Investment Recommendation of Tencent: Based on Financial Analysis

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Abstract. To gain an in-depth understanding of Tencent's financial health and hidden financial risks from 2020 to 2023, this study will address these issues through a financial analysis of Tencent Holdings.The central analytical focus of this report is to acquire fundamental knowledge of financial ratio analysis and, by applying this knowledge, to familiarize ourselves with the company's financial performance and current development status, thereby gaining deeper insights into its position within the industry and potential financial risks. Additionally, the report will analyze the impact of Tencent's investments in artificial intelligence (AI) on its financial ratios, particularly in the context of rapid AI development. Data has been collected from Yahoo Finance and Tencent's financial statements, and five different ratios have been calculated—profitability ratios, liquidity ratios, activity ratios, cash flow ratios, and debt ratios. The report is primarily supported by concise recommendations as well as some feasible predictions, which may benefit the company's stakeholders and provide some assistance to the development of related technology companies.

Keywords: Ratio Analysis; financial status; liquidity; profitability.

1 Introduction

This research will focus on Tencent, a prominent internet technology company based in China. Tencent's primary business areas encompass social networking and communication, fintech, cloud computing and enterprise services, and artificial intelligence. In recent years, the revolution in AI technology has transformed the global industrial landscape, serving as a key driver of corporate strategic transformation. As a leading technology enterprise in China, Tencent has steadily increased its investments in AI, impacting core areas such as social entertainment, cloud computing, fintech, and content recommendation. This study will utilise ratio analysis to evaluate Tencent's financial performance over the past four years, as such analysis can provide multi-dimensional financial ecosystem mapping. By performing ratio-based solvency assessment, the study aims to provide investment recommendations to investors by evaluating its financial performance and the impact of expanding its AI business.

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2 Method

2.1 Ratio Analysis

Financial ratio analysis serves as an empirical assessment tool for corporate fiscal health diagnosis by calculating and benchmarking solvency metrics. It enables analysts and management to better understand the company's financial performance under various circumstances. Since ratio analysis can demonstrate the actual operational performance of a company over multiple financial years, it has become one of the most commonly used tools by financial analysts. According to studies by Kim & Im and Al-Marzooqi & Nobanee, ratio analysis can assist financial researchers in assessing a company's financial condition from multiple dimensions, including measuring the company's working capital adequacy, evaluating its ability to generate profits, reflecting the efficiency of its asset and resource utilisation, and analysing the proportion of its liabilities to shareholders' equity [1, 2]. These ratios can reveal the company's financial health from different perspectives, aiding management and investors in making more informed decisions.

Additionally, Kourtis et al. point out that ratio analysis can also be used to compare companies within the same industry [3]. Analysts can better understand their relative strengths and weaknesses by comparing the performance of two companies on the same financial ratios. For example, a company's higher profitability ratio than the industry average may indicate stronger market competitiveness. However, Otekunrin et al. emphasise that ratio analysis should not be used in isolation but should be combined with other financial indicators and non-financial information [4]. Therefore, a multidimensional set of indicators can more precisely demonstrate a company's financial status and risk resilience capabilities.Ratio analysis is useful not only for company management but also for investors. According to research Islami & Ri, investors can analyse a company's past and present financial statements and compare the trends in its financial ratios to determine whether the company is performing well [5].

According to research from Srinivasan, ratio analysis can typically be divided into the following four steps, which are recommended for all companies to use: First, extract the necessary data from the company's financial disclosures (such as the balance sheet, income statement, and cash flow statement), then construct financial ratios, calculate the relevant financial ratios based on the collected data, and subsequently compare the calculated ratios with industry averages or competitors' ratios, which helps to understand the company's relative performance within the industry [6]. Finally, management needs to conduct an in-depth analysis of these ratios and present the results in annual reports or other formats to stakeholders (such as shareholders, investors, and creditors). Through these four steps, ratio analysis can support the company's financial decision-making and help investors better assess the company's investment value.

In this study, the paper employs the techniques and tools of ratio analysis to conduct an in-depth analysis of Tencent's financial condition. Financial ratio evaluation is a method that evaluates a accounting performance indicators by calculating and normalizing financial ratios, enabling a multi-dimensional diagnostics of the company's financial health. Specifically, the paper collects relevant financial data for Tencent from

2020 to 2023 from Yahoo Finance. This data is primarily derived from Tencent's three core financial statements: the balance sheet, the income statement, and the cash flow statement. These statements form the foundation of financial analysis, providing detailed information on the company's assets, liabilities, revenues, expenses, and cash flows.

