

Zhihu (ZH US)

Focus shifting to monetization and margin

Given macro challenges and epidemic resurgence, Zhihu's 4Q22E would be a mixed quarter, with soft ads & CCS (content-commerce solutions). However, its membership and vocational training would be resilient ahead, forecasting +77%/301% YoY in 4Q22E. We suggest to look beyond its short-term ads headwinds, and move into: 1) margin improvement, with focus shifting to cost discipline (targeting 4Q23E to achieve quarterly breakeven); and 2) vocational training as long-term driver (>20% rev contribution in the long run). To factor in epidemic & transition impact, we trimmed its topline by 13%-33% in FY22-24E, but lifted its margin by 4-10ppts, with new TP at US\$2.3.

■ **Transition year with focus shifting to monetization and margin.** Zhihu shifts its focus to quality user growth, with emphasis on its community ecosystem enhancement. As such, Zhihu might see short-term user volatility (forecasting MAU -3% YoY in 4Q22E). Macro headwinds in ads and CCS will still linger into 4Q22E, due to scaling back of marketing budget, especially for brand ads, amid Covid resurgence. However, we suggest looking beyond mixed 4Q22E (forecasting rev +3% YoY), as 1) ads & CCS will gradually recover with potential reopening; 2) CCS saw sequential growth from 3Q22; and 3) ZH continues to gain share with resilient verticals such as IT/3C/Automobiles. We expect paid membership and vocational training to keep strong momentum (forecasting +77%/301% YoY in 4Q22E), backed by diversified content and enhanced community ecosystem. We expect adj. NPM to improve 3ppts QoQ in 4Q22E thanks to higher GPM and disciplined S&M. Mgmt targeted 4Q23E to achieve quarterly breakeven.

■ **Vocational training as long-term driver.** By leveraging its "knowledge-inspiring" community, Zhihu's vocational training biz saw eye-catching growth. Mgmt guided >20% rev contribution for training biz in the long run (vs. 9% in 3Q22). Zhihu will enhance its content with focus on education & employment improvement. We expect richer content offerings and products matrix to boost its strong momentum ahead, forecasting rev +452%/96%/70% YoY in FY22/23/24E.

■ **Maintain BUY.** To factor in epidemic impact and better margin, we trimmed its topline by 13%-33% in FY22-24E, but lifted its margin by 4-10ppts, with new TP at US\$2.3 (implying 2.2x FY23E P/S).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	1,352	2,927	3,553	4,369	5,276
YoY growth (%)	101.7	116.5	21.4	23.0	20.7
Adj. net income (RMB mn)	(337)	(735)	(1,302)	(687)	(124)
Adj. EPS (RMB)	(0.71)	(1.29)	(2.20)	(1.05)	(0.18)
YoY growth (%)	NA	NA	NA	NA	NA
Consensus EPS (RMB)	NA	NA	(2.4)	(1.6)	(0.7)
P/E (x)	NA	NA	NA	NA	NA
P/S (x)	2.7	1.5	1.3	1.1	0.9
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	(12.3)	(10.9)	(21.9)	(13.1)	(2.4)
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	US\$2.3
(Previous TP	US\$4.5)
Up/Downside	+74.2%
Current Price	US\$1.32

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	848
Avg 3 mths t/o (US\$ mn)	5.24
52w High/Low (US\$)	6.38/ 0.89
Total Issued Shares (mn)	605

Source: Bloomberg

Shareholding Structure

Krane Funds Advisors	3.04%
Cosmic Blue Invest	1.65%
Yiheng Capital	1.65%

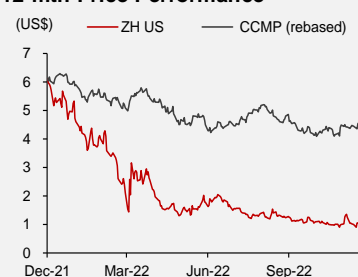
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	32.0%	35.8%
3-mth	6.5%	17.2%
6-mth	-25.8%	-23.6%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

Better-than-feared 3Q22

3Q22 rev +10.7% YoY, 2% above consensus. By segment, CCS/ads -5%/-39 YoY, mainly on macro challenges and pandemic resurgence. On the flip side, vocational training rev surged 458% YoY, with more diversified course offerings. Paid membership grew 88% YoY, driven by rising paying users attracted by new content and better algorithm. Non-GAAP net loss was RMB251mn, better than consensus of RMB423mn. We are impressed by its better-than-feared GPM (at 48.7%, 3ppts above consensus). MAU reached 97mn, -4% YoY, as Zhihu is cleaning up low-quality content to enhance user experience.

