

Cloud Music (9899 HK)

Strong GPM expansion supported the breakeven in 2H22

Cloud Music reported FY22 financial results on 23 Feb. Total revenue was up by 24% YoY to RMB4.7bn in 2H22, largely in line with our/consensus estimate of RMB4.6/4.8bn. FY22 total revenue grew by 29% YoY to RMB9.0bn in FY22, driven by solid growth of social entertainment and music subscription businesses. Cloud Music recorded positive adjusted net income of RMB102mn in 2H22 versus adjusted net loss of RMB511mn in 2H21, beating our/consensus estimate (adj. net loss of RMB135/188mn), mainly attributable to the strong GPM expansion and effective control in marketing. Full-year adjusted net loss narrowed from RMB1.0bn in FY21 to RMB115mn in FY22. We raise FY23/FY24 adjusted net income to RMB187/603mn (previous: RMB-59/+529mn) on the effective cost structure optimization and solid GPM expansion trend. Our DCF-derived target price is HK\$110.0 (previous: HK\$108.6). Maintain BUY.

- **Resilient top-line growth amid sector headwind.** Online music revenue increased by 14% YoY to RMB1.9bn and accounted for 40% of total revenue in 2H22, mainly driven by solid growth of music subscription business. Average monthly paying users was up by 23% YoY to 38.9mn in 2H22, with paying ratio reaching 20% (vs. 17.5% in 2H21). We expect online music revenue growth to reaccelerate to +19% YoY in FY23E driven by solid growth of subscription business and recovery of ad business. Social entertainment services and others revenue delivered resilient growth of 32% YoY and accounted for 60% of total revenue in 2H22, despite regulatory and COVID impact. Monthly paying users grew 95% YoY to 1.3mn in FY22, with monthly ARPPU normalizing to RMB326 in FY22 (vs. RMB448 in FY21).
- **Improving user community and content ecosystem.** Cloud Music user community continues to see healthy development. Average MAUs up by 4% YoY to 189mn in FY22, despite sector-wise slowdown and more disciplined marketing spending. The user growth was primarily driven by the enhanced listening experience, broader music consumption scenarios (e.g. in-game and IoT scenarios) and enriched content library. Total number of independent artists reached 611k and generated 2.6mn music tracks by the end of 2022, up from 400k independent artists by the end of 2021.
- **Solid margin expansion on economies of scale and cost optimization.** Cloud Music GPM expanded from 4.1/12.6% in 2H21/1H22 to 16.0% in 2H22, driven by its enhanced economies of scale and optimised content cost structure. Supported by the better operating leverage, the opex to revenue ratio also dropped from 22.5/20.8% in 2H21/1H22 to 19.7% in 2H22. Adjusted net margin improved from -14.9% in FY21 to -1.3% in FY22, and we expect it will further rise to 2/5/7% in FY23/24/25E.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	6,998	8,992	10,647	12,264	13,614
YoY growth (%)	42.9	28.5	18.4	15.2	11.0
Gross margin (%)	2.0	14.4	18.1	21.2	23.2
Operating profit (RMB mn)	(1,347)	(385)	(84)	376	794
Adjusted net profit (RMB mn)	(1,043.7)	(114.6)	187.1	603.1	989.4
EPS (Adjusted) (RMB cents)	(502.37)	(54.82)	89.54	288.61	473.44
Consensus EPS (RMB cents)	(502.37)	(54.82)	86.50	288.64	359.00
P/S (x)	2.2	1.7	1.5	1.3	1.2
P/E (x)	na	na	194.2	32.6	18.4

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$110.00

(Previous TP) HK\$110.00)

Up/Downside 28.9%

Current Price HK\$85.35

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Stock Data

Mkt Cap (HK\$ mn)	17,836.9
Avg 3 mths t/o (HK\$ mn)	87.4
52w High/Low (HK\$)	117.00/53.15
Total Issued Shares (mn)	209.0
Source: FactSet	

Shareholding Structure

NetEase	61.4%
Alibaba	9.9%

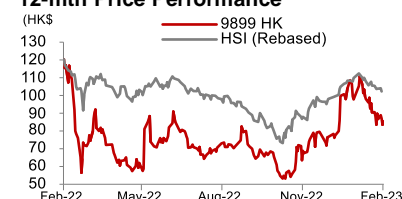
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-12.7%	-5.4%
3-mth	24.2%	7.8%
6-mth	17.7%	12.8%

