

TME (TME US)

Strong core music business supports 1Q23 earnings beat

TME reported 1Q23 results on 16 May. Total revenue increased by 5% YoY to RMB7.0bn in 1Q23 and was in line with consensus/CMBI estimate. Non-IFRS net income grew by 57% YoY to RMB1.4bn in 1Q23, beating consensus/CMBI estimate by 11/9%, mainly due to strong growth of core music business (+34% YoY) and effective expense control. Music business delivered a record-high net addition of 5.9mn subscribers in 1Q23, with 11% YoY APPRU growth, which demonstrates TME's successful execution of its quality growth strategy. Supported by enhanced monetization of online music business and effective cost control. We raise FY23/24 non-IFRS net income forecast by 9/5%. Our DCF-derived TP is lifted by 6% to US\$11.2. Maintain BUY on strong earnings growth outlook (FY23: +25% YoY) and attractive valuation (FY23: 16x PE).

- **Online music business delivers high quality growth.** Online music revenue delivered robust growth of 34% YoY to RMB3.5bn in 1Q23 (50% of total revenue), driven by solid growth of subscription and ads businesses. The number of subscribers grew 18% YoY to 94mn in 1Q23, with a record-high net addition of 5.9mn. With TME's step-up effort on quality growth, ARPPU was also up by 11% YoY to RMB9.2 in 1Q23, marking the fourth consecutive quarter of ARPPU growth. Non-subs music revenue grew by 45% YoY to RMB902mn in 1Q23, driven by notable YoY growth of ad revenue on the low base. Looking ahead, we expect the strong momentum to continue and forecast online music revenue to grow 37% YoY in 2Q23E.
- **New initiatives to support social entertainment business recovery.** Social entertainment and others revenue declined by 13% YoY to RMB3.5bn in 1Q23 (50% of total revenue), with a milder rate of decrease (4Q22/3Q22: -18/20% YoY). Revenue from audio live streaming delivered double-digit YoY growth in 1Q23, which partially offset drop in traditional live streaming revenue amid intensive competition. TME will focus on offering differentiated content and cultivating quality performers to support the recovery of social entertainment business. We expect stabilizing social entertainment business, with revenue down by 13% YoY but largely flat QoQ in 2Q23E.
- **Expect further margin expansion in 2Q23E.** GPM improved by 5.1ppt YoY to 33.1% in 1Q23, primarily attributable to the optimization of content cost structure. Management expects the GPM to further rise QoQ in 2Q23E. S&M expenses as percentage of total revenue was down 2.0/0.6ppt YoY/QoQ to 3.0% in 1Q23, due to effective control in user acquisition spending. Adjusted net margin improved by 6.6ppt YoY to 20.1% in 1Q23. Supported by the expanding GPM and steady opex, we expect adjusted net margin to further increase to 20.9% in 2Q23E.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	31,244	28,339	29,952	31,918	33,863
YoY growth (%)	7.2	(9.3)	5.7	6.6	6.1
Gross margin (%)	30.1	31.0	33.8	34.6	35.5
Adjusted net profit (RMB mn)	4,144.6	4,743.7	5,945.4	6,588.3	7,308.1
EPS (Adjusted) (RMB)	2.50	2.96	3.68	4.07	4.52
Consensus EPS (RMB)	2.50	2.96	3.45	3.70	4.19
P/S (x)	2.8	3.1	2.9	2.8	2.6
P/E (x)	48.9	14.2	18.8	16.9	15.0
ROE (%)	6.3	7.8	9.3	9.4	9.6

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$11.20

(Previous TP) US\$10.50

Up/Downside 40.7%

Current Price US\$7.96

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Stock Data

Mkt Cap (US\$ mn)	12,656.4
Avg 3 mths t/o (US\$ mn)	44.0
52w High/Low (US\$)	9.18/3.61
Total Issued Shares (mn)	1590.0
Source: FactSet	