Figure 1: 3Q22 financial review

RMB mn, Dec-YE	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	QoQ	YoY	Consensus	Diff %
Revenue	383	520	478	638	824	1,019	743	836	912	9.1%	10.7%	895	2%
Operating Profit	(130)	(105)	(342)	(351)	(322)	(375)	(648)	(461)	(279)	NA	NA	(517)	NA
Net profit	(280)	(260)	(495)	(321)	(270)	(383)	(614)	(487)	(300)	NA	NA	(511)	NA
Adj. net profit	(79)	(26)	(194)	(200)	(112)	(241)	(367)	(444)	(251)	NA	NA	(423)	NA
Adj. EPS (RMB)	(0.17)	(0.05)	(1.35)	(0.34)	(0.19)	(0.41)	(0.61)	(0.72)	(0.41)	NA	NA	(0.87)	NA
Margin (%)													
Gross margin	57.5%	64.1%	57.0%	59.0%	51.6%	47.1%	45.1%	47.8%	48.7%			45.5%	
Operating margin	-33.9%	-20.1%	-71.6%	-54.9%	-39.2%	-36.8%	-87.2%	-55.1%	-30.6%			-57.7%	
Adj. net margin	-20.7%	-5.1%	-40.5%	-31.4%	-13.6%	-23.6%	-49.4%	-53.1%	-27.5%			-47.3%	
Growth (%)													
Revenue (YoY)	120.2%	132.0%	154.2%	144.2%	115.1%	96.1%	55.4%	31.0%	10.7%			8.7%	
Revenue (QoQ)	46.5%	35.8%	-8.0%	33.5%	29.0%	23.8%	-27.1%	12.5%	9.1%			7.1%	
Operating Profit	NA	NA	NA	NA	NA	NA	NA	NA	NA			NA	
Adj. net profit	NA	NA	NA	NA	NA	NA	NA	NA	NA			NA	

Source: Company data, Bloomberg

Figure 2: 3Q22 revenue breakdown

RMB mn, Dec-YE	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22	QoQ	YoY
Total revenue	383	520	478	638	824	1,019	743	836	912	9%	11%
Content-commerce solutions	46	76	121	207	278	367	227	240	265	10%	-5%
Advertising	231	319	214	248	321	378	217	238	197	-17%	-39%
Paid membership	91	104	127	155	178	209	222	271	335	24%	88%
Vocational Training			3	7	14	22	40	46	78	69%	458%
Others	15	20	14	21	46	43	38	41	36	-11%	-20%

Source: Company data

Eyes on better margin outlook, despite mixed 4Q22E

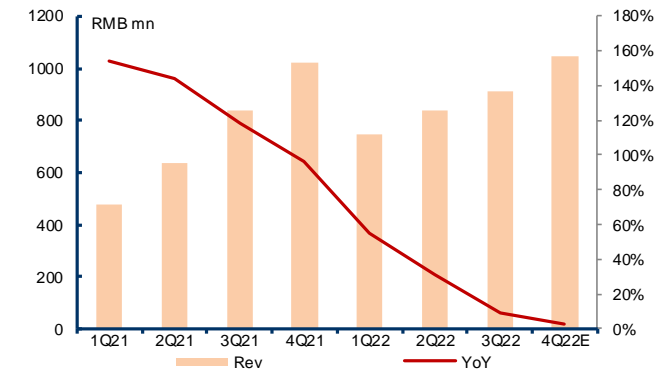
Given challenging macro and epidemic resurgence, 4Q22E would see slower recovery (forecasting rev +3% YoY), in which ads/CCS -22%/30% YoY (in our estimates). By ads verticals, ecommerce, IT, 3C, auto kept resilient, while beauties and FMCG were still under pressure. CCS rev saw sequential growth from 3Q22, and we expect it to grow at high single digit QoQ in 4Q22E. On a 12-month horizon, ads & CCS will gradually recover with potential reopening, in our view. We expect paid membership to keep strong momentum (forecasting +77% YoY in 4Q22E), backed by diversified content and enhanced community ecosystem.

