

Cloud Music (9899 HK)

Solid online music business fuels robust earnings growth

Cloud Music announced 1H24 financial results: total revenue was up by 4% YoY to RMB4.1bn, in line with consensus estimate; adjusted net income grew by 165% YoY to RMB881mn, well ahead of consensus estimate, primarily attributable to the better-than-expected GPM expansion (+10ppt YoY). For FY24, we forecast total revenue to grow by 1% YoY to RMB7.93bn, driven by solid growth of online music business but partially offset by decline in social entertainment revenue. In view of the better-than-expected GPM expansion, we lift FY24 adjusted net income by 10%. We raise our DCF-derived target price to HK\$115.0 (previous: HK\$106.5). Maintain BUY.

- Strong music subscription and advertising businesses.** Online music services revenue grew by 27% YoY to RMB2.56bn in 1H24, driven by strong growth of both membership subscription revenue and advertising revenue. Membership subscription revenue was up by 25% YoY to RMB2.14bn in 1H24, primarily driven by growth in monthly paying users. Social entertainment and others revenue declined by 20% YoY to RMB1.51bn in 1H24, as Cloud music strengthened risk control and prioritized core music business.
- Healthy music ecosystem to support long-term growth outlook.** Cloud Music continued to see healthy development of its user community, with largely stable total user base YoY and DAU/MAU ratio of above 30%. The company also further enriched its content library via expanding partnership with music label and strengthening its independent artists' ecosystem, which we expect to support the long-term revenue growth outlook. For 2H24E, we expect online music revenue to grow by 16% YoY to RMB2.70bn, with slight deceleration in YoY growth due to high-base effect for both membership subscription and online advertising businesses. Social entertainment business remains under pressure due to business adjustment, and we estimate social entertainment revenue to decline by 29% YoY to RMB1.16bn in 2H24E.
- Solid margin expansion on operating leverage.** Overall GPM expanded by 10.3ppt YoY to 35.0% in 1H24, mainly attributable to operating leverage improvement and one-off copyright cost adjustment that boosted GPM by 2.6ppt. We expect its GPM will rise to 32.8% in 2H24E (vs. 32.4% in 1H24 excl. one-off impact), driven by operating leverage but partially offset by continuous investments in content library. For FY24E, we forecast adjusted net income to grow by 73% YoY to RMB1.42bn, with net margin up by 7.5ppt YoY to 17.9%. Cloud Music's current valuation of 13x FY24E non-IFRS PE offers attractive risk-reward in our view. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	8,992	7,867	7,933	8,468	8,888
Gross margin (%)	14.4	26.7	33.9	35.7	37.4
Operating profit (RMB mn)	(384.5)	330.2	950.4	1,314.0	1,629.9
Adjusted net profit (RMB mn)	(114.6)	818.5	1,416.0	1,696.4	1,900.7
EPS (Adjusted) (RMB)	(0.55)	3.89	6.78	8.13	9.11
P/S (x)	2.0	2.3	2.2	2.1	2.0
P/E (x)	na	24.4	13.8	11.4	10.1

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$115.00
 (Previous TP) HK\$106.50
Up/Downside 23.9%
Current Price HK\$92.85

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Stock Data

Mkt Cap (HK\$ mn)	19,380.8
Avg 3 mths t/o (HK\$ mn)	20.0
52w High/Low (HK\$)	110.10/69.45
Total Issued Shares (mn)	208.7