Therefore, following this analysis, financial analysts need to conduct a financial evaluation of Tencent. Below is an introduction to the ratios used for this assessment.

2.2 Liquidity Ratios

Three distinct metrics are utilised to analyse liquidity ratios: the Current Ratio, Quick Ratio, and Cash Ratio. These ratios reflect Tencent's short-term solvency by measuring the coverage of cash and cash-like assets against current liabilities. Consequently, Tencent's management can evaluate the company's liquidity position from 2020 to 2023 through these metrics [7].

2.3 Activity Ratios

Two key indicators for activity ratios are the Total Asset Turnover Ratio and the Current Asset Turnover Ratio. These ratios assess the operational efficiency of the company's asset utilisation. Specifically, the Total Asset Turnover Ratio highlights Tencent's effectiveness in generating revenue from its total assets, while the Current Asset Turnover Ratio is critical for evaluating operational efficiency and capital allocation [8].

2.4 Debt Ratios

The debt ratio analysis incorporates the debt-to-asset ratio and the Times Interest Earned (TIE) Ratio. These metrics gauge Tencent's long-term solvency and financial leverage. Financial analysts can leverage these ratios to determine the company's leverage position and fixed charge coverage ability [9].

2.5 Profitability Ratios

Three ratios are employed in assessing profitability: Return on Equity (ROE), Return on Assets (ROA), and Net Profit Margin. These metrics illustrate Tencent's profit-generating capabilities. By analysing these ratios, management gains insights into the company's profitability trends over recent years [10].

2.6 Cash Flow Ratios

The cash flow analysis focuses on the Cash Flow to Assets Ratio and the Cash Flow to Sales Ratio. These indicators reveal the sufficiency of Tencent's cash flow in supporting debt obligations and ongoing operations [11]. Senior leadership can determine how much operating cash flows cover liabilities through these metrics.

3 Analysis

3.1 Analysis Ratio

Table 1. Liquidity Ratio

Ratio/Year	2023	2022	2021	2020
Current Ratio	1.47	1.30	1.20	1.18
Quick Ratio	1.47	1.29	1.20	1.18

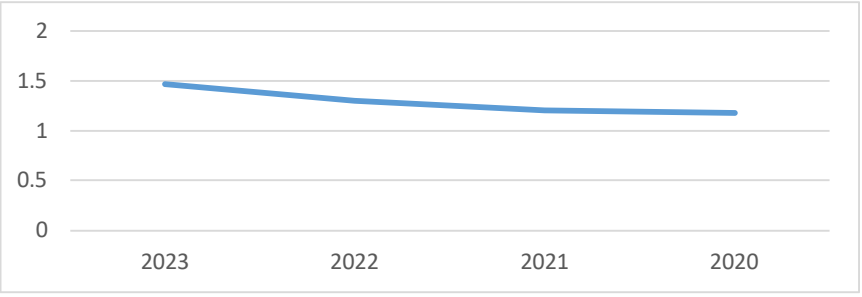

Fig. 1. Current Ratio

The current ratio is a financial method to assess a company's near-term solvency. Based on the current ratio calculation, it can be observed that Tencent's current ratio can be divided into two phases. From 2020 to 2021, the current ratio remained relatively stable at around 1.20, which may be attributed to Tencent's conservative operational approach to stabilising its assets during the pandemic. However, from 2022 to 2023, the ratio increased, reaching a peak of 1.47. (Table 1) (Fig. 1, 2) This indicates that in recent years, Tencent has been optimising its working capital management and expanding its business operations to maintain efficient levels of current assets. This enables the company to meet its immediate-term liabilities and effectively support its daily operations [12].

Like the previous ratio, this ratio has been consistently increasing during the latest quadrennial cycle, reaching a peak of 1.47 in 2023. This indicates that Tencent's short-term debt repayment capability has been continuously strengthening. With such a high quick ratio, even under stress scenarios, the Tencent retains unimpeded access to cash through instant asset mobilization., allowing it to handle sudden financial crises confidently.

