

TME (TME US)

2Q26 results: Navigating competition headwinds

TME reported 2Q26 results: total revenue grew by 6% YoY to RMB8.93bn, and non-IFRS net profit was up by 4% YoY to RMB2.69bn, 2% and 6% ahead of VA consensus estimates respectively, mainly due to the consolidation of Ximalaya, which contributed revenue of RMB407mn in 2Q26. To cope with competition headwinds and reaccelerate revenue growth, the company continued to strengthen copyright protection, deepen cooperation with the Weixin ecosystem (e.g. Weixin Video Accounts and Weixin Pay), and expand freemium access. Looking into 3Q26E, we forecast total revenue to increase by 9% YoY to RMB9.18bn. We lower our FY26-28E earnings forecasts by 6-9%, mainly to reflect the increased expenses related to Ximalaya's integration and competition headwinds. We trim our DCF-derived TP to US\$15.0 (previous: US\$17.5 based on DCF). TME's current valuation (10x FY26E non-IFRS PE) and attractive shareholder return offer ample protection in our view, while it is pending fundamental recovery. Maintain BUY.

- **Resilient music-related business growth.** Music-related service revenue increased by 11% YoY to RMB7.61bn in 2Q26: 1) Membership services revenue grew by 8% YoY to RMB4.79bn (54% of total revenue), mainly due to the consolidation of Ximalaya and expansion of SVIP program; 2) Revenues from marketing and consumption services were up by 16% YoY to RMB2.81bn (31% of total revenue), fuelled by the robust growth of revenue from offline performances, but partially offset by the ad business headwind. Social entertainment and others revenue declined by 16% YoY to RMB1.33bn (15% of total revenue) in 2Q26. For 3Q26E, we forecast total revenue to grow by 9% YoY to RMB9.18bn, with revenue from membership services/marketing & consumption services up by 9%/20% YoY respectively.
- **Product innovation to cope with competition.** The company continued to revamp its products to expand user reach and cope with competition. It has 1) introduced vertical swipe-based discovery and video feeds to drive higher user time spent, 2) strengthened music content distribution through Weixin Video Accounts, 3) deepened cooperation with Weixin Pay to drive traffic to its lightweight apps, such as Bodian Music and Kugou Concept, 4) integrated with Weixin XiaoWei to tap into Weixin's user base, and 5) upgraded AI agents to help users create personalized playlists.
- **Stepping up shareholder return.** Overall GPM dropped by 0.2ppt YoY to 44.2% in 2Q26, mainly due to the increased costs related to offline performances and audio content. Non-IFRS net margin was down by 0.4ppt YoY to 30.1% in 2Q26. Looking ahead in 2H26E, management expected GPM/non-IFRS margin to decline slightly YoY, primarily attributable to revenue mix shift and increased opex. The company accelerated the pace of shareholder return, and repurchased a total of 43.5mn ADSs with c.US\$400mn cash (c.3% of current market cap) in 2Q26.

Earnings Summary

(YE 31 Dec)	FY24A	FY25A	FY26E	FY27E	FY28E
Revenue (RMB mn)	28,401	32,902	35,344	38,066	40,162
Gross margin (%)	42.3	44.2	43.7	43.0	42.7
Adjusted net profit (RMB mn)	7,671.0	9,588.0	9,742.8	10,581.8	10,949.1
YoY growth (%)	29.5	25.0	1.6	8.6	3.5
EPS (Adjusted) (RMB)	4.90	6.17	6.18	6.72	6.95
Consensus EPS (RMB)	4.90	6.17	6.52	7.15	7.78
P/E (x)	12.8	7.9	10.1	9.7	9.4

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price	US\$15.00
(Previous TP)	US\$17.50)
Up/Downside	72.0%
Current Price	US\$8.72

China Internet

Saiyi HE, CFA
 (852) 3916 1739
 hesaiyi@cmbi.com.hk

Wentao LU, CFA
 luwentao@cmbi.com.hk

Ye TAO, CFA
 (852) 3850 5226
 franktao@cmbi.com.hk

Shuyin GUO
 (852) 3916 3716
 guoshuyin@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	13,639.5
Avg 3 mths t/o (US\$ mn)	32.6
52w High/Low (US\$)	26.36/8.16
Total Issued Shares (mn)	1564.2