Vocational training would be Zhihu's next driver. By leveraging its "knowledge-inspiring" community, Zhihu's vocational training biz climbed up quickly, and we forecast 4Q22E training rev +301% YoY (9% of total rev). Mgmt guided >20% rev contribution for training biz in the long run. Zhihu will enhance its content with focus on education & employment improvement. We expect richer content offerings and products matrix to boost its strong momentum ahead. As such, we forecast vocational training to deliver 10.2%/65.5%/82.5%

ASP/number of paying users/revenue CAGR during FY22E-24E, and to account for 7%/11%/16% of total revenue in FY22/23/24E.

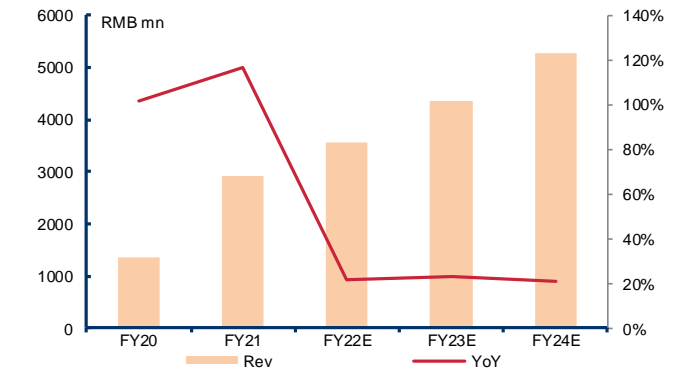
Zhihu upgraded its priority on margin improvement. We expect adj. NPM to improve 3ppts QoQ in 4Q22E thanks to higher GPM (mainly on efficiency improvement in fixed costs and cost optimization across all business lines, despite macro challenges) and disciplined S&M. Mgmt targeted 4Q23E to achieve quarterly breakeven.

