

Tencent (700 HK)

Tencent MaaS: offering one-stop industry LLM solutions

Tencent disclosed the latest progress of its industry LLM (large language model) solution on 19 Jun. The company will offer a comprehensive set of MaaS solutions that enable enterprises to adopt LLM and AI applications at an affordable cost. We expect Tencent to benefit from the LLM development: 1) Tencent's MaaS offering will create new revenue stream and drive growth of Tencent Cloud revenue in the long term; 2) flagship SaaS products like Tencent Meeting will soon adopt LLM capabilities to improve user experience; 3) LLM will be applied to Tencent's other businesses (e.g. gaming and ads) and become a growth multiplier. We are positive on Tencent's AI development in the long term, mainly due to its abundant use cases, ample user data and strong digital infrastructure. Our SOTP-derived TP remained unchanged at HK\$455.0. Maintain BUY.

■ One-store industry LLM solutions to address enterprise AI demand.

Tencent launched a one-store industry LLM service offering based on Tencent Cloud TI platform, facilitating enterprises to build their industry LLM and applications at a more cost/time-efficient manner. Tencent's LLM solution has three major layers: 1) MaaS: offers model services including LLM fine-tuning, training and applications; 2) TI platform: offers tools such as data labelling and AI accelerator to accelerate LLM development; 3) tech infrastructure: Tencent Cloud High-Performance Computing Cluster (HCC) and industry LLM pre-built by Tencent. Supported by Tencent's strong digital infrastructure, abundant AI use cases and comprehensive model service capabilities, we believe Tencent is well positioned to capture the monetization opportunities of enterprise AI transformation.

■ AI capability empowering Tencent SaaS products. Tencent announced to apply LLM capabilities to its own SaaS products: 1) Tencent Meeting will launch AI assistant which can extract key meeting information and analyse meeting content, etc.; 2) Tencent Qidian will upgrade its customer service capability and data analysis efficiency based on LLM; 3) Tencent Cloud AI coding assistant will be upgraded to accelerate the coding process. Going forward, we expect Tencent will expand the AI application to its other businesses such as gaming, ads and short video. As a growth multiplier, AI will help Tencent enhance user experience and reduce costs.

■ Positive on the long-term development of Tencent AI. We are upbeat on Tencent AI development given: 1) Tencent's wide spectrum of use cases to which AI can be applied; 2) abundant C-end and B-end data for model training; 3) advanced cloud infrastructure; 4) long-term investment in machine learning, AI and LLM. Though we do not expect meaningful revenue contribution in the short term, we expect MaaS to drive Tencent Cloud revenue growth in the long term as enterprises increasingly adopt LLM.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	560,118	554,552	613,195	668,542	720,198
YoY growth (%)	16.2	(1.0)	10.6	9.0	7.7
Gross margin (%)	43.9	43.1	44.7	45.4	46.3
Adjusted net profit (RMB mn)	123,788.0	115,649.0	142,333.0	165,655.3	185,752.3
YoY growth (%)	0.9	(6.6)	23.1	16.4	12.1
EPS (Adjusted) (RMB)	12.99	12.13	14.70	17.11	19.18
Consensus EPS (RMB)	12.99	12.13	14.89	17.54	20.17
P/S (x)	5.2	5.2	4.7	4.3	4.0
P/E (x)	18.1	14.1	21.8	19.5	16.5

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$455.00**

(Previous TP) **HK\$455.00**

Up/Downside **27.4%**

Current Price **HK\$357.20**

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Stock Data

Mkt Cap (HK\$ mn)	3,251,286.6
Avg 3 mths t/o (HK\$ mn)	7,448.2
52w High/Low (HK\$)	415.00/190.72
Total Issued Shares (mn)	9484.5

Source: FactSet

Shareholding Structure

MIH TC	26.9%
Advance Data Services Limited	8.4%

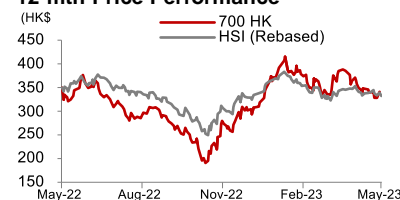
Source: HKEx

Share Performance

	Absolute	Relative
1-mth	-7.6%	-1.8%
3-mth	-8.3%	-2.1%
6-mth	23.6%	14.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Tencent's LLM solution has three major layers: 1) MaaS: offers model services including LLM fine-tuning, training and applications; 2) TI platform: offers tools such as data labelling and AI accelerator to accelerate LLM development; 3) tech infrastructure: Tencent Cloud High-Performance Computing Cluster (HCC) and industry LLM pre-built by Tencent.