Source: FactSet

Shareholding Structure

Tencent	53.0%
Spotify	9.1%

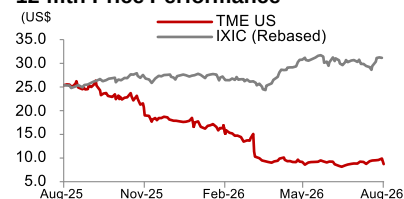
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-1.8%	-2.4%
3-mth	-3.9%	-5.2%
6-mth	-42.4%	-50.8%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	35,344	38,066	40,162	35,763	38,602	40,735	-1.2%	-1.4%	-1.4%
Gross profit	15,458	16,354	17,161	15,704	17,127	18,197	-1.6%	-4.5%	-5.7%
Non-IFRS net profit	9,743	10,582	10,949	10,333	11,240	12,072	-5.7%	-5.9%	-9.3%
Non-IFRS EPS (RMB)	6.2	6.7	6.9	6.6	7.2	7.8	-6.9%	-7.0%	-10.5%
Gross margin	43.7%	43.0%	42.7%	43.9%	44.4%	44.7%	-0.2 ppt	-1.4 ppt	-1.9 ppt
Non-IFRS net margin	27.6%	27.8%	27.3%	28.9%	29.1%	29.6%	-1.3 ppt	-1.3 ppt	-2.4 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E	FY26E	FY27E	FY28E
Revenue	35,344	38,066	40,162	35,607	38,817	41,716	-0.7%	-1.9%	-3.7%
Gross profit	15,458	16,354	17,161	15,779	17,261	18,671	-2.0%	-5.3%	-8.1%
Non-IFRS net profit	9,743	10,582	10,949	10,138	11,107	12,097	-3.9%	-4.7%	-9.5%
Non-IFRS EPS (RMB)	6.2	6.7	6.9	6.5	7.2	7.8	-5.1%	-6.1%	-10.7%
Gross margin	43.7%	43.0%	42.7%	44.3%	44.5%	44.8%	-0.6 ppt	-1.5 ppt	-2.0 ppt
Non-IFRS net margin	27.6%	27.8%	27.3%	28.5%	28.6%	29.0%	-0.9 ppt	-0.8 ppt	-1.7 ppt

Source: Visible Alpha, CMBIGM estimates

DCF valuation

Our target price of US\$15.0 is based on the DCF valuation methodology (unchanged WACC of 9.6% and terminal growth of 3.0%).

Figure 3: TME: DCF Valuation

(RMBmn)	FY26E	FY27E	FY28E	FY29E	FY30E	FY31E	FY32E
Free cash flow	9,871	10,595	10,737	10,434	9,957	9,365	8,464
NPV of free cash flow	54,171						
Discounted terminal value	83,766						
Net cash	22,020						
Total TME valuation	159,957						
Number of ADS (diluted, mn)	1,576						
Valuation per ADS (US\$)	15.0						

Source: Company data, CMBIGM estimates

Note: CNY/USD = 6.8

Risks

Intensifying competition; macro headwinds impact ad business growth; increased investment in new initiatives drags profit margin.

Financial Summary

INCOME STATEMENT	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Revenue	27,752	28,401	32,902	35,344	38,066	40,162
Cost of goods sold	17,957	16,376	18,367	19,887	21,712	23,001
Gross profit	9,795	12,025	14,535	15,458	16,354	17,161
Operating expenses	3,736	3,315	1,171	4,334	4,832	5,290
Selling expense	897	865	941	1,082	1,120	1,136
Admin expense	4,121	3,811	3,916	4,346	4,521	4,608
Others	(1,282)	(1,361)	(3,686)	(1,095)	(809)	(453)
Operating profit	6,059	8,710	13,364	11,124	11,521	11,871
Share of (losses)/profits of associates/JV	127	96	42	30	0	0
Interest expense	(141)	(94)	(129)	(212)	(191)	(191)
Pre-tax profit	6,045	8,712	13,277	10,942	11,331	11,680
Income tax	(825)	(1,603)	(1,924)	(1,806)	(1,813)	(1,869)
After tax profit	5,220	7,109	11,353	9,136	9,518	9,811
Net profit	5,220	7,109	11,353	9,136	9,518	9,811
Adjusted net profit	5,923	7,671	9,588	9,743	10,582	10,949

