First Read

China Internet Sector

Ad pulse check: Q1 resilience despite macro

Equities
China
Internet Services

Kenneth Fong
Analyst
kenneth-kc.fong@ubs.com
+852-3712 3890

Jenny Yuan
Analyst
S1460525030004
jenny-za.yuan@ubs.com
+86-21-3866 8912

Sardonna Fong
Analyst
sardonna.fong@ubs.com
+852-3712 3042

Wei Xiong
Analyst
S1460518100005
wei.xiong@ubs.com
+86-21-3866 8883

Charles Chen
Associate
S1460524020001
charles-za.chen@ubs.com
+86-21-3866 8907

Growth: Q1 better than expected; Q2 likely steady

1) Q1 trends: China digital ad growth +8.3% YoY in Q1, slightly ahead, according to our channel checks with leading ad agencies in China. Key observations: **i) Supply: Rising AI penetration across the value chain** brings meaningful efficiency and ROI improvements. **ii) Demand: Resilience despite macro uncertainties.** Incremental ad demand emerges from AI tools (e.g. Doubao, Yuanbao) and short dramas/AI animated short dramas, while verticals (e.g. mini games, local services, education and 3C electronics) continue to deliver solid growth. **iii) Advertisers**: Prefer platforms with stronger AI capabilities, measurable ROI and sustained traffic growth, against the backdrop of macro softness. **2) Outlook**: Ad agencies we surveyed expect Q2 growth to grow 9%, with room for H2 contingent on i) sustainability of AI-related demand, ii) macro outlook iii) optimisation flexibility amid the new ad tax policy.

Ad tax: Muted impact so far; Potential upside from optimizing implementation

On top of a moderate local government implementation which aims to balance economic growth and tax revenue, platforms have provided alternative solution to help lowering advertiser tax burden. For example, **ByteDance** was a first mover in reclassifying the fee structure in its performance ad (c40% of ad income) since Dec-25, which expert stated is tax compliant. Their invoice splits the ad spent into **1)** 91.5% as fully tax-deductible information technology service fees (essentially function as services income from algorithmic bidding, user profiling and matching), and **2)** 8.5% as ad spending (for ad exposure/illustration). Recall that effective 1 Oct 2025, marketing expenses exceeding 15% (30% for cosmetics, healthcare and non-alcoholic beverages) of revenue will no longer be tax deductible for enterprise income tax. **Potential upside for other platforms to optimize implementation,** following Douyin. That said, it would be contingent on the nature of ad; social ad nature (predominantly ad illustration) can't qualify, according to the expert.

AI: Room for further ad tech upgrade

Platforms are actively leveraging AI to improve product competitiveness and ROI for ad wallet share. Our checks suggest that AI remains in scaling phase, with higher penetration potential ahead. It has been progressing from single point tools to full-funnel integration: **i) Ad campaign planning**: c20% reduction in manual workload; AI penetration in standardised planning at ~20–30%; **ii) Creative production**: Rapid AIGC advancement (eg, Seedance 2.0, Kling 3.0) notably improves CTR/ROI while lowering production costs; **iii) Ad placement**: AI tools (eg, Bytedance Qianchuan Chengfang, Tencent ADQ 3.0/AIM, Alibaba Wanxiangtai AI, Kuaishou UAX) enhance real-time matching efficiency, etc. **By platforms**, the experts comment that ad tech improvement is most significant in ByteDance, followed by Tencent and Alibaba, then Kuaishou and RedNote so far.

Platforms: company level trends

- **Tencent: sustainable levers to support high-teens growth**. We believe Tencent is on track to deliver +18% growth in Q1 and 2026E, driven by **1) Video Accounts (VA)**: on both higher ad load (now c5%) and increasing user traffic and engagement (with time spent per user up mid-high teens YoY); **2) AI-driven ad tech upgrade**: estimated to contribute MSD% growth, with broader cross-scenario penetration, enhancing ad CTR and conversion and advertiser expansion; **3) close-looped ad**: strengthening closed-loop ecosystem (Mini Programs, Mini Shops) across Weixin; and **4) key accounts' growing budgets** (e.g. BABA) on optimizing conversion funnel and data callback. By property, in addition to VA, we believe **Search** presents meaningful potential.

