

TME (TME US)

Making progress into scale optimization

TME online music business operating efficiency continues to improve progressively amid economic recovery. It is on track for strong earnings rebound despite near-term top-line pressure. Social entertainment business continues to face pressure as the surge of COVID-19 cases impact content supply and competition is still abundant. Through online music business model optimization and leveraging off parent co user traffic synergies, overall costs control could help stabilize margins. We slightly adjusted FY23/24 total revenue forecast down by 2/1% to reflect challenges faced by the social entertainment business, but raised FY23/24 adjusted net income forecast by 7/11% in view of its business model optimization and long-term recurring income from its online music services business. We rolled forward valuation to FY23E and the DCF-valuation derived TP is raised by 54% to US\$10.50, due to enhanced long-term profit profile, which translates into 22x/19x FY23/24 PE. Maintain BUY.

■ **Resilient 4Q22E earnings rebound.** For 4Q22E, we estimate total revenue decline will decelerate to 4% YoY (3Q22/2Q22: -14/-6% YoY), as the online music revenue growth reaccelerates. We forecast online music revenue to increase by 23% YoY to RMB3.6bn in 4Q22E, driven by strong growth of music subscription and recovery of ad business. Social entertainment is expected to drop by 19% YoY to RMB3.8bn in 4Q22E, slightly below our previous expectation as the surge of COVID-19 cases in December impacted live streaming content supply. We forecast GPM to improve from 28.8/32.6% in 4Q21/3Q22 to 32.9% in 4Q22E, driven by control in audio content investment and recovery higher-margin non-subs music business. We forecast non-IFRS net income will grow by 76% YoY to RMB1.5bn in 4Q22E, better than our previous expectation, mainly due to its stringent budget control in sales and marketing.

■ **Revenue recovering in FY23/24E.** Looking ahead, we forecast total revenue to rebound by 5/8% in FY23/24E, mainly driven by solid growth of online music business (FY23/24E: +15/15% YoY). Music subscription will remain as the key growth driver with balanced growth of subscriber base and ARPPU, while ad business will rebound from the low base. We forecast social entertainment revenue will drop by 4% in FY23E due to competitive pressure, before stabilizing in FY24E. TME will see strong operating leverage in FY23/24E after expenses optimization and top-line recovery. We estimate 15% non-IFRS net income CAGR over FY22-24E.

■ **Maintain BUY.** We like TME due to its resilient earnings growth outlook (>70% YoY earnings growth in 4Q22E and 15% earnings CAGR over FY22-24E) amid the macro backdrop. TME remains as the absolute market leader in term of content and subscriber base (TME/Cloud Music: 85/38mn music subscribers). TME's current valuation is fair at 16x FY24 PE considering its strong earnings growth. Reiterate BUY.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	29,153	31,244	28,254	29,556	31,825
YoY growth (%)	14.6	7.2	(9.6)	4.6	7.7
Gross margin (%)	31.9	30.1	30.9	33.2	34.8
Net profit (RMB mn)	4,176.0	3,215.0	3,737.6	3,996.0	4,789.3
Adjusted net profit (RMB mn)	4,949.0	4,146.0	4,774.6	5,415.9	6,287.5
EPS (Adjusted) (RMB)	2.99	2.50	2.97	3.37	3.91
Consensus EPS (RMB)	2.99	2.50	2.88	3.14	3.43
P/S (x)	3.3	3.1	3.4	3.3	3.0
Non-IFRS P/E (x)	19.7	23.5	20.4	18.0	15.5

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$10.50
(Previous TP US\$6.84)
Up/Downside 16.8%
Current Price US\$8.99

China Internet

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

Wentao LU
luwentao@cmbi.com.hk

Ye TAO
franktao@cmbi.com.hk

Stock Data

Mkt Cap (US\$ mn)	14,442.2
Avg 3 mths t/o (US\$ mn)	6.3
52w High/Low (US\$)	9.18/3.12
Total Issued Shares (mn)	1606.5