BALANCE SHEET	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Current assets	29,936	34,544	32,458	41,121	36,878	38,341
Cash & equivalents	13,598	13,175	8,485	15,319	8,573	7,500
Account receivables	2,918	3,508	3,903	3,981	4,287	4,523
Inventories	8	23	41	73	130	232
Prepayment	3,438	3,793	4,183	4,318	4,714	4,994
ST bank deposits	9,937	13,999	15,763	17,339	19,073	20,981
Other current assets	37	46	83	91	100	110
Non-current assets	45,600	55,900	70,064	77,458	82,170	87,307
PP&E	490	803	1,201	1,643	2,086	2,518
Right-of-use assets	367	295	287	287	287	287
Deferred income tax	352	422	498	523	549	576
Investment in JVs & assos	4,274	4,669	1,659	1,709	1,759	1,809
Intangibles	2,032	2,049	2,899	2,644	2,387	2,118
Goodwill	19,542	19,647	20,521	23,606	23,606	23,606
Financial assets at FVTPL	6,540	14,498	26,231	28,854	31,740	34,913
Other non-current assets	12,003	13,517	16,768	18,192	19,757	21,478
Total assets	75,536	90,444	102,522	118,580	119,048	125,648
Current liabilities	12,014	16,550	14,589	22,301	18,076	19,501
Account payables	5,006	6,879	6,284	7,289	8,137	8,809
Tax payable	567	934	1,092	1,173	1,263	1,333
Other current liabilities	6,326	8,631	7,097	13,719	8,553	9,232
Lease liabilities	115	106	116	119	123	127
Long-term borrowings	6,320	4,168	4,883	12,035	12,047	12,048
Bond payables	5,636	3,572	3,497	10,639	10,639	10,639
Obligations under finance leases	297	219	200	200	200	200
Other non-current liabilities	387	377	1,186	1,196	1,208	1,209
Total liabilities	18,334	20,718	19,472	34,336	30,123	31,550
Share capital	2	2	2	2	2	2
Capital surplus	29,278	27,965	28,454	23,014	20,294	17,846
Retained earnings	16,969	20,051	29,381	36,015	43,416	51,037
Other reserves	9,658	19,845	22,450	22,450	22,450	22,450
Total shareholders equity	55,907	67,863	80,287	81,481	86,162	91,335
Minority interest	1,295	1,863	2,763	2,763	2,763	2,763
Total equity and liabilities	75,536	90,444	102,522	118,580	119,048	125,648