- **ByteDance: Q1 outperforming peers at an est. +22% YoY**, supported by: **1)** its first mover advantage in ad invoicing reclassification as discussed; **2)** solid growth in short dramas, underpinning DAU/time spent growth, while also offering higher ad load capacity (IAA potential after every episode); vs typical feed ads; **3)** QCPx optimisation and AI tools (eg, Qianchuan Chengfang, AI Mars) improving ROI and advertiser penetration. Qianchuan Chengfang, its AI-powered omnichannel marketing solution, lowers service fee to c0.6%, meaningfully reducing merchant operating costs and improving their profitability and create a positive virtuous cycle for ad growth.
- **Bilibili: benefiting from AI/gaming ad demand and an expanding advertiser base supported by omnichannel awareness & conversion.** Improved collaboration with Alibaba and JD has enhanced e-commerce ad ROI, enabling expansion into more verticals eg, apparel, sports, smart home appliance, which drives sustained ad growth. AI tools (eg, Bida, Bihuo, Sanlian ad platform) are enhancing content matching and data insights, improving overall ad efficiency.
- **Kuaishou: softer growth momentum but adtech improvements continue**. Kuaishou remains committed to improving ad efficiency performance via AI tools incl. OneRec and UAX. However, the near term ad growth see some softness due to macro softness and slower GMV growth. That said, Kling AI continues to deliver notable improvements in CTR/ad material spend ratio/ROI.
- **Baidu: core growth remains under pressure** while its AI-native marketing products (including AI agents for advertisers and digital humans) are still taking time to improve ad ROI and scale revenue.
- **Long-form videos: cautious outlook given pressure from short dramas**. The experts noted recent blockbuster titles has drove incremental ad revenue on a per-title basis but structural pressure from short-form content persists.

Stock implications: prefer bottom-up outperformance

Within media/ad, we prefer **Tencent** (solid bottom-up drivers amid its under-monetized ecosystem, and longer-term AI upside optionality), **Bilibili** (offering one of the fastest ad growths in China, with a still under-monetised high quality user base), **Kuaishou** (AIGC global leader, with near-term fundamental headwinds priced in at 10x 2026E PE, or 8x ex Kling; key catalysts include major model upgrades and earnings bottoming), **Focus Media** (benefiting from an improving competition landscape with potential Xinchao acquisition).