Source: FactSet

Shareholding Structure

NetEase	61.4%
Alibaba	9.9%

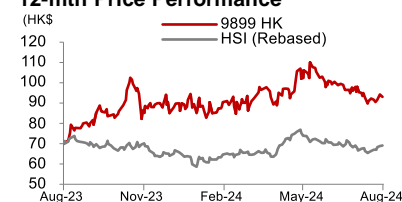
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-2.9%	-3.7%
3-mth	-9.3%	-2.9%
6-mth	2.1%	-3.0%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Cloud Music: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	7,933	8,468	8,888	8,001	8,566	9,067	-0.9%	-1.1%	-2.0%
Gross profit	2,692	3,023	3,327	2,833	3,225	3,568	-5.0%	-6.3%	-6.8%
Operating profit	950	1,314	1,630	1,017	1,384	1,705	-6.5%	-5.1%	-4.4%
Adjusted net profit	1,416	1,696	1,901	1,291	1,659	2,002	9.6%	2.3%	-5.1%
Adjusted EPS (RMB)	6.7	8.1	9.0	6.1	7.9	9.5	9.6%	2.3%	-5.1%
Gross margin	33.9%	35.7%	37.4%	35.4%	37.7%	39.4%	-1.5 ppt	-1.9 ppt	-1.9 ppt
Operating margin	12.0%	15.5%	18.3%	12.7%	16.2%	18.8%	-0.7 ppt	-0.6 ppt	-0.5 ppt
Adjusted net margin	17.9%	20.0%	21.4%	16.1%	19.4%	22.1%	1.7 ppt	0.7 ppt	-0.7 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	7,933	8,468	8,888	8,217	9,062	9,927	-3.5%	-6.6%	-10.5%
Gross profit	2,692	3,023	3,327	2,598	3,000	3,379	3.6%	0.8%	-1.6%
Adjusted net profit	1,416	1,696	1,901	1,066	1,313	1,577	32.9%	29.2%	20.5%
Adjusted EPS (RMB)	6.7	8.1	9.0	5.1	6.1	7.1	32.4%	31.5%	26.5%
Gross margin	33.9%	35.7%	37.4%	31.6%	33.1%	34.0%	2.3 ppt	2.6 ppt	3.4 ppt
Adjusted net margin	17.9%	20.0%	21.4%	13.0%	14.5%	15.9%	4.9 ppt	5.5 ppt	5.5 ppt

Source: Company data, CMBIGM estimates

Based on DCF valuation (WACC of 14.7% and terminal growth of 2.5%), our target price of Cloud Music is HK\$115.0, which implies 16x FY24E PE.

Figure 3: Cloud Music: DCF valuation

(RMB mn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Adjusted EBITDA	1,051	1,416	1,728	1,828	1,790	1,708	1,616
Free cash flow	932	1,324	1,431	1,536	1,459	1,384	1,299
NPV of FCF	6,309						
Discounted terminal value	4,823						
Enterprise value	11,132						
Net cash	10,842						
Equity value	21,974						
Number of shares (diluted, mn)	208.7						
Exchange rate (HKD/RMB)	0.92						
Valuation per share (HK\$)	115.0						
WACC	14.7%						
Terminal FCF growth (%)	2.5%						

Source: CMBIGM estimates

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	6,998	8,992	7,867	7,933	8,468	8,888
Cost of goods sold	6,855	7,699	5,764	5,241	5,444	5,561
Gross profit	143	1,293	2,103	2,692	3,023	3,327
Operating expenses	1,490	1,678	1,772	1,741	1,709	1,697
Selling expense	431	635	758	785	762	760
Admin expense	264	172	165	186	186	186
R&D expense	869	1,011	869	809	803	800
Others	(75)	(140)	(20)	(40)	(42)	(49)
Operating profit	(1,347)	(385)	330	950	1,314	1,630
Investment gain/loss	2	(3)	(0)	(0)	(0)	(0)
Other gains/(losses)	(755)	0	0	0	0	0
Interest income	48	183	438	365	401	439
Interest expense	0	(0)	(0)	0	0	0
Pre-tax profit	(2,051)	(204)	768	1,315	1,715	2,069
Income tax	(5)	(17)	(33)	(26)	(154)	(310)
After tax profit	(2,056)	(221)	734	1,289	1,561	1,759
Net profit	(2,056)	(221)	734	1,289	1,561	1,759
Adjusted net profit	(1,044)	(115)	819	1,416	1,696	1,901

