

# TME (TME US)

## Expect a year of mild recovery in FY23

TME announced its 4Q22 financial results on 21 March. Total revenue declined 2% YoY to RMB7.4bn in 4Q22, inline with consensus and CMBI estimates. 2022 Full-year revenue declined 9% YoY, mainly due to soft social entertainment and ad businesses amid macro uncertainty. However, the music subscription business remained resilient, with revenue up 19% YoY in FY22. Despite the revenue decline, 4Q22 non-IFRS net income grew 73% YoY to RMB1.4bn on effective costs and expenses control, and was in line with consensus/CMBI estimate. Full-year non-IFRS net income grew 14% YoY to RMB4.7bn. Management expects online music quarterly revenue to surpass social entertainment revenue within the year, and also expect mid-single digit total revenue growth and low-teens non-IFRS net profit growth in FY23E. We maintain FY23-24 non-IFRS net income forecast largely unchanged. Our DCF-derived TP is unchanged at US\$10.5. Maintain BUY.

- **Expect solid music revenue growth in FY23.** Online music service revenue grew 24% YoY (3Q22/2Q22: +19%/-2% YoY) and accounted for 48% of total revenue in 4Q22, driven by strong subscription and ads recovery. MAU declined by 8% YoY to 567mn in 4Q22 due to the churn of casual users and prudent marketing control to focus on user quality. The number of subscribers grew 16% YoY to 88.5mn, with QoQ net addition of 3.2mn and paying ratio up by 3.2ppt YoY to 15.6% in 4Q22. Music subscription will continue to be the main growth driver with revenue growth target over 20% YoY in 2023. TME will also develop more monetization methods such as ad-supported mode and super VIP membership.
- **Social entertainment: expect milder decline in FY23.** Social entertainment and others revenue decreased by 18% YoY (3Q22/2Q22: -20%/-20% YoY) and represented 52% of total revenue in 4Q22. The decline was mainly due to the intensifying competition and COVID-related disruptions in 4Q22. In 2023 management expects milder rate of decline for social entertainment revenue, as the growth of audio live streaming and international business will partially offset the decrease of traditional live streaming revenue.
- **Strong earnings growth on efficiency improvement.** Non-IFRS net income delivered a robust growth of 73% YoY, with net margin up by 8.4ppt YoY to 19.4% in 4Q22, attributable to the prudent S&M expense control (-65% YoY) and improvement in GPM (+4.1ppt YoY). The Management expect further decline in S&M expenses (but at a slower pace compared to FY22) and also net margin improvement in FY23. Driven by solid online music revenue growth and operating efficiency improvement, we forecast non-IFRS net income CAGR of 15% over FY23-25E.

### Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	31,244	28,339	29,713	31,832	33,943
YoY growth (%)	7.2	(9.3)	4.8	7.1	6.6
Gross margin (%)	30.1	31.0	32.7	34.3	35.8
Operating profit (RMB mn)	3,800	4,443	4,928	5,853	6,829
Adjusted net profit (RMB mn)	4,146.0	4,745.0	5,450.0	6,315.8	7,237.7
EPS (Adjusted) (RMB)	2.50	2.96	3.37	3.91	4.48
Consensus EPS (RMB)	2.50	2.96	3.29	3.55	4.39
P/S (x)	2.8	3.0	2.9	2.7	2.5
P/E (x)	48.9	14.2	21.1	17.6	15.0

Source: Company data, Bloomberg, CMBIGM estimates

## BUY (Maintain)

**Target Price** US\$10.50  
(Previous TP US\$10.50)  
**Up/Downside** 33.6%  
**Current Price** US\$7.86

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### Stock Data

Mkt Cap (US\$ mn)	12,497.4
Avg 3 mths t/o (US\$ mn)	8.2
52w High/Low (US\$)	9.18/3.61
Total Issued Shares (mn)	1590.0