Shareholding Structure

Tencent	53.2%
Spotify	8.2%

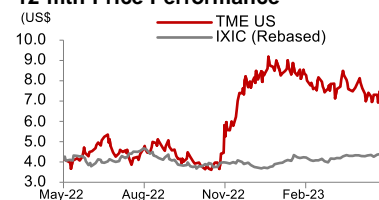
Source: Company data

Share Performance

	Absolute	Relative
1-mth	4.7%	2.7%
3-mth	-5.8%	-8.0%
6-mth	37.0%	25.8%

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	29,952	31,918	33,863	29,713	31,832	33,943	0.8%	0.3%	-0.2%
Gross Profit	10,129	11,056	12,017	9,709	10,930	12,137	4.3%	1.2%	-1.0%
Operating Profit	5,554	6,225	6,972	4,915	5,839	6,814	13.0%	6.6%	2.3%
Non-IFRS net profit	5,945	6,588	7,308	5,439	6,304	7,225	9.3%	4.5%	1.2%
Non-IFRS EPS (RMB)	3.7	4.1	4.5	3.4	3.9	4.5	9.3%	4.5%	1.2%
Gross Margin	33.8%	34.6%	35.5%	32.7%	34.3%	35.8%	1.1 ppt	0.3 ppt	-0.3 ppt
Operating Margin	18.5%	19.5%	20.6%	16.5%	18.3%	20.1%	2.0 ppt	1.2 ppt	0.5 ppt
Non-IFRS net margin	19.8%	20.6%	21.6%	18.3%	19.8%	21.3%	1.5 ppt	0.8 ppt	0.3 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	29,952	31,918	33,863	29,752	31,933	34,305	0.7%	0.0%	-1.3%
Gross Profit	10,129	11,056	12,017	9,598	10,656	11,813	5.5%	3.8%	1.7%
Operating Profit	5,554	6,225	6,972	4,898	5,480	6,227	13.4%	13.6%	12.0%
Non-IFRS net profit	5,945	6,588	7,308	5,483	5,879	6,660	8.4%	12.1%	9.7%
Non-IFRS EPS (RMB)	3.7	4.1	4.5	3.4	3.7	4.2	6.6%	10.2%	7.9%
Gross Margin	33.8%	34.6%	35.5%	32.3%	33.4%	34.4%	1.6 ppt	1.3 ppt	1.1 ppt
Operating Margin	18.5%	19.5%	20.6%	16.5%	17.2%	18.2%	2.1 ppt	2.3 ppt	2.4 ppt
Non-IFRS net margin	19.8%	20.6%	21.6%	18.4%	18.4%	19.4%	1.4 ppt	2.2 ppt	2.2 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: quarterly financial

(RMB mn)	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23E	Cons.	Diff%	CMBI	Diff%
Online music	2,888	2,880	2,616	2,878	3,430	3,559	3,501			3,323	5.4%
YoY change (%)	24.3%	4.3%	-4.8%	-2.4%	18.8%	23.6%	33.8%				
Subscription revenue	1,901	1,950	1,993	2,107	2,249	2,352	2,599			2,477	4.9%
YoY change (%)	30.2%	23.5%	17.8%	17.6%	18.3%	20.6%	30.4%				
Other revenue	987	930	623	771	1,181	1,207	902			845	6.7%
YoY change (%)	14.2%	-21.3%	-41.1%	-33.4%	19.7%	29.8%	44.8%				
Social entertainment	4,917	4,727	4,028	4,027	3,935	3,866	3,503			3,602	-2.7%
YoY change (%)	-6.4%	-15.2%	-20.6%	-20.4%	-20.0%	-18.2%	-13.0%				
Total revenue	7,805	7,607	6,644	6,905	7,365	7,425	7,004	6,843	2.3%	6,925	1.1%
YoY change (%)	3.0%	-8.7%	-15.1%	-13.8%	-5.6%	-2.4%	5.4%				
GPM (%)	29.6%	28.8%	28.0%	29.9%	32.6%	33.0%	33.1%				
Adjusted NPM (%)	13.0%	10.9%	13.5%	14.9%	18.7%	19.4%	20.1%				
Adjusted net profit	1,015	831	899	1,029	1,379	1,438	1,411	1,270	11.1%	1,294	9.0%
YoY change (%)	-24.6%	-38.4%	-23.9%	-7.9%	35.9%	73.1%	57.0%				

Source: Company data, CMBIGM

DCF valuation

Our target price is US\$11.2, 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	4,925	6,258	6,876	8,148	9,382	10,751	12,103	13,026
NPV of free cash flow	46,512							
Discounted terminal value	68,287							
Net cash	7,783							
Total TME valuation	122,582							
Number of ADS (diluted, mn)	1,590							
Valuation per ADS (US\$)	11.20							