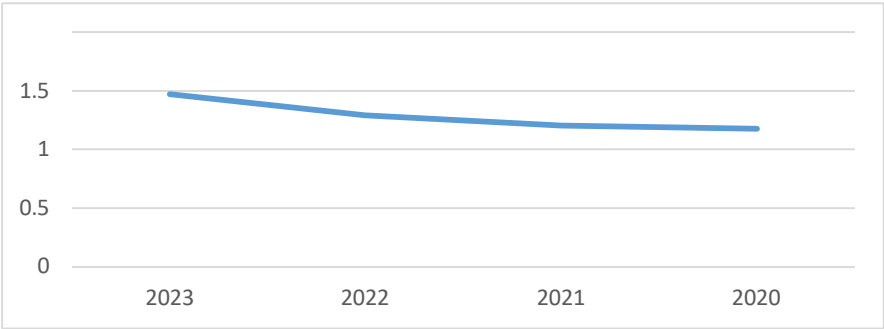

Fig. 2. Quick Ratio

Table 2. Activity Ratio

Ratio/Year	2023	2022	2021	2020
Current Asset Turnover Ratio	1.17	0.98	1.16	1.52
Total Asset TurnoverRatio	0.39	0.35	0.35	0.36

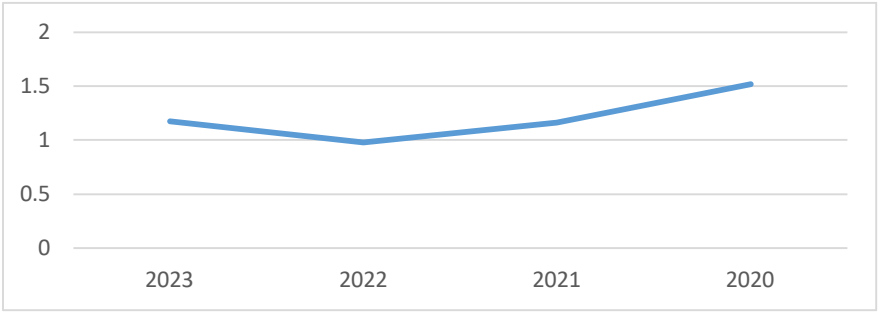

Fig. 3. Current Asset Turnover Ratio

Based on the calculated current asset turnover ratio, it can be observed that Tencent's current asset turnover ratio initially declined and then increased, reflecting adjustments in its asset management and operational efficiency. In 2021, Tencent's inventory grew by 25% due to investments in AI companies and server capacity expansion, while revenue growth during the same period was only 12%, leading to a decline in the turnover ratio [13]. (Table 2) (Fig. 3, 4) This indicates that the initial asset growth and slower revenue growth caused the ratio to decrease. Subsequently, asset optimisation efforts again led to an increase in the ratio.

Based on the calculated total asset turnover ratio, it can be observed that Tencent's ratio declined from 2020 to 2021, which is related to its early investments in the artificial intelligence sector and acquisitions of gaming companies, as mentioned in the previous ratio analysis. The subsequent increase in the ratio indicates that these invested sectors have matured. For example, by 2023, Tencent Cloud served over 20 million enterprise customers, and the company's revenue growth outpaced the growth of its assets [14].

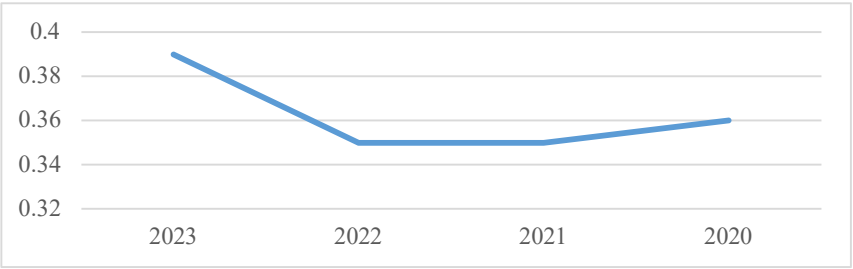

Fig. 4. Total Asset Turnover Ratio

Table 3. Debt Ratio

Ratio/Year	2023	2022	2021	2020
Debt-to-Asset Ratio	0.45	0.50	0.46	0.42
Times Interest Earned Ratio	14.57	22.05	32.33	25.17