Source: FactSet

Shareholding Structure

Tencent	53.2%
Spotify	8.2%

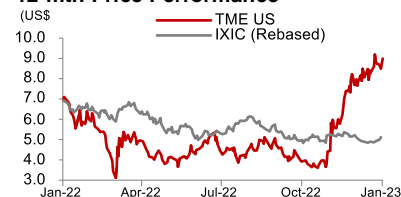
Source: Company data

Share Performance

	Absolute	Relative
1-mth	14.8%	16.7%
3-mth	128.2%	119.3%
6-mth	102.5%	105.6%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

We slightly adjusted FY23/24 total revenue forecast down by 2/1% to reflect challenges faced by the social entertainment business, but raised FY23/24 adjusted net income forecast by 7/11% in view of its prudent control in content investment and marketing expenses.

Figure 1: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	28,254	29,556	31,825	28,304	30,243	32,189	-0.2%	-2.3%	-1.1%
Gross Profit	8,742	9,812	11,071	8,760	9,550	10,413	-0.2%	2.7%	6.3%
Operating Profit	4,353	4,816	5,738	4,296	4,392	4,988	1.3%	9.7%	15.0%
Non-IFRS net profit	4,775	5,416	6,288	4,700	5,062	5,645	1.6%	7.0%	11.4%
Non-IFRS EPS (RMB)	2.9	3.3	3.9	2.9	3.1	3.5	1.6%	7.0%	11.4%
Gross Margin	30.9%	33.2%	34.8%	31.0%	31.6%	32.3%	0.0 ppt	1.6 ppt	2.4 ppt
Operating Margin	15.4%	16.3%	18.0%	15.2%	14.5%	15.5%	0.2 ppt	1.8 ppt	2.5 ppt
Non-IFRS net margin	16.9%	18.3%	19.8%	16.6%	16.7%	17.5%	0.3 ppt	1.6 ppt	2.2 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	28,254	29,556	31,825	28,306	29,538	31,520	-0.2%	0.1%	1.0%
Gross Profit	8,742	9,812	11,071	8,760	9,465	10,328	-0.2%	3.7%	7.2%
Operating Profit	4,353	4,816	5,738	4,072	4,656	5,208	6.9%	3.4%	10.2%
Non-IFRS net profit	4,775	5,416	6,288	4,670	5,089	5,556	2.2%	6.4%	13.2%
Non-IFRS EPS (RMB)	2.9	3.3	3.9	2.9	3.1	3.4	2.2%	6.4%	13.2%
Gross Margin	30.9%	33.2%	34.8%	30.9%	32.0%	32.8%	0.0 ppt	1.2 ppt	2.0 ppt
Operating Margin	15.4%	16.3%	18.0%	14.4%	15.8%	16.5%	1.0 ppt	0.5 ppt	1.5 ppt
Non-IFRS net margin	16.9%	18.3%	19.8%	16.5%	17.2%	17.6%	0.4 ppt	1.1 ppt	2.1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: key financial data forecasts

(RMB mn)	2021	2022E	2023E	2024E	4Q22E
Online music	11,467	12,455	14,366	16,462	3,531
YoY change (%)	22.7%	8.6%	15.3%	14.6%	22.6%
Subscription revenue	7,335	8,693	10,225	12,079	2,344
YoY change (%)	31.9%	18.5%	17.6%	18.1%	20.2%
Other revenue	4,132	3,761	4,141	4,383	1,186
YoY change (%)	9.1%	-9.0%	10.1%	5.8%	27.6%
Social entertainment and others	19,777	15,799	15,190	15,363	3,809
YoY change (%)	-0.1%	-20.1%	-3.9%	1.1%	-19.4%
Total revenue	31,244	28,254	29,556	31,825	7,340
YoY change (%)	7.2%	-9.6%	4.6%	7.7%	-3.5%
GPM (%)	30.1%	30.9%	33.2%	34.8%	32.9%
Adjusted NPM (%)	13.3%	16.9%	18.3%	19.8%	20.0%
Adjusted net profit	4,146	4,775	5,416	6,288	1,468
YoY change (%)	-16.2%	15.2%	13.4%	16.1%	76.4%

Source: Company data, CMBIGM estimates

DCF valuation

Our target price is US\$10.50, based on the DCF valuation methodology (WACC of 11.6% and terminal growth of 2.5%). Our target price translates into 22/19x FY23/24E non-IFRS PE.