Figure 1: Tencent: one-stop industry LLM solutions



Source: Tencent, CMBIGM

Tencent also announced to apply LLM capabilities to its own SaaS products: 1) Tencent Meeting will launch AI assistant which can extract key meeting information and analyse meeting content, etc.; 2) Tencent Qidian will upgrade its customer service capability and data analysis efficiency based on LLM; 3) Tencent Cloud AI coding assistant will be upgraded to accelerate the coding process.

Figure 2: Tencent: LLM applications in SaaS products

SaaS product	LLM applications
Tencent Meeting	AI assistant can extract key meeting information, analyse meeting content and manage meeting; the AI assistant can also generate meeting abstract to help review the meeting content
Tencent Qidian	The new-generation of smart client services has learning and smart response capability, and can offer more precise answers; Qidian AI assistant can ask business-related questions and generate visual charts to improve efficiency of data analysis
Tencent Cloud AI Coding Assistant	Cover the key process of development including communication, coding, evaluation and fine-tuning; handle the mechanic works; the assistant can be upgraded based on feedback.

Source: Tencent, CMBIGM

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	482,064	560,118	554,552	613,195	668,542	720,198
Cost of goods sold	(260,532)	(314,174)	(315,806)	(338,851)	(364,967)	(386,900)
Gross profit	221,532	245,944	238,746	274,345	303,575	333,298
Operating expenses	(37,295)	25,676	(3,040)	(101,934)	(120,844)	(129,133)
Selling expense	(33,758)	(40,594)	(29,229)	(30,660)	(35,433)	(36,730)
Admin expense	(67,625)	(89,847)	(106,696)	(105,470)	(123,680)	(129,636)
Others	64,088	156,117	132,885	34,195	38,269	37,233
Operating profit	184,237	271,620	235,706	172,410	182,731	204,164
Share of (losses)/profits of associates/JV	3,672	(16,444)	(16,129)	320	320	320
Interest income	6,957	6,650	8,592	7,929	11,215	9,367
Interest expense	(7,887)	(7,114)	(9,352)	(10,963)	(11,063)	(2,692)
Pre-tax profit	180,022	248,062	210,225	161,767	171,988	201,792
Income tax	(19,897)	(20,252)	(21,516)	(29,118)	(23,218)	(26,102)
After tax profit	160,125	227,810	188,709	132,649	148,770	175,690
Minority interest	(278)	(2,988)	(466)	(328)	(367)	(413)
Net profit	159,847	224,822	188,243	132,322	148,402	175,277
Adjusted net profit	122,742	123,788	115,649	142,333	165,655	185,752
Gross dividends	12,653	12,704	20,256	16,374	18,364	20,645
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	317,647	484,812	565,989	581,068	656,437	825,351
Cash & equivalents	152,798	167,966	156,739	337,274	331,066	509,381
Account receivables	44,981	49,331	45,467	48,574	51,369	53,678
Inventories	814	1,063	2,333	1,872	1,939	2,047
Prepayment	40,321	65,390	76,685	32,204	82,952	37,380
ST bank deposits	68,487	83,813	104,776	127,294	154,105	185,913
Financial assets at FVTPL	6,593	10,573	27,963	29,361	30,829	32,371
Other current assets	3,653	106,676	152,026	4,488	4,177	4,581
Non-current assets	1,015,778	1,127,552	1,012,142	1,058,838	1,132,469	1,178,078
PP&E	59,843	61,914	53,978	71,813	85,919	97,275
Deferred income tax	21,348	26,068	29,882	20,435	34,424	24,674
Investment in JVs & assos	305,258	323,188	252,715	264,094	275,842	287,948
Intangibles	159,437	171,376	161,802	190,451	217,107	241,638
Financial assets at FVTPL	165,944	192,184	206,085	206,085	206,085	206,085
Other non-current assets	303,948	352,822	307,680	305,960	313,092	320,458
Total assets	1,333,425	1,612,364	1,578,131	1,639,906	1,788,906	2,003,430
Current liabilities	269,079	403,098	434,204	352,359	353,927	404,259
Short-term borrowings	14,242	19,003	22,026	18,153	19,552	20,727
Account payables	94,030	109,470	92,381	125,885	106,853	137,405
Tax payable	12,134	12,506	13,488	14,854	15,678	16,288
Other current liabilities	144,851	256,673	299,955	187,113	205,489	223,485
Lease liabilities	3,822	5,446	6,354	6,354	6,354	6,354
Non-current liabilities	286,303	332,573	361,067	383,285	394,562	405,690
Long-term borrowings	112,145	136,936	163,668	164,560	164,829	164,909
Bond payables	122,057	145,590	148,669	154,244	157,136	158,609
Deferred income	6,678	4,526	3,503	13,554	14,599	15,476
Other non-current liabilities	45,423	45,521	45,227	50,927	57,999	66,695
Total liabilities	555,382	735,671	795,271	735,644	748,489	809,948
Retained earnings	538,464	669,911	705,981	827,055	962,843	1,115,494
Other reserves	165,520	136,388	15,410	15,410	15,410	15,410
Total shareholders equity	703,984	806,299	721,391	842,465	978,253	1,130,904
Minority interest	74,059	70,394	61,469	61,797	62,164	62,577
Total equity and liabilities	1,333,425	1,612,364	1,578,131	1,639,906	1,788,906	2,003,430