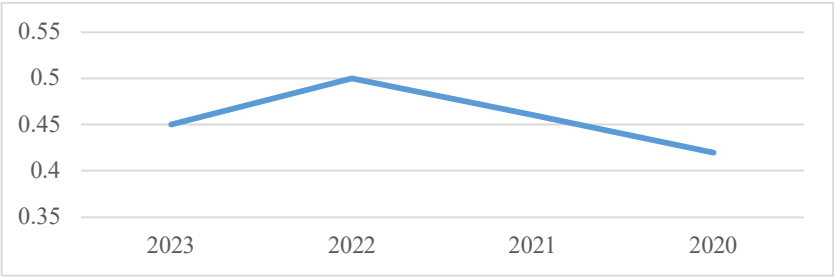

Fig. 5. Debt-to-Asset Ratio

The leverage ratio quantifies debt financing's relative weight in the capital structure. Notably, Tencent's debt ratio initially rose and then declined during the latest quadrennial cycle, dropping to 0.45 in 2023. The data implies a reduced dependency on debt instruments for Tencent's capital formation, suggesting that the company is reducing its dependence on debt financing, thereby lowering risks associated with debt and repayment obligations [15]. While Tencent's performance in this ratio is relatively strong, some risks remain, such as the ratio reaching 0.5 in 2022. Tencent's management needs to continue monitoring this ratio closely. (Table 3) (Fig. 5, 6)

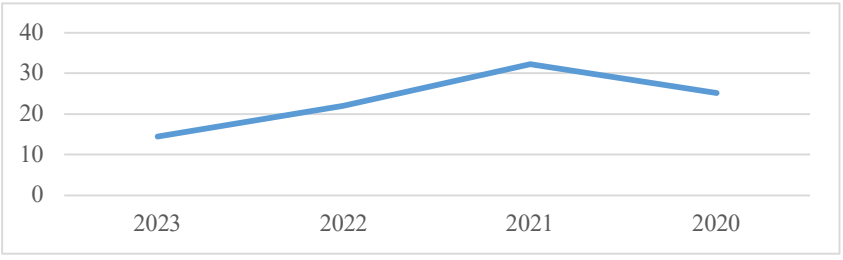

Fig. 6. Times Interest Earned Ratio

This debt coverage metric assesses repayment capability for financial obligations. As shown in the figure, Tencent's ratio generally has a downward trend, reaching its lowest point of 14.57 in 2023. This indicates that the company's payment coverage ability coupon obligations with recurring earnings is declining, which is related to the short-term profit lag caused by investments in new businesses. In 2022, Tencent invested over $1 billion in the development of AI chips, resulting in profit growth that lagged behind the growth of interest expenses [16].

Table 4. Profitability Ratio

Ratio/Year	2023	2022	2021	2020
ROA	0.07	0.12	0.14	0.12
ROE	0.14	0.26	0.28	0.23
Net Profit Margin	0.19	0.34	0.40	0.33

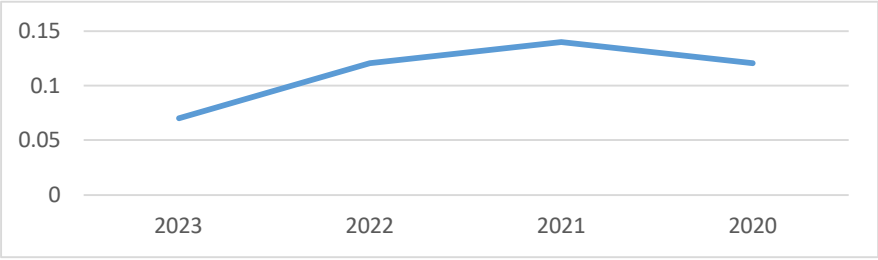

Fig. 7. ROA

This profitability ratio evaluates how effectively corporate resources are converted into net income. Over the past four years, Tencent's ROA ratio has generally shown a downward trend, reaching its lowest point of 0.12 in 2023. This indicates a decline in Tencent's net profit in recent years, primarily due to intensified competition in the artificial intelligence and gaming markets, which has led to slower revenue growth. In the gaming sector, revenue growth dropped to 5% in 2023, impacted by competitors such as Genshin Impact [17]. Additionally, Tencent's R&D expenditure reached 35 billion yuan in 2023, which was allocated to developing the Hunyuan AI model and metaverse technologies [18]. As a result, Tencent's asset efficiency is declining, and its financing costs and risks are expected to increase. (Table 4) (Fig. 7, 8, 9)