CASH FLOW	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	6,045	8,712	13,277	10,942	11,331	11,680
Depreciation & amortization	1,027	1,042	233	685	744	805
Tax paid	(825)	(1,355)	0	0	0	0
Change in working capital	786	1,556	(1,355)	1,419	958	736
Others	304	320	(1,924)	(1,806)	(1,813)	(1,869)
Net cash from operations	7,337	10,275	10,231	11,240	11,220	11,352
Investing						
Capital expenditure	(1,164)	(1,032)	(1,481)	(873)	(929)	(969)
Acquisition of subsidiaries/ investments	(9)	(34)	(250)	(3,085)	0	0
Net proceeds from disposal of short-term investments	(835)	(5,572)	0	0	0	0
Others	145	(180)	(8,496)	(5,645)	(6,204)	(6,819)
Net cash from investing	(1,863)	(6,818)	(10,227)	(9,603)	(7,133)	(7,787)
Financing						
Dividend paid	na	(1,508)	(1,981)	(2,502)	(2,116)	(2,190)
Net borrowings	0	0	0	7,142	0	0
Proceeds from share issues	0	0	0	0	0	0
Share repurchases	na	(1,925)	(390)	(5,440)	(2,720)	(2,448)
Others	(289)	(397)	(2,278)	5,997	(5,997)	0
Net cash from financing	(289)	(3,830)	(4,649)	5,197	(10,833)	(4,638)
Net change in cash						
Cash at the beginning of the year	9,589	13,598	13,175	8,485	15,319	8,573
Exchange difference	73	(50)	(45)	0	0	0
Cash at the end of the year	14,847	13,175	8,485	15,319	8,573	7,500
GROWTH	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Revenue	(2.1%)	2.3%	15.8%	7.4%	7.7%	5.5%
Gross profit	11.6%	22.8%	20.9%	6.3%	5.8%	4.9%
Operating profit	36.4%	43.8%	53.4%	(16.8%)	3.6%	3.0%
Net profit	36.0%	36.2%	59.7%	(19.5%)	4.2%	3.1%
Adj. net profit	24.8%	29.5%	25.0%	1.6%	8.6%	3.5%
PROFITABILITY	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Gross profit margin	35.3%	42.3%	44.2%	43.7%	43.0%	42.7%
Operating margin	21.8%	30.7%	40.6%	31.5%	30.3%	29.6%
Adj. net profit margin	21.3%	27.0%	29.1%	27.6%	27.8%	27.3%
Return on equity (ROE)	10.0%	11.5%	15.3%	11.3%	11.4%	11.1%
GEARING/LIQUIDITY/ACTIVITIES	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
Net debt to equity (x)	(0.1)	(0.1)	(0.0)	(0.0)	0.0	0.0
Current ratio (x)	2.5	2.1	2.2	1.8	2.0	2.0
Receivable turnover days	36.7	41.3	41.1	40.7	39.6	40.0
Payable turnover days	101.7	132.5	130.8	124.6	129.7	134.5
VALUATION	2023A	2024A	2025A	2026E	2027E	2028E
YE 31 Dec						
P/E	17.6	12.8	7.9	10.1	9.7	9.4
P/E (diluted)	17.9	13.0	8.1	10.1	9.7	9.4
P/B	1.6	1.3	1.1	1.1	1.1	1.0

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

Disclosures & Disclaimers

Analyst Certification

The research analyst who is primary responsible for the content of this research report, in whole or in part, certifies that with respect to the securities or issuer that the analyst covered in this report: (1) all of the views expressed accurately reflect his or her personal views about the subject securities or issuer; and (2) no part of his or her compensation was, is, or will be, directly or indirectly, related to the specific views expressed by that analyst in this report. Besides, the analyst confirms that neither the analyst nor his/her associates (as defined in the code of conduct issued by The Hong Kong Securities and Futures Commission) (1) have dealt in or traded in the stock(s) covered in this research report within 30 calendar days prior to the date of issue of this report; (2) will deal in or trade in the stock(s) covered in this research report 3 business days after the date of issue of this report; (3) serve as an officer of any of the Hong Kong listed companies covered in this report; and (4) have any financial interests in the Hong Kong listed companies covered in this report.

CMBIGM Ratings

BUY : Stock with potential return of over 15% over next 12 months
HOLD : Stock with potential return of +15% to -10% over next 12 months
SELL : Stock with potential loss of over 10% over next 12 months
NOT RATED : Stock is not rated by CMBIGM

OUTPERFORM : Industry expected to outperform the relevant broad market benchmark over next 12 months
MARKET-PERFORM : Industry expected to perform in-line with the relevant broad market benchmark over next 12 months
UNDERPERFORM : Industry expected to underperform the relevant broad market benchmark over next 12 months

CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

CMB International Global Markets Limited ("CMBIGM") is a wholly owned subsidiary of CMB International Capital Corporation Limited (a wholly owned subsidiary of China Merchants Bank)

Important Disclosures

There are risks involved in transacting in any securities. The information contained in this report may not be suitable for the purposes of all investors. CMBIGM does not provide individually tailored investment advice. This report has been prepared without regard to the individual investment objectives, financial position or special requirements. Past performance has no indication of future performance, and actual events may differ materially from that which is contained in the report. The value of, and returns from, any investments are uncertain and are not guaranteed and may fluctuate as a result of their dependence on the performance of underlying assets or other variable market factors. CMBIGM recommends that investors should independently evaluate particular investments and strategies, and encourages investors to consult with a professional financial advisor in order to make their own investment decisions.