Source: FactSet

### Shareholding Structure

Tencent	53.2%
Spotify	8.2%

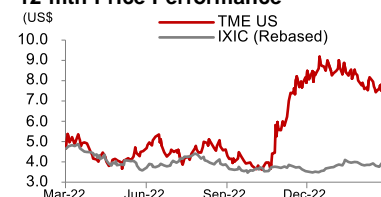
Source: Company data

### Share Performance

	Absolute	Relative
1-mth	-1.9%	-0.6%
3-mth	-0.5%	-9.8%
6-mth	71.6%	68.6%

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	29,713	31,832	33,943	29,556	31,825	-	0.5%	0.0%	-
Gross Profit	9,709	10,930	12,137	9,812	11,071	-	-1.0%	-1.3%	-
Operating Profit	4,928	5,861	6,843	4,816	5,738	-	2.3%	2.1%	-
Non-IFRS net profit	5,450	6,322	7,250	5,416	6,288	-	0.6%	0.6%	-
Non-IFRS EPS (RMB)	3.4	3.9	4.5	3.3	3.9	-	0.8%	0.8%	-
Gross Margin	32.7%	34.3%	35.8%	33.2%	34.8%	-	-0.5 ppt	-0.4 ppt	-
Operating Margin	16.6%	18.4%	20.2%	16.3%	18.0%	-	0.3 ppt	0.4 ppt	-
Non-IFRS net margin	18.3%	19.9%	21.4%	18.3%	19.8%	-	0.0 ppt	0.1 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	29,713	31,832	33,943	29,445	31,498	34,445	0.9%	1.1%	-1.5%
Gross Profit	9,709	10,930	12,137	9,534	10,510	11,808	1.8%	4.0%	2.8%
Operating Profit	4,928	5,861	6,843	4,804	5,410	6,558	2.6%	8.3%	4.3%
Non-IFRS net profit	5,450	6,322	7,250	5,262	5,755	7,194	3.6%	9.9%	0.8%
Non-IFRS EPS (RMB)	3.4	3.9	4.5	3.3	3.6	4.4	3.6%	9.9%	0.8%
Gross Margin	32.7%	34.3%	35.8%	32.4%	33.4%	34.3%	0.3 ppt	1.0 ppt	1.5 ppt
Operating Margin	16.6%	18.4%	20.2%	16.3%	17.2%	19.0%	0.3 ppt	1.2 ppt	1.1 ppt
Non-IFRS net margin	18.3%	19.9%	21.4%	17.9%	18.3%	20.9%	0.5 ppt	1.6 ppt	0.5 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: quarterly financial

(RMB mn)	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	Cons.	Diff%	CMBI	Diff%
Online music	2,950	2,888	2,880	2,616	2,878	3,430	3,559			3,531	0.8%
yoy change (%)	32.8%	24.3%	4.3%	-4.8%	-2.4%	18.8%	23.6%				
Subscription revenue	1,791	1,901	1,950	1,993	2,107	2,249	2,352			2,344	0.3%
yoy change (%)	36.3%	30.2%	23.5%	17.8%	17.6%	18.3%	20.6%				
Other revenue	1,159	987	930	623	771	1,181	1,207			1,186	1.8%
yoy change (%)	27.8%	14.2%	-21.3%	-41.1%	-33.4%	19.7%	29.8%				
Social entertainment	5,058	4,917	4,727	4,028	4,027	3,935	3,866			3,809	1.5%
yoy change (%)	7.4%	-6.4%	-15.2%	-20.6%	-20.4%	-20.0%	-18.2%				
<b>Total revenue</b>	<b>8,008</b>	<b>7,805</b>	<b>7,607</b>	<b>6,644</b>	<b>6,905</b>	<b>7,365</b>	<b>7,425</b>	<b>7,344</b>	1.1%	<b>7,340</b>	1.2%
yoy change (%)	15.5%	3.0%	-8.7%	-15.1%	-13.8%	-5.6%	-2.4%				
GPM (%)	30.4%	29.6%	28.8%	28.0%	29.9%	32.6%	33.0%				
Adjusted NPM (%)	13.9%	13.0%	10.9%	13.5%	14.9%	18.7%	19.4%				
<b>Adjusted net profit</b>	<b>1,117</b>	<b>1,015</b>	<b>832</b>	<b>899</b>	<b>1,029</b>	<b>1,379</b>	<b>1,438</b>	<b>1,464</b>	-1.8%	<b>1,468</b>	-2.0%
yoy change (%)	-3.0%	-24.6%	-38.3%	-23.9%	-7.9%	35.9%	72.8%				

Source: Company data, CMBIGM

## DCF valuation

Our target price is US\$10.5, based on the DCF valuation methodology (WACC of 11.6% and terminal growth of 2.5%). Besides, the company has equity investment valued at RMB7.5bn as of 31 Dec 2022, which is equivalent to 7% of our DCF-derived valuation.