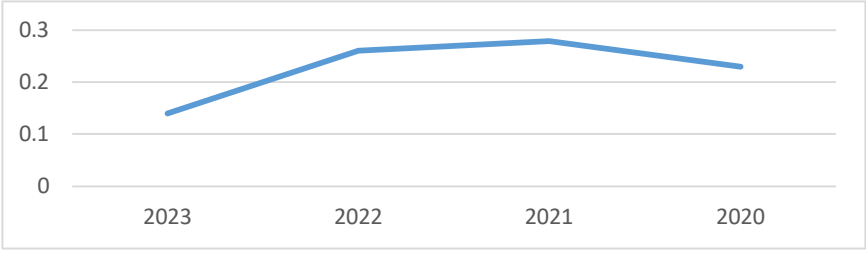

Fig. 8. ROE

Like ROA, ROE also follows the same trend, with Tencent's ROE reaching its lowest point of 0.26 in 2023. This indicates a decline in Tencent's financial leverage, placing the company in a situation of high financing risk and a falling stock price.

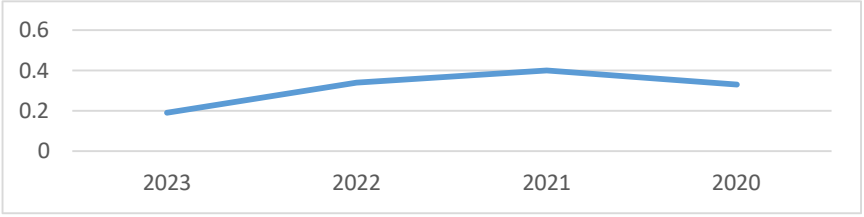

Fig. 9. Net Profit Margin

Additionally, Tencent's net profit margin has fluctuated during the 2020-2023 period, reaching its highest point of 0.4 in 2021 before continuously declining to its lowest point of 0.19 in 2023. The primary factor for the reduced margin performance is the instability in profitability, which is related to Tencent's significant R&D investments in artificial intelligence in recent years, leading to increased expenses.

Table 5. Cash Flow Ratio

Ratio/Year	2023	2022	2021	2020
Cash Flow to Assets Ratio	0.14	0.09	0.11	0.15
Cash Flow to Sales Ratio	0.36	0.26	0.31	0.40
Cash Ratio	0.49	0.36	0.42	0.57

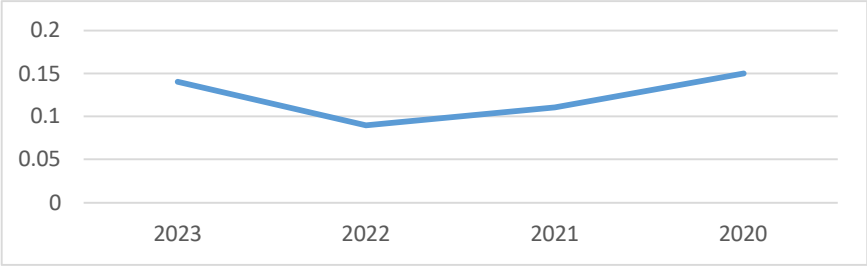

Fig. 10. Cash Flow to Assets Ratio

This specific ratio measures a company's efficiency by evaluating cash flow, as revenue recognition and measurement do not affect assets. In this case, it can be observed that Tencent's cash flow to total assets ratio has been rising steadily after 2022, reaching 0.14 by 2023. The significant increase in this ratio is attributed to the spin-off and listing of Tencent Music Entertainment Group, which generated a one-time cash flow of approximately $2 billion [19]. The rise in this ratio indicates that Tencent is effectively utilising its cash flow to manage its assets. (Table 5) (Fig. 10, 11, 12)