Source: FactSet

12-mth Price Performance



Source: FactSet

Figure 1: Cloud Music: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	10,647	12,264	13,614	10,789	12,769	-	-1.3%	-4.0%	-
Gross Profit	1,928	2,599	3,153	1,846	2,691	-	4.4%	-3.4%	-
Operating Profit	(84)	376	794	(238)	397	-	NA	-5.4%	-
Adjusted net profit	187	603	989	(59)	529	-	NA	14.0%	-
Adjusted EPS (RMB)	0.9	2.9	4.7	(0.3)	2.5	-	NA	15.4%	-
Gross Margin	18.1%	21.2%	23.2%	17.1%	21.1%	-	1.0 ppt	0.1 ppt	-
Operating Margin	-0.8%	3.1%	5.8%	-2.2%	3.1%	-	1.4 ppt	0.0 ppt	-
Adjusted net margin	1.8%	4.9%	7.3%	-0.5%	4.1%	-	2.3 ppt	0.8 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	10,647	12,264	13,614	11,244	13,264	-	-5.3%	-7.5%	-
Gross Profit	1,928	2,599	3,153	1,951	2,811	-	-1.2%	-7.5%	-
Adjusted net profit	187	603	989	(111)	603	-	NA	0.0%	-
Adjusted EPS (RMB)	0.9	2.9	4.7	(0.8650)	2.8864	-	NA	0.0%	-
Gross Margin	18.1%	21.2%	23.2%	17.4%	21.2%	-	0.8 ppt	0.0 ppt	-
Adjusted net margin	1.8%	4.9%	7.3%	-1.0%	4.5%	-	2.7 ppt	0.4 ppt	-

Source: Company data, CMBIGM estimates

Figure 3: Cloud Music: financial summary

(RMB mn)	2021	2022	2023E	2024E	2025E
Online music segment					
Online music MAUs (mn)	182.6	189.4	197.0	202.9	209.0
YoY	1.2%	3.7%	4.0%	3.0%	3.0%
Online music paying users (mn)	28.9	38.3	45.3	51.7	57.5
YoY	81.1%	32.4%	18.4%	14.2%	11.1%
Paying ratio	15.8%	20.2%	23.0%	25.5%	27.5%
Online music revenue	3,290	3,699	4,437	5,136	5,749
YoY	25.4%	12.4%	19.9%	15.8%	11.9%
Subscription revenue	2,324	3,031	3,714	4,368	4,949
YoY	44.9%	30.4%	22.5%	17.6%	13.3%
Non-subscription revenue	966	668	723	768	800
YoY	-5.1%	-30.9%	8.2%	6.2%	4.1%
Social entertainment segment					
Social entertainment paying users (mn)	0.7	1.3	1.7	2.0	2.3
YoY	108.9%	95.0%	27.5%	18.9%	13.8%
Social entertainment revenue	3,708	5,293	6,210	7,128	7,865
YoY	63.1%	42.8%	17.3%	14.8%	10.3%
Overall					
Total revenue	6,998	8,992	10,647	12,264	13,614
YoY	42.9%	28.5%	18.4%	15.2%	11.0%
Gross profit margin	2.0%	14.4%	18.1%	21.2%	23.2%
S&M expense ratio	6.2%	7.1%	7.1%	6.8%	6.5%
R&D expense ratio	12.4%	11.2%	10.8%	10.2%	9.6%
Adjusted net loss margin	-14.9%	-1.3%	1.8%	4.9%	7.3%
Adjusted net loss	-1,044	-115	187	603	989

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\$110.0, which implies 1.9x FY23E PS.

Figure 4: Cloud Music: DCF valuation

(RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Adjusted EBITDA	(28)	454	890	1,275	1,685	2,181	2,573	2,999
Free cash flow	317	516	828	1,083	1,367	1,706	2,042	2,393
NPV of FCF	5,585							
Discounted terminal value	7,751							
Enterprise value	13,336							
Net cash	6,907							
Equity value	20,243							
Number of shares (diluted, mn)	209							
Exchange rate (HKD/RMB)	0.88							
Valuation per share (HK\$)	110.0							
Risk free rate	2.8%							
Beta	121.0%							
Equity risk premium	9.8%							
Cost of equity	14.7%							
Cost of debt	5.0%							
Tax rate	15.0%							
Debt/capital	Net Cash							
WACC	14.7%							
Terminal FCF growth (%)	2.5%							

Source: CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	4,896	6,998	8,992	10,647	12,264	13,614
Cost of goods sold	5,491	6,855	7,699	8,719	9,665	10,461
Gross profit	(595)	143	1,293	1,928	2,599	3,153
Operating expenses	929	1,490	1,678	2,012	2,224	2,359
Selling expense	327	431	635	756	834	879
Admin expense	97	264	172	192	208	231
R&D expense	576	869	1,011	1,150	1,245	1,313
Others	(71)	(75)	(140)	(85)	(64)	(65)
Operating profit	(1,525)	(1,347)	(385)	(84)	376	794
Investment gain/loss	(4)	2	(3)	(3)	(4)	(4)
Other gains/(losses)	(1,522)	(755)	0	0	0	0
Interest income	101	48	183	182	193	214
Interest expense	0	0	(0)	0	0	0
Pre-tax profit	(2,950)	(2,051)	(204)	95	565	1,004
Income tax	(2)	(5)	(17)	(14)	(85)	(151)
After tax profit	(2,951)	(2,056)	(221)	81	481	853
Net profit	(2,951)	(2,056)	(221)	81	481	853
Adjusted net profit	(1,568)	(1,044)	(115)	187	603	989