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	29,952	31,918	33,863
Cost of goods sold	19,851	21,840	19,566	19,822	20,861	21,846
Gross profit	9,302	9,404	8,773	10,129	11,056	12,017
Operating expenses	4,592	5,604	4,330	4,576	4,832	5,046
Selling expense	2,475	2,678	1,144	1,104	1,165	1,237
Admin expense	3,101	4,009	4,413	4,438	4,650	4,934
Others	(984)	(1,083)	(1,227)	(966)	(984)	(1,125)
Operating profit	4,710	3,800	4,443	5,554	6,225	6,972
Share of (losses)/profits of associates/JV	19	(47)	38	20	0	0
Interest expense	(97)	(121)	(108)	(115)	(103)	(93)
Pre-tax profit	4,632	3,632	4,373	5,459	6,121	6,879
Income tax	(456)	(417)	(534)	(781)	(918)	(1,032)
After tax profit	4,176	3,215	3,839	4,678	5,203	5,847
Net profit	4,176	3,215	3,839	4,678	5,203	5,847
Adjusted net profit	4,949	4,145	4,744	5,945	6,588	7,308
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	31,687	26,791	26,559	30,759	36,271	42,391
Cash & equivalents	11,128	6,591	9,589	13,319	18,313	23,932
Account receivables	2,800	3,610	2,670	3,155	3,187	3,195
Inventories	18	24	14	8	5	3
Prepayment	2,846	2,731	2,958	2,607	2,743	2,873
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	40,886	41,354	41,843
PP&E	176	243	323	282	264	259
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	2,191	2,009	1,818
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	71,645	77,625	84,234
Current liabilities	9,602	10,450	11,717	11,659	12,417	13,161
Account payables	3,565	4,329	4,998	4,779	5,087	5,386
Tax payable	445	363	404	427	455	483
Other current liabilities	5,489	5,666	6,192	6,326	6,745	7,157
Lease liabilities	103	92	123	127	130	134
Long-term borrowings	5,940	5,749	6,165	6,181	6,200	6,218
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	324	326	328
Total liabilities	15,542	16,199	17,882	17,840	18,617	19,379
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	16,730	21,933	27,780
Other reserves	6,222	3,726	6,140	6,140	6,140	6,140
Total shareholders equity	52,245	50,317	48,099	52,777	57,980	63,827
Minority interest	486	738	1,028	1,028	1,028	1,028
Total equity and liabilities	68,273	67,254	67,009	71,645	77,625	84,234

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,632	3,632	4,373	5,459	6,121	6,879
Depreciation & amortization	824	1,001	1,160	622	629	648
Tax paid	(637)	(589)	(733)	0	0	0
Change in working capital	(497)	579	2,211	(273)	500	504
Others	563	616	470	(781)	(918)	(1,032)
Net cash from operations	4,885	5,239	7,481	5,027	6,331	6,999
Investing						
Capital expenditure	(501)	(2,758)	(1,053)	(404)	(428)	(452)
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)	(1,312)	(1,354)	(1,396)
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	13,319	18,313
Exchange difference	(269)	(67)	382	0	0	0
Cash at the end of the year	11,128	6,591	9,589	13,319	18,313	23,932
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	14.6%	7.2%	(9.3%)	5.7%	6.6%	6.1%
Gross profit	7.3%	1.1%	(6.7%)	15.5%	9.2%	8.7%
Operating profit	1.9%	(19.3%)	16.9%	25.0%	12.1%	12.0%
Net profit	5.0%	(23.0%)	19.4%	21.9%	11.2%	12.4%
Adj. net profit	0.8%	(16.3%)	14.5%	25.3%	10.8%	10.9%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	31.9%	30.1%	31.0%	33.8%	34.6%	35.5%
Operating margin	16.2%	12.2%	15.7%	18.5%	19.5%	20.6%
Adj. net profit margin	17.0%	13.3%	16.7%	19.8%	20.6%	21.6%
Return on equity (ROE)	8.7%	6.3%	7.8%	9.3%	9.4%	9.6%
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	2.6	2.9	3.2
Receivable turnover days	31.3	37.4	40.4	35.5	36.3	34.4
Payable turnover days	56.3	66.0	87.0	90.0	86.3	87.5
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	38.1	48.9	14.2	18.8	16.9	15.0
P/E (diluted)	38.7	49.5	14.3	19.1	17.2	15.3
P/B	3.0	3.1	1.1	1.7	1.5	1.4

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

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