**Figure 4: TME: DCF Valuation**

(RMBmn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Free cash flow	4,742	5,604	6,460	7,583	8,739	10,029	11,318	12,325
NPV of free cash flow	43,437							
Discounted terminal value	64,611							
Net cash	6,818							
Total TME valuation	114,865							
Number of ADS (diluted, mn)	1,590							
<b>Valuation per ADS (US\$)</b>	<b>10.50</b>							

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	29,713	31,832	33,943
Cost of goods sold	19,851	21,840	19,566	20,004	20,902	21,806
Gross profit	9,302	9,404	8,773	9,709	10,930	12,137
Operating expenses	4,592	5,604	4,330	4,781	5,077	5,308
Selling expense	2,475	2,678	1,144	1,067	1,132	1,196
Admin expense	3,101	4,009	4,413	4,582	4,828	5,105
Others	(984)	(1,083)	(1,227)	(868)	(883)	(993)
Operating profit	4,710	3,800	4,443	4,928	5,853	6,829
Share of (losses)/profits of associates/JV	19	(47)	38	0	0	0
Interest expense	(97)	(121)	(108)	(115)	(103)	(93)
Pre-tax profit	4,632	3,632	4,373	4,813	5,750	6,736
Income tax	(456)	(417)	(534)	(722)	(862)	(1,010)
After tax profit	4,176	3,215	3,839	4,091	4,887	5,726
Net profit	4,176	3,215	3,839	4,091	4,887	5,726
Adjusted net profit	4,949	4,146	4,745	5,450	6,316	7,238
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	31,687	26,791	28,924	32,890	37,872	43,689
Cash & equivalents	11,128	6,591	8,500	11,880	16,119	21,187
Account receivables	2,800	3,610	3,494	3,500	3,576	3,627
Inventories	18	24	32	43	57	76
Prepayment	2,846	2,731	2,573	2,631	2,749	2,868
ST bank deposits	14,858	12,769	13,152	13,547	13,953	14,372
Other current assets	37	1,066	1,173	1,290	1,419	1,561
Non-current assets	36,586	40,463	40,987	41,492	42,015	42,552
PP&E	176	243	234	233	237	244
Right-of-use assets	311	283	283	283	283	283
Deferred income tax	303	346	363	381	401	421
Investment in JVs & assos	2,255	3,599	3,649	3,699	3,749	3,799
Intangibles	2,020	2,829	2,691	2,512	2,328	2,139
Goodwill	17,492	19,121	19,371	19,621	19,871	20,121
Financial assets at FVTPL	9,771	7,302	7,448	7,597	7,749	7,904
Other non-current assets	4,258	6,740	6,947	7,166	7,397	7,641
Total assets	68,273	67,254	69,911	74,382	79,886	86,241
Current liabilities	9,602	10,450	9,295	9,665	10,267	10,881
Account payables	3,565	4,329	3,752	3,891	4,123	4,361
Tax payable	445	363	329	345	370	394
Other current liabilities	5,489	5,666	5,118	5,331	5,674	6,022
Lease liabilities	103	92	95	98	101	104
Long-term borrowings	5,940	5,749	5,722	5,732	5,747	5,762
Bond payables	5,175	5,062	5,062	5,062	5,062	5,062
Obligations under finance leases	218	205	215	226	237	249
Other non-current liabilities	547	482	445	444	448	451
Total liabilities	15,542	16,199	15,017	15,397	16,014	16,643
Share capital	2	2	2	2	2	2
Capital surplus	34,910	32,395	32,395	32,395	32,395	32,395
Retained earnings	11,111	14,194	18,033	22,124	27,011	32,737
Other reserves	6,222	3,726	3,726	3,726	3,726	3,726
Total shareholders equity	52,245	50,317	54,156	58,247	63,134	68,860
Minority interest	486	738	738	738	738	738
Total equity and liabilities	68,273	67,254	69,911	74,382	79,886	86,241