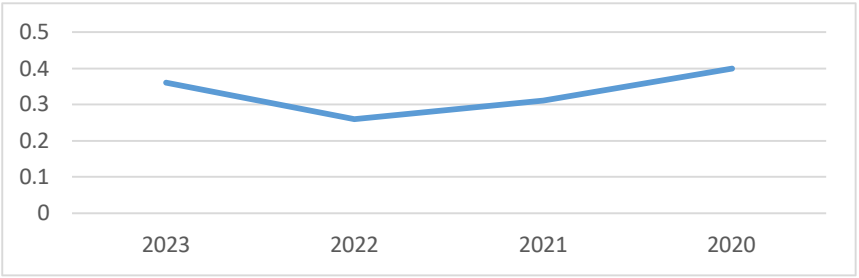

Fig. 11. Cash Flow to Sales Ratio

In addition, the cash-realization ratio reflects the organization's capacity to translate top-line growth into operating liquidity. More importantly, for Tencent, after reaching its lowest point of 0.26 in 2022, the ratio has been rising, recovering to 0.36 in 2023. This increase in the ratio indicates that Tencent has enhanced its ability to convert sales into cash.

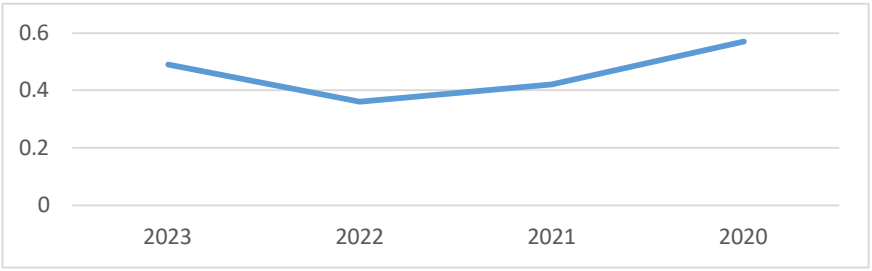

Fig. 12. Cash Ratio

Based on the calculated cash ratio, it can be observed that Tencent's cash ratio has experienced significant fluctuations, showing an initial decline followed by an upward trend. This indicates that Tencent maintained high cash reserves in 2020, but these reserves decreased in 2021 and 2022 due to investment activities and stock repurchases. For instance, in 2021, Tencent spent $15 billion on stock repurchases and invested in the Southeast Asian tech-finance company Sea Limited. By 2023, with the growth in revenue from WeChat Pay and cloud services—where cloud revenue increased by 30% year-over-year—operating cash flow recovered, leading to a renewed accumulation of cash reserves [20].

3.2 Analysis Summarises

Overall, Tencent's ratio analysis highlights five critical points that need attention. First, the enhancement of its liquidity indicates strong short-term debt repayment capabilities and successful cash management optimisation. However, the fluctuations in the cash ratio suggest that Tencent needs to adjust its cash reserves to address sudden investment risks flexibly. Second, the decline in asset efficiency is evident, as the current asset

turnover ratio has significantly decreased. Tencent needs to address the efficiency drop caused by the diversification of its business expansion. Third, changes in leverage and debt repayment pressure are notable. After the increase in debt in 2022, some of it was repaid, but the decline in the interest coverage ratio requires Tencent to balance the trade-off between debt costs and profit growth. Fourth, the decline in profitability is concerning. The decreases in ROA, ROE, and net profit margin indicate that Tencent's core businesses face growth bottlenecks due to market pressures. The company needs to find innovative ways to control costs and enhance profitability. Fifth, the instability in cash flow is a significant issue. The development and adjustment of AI-related businesses in recent years have led to excessive capital expenditures and rapid business expansion, resulting in cash flow volatility. In conclusion, while continuing to expand its business, Tencent needs to optimise asset utilisation, improve profitability, and balance its debt structure to maintain long-term financial health.

4 Conclusion

From the current perspective, based on the above analysis and evaluation, it is clear that ratio analysis in the financial field is indispensable. This is primarily because financial metric evaluation helps examine and fathom Tencent financial condition, liquidity, profitability, and cash flow capabilities regarding solvency while identifying associated risks. By analysing the financial statements of global internet giant Tencent in recent years based on these ratios, this empirical data confirms the corporation's superior market positioning in terms of financial robustness. More specifically, Tencent's short-term solvency is robust. However, due to the company's current focus on expanding into new markets, profitability is under pressure, with declining profit margins, insufficient interest coverage on debt, and fluctuations in asset efficiency caused by business diversification being the main challenges faced. Therefore, it is recommended that Tencent pay more attention to the profitability of its investment businesses and optimise debt management. This will provide the company with greater operational efficiency and enhance its profit prospects in the long run.

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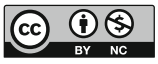
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