This report or any information contained herein, have been prepared by the CMBIGM, solely for the purpose of supplying information to the clients of CMBIGM or its affiliate(s) to whom it is distributed. This report is not and should not be construed as an offer or solicitation to buy or sell any security or any interest in securities or enter into any transaction. Neither CMBIGM nor any of its affiliates, shareholders, agents, consultants, directors, officers or employees shall be liable for any loss, damage or expense whatsoever, whether direct or consequential, incurred in relying on the information contained in this report. Anyone making use of the information contained in this report does so entirely at their own risk.

The information and contents contained in this report are based on the analyses and interpretations of information believed to be publicly available and reliable. CMBIGM has exerted every effort in its capacity to ensure, but not to guarantee, their accuracy, completeness, timeliness or correctness. CMBIGM provides the information, advices and forecasts on an "AS IS" basis. The information and contents are subject to change without notice. CMBIGM may issue other publications having information and/ or conclusions different from this report. These publications reflect different assumption, point-of-view and analytical methods when compiling. CMBIGM may make investment decisions or take proprietary positions that are inconsistent with the recommendations or views in this report.

CMBIGM may have a position, make markets or act as principal or engage in transactions in securities of companies referred to in this report for itself and/or on behalf of its clients from time to time. Investors should assume that CMBIGM does or seeks to have investment banking or other business relationships with the companies in this report. As a result, recipients should be aware that CMBIGM may have a conflict of interest that could affect the objectivity of this report and CMBIGM will not assume any responsibility in respect thereof. This report is for the use of intended recipients only and this publication, may not be reproduced, reprinted, sold, redistributed or published in whole or in part for any purpose without prior written consent of CMBIGM. Additional information on recommended securities is available upon request.

For recipients of this document in the United Kingdom

This report has been provided only to persons (I) falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended from time to time) ("The Order") or (II) are persons falling within Article 49(2) (a) to (d) ("High Net Worth Companies, Unincorporated Associations, etc.") of the Order, and may not be provided to any other person without the prior written consent of CMBIGM.

For recipients of this document in the United States

CMBIGM is not a registered broker-dealer in the United States. As a result, CMBIGM is not subject to U.S. rules regarding the preparation of research reports and the independence of research analysts. The research analyst who is primary responsible for the content of this research report is not registered or qualified as a research analyst with the Financial Industry Regulatory Authority ("FINRA"). The analyst is not subject to applicable restrictions under FINRA Rules intended to ensure that the analyst is not affected by potential conflicts of interest that could bear upon the reliability of the research report. This report is intended for distribution in the United States solely to "major US institutional investors", as defined in Rule 15a-6 under the US Securities Exchange Act of 1934, as amended, and may not be furnished to any other person in the United States. Each major US institutional investor that receives a copy of this report by its acceptance hereof represents and agrees that it shall not distribute or provide this report to any other person. Any U.S. recipient of this report wishing to effect any transaction to buy or sell securities based on the information provided in this report should do so only through a U.S.-registered broker-dealer.

For recipients of this document in Singapore

This report is distributed in Singapore by CMBI (Singapore) Pte. Limited (CMBISG) (Company Regn. No. 201731928D), an Exempt Financial Adviser as defined in the Financial Advisers Act (Cap. 110) of Singapore and regulated by the Monetary Authority of Singapore. CMBISG may distribute reports produced by its respective foreign entities, affiliates or other foreign research houses pursuant to an arrangement under Regulation 32C of the Financial Advisers Regulations. Where the report is distributed in Singapore to a person who is not an Accredited Investor, Expert Investor or an Institutional Investor, as defined in the Securities and Futures Act (Cap. 289) of Singapore, CMBISG accepts legal responsibility for the contents of the report to such persons only to the extent required by law. Singapore recipients should contact CMBISG at +65 6350 4400 for matters arising from, or in connection with the report.