY-World 2.0
23 Apr 26	Open-sourced Hy3 Preview
5 Jun 26	WorkBuddy Enterprise and ADP 4.0
6 Jul 26	Hy3 official release
28 Aug 26	Open-sourced Hy4 Preview
2 Sep 26	WorkBuddy Open Platform
22 Sep 26	Hy Image 3.5 Preview
24 Sep 26	Announced QClaw shutdown; focus on WorkBuddy
21 Oct 26	Open-sourced Hy-Nomas world-generation model

Source: Tencent, UOB Kay Hian

Profit & Loss

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Net turnover	751,766.0	825,229.9	906,890.0	987,199.2
EBITDA	258,027.0	276,548.0	289,708.3	322,622.4
Deprec. & amort.	16,465.0	16,450.0	17,050.0	17,650.0
EBIT	241,562.0	260,098.0	272,658.3	304,972.4
Total other non-operating income	27,077.0	17,267.0	18,993.7	20,893.1
Associate contributions	23,740.0	2,027.0	6,917.0	6,917.0
Net interest income/(expense)	(15,130.0)	(12,196.8)	(12,196.8)	(12,196.8)
Pre-tax profit	277,249.0	267,195.2	286,372.2	320,585.7
Tax	(47,448.0)	(48,823.1)	(52,119.7)	(64,117.1)
Minorities	(4,959.0)	(3,254.0)	(3,254.0)	(3,254.0)
Net profit	224,842.0	215,118.1	230,998.5	253,214.5
Net profit (adj.)	259,626.0	254,282.6	274,530.1	299,958.5

Cash Flow

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Operating	303,052.0	254,578.3	271,633.3	274,100.2
Profit to the year	277,249.0	267,195.2	286,372.2	320,585.7
Tax	(47,448.0)	(48,823.1)	(52,119.7)	(64,117.1)
Deprec. & amort.	16,465.0	16,450.0	17,050.0	17,650.0
Associates	(23,740.0)	(2,027.0)	(6,917.0)	(6,917.0)
Working capital changes	(17,182.0)	35,207.0	35,781.6	15,432.5
Non-cash items	0.0	0.0	0.0	0.0
Other operating cashflows	97,708.0	(13,423.8)	(8,533.8)	(8,533.8)
Investing	(83,762.0)	(193,149.4)	(315,289.3)	(305,077.8)
Capex (growth)	(79,198.0)	(181,550.6)	(199,515.8)	(177,695.8)
Investment	0.0	0.0	0.0	0.0
Others	(4,564.0)	(11,598.8)	(115,773.5)	(127,382.0)
Financing	(136,165.0)	(33,779.4)	(33,878.6)	(37,656.5)
Dividend payments	(43,580.2)	(50,748.2)	(49,760.0)	(53,722.2)
Proceeds from borrowings	15,130.0	12,196.8	12,196.8	12,196.8
Loan repayment	0.0	0.0	0.0	0.0
Others/interest paid	(107,714.8)	4,772.0	3,684.6	3,868.8
Net cash inflow (outflow)	83,125.0	27,649.6	(77,534.6)	(68,634.1)
Beginning cash & cash equivalent	132,519.0	214,001.0	241,650.6	164,116.0
Changes due to forex impact	(1,643.0)	0.0	0.0	0.0
Ending cash & cash equivalent	214,001.0	241,650.6	164,116.0	95,481.9

Balance Sheet

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Fixed assets	176,942.0	223,722.0	413,184.8	580,327.6
Other LT assets	1,266,584.0	1,272,248.0	1,381,024.7	1,501,309.8
Cash/ST investment	384,819.0	428,934.0	164,116.0	95,481.9
Other current assets	210,641.0	234,490.0	257,327.4	282,340.7
Total assets	2,038,986.0	2,159,394.0	2,215,652.9	2,459,460.1
ST debt	42,618.0	86,292.0	86,292.0	86,292.0
Other current liabilities	370,133.0	429,189.0	232,917.0	273,362.7
LT debt	208,369.0	212,650.0	212,650.0	212,650.0
Other LT liabilities	176,801.0	208,750.0	208,750.0	208,750.0
Shareholders' equity	1,154,152.0	1,135,853.0	1,388,383.9	1,591,745.1
Minority interest	86,913.0	86,660.0	86,660.0	86,660.0
Total liabilities & equity	2,038,986.0	2,159,394.0	2,215,652.9	2,459,459.9

Key Metrics

Year to 31 Dec (%)	2025	2026F	2027F	2028F
Profitability				
EBITDA margin	34.3	33.5	31.9	32.7
Pre-tax margin	36.9	32.4	31.6	32.5
Net margin	29.9	26.1	25.5	25.6
ROA	11.8	10.2	10.6	10.8
ROE	21.1	18.8	18.3	17.0
Growth				
Turnover	13.9	9.8	9.9	8.9
EBITDA	16.5	7.2	4.8	11.4
Pre-tax profit	14.8	(3.6)	7.2	11.9
Net profit	15.9	(4.3)	7.4	9.6
Net profit (adj.)	16.6	(2.1)	8.0	9.3
EPS	18.7	0.0	7.7	9.0
Leverage				
Debt to total capital	16.8	19.6	16.9	15.1
Debt to equity	21.7	26.3	21.5	18.8
Net debt/(cash) to equity	(11.6)	(11.4)	9.7	12.8

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