

TME (TME US)

Inline 3Q23 results; strong music subscription revenue growth

TME reported in-line 3Q23 results on 14 Nov: total revenue declined by 11% YoY and 10% QoQ to RMB6.6bn mainly on soft social entertainment business, versus consensus/our estimate of RMB6.4/6.3bn; non-IFRS net income was up 2% YoY to RMB1.41bn, in line with consensus/our estimate of RMB1.42/1.37bn. Core music subscription revenue growth further accelerated to +42% YoY in 3Q23 (vs. 1Q23/2Q23 +30/37% YoY & consensus +37% YoY), driven by solid growth of both paying users and ARPPU. Looking ahead, we forecast total revenue to decline by 10% YoY to RMB6.7bn in 4Q23E, due to the persisting impact of social entertainment business adjustment. Management currently targets to drive positive total revenue growth and net margin expansion in FY24E. We lower FY23-25 non-IFRS earnings forecast by 2-6%, mainly to reflect uncertainty on social entertainment business. We lower our DCF-derived TP to US\$8.90 (previous: US\$9.20). Maintain BUY.

- **Strong music subscription revenue growth.** Online music revenue was up 33% YoY to RMB4.6bn in 3Q23, accounting for 69% of total revenue (3Q22: 47%). Music subscription revenue grew by 42% YoY to RMB3.2bn in 3Q23, underpinned by solid growth of ARPPU/paying users (+18/21% YoY). Music paying ratio reached 17.3% in 3Q23. Non-subscription music revenue increased by 15% YoY to RMB1.4bn in 3Q23, primarily due to increase in ad revenue on more innovative ad formats. Leveraging LLMs, TME enhances its music recommendation and personalization capabilities to improve user experience and facilitate users' content consumption in 3Q23. For 4Q23E, we forecast online music revenue to grow by 36% YoY to RMB4.9bn. To drive music subscription revenue growth in 2024, TME will step up effort to develop its IoT business, promote Super VIP subscription, and roll out family membership.
- **Expect social entertainment revenue to stabilize in FY24.** Social entertainment and others revenue was down by 49% YoY to RMB2.0bn and represented 31% of total revenue in 3Q23, as TME adjusted certain live-streaming interactive functions and implemented more stringent compliance procedures. We forecast social entertainment revenue to further decline by 53% YoY and 9% QoQ to RMB1.8bn in 4Q23E, and to gradually stabilize QoQ in FY24E.
- **Further margin expansion in 4Q23E.** TME's GPM rose by 3.0ppt YoY and 1.4ppt QoQ to 35.7% in 3Q23, mainly on the enhanced monetization efficiency of online music business and the ramp-up of self-produced music content. And management expects GPM to further rise sequentially in 4Q23E. TME's strong execution of expense control continues to bear fruit, with operating expenses down by 12% YoY and non-IFRS net margin up by 2.7ppt in 3Q23. For 4Q23E, we expect non-IFRS net income to grow by 2% YoY to RMB1.46bn, supported by improved GPM and opex control.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	31,244	28,339	27,549	27,874	29,793
YoY growth (%)	7.2	(9.3)	(2.8)	1.2	6.9
Gross margin (%)	30.1	31.0	35.0	37.6	38.0
Adjusted net profit (RMB mn)	4,144.6	4,743.7	5,769.9	6,302.5	7,133.5
EPS (Adjusted) (RMB)	2.50	2.96	3.64	3.97	4.50
Consensus EPS (RMB)	2.50	2.96	3.75	3.96	4.48
P/E (x)	48.9	14.2	17.1	16.0	14.6

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$8.90
(Previous TP) US\$9.20
Up/Downside 19.8%
Current Price US\$7.43

China Internet

Saiyi HE, CFA
(852) 3916 1739
hesaiyi@cmbi.com.hk

Wentao LU, CFA
luwentao@cmbi.com.hk

Ye TAO
franktao@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	11,646.4
Avg 3 mths t/o (US\$ mn)	15.5
52w High/Low (US\$)	9.18/5.27
Total Issued Shares (mn)	1567.5