Figure 3: Quarterly rev estimates



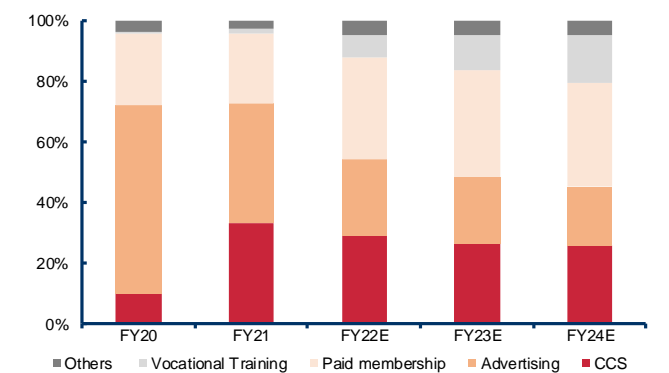
Source: Company data, CMBIGM estimates

Figure 4: Yearly rev estimates



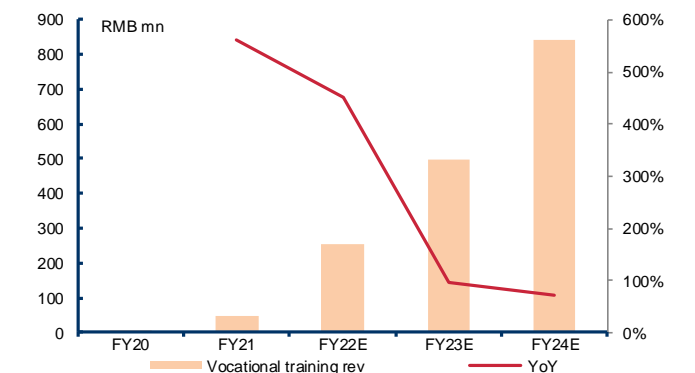
Source: Company data, CMBIGM estimates

Figure 5: Rev mix change



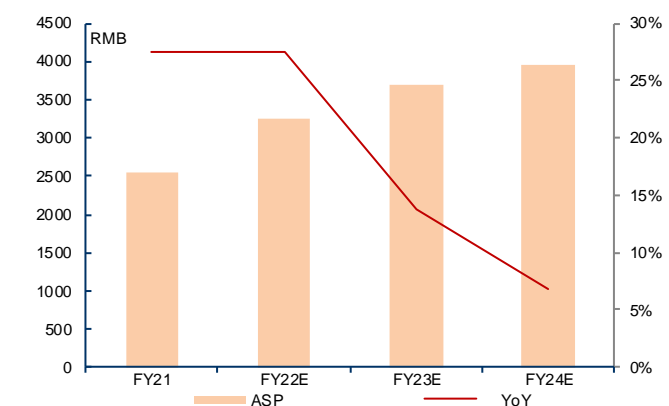
Source: Company data, CMBIGM estimates

Figure 6: Vocational training rev estimates



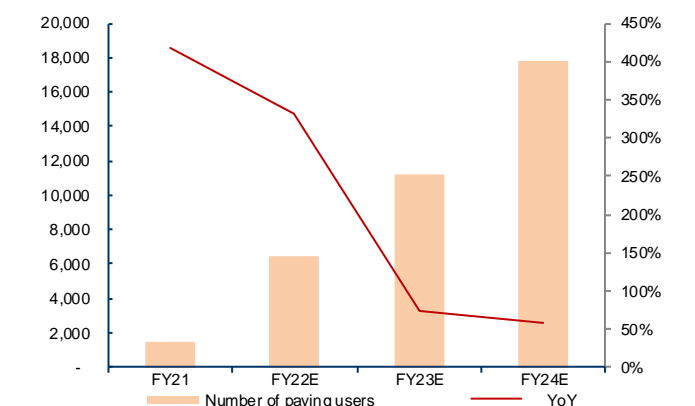
Source: Company data, CMBIGM estimates

Figure 7: Vocational training ASP estimates



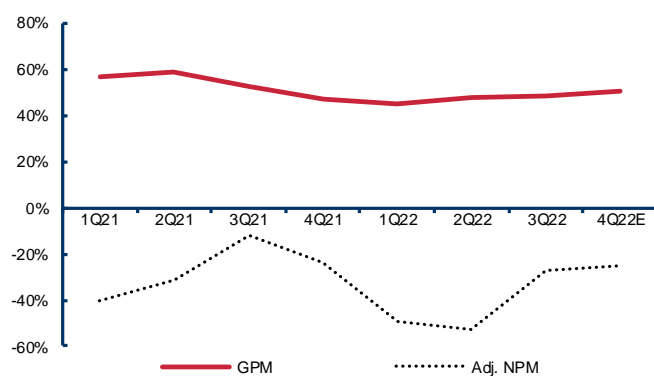
Source: Company data, CMBIGM estimates

Figure 8: Vocational training paying users estimates



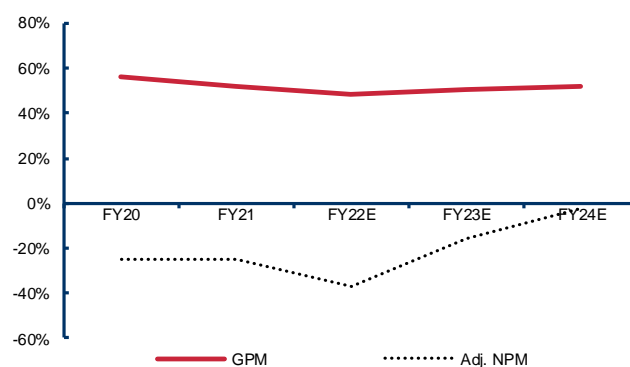
Source: Company data, CMBIGM estimates

Figure 9: Quarterly margin estimates



Source: Company data, CMBIGM estimates

Figure 10: Yearly margin estimates



Source: Company data, CMBIGM estimates

Maintain BUY with new TP of US\$2.3

To factor in epidemic impact and better margin, we trimmed its topline by 13%-33% in FY22-24E, but lifted its margin by 4-10ppts, with new DCF-based TP at **US\$2.3** (implying 2.2x FY23E P/S).