Figure 1: China ad industry model

	2020	2021	2022	2023	2024	2025	2026E	2027E
Total Online ad	**710.7**	**850.2**	**882.5**	**1,067.6**	**1,312.1**	**1,484.5**	**1,653.6**	**1,843.7**
YoY Growth	*16.2%*	*19.6%*	*3.8%*	*21.0%*	*22.9%*	*13.1%*	*11.4%*	*11.5%*
% of Total Advertising	*86.7%*	*87.1%*	*89.9%*	*91.6%*	*92.7%*	*93.2%*	*93.6%*	*94.0%*
Major online ad companies								
Bytedance	183.1	263.0	292.8	390.0	545.7	657.3	781.6	898.8
YoY Growth	*58.5%*	*43.6%*	*18.0%*	*33.2%*	*39.9%*	*20.5%*	*18.9%*	*15.0%*
% of Online Advertising	*25.8%*	*30.9%*	*33.2%*	*36.5%*	*41.6%*	*44.3%*	*47.3%*	*48.8%*
Alibaba	207.0	226.6	214.4	221.5	235.9	249.7	249.9	253.1
YoY Growth	*18.6%*	*9.5%*	*-5.4%*	*3.3%*	*6.5%*	*5.8%*	*0.1%*	*1.3%*
% of Online Advertising	*29.1%*	*26.7%*	*24.3%*	*20.7%*	*18.0%*	*16.8%*	*15.1%*	*13.7%*
Pinduoduo	48.0	72.6	102.7	153.5	197.9	217.8	233.4	268.6
YoY Growth	*78.8%*	*51.3%*	*41.6%*	*49.5%*	*28.9%*	*10.0%*	*7.2%*	*15.1%*
% of Online Advertising	*6.7%*	*8.5%*	*11.6%*	*14.4%*	*15.1%*	*14.7%*	*14.1%*	*14.6%*
Tencent	82.3	88.7	83.3	101.5	121.4	145.0	169.3	193.2
YoY Growth	*20.3%*	*7.8%*	*-6.0%*	*21.8%*	*19.6%*	*19.4%*	*16.8%*	*14.1%*
% of Online Advertising	*11.6%*	*10.4%*	*9.4%*	*9.5%*	*9.3%*	*9.8%*	*10.2%*	*10.5%*
Kuaishou	21.9	42.7	49.0	60.3	72.4	81.5	86.8	91.9
YoY Growth	*194.6%*	*95.2%*	*14.9%*	*23.0%*	*20.1%*	*12.5%*	*6.5%*	*5.9%*
% of Online Advertising	*3.1%*	*5.0%*	*5.6%*	*5.6%*	*5.5%*	*5.5%*	*5.2%*	*5.0%*
Baidu	66.0	73.6	69.4	75.0	72.8	62.4	55.9	57.1
YoY Growth	*-5.4%*	*11.5%*	*-5.8%*	*8.1%*	*-2.8%*	*-14.3%*	*-10.4%*	*2.0%*
% of Online Advertising	*9.3%*	*8.7%*	*7.9%*	*7.0%*	*5.6%*	*4.2%*	*3.4%*	*3.1%*
Weibo	10.2	12.7	10.7	10.7	10.5	10.5	11.3	11.6
YoY Growth	*24.9%*	*-15.1%*	*0.8%*	*1.0%*	*-1.7%*	*2.3%*	*2.3%*	*2.1%*
% of Online Advertising	*1.4%*	*1.5%*	*1.2%*	*1.0%*	*0.8%*	*0.7%*	*0.7%*	*0.6%*
BiliBili	1.8	4.5	5.1	6.4	8.2	10.1	12.3	13.9
YoY Growth	*125.5%*	*145.5%*	*12.0%*	*26.6%*	*27.7%*	*22.8%*	*22.7%*	*12.3%*
% of Online Advertising	*0.26%*	*0.53%*	*0.57%*	*0.60%*	*0.62%*	*0.68%*	*0.75%*	*0.75%*
Mango	4.1	5.5	4.0	3.5	3.4	3.3	3.6	3.7
YoY Growth	*23.6%*	*31.7%*	*-26.8%*	*-11.6%*	*-2.7%*	*-3.0%*	*7.0%*	*5.0%*
% of Online Advertising	*0.58%*	*0.64%*	*0.45%*	*0.33%*	*0.26%*	*0.22%*	*0.22%*	*0.20%*
E-commerce/non e-commerce ad								
E-commerce related ad			**447.8**	**587.7**	**745.8**	**879.8**	**948.9**	**1,028.2**
YoY Growth				*31.2%*	*26.9%*	*18.0%*	*7.9%*	*8.4%*
% of Online Advertising			*50.7%*	*55.1%*	*56.8%*	*59.3%*	*57.4%*	*55.8%*
Non e-commerce ad			**434.7**	**479.9**	**566.4**	**604.8**	**704.7**	**815.4**
YoY Growth				*10.4%*	*18.0%*	*6.8%*	*16.5%*	*15.7%*
% of Online Advertising			*49.3%*	*44.9%*	*43.2%*	*40.7%*	*42.6%*	*44.2%*