Source: FactSet

Shareholding Structure

Tencent	53.2%
Spotify	8.2%

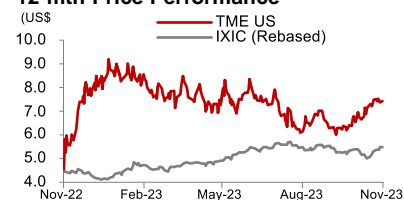
Source: Company data

Share Performance

	Absolute	Relative
1-mth	13.4%	10.5%
3-mth	20.8%	21.0%
6-mth	2.1%	-8.9%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	27,549	27,874	29,793	26,986	28,848	30,606	2.1%	-3.4%	-2.7%
Gross Profit	9,638	10,483	11,335	9,478	10,659	11,391	1.7%	-1.7%	-0.5%
Operating Profit	5,765	6,363	6,964	5,634	6,547	7,126	2.3%	-2.8%	-2.3%
Non-IFRS net profit	5,770	6,303	7,134	5,893	6,690	7,256	-2.1%	-5.8%	-1.7%
Non-IFRS EPS (RMB)	3.6	4.0	4.5	3.7	4.2	4.6	-2.2%	-5.9%	-1.8%
Gross Margin	35.0%	37.6%	38.0%	35.1%	36.9%	37.2%	-0.1 ppt	0.7 ppt	0.8 ppt
Operating Margin	20.9%	22.8%	23.4%	20.9%	22.7%	23.3%	0.0 ppt	0.1 ppt	0.1 ppt
Non-IFRS net margin	20.9%	22.6%	23.9%	21.8%	23.2%	23.7%	-0.9 ppt	-0.6 ppt	0.2 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	27,549	27,874	29,793	26,951	27,281	30,518	2.2%	2.2%	-2.4%
Gross Profit	9,638	10,483	11,335	9,386	9,880	11,423	2.7%	6.1%	-0.8%
Operating Profit	5,765	6,363	6,964	5,408	5,856	6,930	6.6%	8.7%	0.5%
Non-IFRS net profit	5,770	6,303	7,134	5,882	6,209	7,028	-1.9%	1.5%	1.5%
Non-IFRS EPS (RMB)	3.6	4.0	4.5	3.8	4.0	4.5	-3.1%	0.3%	0.3%
Gross Margin	35.0%	37.6%	38.0%	34.8%	36.2%	37.4%	0.2 ppt	1.4 ppt	0.6 ppt
Operating Margin	20.9%	22.8%	23.4%	20.1%	21.5%	22.7%	0.9 ppt	1.4 ppt	0.7 ppt
Non-IFRS net margin	20.9%	22.6%	23.9%	21.8%	22.8%	23.0%	-0.9 ppt	-0.1 ppt	0.9 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: quarterly financial

(RMB mn)	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	Cons.	Diff%	CMBI	Diff%
Online music	2,616	2,878	3,430	3,559	3,501	4,249	4,553	4,538	0.3%	4,472	1.8%
YoY change (%)	-4.8%	-2.4%	18.8%	23.6%	33.8%	47.6%	32.7%				
Subscription revenue	1,993	2,107	2,249	2,352	2,599	2,890	3,193	3,077	3.8%	3,046	4.9%
YoY change (%)	17.8%	17.6%	18.3%	20.6%	30.4%	37.2%	42.0%				
Other revenue	623	771	1,181	1,207	902	1,359	1,360	1,461	-7.0%	1,427	-4.7%
YoY change (%)	-41.1%	-33.4%	19.7%	29.8%	44.8%	76.1%	15.1%				
Social entertainment	4,028	4,027	3,935	3,866	3,503	3,037	2,016	1,788	12.8%	1,779	13.3%
YoY change (%)	-20.6%	-20.4%	-20.0%	-18.2%	-13.0%	-24.6%	-48.8%				
Total revenue	6,644	6,905	7,365	7,425	7,004	7,286	6,569	6,399	2.7%	6,251	5.1%
YoY change (%)	-15.1%	-13.8%	-5.6%	-2.4%	5.4%	5.5%	-10.8%				
GPM (%)	28.0%	29.9%	32.6%	33.0%	33.1%	34.3%	35.7%				
Adjusted NPM (%)	13.5%	14.9%	18.7%	19.4%	20.1%	21.0%	21.4%				
Adjusted net profit	899	1,029	1,379	1,438	1,411	1,529	1,408	1,415	-0.5%	1,370	2.7%
YoY change (%)	-23.9%	-7.9%	35.9%	73.1%	57.0%	48.6%	2.1%				