<b>CASH FLOW</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec (RMB mn)</b>						
<b>Operating</b>						
Profit before taxation	4,632	3,632	4,373	4,813	5,750	6,736
Depreciation & amortization	824	1,001	559	582	606	635
Tax paid	(637)	(589)	0	0	0	0
Change in working capital	(497)	579	(1,121)	82	165	172
Others	563	616	(534)	(722)	(862)	(1,010)
<b>Net cash from operations</b>	<b>4,885</b>	<b>5,239</b>	<b>3,277</b>	<b>4,754</b>	<b>5,659</b>	<b>6,533</b>
<b>Investing</b>						
Capital expenditure	(501)	(2,758)	(413)	(401)	(427)	(453)
Acquisition of subsidiaries/ investments	(540)	(2,078)	(250)	(250)	(250)	(250)
Net proceeds from disposal of short-term investments	6	(877)	0	0	0	0
Others	(13,171)	(286)	(716)	(735)	(754)	(774)
<b>Net cash from investing</b>	<b>(14,206)</b>	<b>(5,999)</b>	<b>(1,378)</b>	<b>(1,385)</b>	<b>(1,431)</b>	<b>(1,477)</b>
<b>Financing</b>						
Net borrowings	5,400	0	0	0	0	0
Proceeds from share issues	(134)	0	0	0	0	0
Others	26	(3,710)	10	11	11	12
<b>Net cash from financing</b>	<b>5,292</b>	<b>(3,710)</b>	<b>10</b>	<b>11</b>	<b>11</b>	<b>12</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	15,426	11,128	6,591	8,500	11,880	16,119
Exchange difference	(269)	(67)	0	0	0	0
<b>Cash at the end of the year</b>	<b>11,128</b>	<b>6,591</b>	<b>8,500</b>	<b>11,880</b>	<b>16,119</b>	<b>21,187</b>
<b>GROWTH</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Revenue	14.6%	7.2%	(9.3%)	4.8%	7.1%	6.6%
Gross profit	7.3%	1.1%	(6.7%)	10.7%	12.6%	11.0%
Operating profit	1.9%	(19.3%)	16.9%	10.9%	18.8%	16.7%
Net profit	5.0%	(23.0%)	19.4%	6.6%	19.5%	17.2%
Adj. net profit	0.8%	(16.2%)	14.4%	14.9%	15.9%	14.6%
<b>PROFITABILITY</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Gross profit margin	31.9%	30.1%	31.0%	32.7%	34.3%	35.8%
Operating margin	16.2%	12.2%	15.7%	16.6%	18.4%	20.1%
Adj. net profit margin	17.0%	13.3%	16.7%	18.3%	19.8%	21.3%
Return on equity (ROE)	8.7%	6.3%	7.3%	7.3%	8.1%	8.7%
<b>GEARING/LIQUIDITY/ACTIVITIES</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
Net debt to equity (x)	(0.1)	(0.0)	(0.1)	(0.1)	(0.2)	(0.2)
Current ratio (x)	3.3	2.6	3.1	3.4	3.7	4.0
Receivable turnover days	31.3	37.4	45.7	43.0	40.6	38.7
Payable turnover days	56.3	66.0	75.4	69.7	70.0	71.0
<b>VALUATION</b>	<b>2020A</b>	<b>2021A</b>	<b>2022A</b>	<b>2023E</b>	<b>2024E</b>	<b>2025E</b>
<b>YE 31 Dec</b>						
P/E	38.1	48.9	14.2	21.1	17.6	15.0
P/E (diluted)	38.7	49.5	14.3	21.4	17.9	15.3
P/B	3.0	3.1	1.0	1.5	1.4	1.3

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

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