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	180,022	248,062	210,225	161,767	171,988	201,792
Depreciation & amortization	50,774	56,818	60,230	55,298	67,986	78,921
Tax paid	(19,897)	(20,252)	(21,516)	(29,118)	(23,218)	(26,102)
Change in working capital	27,423	(2,844)	(28,405)	110,463	(54,266)	91,702
Others	(44,203)	(106,598)	(74,443)	0	0	(8,446)
Net cash from operations	194,119	175,186	146,091	298,410	162,489	337,867
Investing						
Capital expenditure	(33,906)	(34,931)	(33,892)	(36,727)	(39,241)	(41,428)
Acquisition of subsidiaries/ investments	(108,665)	(117,642)	59,711	(24,556)	(60,835)	(43,476)
Net proceeds from disposal of short-term investments	15,376	0	0	0	0	0
Others	(54,760)	(25,976)	(130,690)	(65,054)	(69,507)	(73,380)
Net cash from investing	(181,955)	(178,549)	(104,871)	(126,338)	(169,584)	(158,284)
Financing						
Net borrowings	44,490	45,239	31,982	9,659	12,456	12,035
Proceeds from share issues	1,716	0	0	0	0	0
Others	(32,559)	(23,619)	(91,935)	(1,196)	(11,570)	(13,303)
Net cash from financing	13,647	21,620	(59,953)	8,463	887	(1,268)
Net change in cash						
Cash at the beginning of the year	132,991	152,798	167,966	156,739	337,274	331,066
Exchange difference	(6,004)	(3,089)	7,506	0	0	0
Cash at the end of the year	152,798	167,966	156,739	337,274	331,066	509,381
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	27.8%	16.2%	(1.0%)	10.6%	9.0%	7.7%
Gross profit	32.2%	11.0%	(2.9%)	14.9%	10.7%	9.8%
Operating profit	55.2%	47.4%	(13.2%)	(26.9%)	6.0%	11.7%
Net profit	71.3%	40.6%	(16.3%)	(29.7%)	12.2%	18.1%
Adj. net profit	30.1%	0.9%	(6.6%)	23.1%	16.4%	12.1%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	46.0%	43.9%	43.1%	44.7%	45.4%	46.3%
Operating margin	38.2%	48.5%	42.5%	28.1%	27.3%	28.3%
Adj. net profit margin	25.5%	22.1%	20.9%	23.2%	24.8%	25.8%
Return on equity (ROE)	28.1%	29.8%	24.6%	16.9%	16.3%	16.6%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	0.1	0.2	0.2	(0.0)	0.0	(0.1)
Current ratio (x)	1.2	1.2	1.3	1.6	1.9	2.0
Receivable turnover days	34.1	32.1	29.9	28.9	28.0	27.2
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	23.2	18.1	14.1	21.8	19.5	16.5
P/E (diluted)	23.6	18.4	14.3	22.2	19.8	16.8
P/B	5.3	5.0	3.7	3.4	3.0	2.6

Source: Company data, CMBIGM estimates. Note: The calculation of net cash includes financial assets.

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