Tencent Music Entertainment Group (1698 HK)

2Q26: Resilient Earnings With Potential Ximalaya Synergies

Highlights

- TME delivered solid 2Q26 results that were slightly above our expectation. Revenue rose 5.8% yoy to Rmb8.9b, while music-related services revenue increased 11.0% yoy to Rmb7.6b. Membership revenue grew 8.1% yoy to Rmb4.79b, supported by continued SVIP expansion and the consolidation of Ximalaya. Non-GAAP net profit rose 4.4% yoy to Rmb2.7b, 7% ahead of our and consensus expectations, with net margin remaining solid at 31%.
- Maintain BUY with a higher target price of HK$53.00 (US$14.00).

2Q26 Results

Year to 31 Dec (Rmbm)	2Q25	1Q26	2Q26	QoQ	YoY	UOBKH	Var	Cons	Var
Revenue	8,442	7,895	8,933	13.1%	5.8%	8,812	1.4%	8,754	2.0%
Online music service	6,854	6,514	7,605	16.7%	11.0%	7,348	3.5%		
Social entertainment / others	1,588	1,381	1,328	-3.8%	-16.4%	1,464	-9.3%		
Cost of sales	4,693	4,349	4,984	14.6%	6.2%	4,999	-0.3%		
Gross profit	3,749	3,546	3,949	11.4%	5.3%	3,813	3.6%	3,872	2.0%
Gross margin	44%	45%	44%	(1 ppt)	(0 ppt)	43%	1 ppt		
Operating expenses	1,156	1,211	1,295	7%	12%	1,240	4%		
S&M	216	271	236	-13%	9%	244	-3%		
G&A	332	332	434	31%	31%	379	14%		
R&D	608	608	625	3%	3%	617	1%		
Non-GAAP OP	3,212	2,897	3,340	15.3%	4.0%	3,197	4%		
Non-GAAP OPM	38%	37%	37%	1 ppt	(1 ppt)	36%	1 ppt		
Non-GAAP NP	2,574	2,273	2,686	18.2%	4.4%	2,512	6.9%		
Non-GAAP NPM	31%	30%	31%	2 ppt	(0 ppt)	29%	2 ppt		
Non-GAAP diluted EPS (RMB)	1.66	1.46	1.70	16.7%	2.8%	1.61	5.9%	1.59	7.2%

Source: Minimax, UOB Kay Hian

Analysis

- **Resilient music-related services growth**. Tencent Music Entertainment Group's (TME) music related services revenue rose 11.0% yoy to Rmb7.6b in 2Q26 (vs 1Q26: 12.2%) to Rmb7.1b, supported by solid growth in advertising revenues. Subscription revenue grew 8.1% yoy (vs 1Q26: 6.7%) to Rmb4.79b. Revenues from marketing and consumption grew 16.2% yoy (vs 1Q26: 28.0%) to Rmb2.81b. Revenues from offline performances related services achieved robust yoy growth.
- **Social entertainment services and other revenue declined 16% yoy** (vs 1Q26: -11%) to Rmb1.33b, due to the adjustments to certain live-streaming interactive functions.

Key Financials

Year to 31 Dec (Rmbm)	2024	2025	2026F	2027F	2028F
Net turnover	28,401	32,902	35,948	38,939	42,311
EBITDA	6,489	8,411	9,352	10,242	11,415
Operating profit	7,349	9,678	10,710	11,740	13,062
Net profit (rep./act.)	7,109	11,353	9,955	10,788	12,090
Net profit (adj.)	6,082	12,782	8,977	9,683	10,916
EPS	192.3	408.7	288.3	309.2	348.6
PE	17.2	8.1	11.5	10.7	9.5
P/B	1.5	1.3	1.3	1.6	1.4
EV/EBITDA	13.8	10.6	9.5	8.7	7.8
Dividend yield	0.0	0.0	0.0	0.0	0.0
Net margin	25.0	34.5	27.7	27.7	28.6
Net debt/(cash) to equity	(19.4)	(10.5)	(30.3)	(37.8)	(45.1)
ROE	11.5	15.3	12.6	15.0	17.1
Consensus net profit	-	-	10,046.7	11,056.0	12,177.7
UOBKH/Consensus (x)	-	-	0.89	0.88	0.90

Source: TME, Bloomberg, UOB Kay Hian

Analyst(s)

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BUY (Maintained)

Share Price	HK$38.56
Target Price	HK$53.00
Upside	37.4%
Previous TP	HK$50.00

Stock Data

Sector	Communication Services
Bloomberg ticker	1698 HK
Shares issued (m)	1,658.1
Market cap (US$m)	128,138.7
Market cap (US$m)	16,331.3
3-mth avg daily t'over (US$m)	8.9