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	6,863	8,769	8,909	9,511	10,380	11,544
Cash & equivalents	3,006	853	548	813	1,248	1,999
Account receivables	254	674	736	741	768	810
Prepayment	1,642	1,345	1,428	1,444	1,516	1,535
ST bank deposits	817	5,528	5,804	6,094	6,399	6,719
Financial assets at FVTPL	971	241	265	291	320	353
Other current assets	172	128	128	128	128	128
Non-current assets	1,195	619	637	610	588	594
PP&E	21	44	49	48	62	68
Right-of-use assets	0	11	11	11	11	11
Investment in JVs & assos	89	93	93	93	93	93
Other non-current assets	1,085	471	485	459	423	423
Total assets	8,057	9,388	9,546	10,122	10,968	12,138
Current liabilities	2,173	1,948	2,206	2,553	2,780	2,947
Account payables	1	0	0	0	0	0
Tax payable	1	0	0	0	0	0
Other current liabilities	146	56	56	56	56	56
Lease liabilities	0	3	3	3	3	3
Contract liabilities	385	605	777	958	1,104	1,225
Accrued expenses	1,640	1,284	1,370	1,536	1,617	1,663
Non-current liabilities	11,192	58	73	114	131	144
Convertible bonds	11,162	0	0	0	0	0
Other non-current liabilities	29	58	73	114	131	144
Total liabilities	13,364	2,006	2,279	2,667	2,911	3,091
Share capital	0	0	0	0	0	0
Retained earnings	(8,372)	(10,600)	(10,822)	(10,741)	(10,261)	(9,407)
Other reserves	3,066	17,982	18,089	18,195	18,318	18,454
Total shareholders equity	(5,307)	7,382	7,267	7,454	8,057	9,047
Total equity and liabilities	8,057	9,388	9,546	10,122	10,968	12,138

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(2,950)	(2,051)	(204)	95	565	1,004
Depreciation & amortization	22	15	32	35	19	25
Tax paid	(2)	(6)	(17)	(14)	(85)	(151)
Change in working capital	531	177	114	393	180	120
Others	1,429	957	(76)	(76)	(71)	(78)
Net cash from operations	(969)	(908)	(151)	433	609	920
Investing						
Capital expenditure	(21)	(40)	(36)	(35)	(33)	(31)
Acquisition of subsidiaries/ investments	(6,534)	(11,544)	(300)	(317)	(334)	(352)
Net proceeds from disposal of short-term investments	10,045	7,681	0	0	0	0
Others	(85)	40	183	182	193	214
Net cash from investing	3,406	(3,862)	(154)	(169)	(173)	(169)
Financing						
Proceeds from share issues	0	2,679	0	0	0	0
Share repurchases	0	0	0	0	0	0
Others	(321)	(65)	(0)	0	0	0
Net cash from financing	(321)	2,614	(0)	0	0	0
Net change in cash						
Cash at the beginning of the year	911	3,006	853	548	813	1,248
Exchange difference	(21)	4	0	0	0	0
Cash at the end of the year	3,006	853	548	813	1,248	1,999
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	111.2%	42.9%	28.5%	18.4%	15.2%	11.0%
Gross profit	na	na	806.3%	49.1%	34.8%	21.3%
Operating profit	na	na	na	na	na	111.3%
Net profit	na	na	na	na	495.7%	77.6%
Adj. net profit	na	na	na	na	222.3%	64.0%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	(12.2%)	2.0%	14.4%	18.1%	21.2%	23.2%
Operating margin	(31.1%)	(19.2%)	(4.3%)	(0.8%)	3.1%	5.8%
Adj. net profit margin	(32.0%)	(14.9%)	(1.3%)	1.8%	4.9%	7.3%
Return on equity (ROE)	na	(198.2%)	(3.0%)	1.1%	6.2%	10.0%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	na	(0.9)	(0.9)	(0.9)	(0.9)	(1.0)
Current ratio (x)	3.2	4.5	4.0	3.7	3.7	3.9
Receivable turnover days	19.0	35.1	29.9	25.4	22.8	21.7
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	na	na	na	194.2	32.6	18.4
P/E (diluted)	na	na	na	194.2	32.6	18.4
P/B	na	3.8	2.0	2.1	1.9	1.7

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

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