Figure 11: CMBIGM estimates vs consensus

RMB mn, Dec-YE	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	3,553	4,369	5,276	3,624	4,898	6,243	-2.0%	-10.8%	-15.5%
Gross profit	1,721	2,206	2,752	1,675	2,473	3,383	2.7%	-10.8%	-18.6%
Operating profit	(1,715)	(1,132)	(695)	(1,981)	(1,526)	(1,076)	13.5%	25.8%	35.4%
Adj. net profit	(1,302)	(687)	(124)	(1,457)	(930)	(389)	10.7%	26.1%	68.1%
EPS (RMB)	(2.13)	(1.12)	(0.20)	(2.38)	(1.55)	(0.66)	10.6%	27.6%	69.2%
Gross margin	48.4%	50.5%	52.2%	46.2%	50.5%	54.2%	+2.2ppts	-0.0ppts	-2.0ppts
Operating margin	-48.3%	-25.9%	-13.2%	-54.7%	-31.1%	-17.2%	+6.4ppts	+5.2ppts	+4.1ppts
Net margin	-36.6%	-15.7%	-2.4%	-40.2%	-19.0%	-6.2%	+3.6ppts	+3.3ppts	+3.9ppts

Source: Company data, Bloomberg, CMBIGM estimates

Figure 12: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	3,553	4,369	5,276	4,094	5,863	7,840	-13.2%	-25.5%	-32.7%
Gross profit	1,721	2,206	2,752	1,838	3,004	4,249	-6.4%	-26.5%	-35.2%
Operating profit	(1,715)	(1,132)	(695)	(2,448)	(2,060)	(1,327)	30.0%	45.0%	47.6%
Adj. net profit	(1,302)	(687)	(124)	(1,896)	(1,475)	(494)	31.3%	53.4%	74.9%
EPS (RMB)	(2.13)	(1.12)	(0.20)	(3.33)	(2.59)	(0.87)	36.1%	56.6%	76.6%
Gross margin	48.4%	50.5%	52.2%	44.9%	51.2%	54.2%	+3.5ppts	-0.7ppts	-2.0ppts
Operating margin	-48.3%	-25.9%	-13.2%	-59.8%	-35.1%	-16.9%	+11.5ppts	+9.2ppts	+3.7ppts
Net margin	-36.6%	-15.7%	-2.4%	-46.3%	-25.2%	-6.3%	+9.7ppts	+9.4ppts	+3.9ppts

Source: Company data, CMBIGM estimates

Figure 13: DCF Valuation

DCF valuation (RMB mn)										
	2021	2022E	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
EBIT	(874)	(1,290)	(799)	(343)	(182)	55	229	413	578	740
Tax	(2)	0	0	0	0	(8)	(34)	(62)	(87)	(111)
D&A	14	19	25	29	30	36	42	48	53	57
Working capital	262	(173)	218	196	387	406	427	448	470	494
CAPEX	(20)	(25)	(31)	(37)	(43)	(47)	(52)	(57)	(63)	(69)
FCF	(621)	(1,469)	(586)	(154)	192	441	611	789	951	1,111
FCF Growth		NA	NA	NA	NA	130%	38%	29%	21%	17%
Terminal Value										12,257
PV (FCF+ Terminal Value)	(621)	(1,469)	(522)	(122)	135	277	342	393	421	5,272

Assumptions

WACC	12.3%
Tax rate	15.0%
Risk free rate	3.2%
Beta	1.10
Market risk return	11.5%
Cost of equity	12.3%
WACC	12.3%
Terminal growth rate	3.0%

Equity Value

PV	6,197
minus: Net cash	3,763
minus: Minority Interest	0
Equity Value	9,960
Shares (mn)	612
Target Price (US\$) based on DCF	2.3

		WACC				
Growth	1.5%	10.3%	11.3%	12.3%	13.3%	14.3%
	2.0%	2.5	2.3	2.1	1.9	1.8
	2.5%	2.6	2.4	2.2	2.0	1.8
	3.0%	2.7	2.4	2.2	2.0	1.9
	3.5%	2.8	2.5	2.3	2.1	1.9
	4.0%	3.0	2.6	2.3	2.1	2.0
	4.5%	3.1	2.7	2.4	2.2	2.0
		3.3	2.8	2.5	2.3	2.1

Source: Company data, CMBIGM estimates

As a crosscheck, we selected 2 online community players, 6 VAS peers and 2 ads peers for comparison. The industry multiple is **2.2x** FY23E P/S, in line with our DCF-based multiple.