Price Performance (%)

52-week high/low HK$104/HK$31.16

1mth	3mth	6mth	1yr	YTD
10.0	5.0	(38.7)	(55.0)	(44.1)

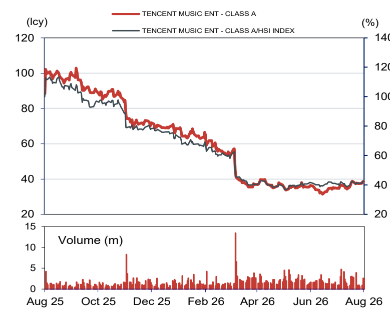
Major Shareholders (%)

Spotify Technology S.A	16.0

Balance Sheet Metrics

FY26 NAV/Share (Rmb)	25.25
FY26 Net Debt/Share (Rmb)	7.65

Price Chart



Source: Bloomberg

Company Description

TME is the world's largest online music platform by monthly average users, with the biggest market share of about 70%. It operates leading music apps including QQ Music, Kugou Music, Kuwo Music and WeSing.

- **Margin improvement.** Gross profit grew 5.3% yoy to Rmb3.9b, with gross margin shrinking 0.2ppt yoy to 44.2% in 2Q26, with the consolidation of Ximalaya having a positive impact on its gross margin this quarter; this was however offset by the decrease in social entertainment revenue. Non-GAAP operating profit rose 4% yoy to Rmb3.3b, with operating margin remaining flattish at 37%.
- **Ximalaya adds scale and broadens TME's audio ecosystem.** Ximalaya contributed Rmb407m of revenue following its consolidation from 18 May 26. Management highlighted its extensive audio content library and expects backend integration to support operational efficiency over time, while also strengthening TME's SVIP offering.
- **AI emerging as an incremental engagement and monetisation driver**. TME is increasingly integrating AI agents across its music ecosystem to enhance personalised discovery, playlist generation and user interaction. Management noted that early adoption has improved retention, particularly among high-value users, while also supporting recommendation engagement and operating efficiency. Generative-AI music features have already delivered positive commercial returns, and management sees further opportunities for AI to support subscription growth and become an incremental revenue contributor over time.
- **Margin outlook remains resilient despite higher Ximalaya investment.** Management expects 2H26 gross margin to increase slightly yoy, supported by a favourable contribution from Ximalaya. From July, TME resumed ROI-disciplined marketing investment in Ximalaya, which should drive a slight increase in 2026 S&M and operating expenses. As a result, 2026 net margin is expected to decline slightly, while adjusted EBITDA should still edge up slightly, supported by continued gross profit growth and cost discipline.
- **Strong cash position supports continued shareholder returns.** TME ended 2Q26 with Rmb44.2b in cash, cash equivalents, term deposits and short-term investments, providing ample liquidity to sustain shareholder returns. Under its existing US$1b share repurchase programme, the company completed US$400m of share buybacks in 2Q26 alone and remains committed to completing the remaining programme. Management also indicated that it is preparing for another round of share repurchases, highlighting continued confidence in the company's outlook and potential for further capital returns.

Valuation/Recommendation

- **Maintain BUY on TME with a higher target price of HK$53.00 (US$14.00),** based on lower 15x 2026F PE and 13x 2027F PE from the previous 20x, reflecting concerns over intensifying competition, potential margin pressure and uncertainties around AI-related industry disruption. Our 15x 2027F PE target multiple also remains below the historical average. We see potential for a re-rating if music-related services growth remains resilient, Ximalaya synergies become more visible and competitive concerns ease. The company currently trades at **8.9x 2026F PE, more than 1SD below its historical mean of 14x**, suggesting potential re-rating upside.

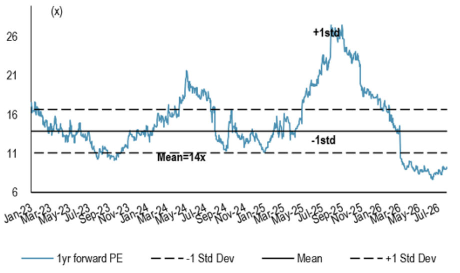
Earnings Revision/Risk

- Our 2026 revenue estimate is largely unchanged, representing a 9.3% yoy revenue growth. We raise 2026 net profit forecast by 6%, implying a 10% yoy growth and a net margin of 34% in 2026.
- **Key risks:** a) Interruption from rising AI content; b) slower net add growth, whereby the retention rate falls with every increase in ARPPU; and c) increasing competition from Soda Music.

Share Price Catalyst

- a) Better-than-expected music services revenue driven by ARPPU hikes; b) upward earnings revisions driven by operating leverage from higher-margin segments including music subscription and advertisement, and c) greater synergy from Ximalaya.