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	8,769	10,475	11,323	12,512	14,273	16,187
Cash & equivalents	853	2,917	4,020	5,083	6,563	8,179
Account receivables	674	558	923	838	850	847
Prepayment	1,345	662	775	713	694	692
ST bank deposits	5,528	6,192	5,485	5,759	6,047	6,349
Financial assets at FVTPL	241	0	0	0	0	0
Other current assets	128	139	98	98	98	98
Non-current assets	619	416	287	246	234	232
PP&E	44	46	33	23	17	15
Right-of-use assets	11	8	6	6	6	6
Investment in JVs & assos	93	79	79	79	79	79
Other non-current assets	471	283	169	137	132	131
Total assets	9,388	10,891	11,611	12,758	14,508	16,419
Current liabilities	1,948	3,010	3,100	2,830	2,879	2,887
Account payables	0	0	0	0	0	0
Tax payable	0	6	4	1	5	9
Other current liabilities	56	53	76	76	76	76
Lease liabilities	3	3	3	3	3	3
Contract liabilities	605	714	1,001	1,009	1,077	1,131
Accrued expenses	1,284	2,235	2,015	1,741	1,718	1,667
Non-current liabilities	58	61	70	70	75	79
Convertible bonds	0	0	0	0	0	0
Other non-current liabilities	58	61	70	70	75	79
Total liabilities	2,006	3,071	3,170	2,901	2,954	2,965
Share capital	0	0	0	0	0	0
Retained earnings	(10,600)	(10,824)	(10,091)	(8,802)	(7,241)	(5,483)
Other reserves	17,982	18,644	18,532	18,659	18,795	18,937
Total shareholders equity	7,382	7,820	8,441	9,857	11,553	13,454
Total equity and liabilities	9,388	10,891	11,611	12,758	14,508	16,419

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(2,051)	(204)	768	1,315	1,715	2,069
Depreciation & amortization	15	23	16	13	9	5
Tax paid	(6)	(20)	(35)	(30)	(151)	(306)
Change in working capital	177	2,102	(222)	(86)	62	11
Others	957	(58)	(353)	(238)	(266)	(297)
Net cash from operations	(908)	1,843	174	975	1,370	1,483
Investing						
Capital expenditure	(40)	(26)	(4)	(3)	(3)	(3)
Acquisition of subsidiaries/ investments	(11,544)	(13,619)	707	(274)	(288)	(302)
Net proceeds from disposal of short-term investments	7,681	13,650	0	0	0	0
Others	40	153	438	365	401	439
Net cash from investing	(3,862)	159	1,141	87	110	133
Financing						
Proceeds from share issues	2,679	0	0	0	0	0
Share repurchases	0	(31)	0	0	0	0
Others	(65)	28	(0)	0	0	0
Net cash from financing	2,614	(3)	(0)	0	0	0
Net change in cash						
Cash at the beginning of the year	3,006	853	2,917	4,020	5,083	6,563
Exchange difference	4	64	(211)	0	0	0
Cash at the end of the year	853	2,917	4,020	5,083	6,563	8,179
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	42.9%	28.5%	(12.5%)	0.8%	6.7%	5.0%
Gross profit	na	806.3%	62.6%	28.0%	12.3%	10.0%
Operating profit	na	na	na	187.9%	38.3%	24.0%
Net profit	na	na	na	75.6%	21.1%	12.7%
Adj. net profit	na	na	na	73.0%	19.8%	12.0%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	2.0%	14.4%	26.7%	33.9%	35.7%	37.4%
Operating margin	(19.2%)	(4.3%)	4.2%	12.0%	15.5%	18.3%
Adj. net profit margin	(14.9%)	(1.3%)	10.4%	17.9%	20.0%	21.4%
Return on equity (ROE)	(198.2%)	(2.9%)	9.0%	14.1%	14.6%	14.1%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.9)	(1.2)	(1.1)	(1.1)	(1.1)	(1.1)
Current ratio (x)	4.5	3.5	3.7	4.4	5.0	5.6
Receivable turnover days	35.1	22.7	42.8	38.6	36.6	34.8
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	ns	ns	24.4	13.8	11.4	10.1
P/E (diluted)	ns	ns	24.4	13.8	11.4	10.1
P/B	2.4	2.3	2.1	1.8	1.5	1.3

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

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