Zhihu is now trading at 1.3x FY23E P/S with attractive valuation (largely below industry average). We think our TP of 2.2x is not demanding for Zhihu, since: 1) it excelled itself with high-quality “knowledge-inspiring” content; and 2) it would deliver higher rev CAGR (22% in FY22-24E, vs. 13% for industrial average). Its potential ads recovery, rising vocational training, and breakeven in 4Q23E would further help it re-rate after the transition period.

Figure 14: Valuation comps

Company	Ticker	Mkt cap (USD mn)	Currency	Price	CMBI Rating	CMBI TP	PE			PS			PS/G			FY22-24 CAGR	EPS
							FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E		
Zhihu	ZH US	848	USD	1.3	BUY	2.3	NA	NA	NA	1.7	1.3	1.0	0.08	0.04	0.04	NA	
Online Community																	
Bilibili	BILI US	10,162	USD	25	BUY	21	NA	NA	NA	3.2	2.6	2.2	0.25	0.12	0.11	NA	
Kuaishou	1024 HK	38,961	HKD	69	BUY	80	NA	NA	31.3	2.9	2.5	2.2	0.20	0.15	0.14	NA	
Average							NA	NA	31.3	3.1	2.6	2.2	0.22	0.13	0.13	NA	
VAS																	
China Literature	772 HK	4,087	HKD	31	NA	NA	22.0	18.2	15.9	3.5	3.1	2.9	-0.87	0.29	0.31	19%	
Tencent	700 HK	394,654	HKD	318	BUY	402	23.6	19.5	16.5	5.0	4.5	4.0	-5.09	0.41	0.33	18%	
JOYY	YY US	2,473	USD	35	BUY	50	14.0	14.1	11.2	1.0	1.0	0.9	-0.15	0.18	0.11	13%	
Huya	HUYA US	831	USD	3	BUY	4	NA	NA	35.7	0.6	0.7	0.6	-0.03	-0.25	0.13	NA	
Douyu	DOYU US	479	USD	2	NA	NA	NA	45.1	24.4	0.5	0.5	0.5	-0.02	-0.09	0.12	158%	
TME	TME US	14,089	USD	8	BUY	7	21.3	19.7	18.3	3.5	3.4	3.2	-0.38	0.85	0.52	11%	
Mango	300413 CH	7,055	CNY	26	NA	NA	23.0	19.5	16.8	3.4	3.0	2.6	-0.71	0.19	0.20	17%	
iQIYI	IQ US	3,161	USD	4	BUY	3	NA	24.4	14.5	0.8	0.7	0.7	-0.13	0.13	0.13	201%	
Average							20.8	19.2	18.4	2.3	2.1	1.9	-0.33	0.21	0.23	16%	
Ad																	
Baidu	BIDU US	41,463	USD	120	BUY	193	14.2	13.1	11.0	2.3	2.1	1.9	9.74	0.21	0.18	10%	
Weibo	WB US	4,268	USD	18	BUY	20	8.6	8.1	7.6	2.3	2.3	2.1	-0.13	3.98	0.24	8%	
Average							11.4	10.6	9.3	2.3	2.2	2.0	-0.13	0.21	0.21	9%	
Average							18.1	17.1	15.9	2.4	2.2	2.0	0.71	0.20	0.21	14%	