12-Month Forward PE Band



Source: Bloomberg; UOB Kay Hian

Profit & Loss

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Net turnover	32,902.0	35,948.2	38,938.9	42,311.2
EBITDA	8,411.0	9,352.0	10,241.9	11,415.3
Deprec. & amort.	(1,267.0)	(1,358.3)	(1,498.5)	(1,646.8)
EBIT	9,678.0	10,710.3	11,740.4	13,062.1
Total other non-operating income	2,674.0	626.0	626.0	626.0
Associate contributions	0.0	0.0	0.0	0.0
Net interest income/(expense)	925.0	954.1	952.4	1,056.3
Pre-tax profit	13,277.0	12,290.4	13,318.8	14,744.4
Tax	(1,924.0)	(2,335.2)	(2,530.6)	(2,654.0)
Minorities	0.0	0.0	0.0	0.0
Net profit	11,353.0	9,955.2	10,788.2	12,090.4
Net profit (adj.)	12,782.0	8,977.2	9,683.4	10,915.9

Balance Sheet

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Fixed assets	1,201.0	1,540.0	481.8	524.3
Other LT assets	68,863.0	75,718.0	61,670.1	62,874.5
Cash/ST investment	8,470.0	23,698.0	24,810.2	34,119.0
Other current assets	23,988.0	15,991.0	16,339.4	17,150.8
Total assets	102,522.0	116,947.0	103,301.5	114,668.6
ST debt	0.0	0.0	0.0	0.0
Other current liabilities	14,589.0	16,750.0	17,795.1	19,180.0
LT debt	0.0	0.0	0.0	0.0
Other LT liabilities	4,883.0	19,124.0	19,124.0	19,124.0
Shareholders' equity	80,287.0	78,272.0	65,642.9	75,639.3
Minority interest	2,763.0	2,801.0	739.5	725.2
Total liabilities & equity	102,522.0	116,947.0	103,301.5	114,668.6

Cash Flow

Year to 31 Dec (Rmbm)	2025	2026F	2027F	2028F
Operating	10,231.0	14,233.4	13,751.1	15,143.4
Profit fo the year	13,277.0	12,290.4	13,318.8	14,744.4
Tax	(1,924.0)	(2,335.2)	(2,530.6)	(2,654.0)
Deprec. & amort.	(1,267.0)	(1,358.3)	(1,498.5)	(1,646.8)
Associates	0.0	0.0	0.0	0.0
Working capital changes	(125.0)	(2,207.0)	(659.7)	(531.8)
Non-cash items	0.0	0.0	0.0	0.0
Other operating cashflows	270.0	7,843.5	5,121.1	5,231.6
Investing	(10,227.0)	(2,545.3)	(2,743.0)	(2,872.3)
Capex (growth)	(305.0)	(71.9)	(77.9)	(84.6)
Investment	0.0	0.0	0.0	0.0
Others	(9,922.0)	(2,473.4)	(2,665.1)	(2,787.7)
Financing	(4,649.0)	(3,393.7)	(2,962.3)	(2,962.3)
Dividend payments	0.0	(3,393.7)	(2,962.3)	(2,962.3)
Proceeds from borrowings	0.0	0.0	0.0	0.0
Loan repayment	(243.0)	0.0	0.0	0.0
Others/interest paid	(4,406.0)	0.0	0.0	0.0
Net cash inflow (outflow)	(4,645.0)	8,294.4	8,045.8	9,308.8
Beginning cash & cash equivalent	13,164.0	8,470.0	16,764.4	24,810.2
Changes due to forex impact	(49.0)	0.0	0.0	0.0
Ending cash & cash equivalent	8,470.0	16,764.4	24,810.2	34,119.0

Key Metric

Year to 31 Dec (%)	2025	2026F	2027F	2028F
Profitability				
EBITDA margin	25.6	26.0	26.3	27.0
Pre-tax margin	40.4	34.2	34.2	34.8
Net margin	34.5	27.7	27.7	28.6
ROA	11.8	9.1	9.8	11.1
ROE	15.3	12.6	15.0	17.1
Growth				
Turnover	15.8	9.3	8.3	8.7
EBITDA	29.6	11.2	9.5	11.5
Pre-tax profit	52.4	(7.4)	8.4	10.7
Net profit	59.7	(12.3)	8.4	12.1
Net profit (adj.)	110.2	(29.8)	7.9	12.7
EPS	112.5	(29.5)	7.2	12.7
Leverage				
Debt to total capital	0.0	0.0	0.0	0.0
Debt to equity	0.0	0.0	0.0	0.0
Net debt/(cash) to equity	(10.5)	(30.3)	(37.8)	(45.1)