Source: Company data, CMBIGM

DCF valuation

Our target price of US\$8.90 is based on the DCF valuation methodology (WACC of 11.6% and terminal growth of 2.5%).

Figure 4: TME: DCF Valuation

(RMBmn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Free cash flow	4,573	5,920	6,878	7,655	8,464	9,271	9,986	10,069
NPV of free cash flow	41,585							
Discounted terminal value	52,786							
Net cash	7,513							
Total TME valuation	101,884							
Number of ADS (diluted, mn)	1,567							
Valuation per ADS (US\$)	8.90							

Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	29,153	31,244	28,339	27,549	27,874	29,793
Cost of goods sold	19,851	21,840	19,566	17,911	17,391	18,458
Gross profit	9,302	9,404	8,773	9,638	10,483	11,335
Operating expenses	4,592	5,604	4,330	3,873	4,120	4,371
Selling expense	2,475	2,678	1,144	913	915	978
Admin expense	3,101	4,009	4,413	4,195	4,208	4,498
Others	(984)	(1,083)	(1,227)	(1,235)	(1,003)	(1,105)
Operating profit	4,710	3,800	4,443	5,765	6,363	6,964
Share of (losses)/profits of associates/JV	19	(47)	38	120	0	0
Interest expense	(97)	(121)	(108)	(150)	(135)	(122)
Pre-tax profit	4,632	3,632	4,373	5,735	6,228	6,842
Income tax	(456)	(417)	(534)	(779)	(934)	(1,026)
After tax profit	4,176	3,215	3,839	4,956	5,294	5,816
Net profit	4,176	3,215	3,839	4,956	5,294	5,816
Adjusted net profit	4,949	4,145	4,744	5,770	6,303	7,134
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	31,687	26,791	26,559	29,985	34,765	40,911
Cash & equivalents	11,128	6,591	9,589	13,049	17,667	23,283
Account receivables	2,800	3,610	2,670	2,902	2,783	2,811
Inventories	18	24	14	8	5	3
Prepayment	2,846	2,731	2,958	2,355	2,287	2,427
ST bank deposits	14,858	12,769	11,291	11,630	11,979	12,338
Other current assets	37	1,066	37	41	45	49
Non-current assets	36,586	40,463	40,450	40,853	41,273	41,722
PP&E	176	243	323	274	246	235
Right-of-use assets	311	283	398	398	398	398
Deferred income tax	303	346	347	364	383	402
Investment in JVs & assos	2,255	3,599	4,330	4,380	4,430	4,480
Intangibles	2,020	2,829	2,368	2,167	1,946	1,721
Goodwill	17,492	19,121	19,493	19,743	19,993	20,243
Financial assets at FVTPL	9,771	7,302	3,168	3,231	3,296	3,362
Other non-current assets	4,258	6,740	10,023	10,296	10,582	10,882
Total assets	68,273	67,254	67,009	70,838	76,038	82,633
Current liabilities	9,602	10,450	11,717	10,591	10,489	11,248
Account payables	3,565	4,329	4,998	4,318	4,240	4,551
Tax payable	445	363	404	393	397	425
Other current liabilities	5,489	5,666	6,192	5,754	5,720	6,138
Lease liabilities	103	92	123	127	130	134
Long-term borrowings	5,940	5,749	6,165	6,164	6,173	6,192
Bond payables	5,175	5,062	5,536	5,536	5,536	5,536
Obligations under finance leases	218	205	306	321	337	354
Other non-current liabilities	547	482	323	307	299	302
Total liabilities	15,542	16,199	17,882	16,755	16,661	17,440
Share capital	2	2	2	2	2	2
Capital surplus	34,910	32,395	29,905	29,905	29,905	29,905
Retained earnings	11,111	14,194	12,052	17,008	22,302	28,118
Other reserves	6,222	3,726	6,140	6,140	6,140	6,140
Total shareholders equity	52,245	50,317	48,099	53,055	58,349	64,165
Minority interest	486	738	1,028	1,028	1,028	1,028
Total equity and liabilities	68,273	67,254	67,009	70,838	76,038	82,633