Source: Company data, Group M, UBS estimates

Figure 2: China internet valuation comp

Company name	Ticker	Mkt cap (USD m)	Rating	Price target (LC)	Price (LC)	Implied upside	PE (x) 2026E	PE (x) 2027E	EPS CAGR (2025E-2027E)	PEG 2026E	Dividend yield 2025E	Dividend yield 2026E	Stock performance 1M	Stock performance 3M	Stock performance YTD
China Internet large cap															
Tencent Holdings	0700.HK	584,673	Buy	780.00	504.00	55%	14.0	12.5	11.9%	1.18x	1.2%	1.4%	1%	-16%	-16%
Meituan	3690.HK	65,892	Buy	128.00	84.25	52%	n.m.	20.1	n.m.	n/a	0.0%	0.0%	10%	-13%	-18%
Baidu, Inc.	BIDU.O	42,530	Buy	170.00	123.49	38%	14.7	14.7	1.9%	7.67x	0.0%	0.0%	8%	-24%	-5%
Average							**14.4**	**15.7**	**6.9%**	**2.08x**	**0.4%**	**0.5%**	**6%**	**-18%**	**-13%**
China e-commerce															
Alibaba Group	BABA.N	317,991	Buy	170.00	135.38	26%	22.5	17.8	32.7%	0.69x	0.7%	0.9%	7%	-24%	-8%
JD.com	JD.O	44,315	Buy	48.00	30.52	57%	8.8	6.4	34.4%	0.26x	3.2%	3.6%	11%	2%	6%
PDD Holdings Inc	PDD.O	137,517	Buy	198.00	98.99	100%	7.2	5.4	31.0%	0.23x	0.0%	0.0%	3%	-7%	-13%
Vipshop	VIPS.N	7,211	Neutral	20.00	14.74	36%	5.8	5.5	3.7%	1.54x	3.2%	4.2%	-6%	-15%	-17%
Average							**11.1**	**8.8**	**25.5%**	**0.43x**	**1.8%**	**2.2%**	**4%**	**-11%**	**-8%**
Online Social Media & Entertainment															
NetEase	NTES.O	73,615	Buy	180.00	114.81	57%	12.7	10.5	13.3%	0.95x	2.6%	3.3%	1%	-14%	-17%
Kuaishou Technology	1024.HK	24,866	Buy	68.00	45.34	50%	10.2	9.3	(4.6%)	NA	2.6%	0.0%	-12%	-43%	-29%
Tencent Music Entertainment	TME.N	14,796	Neutral	13.00	9.62	35%	9.9	9.0	8.8%	1.13x	2.3%	2.5%	-4%	-40%	-45%
NetEase Cloud Music	9899.HK	3,455	Buy	300.00	124.80	140%	11.0	9.4	(7.2%)	NA	0.0%	0.0%	-2%	-29%	-33%
Bilibili	BILI.O	9,768	Buy	37.50	23.37	60%	23.6	17.7	24.4%	0.97x	0.0%	0.0%	-4%	-30%	-5%
iQIYI	IQ.O	1,274	Buy	2.50	1.32	89%	12.9	7.1	n.m.	n/a	0.0%	3.9%	6%	-37%	-31%
Joyy Group	JOYY.O	3,187	Buy	80.00	60.63	32%	10.8	9.4	11.2%	0.96x	6.9%	6.3%	4%	-10%	-6%
Weibo Corp	WB.O	2,108	Buy	12.80	8.63	48%	5.5	5.2	0.4%	15.28x	7.3%	7.0%	-1%	-21%	-16%
Hello Group	MOMO.O	1,032	Buy	8.80	6.29	40%	6.6	6.4	7.0%	0.94x	4.0%	4.2%	5%	-9%	-4%
Average							**11.5**	**9.3**	**6.7%**	**1.72x**	**2.9%**	**3.0%**	**-1%**	**-26%**	**-21%**
A-share Media															
China Literature	0772.HK	3,458	Buy	50.00	26.50	89%	16.6	14.6	37.0%	0.45x	0.0%	0.0%	0%	-29%	-20%
Focus Media Information Technology	002027.SZ	13,252	Buy	9.80	6.26	57%	15.0	14.2	5.7%	2.62x	5.8%	6.1%	-2%	-15%	-15%
Average							**15.8**	**14.4**	**21.4%**	**0.74x**	**2.9%**	**3.1%**	**-1%**	**-22%**	**-17%**
Travel and transactional platforms															
Kanzhun Limited	BZ.O	6,226	Buy	23.00	13.82	66%	10.9	9.8	11.3%	0.97x	0.0%	0.0%	4%	-27%	-32%
Trip.com	TCOM.O	35,632	Buy	80.00	54.65	46%	12.0	10.6	(12.2%)	NA	1.0%	0.7%	6%	-12%	-24%
Tongcheng Travel	0780.HK	5,476	Buy	26.50	18.90	40%	9.8	8.7	13.1%	0.75x	1.2%	1.4%	2%	-19%	-16%
Average							**10.9**	**9.7**	**4.0%**	**2.70x**	**0.7%**	**0.7%**	**4%**	**-19%**	**-24%**
K12 Afterschool Tutoring															
TAL Education Group	TAL.N	7,295	Buy	19.50	11.96	63%	18.0	14.4	n.m.	n/a	0.0%	0.0%	7%	7%	10%
New Oriental Education & Technology	EDU.N	9,285	Buy	80.00	56.36	42%	16.3	13.6	14.5%	1.12x	1.1%	2.0%	2%	0%	2%
Average							**17.2**	**14.0**	**14.5%**	**1.18x**	**0.5%**	**1.0%**	**5%**	**4%**	**6%**
China internet average							**12.5**	**11.0**	**11.9%**	**1.65x**	**1.9%**	**2.1%**	**2%**	**-18%**	**-15%**
US Magnificent 7															
Apple Inc.	AAPL.O	3,913,418	Neutral	280.00	266.17	5%	32.2	30.7	7.9%	4.10x	0.4%	0.4%	6%	7%	-2%
Microsoft Corp.	MSFT.O	3,164,234	Buy	510.00	424.16	20%	22.6	20.1	14.4%	1.57x	0.8%	0.9%	11%	-6%	-12%
NVIDIA Corp	NVDA.O	4,858,083	Buy	245.00	199.88	23%	22.5	15.8	62.9%	0.36x	0.0%	0.0%	14%	8%	7%
Alphabet Inc.	GOOG.O	4,040,987	Neutral	375.00	330.47	13%	23.9	21.8	17.0%	1.41x	0.3%	0.3%	11%	0%	5%
Amazon.com	AMZN.O	2,569,075	Buy	301.00	249.91	20%	21.7	15.4	30.6%	0.71x	0.0%	0.0%	19%	7%	8%
Meta Platforms	META.O	1,715,575	Buy	908.00	668.84	36%	17.0	15.4	3.5%	4.80x	0.3%	0.3%	11%	3%	1%
Tesla, Inc.	TSLA.O	1,367,540	eutral (CB	352.00	386.42	-9%	n.m.	n.m.	18.8%	n/a	0.0%	0.0%	1%	-14%	-14%
Average							**23.3**	**19.9**	**22.2%**	**1.05x**	**0.2%**	**0.3%**	**10%**	**1%**	**-1%**