Source: BBG, CMBIGM estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenues	1,352	2,927	3,553	4,369	5,276
CCS	136	974	1,021	1,146	1,362
Advertising	843	1,161	915	966	1,025
Paid membership	320	669	1,197	1,555	1,802
Others	53	124	421	703	1,087
COGS	(594)	(1,405)	(1,832)	(2,163)	(2,524)
Gross profit	758	1,522	1,721	2,206	2,752
S&M	(735)	(1,635)	(2,045)	(1,878)	(1,907)
R&D	(330)	(620)	(775)	(821)	(862)
G&A	(296)	(690)	(615)	(639)	(678)
Operating profit	(603)	(1,423)	(1,715)	(1,132)	(695)
Other income	86	97	(14)	111	135
Pre-tax Income	(516)	(1,325)	(1,729)	(1,021)	(561)
Income Tax	(1)	(2)	0	0	0
Net profit	(518)	(1,327)	(1,729)	(1,021)	(477)
Accretions	(681)	(171)	0	0	0
Net profit to shareholder	(1,198)	(1,498)	(1,729)	(1,021)	(477)
Adj. net profit	(337)	(735)	(1,302)	(687)	(124)

Cash flow summary

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Net income	(518)	(1,327)	(1,729)	(1,021)	(477)
D&A	20	14	19	25	29
Change in WC	(10)	262	(173)	218	196
Others	264	548	425	334	353
Operating CF	(244)	(503)	(1,458)	(444)	102
CAPEX	(2)	(20)	(25)	(31)	(37)
Others	432	0	0	0	0
Investing CF	430	(20)	(25)	(31)	(37)
Issuance of shares	0	0	0	0	0
IPO proceeds	0	5,286	0	0	0
Others	9	0	0	0	0
Financing CF	9	5,286	0	0	0
Net change in cash	195	4,763	(1,483)	(475)	65
Cash (beg of yr)	900	958	5,721	4,238	3,763
Fx effect	(138)	0	0	0	0
Cash (end of yr)	958	5,721	4,238	3,763	3,828

Balance sheet

YE 31 Dec (RMB mn)	FY20A	FY21A	FY22E	FY23E	FY24E
Non-current assets	41	471	71	76	84
PP&E	8	10	25	31	41
Intangible assets, net	23	68	20	18	16
Right-of-use assets	3	127	26	26	26
Others	6	266	0	0	0
Current assets	3,720	8,334	7,908	7,408	7,586
Cash, cash equivalents	958	2,157	4,238	3,763	3,828
Term deposits	1,093	2,816	1,093	1,093	1,093
Short-term investments	1,046	2,240	1,046	1,046	1,046
Other current asset	623	1,122	1,531	1,506	1,620
Current liabilities	1,015	1,898	2,029	2,222	2,531
AP and accruals	502	1,027	1,054	1,037	1,200
Salary welfare payables	232	314	405	464	514
Contract liabilities	160	240	429	558	646
Others	121	318	140	163	171
Non-current liabilities	0	169	0	0	0
Lease liabilities	0	82	0	0	0
Mezzanine equity and shareholders' equity	2,747	6,738	5,950	5,263	5,139

Key ratios

YE 31 Dec	FY20A	FY21A	FY22E	FY23E	FY24E
Sales mix (%)					
CCS	10.0	33.3	28.7	26.2	25.8
Advertising	62.4	39.7	25.7	22.1	19.4
Paid membership	23.7	22.8	33.7	35.6	34.2
Others	3.9	4.2	11.8	16.1	20.6
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	101.7	116.5	21.4	23.0	20.7
Gross profit	142.7	100.9	13.1	28.2	24.7
EBIT	NA	NA	NA	NA	NA
Adj. net profit	NA	NA	NA	NA	NA
P&L ratios (%)					
Operating margin	(44.6)	(48.6)	(48.3)	(25.9)	(13.2)
Pre-tax margin	(38.2)	(45.3)	(48.7)	(23.4)	(10.6)
Adj. net margin	(25.0)	(25.1)	(36.6)	(15.7)	(2.4)
Effective tax rate	0.2	0.2	0.0	0.0	0.0
Returns (%)					
ROE	(12.3)	(10.9)	(21.9)	(13.1)	(2.4)
ROA	(9.0)	(8.3)	(16.3)	(9.2)	(1.6)
Per share					
EPS (RMB)	(0.7)	(1.3)	(2.1)	(1.1)	(0.2)
DPS (RMB)	0.0	0.0	0.0	0.0	0.0
BVPS (RMB)	11.5	23.7	19.4	17.2	16.8

Source: Company data, CMBIGM estimates

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