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,632	3,632	4,373	5,735	6,228	6,842
Depreciation & amortization	824	1,001	1,160	622	623	634
Tax paid	(637)	(589)	(733)	0	0	0
Change in working capital	(497)	579	2,211	(853)	(16)	491
Others	563	616	470	(779)	(934)	(1,026)
Net cash from operations	4,885	5,239	7,481	4,724	5,901	6,941
Investing						
Capital expenditure	(501)	(2,758)	(1,053)	(372)	(374)	(398)
Acquisition of subsidiaries/ investments	(540)	(2,078)	(165)	(250)	(250)	(250)
Net proceeds from disposal of short-term investments	6	(877)	1,055	0	0	0
Others	(13,171)	(286)	(1,283)	(658)	(676)	(694)
Net cash from investing	(14,206)	(5,999)	(1,446)	(1,279)	(1,300)	(1,342)
Financing						
Net borrowings	5,400	0	0	0	0	0
Proceeds from share issues	(134)	0	0	0	0	0
Others	26	(3,710)	(3,419)	15	16	17
Net cash from financing	5,292	(3,710)	(3,419)	15	16	17
Net change in cash						
Cash at the beginning of the year	15,426	11,128	6,591	9,589	13,049	17,667
Exchange difference	(269)	(67)	382	0	0	0
Cash at the end of the year	11,128	6,591	9,589	13,049	17,667	23,283
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	14.6%	7.2%	(9.3%)	(2.8%)	1.2%	6.9%
Gross profit	7.3%	1.1%	(6.7%)	9.9%	8.8%	8.1%
Operating profit	1.9%	(19.3%)	16.9%	29.8%	10.4%	9.4%
Net profit	5.0%	(23.0%)	19.4%	29.1%	6.8%	9.9%
Adj. net profit	0.8%	(16.3%)	14.5%	21.6%	9.2%	13.2%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	31.9%	30.1%	31.0%	35.0%	37.6%	38.0%
Operating margin	16.2%	12.2%	15.7%	20.9%	22.8%	23.4%
Adj. net profit margin	17.0%	13.3%	16.7%	20.9%	22.6%	23.9%
Return on equity (ROE)	8.7%	6.3%	7.8%	9.8%	9.5%	9.5%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	(0.1)	(0.0)	(0.1)	(0.1)	(0.2)	(0.3)
Current ratio (x)	3.3	2.6	2.3	2.8	3.3	3.6
Receivable turnover days	31.3	37.4	40.4	36.9	37.2	34.3
Payable turnover days	56.3	66.0	87.0	94.9	89.8	86.9
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	38.1	48.9	14.2	17.1	16.0	14.6
P/E (diluted)	38.7	49.5	14.3	17.4	16.2	14.8
P/B	3.0	3.1	1.1	1.6	1.5	1.3

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

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong. Tel: (852) 3900 0888 Fax: (852) 3900 0800

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