Source: Refinitiv datastream, UBS estimates. Dated as of 22 Apr 2026.

Valuation Method and Risk Statement

We believe key sector risks include: 1) an evolving competitive landscape and intensifying competition; 2) fast-moving trends in technology, as well as internet users' needs and preferences; 3) uncertain monetisation; 4) the rising cost of traffic acquisition, content and brand promotions; 5) the upkeep of IT systems; 6) expansion into international markets; 7) adverse changes in market sentiment; and 8) regulatory risks.

Our price target on Tencent is based on sum of the parts. We believe the key risks for Tencent include: 1) an evolving and intensifying competitive landscape; 2) new business execution; 3) integration of invested companies and businesses; 4) rising costs of traffic acquisition, content and brand promotions; 5) IT system upkeep; 6) expansion into international markets; 7) infringement of intellectual property rights; 8) departures of key management; and 9) regulatory risks.

We value Bilibili using a DCF methodology. We believe the main risks for Bilibili include: 1) tightening regulations on the online videos, games and live-streaming industries; 2) slower-than-expected user growth; 3) intensifying competition leading to diversion of user time spent; 4) slower-than-expected monetisation with a lower paying ratio; 5) concentration of revenue on a single game; 6) heavier-than-expected investments and delays to break even on the bottom line; 7) a better-than-expected macro recovery; 8) better-than-expected performance of new game launches.

We use a SOTP methodology to derive our price target for Kuaishou. We believe the main risks for Kuaishou include: 1) intensifying competition leading to slower-than-expected user growth as well as diversion of user time spent; 2) tightening regulations in the online videos, livestreaming, e-commerce, and online games industries; 3) slower-than-expected monetisation pace of its core business and video GenAI initiatives; 4) the slowing Chinese economy could lead to lower online advertising revenue growth; and 5) higher-than-expected investment and weaker-than-expected profitability.

We derive our price target on Focus Media using a DCF methodology. We believe key downside risks are: 1) regulation; 2) competition from online video advertising or new competitors in the LCD screen sector; and 3) economic risks (slower-than-expected GDP growth, especially in China's lower-tier cities).