Figure 4: TME: DCF Valuation

(RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Free cash flow	4,718	4,884	6,890	7,809	9,888	10,576	12,374	12,501
NPV of free cash flow	44,962							
Discounted terminal value	65,536							
Net cash	6,875							
Total TME valuation	117,373							
Number of ADS (diluted, mn)	1,621							
Valuation per ADS (US\$)	10.50							

Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	25,434	29,153	31,244	28,254	29,556	31,825
Cost of goods sold	16,761	19,851	21,840	19,512	19,744	20,755
Gross profit	8,673	9,302	9,404	8,742	9,812	11,071
Operating expenses	4,051	4,592	5,604	4,389	4,996	5,333
Selling expense	2,041	2,475	2,678	1,158	1,152	1,229
Admin expense	2,703	3,101	4,009	4,473	4,640	4,997
Others	(693)	(984)	(1,083)	(1,242)	(797)	(892)
Operating profit	4,622	4,710	3,800	4,353	4,816	5,738
Share of (losses)/profits of associates/JV	(18)	19	(47)	22	0	0
Interest expense	(64)	(97)	(121)	(77)	(115)	(103)
Pre-tax profit	4,540	4,632	3,632	4,298	4,701	5,634
Income tax	(563)	(456)	(417)	(561)	(705)	(845)
After tax profit	3,977	4,176	3,215	3,738	3,996	4,789
Net profit	3,977	4,176	3,215	3,738	3,996	4,789
Adjusted net profit	4,908	4,949	4,146	4,775	5,416	6,288
BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	26,914	31,687	26,791	27,071	33,205	35,574
Cash & equivalents	15,426	11,128	6,591	8,538	11,937	15,456
Account receivables	2,198	2,800	3,610	2,032	3,708	2,298
Inventories	26	18	24	32	43	57
Prepayment	2,220	2,846	2,731	2,145	2,681	2,392
ST bank deposits	7,000	14,858	12,769	13,152	13,547	13,953
Other current assets	44	37	1,066	1,173	1,290	1,419
Non-current assets	25,764	36,586	40,463	40,986	41,489	42,012
PP&E	179	176	243	234	232	236
Right-of-use assets	148	311	283	283	283	283
Deferred income tax	192	303	346	363	381	401
Investment in JVs & assos	489	2,255	3,599	3,649	3,699	3,749
Intangibles	1,622	2,020	2,829	2,690	2,509	2,326
Goodwill	17,140	17,492	19,121	19,371	19,621	19,871
Financial assets at FVTPL	4,461	9,771	7,302	7,448	7,597	7,749
Other non-current assets	1,533	4,258	6,740	6,947	7,166	7,397
Total assets	52,678	68,273	67,254	68,057	74,693	77,586
Current liabilities	8,490	9,602	10,450	7,543	10,174	8,262
Account payables	2,559	3,565	4,329	2,510	4,194	2,739
Tax payable	386	445	363	328	343	370
Other current liabilities	5,476	5,489	5,666	4,610	5,539	5,052
Lease liabilities	69	103	92	95	98	101
Long-term borrowings	510	5,940	5,749	5,721	5,730	5,747
Bond payables	0	5,175	5,062	5,062	5,062	5,062
Obligations under finance leases	78	218	205	215	226	237
Other non-current liabilities	432	547	482	444	442	448
Total liabilities	9,000	15,542	16,199	13,264	15,905	14,009
Share capital	2	2	2	2	2	2
Capital surplus	34,425	34,910	32,395	32,395	32,395	32,395
Retained earnings	7,007	11,111	14,194	17,932	21,928	26,717
Other reserves	2,156	6,222	3,726	3,726	3,726	3,726
Total shareholders equity	43,590	52,245	50,317	54,055	58,051	62,840
Minority interest	88	486	738	738	738	738
Total equity and liabilities	52,678	68,273	67,254	68,057	74,693	77,586

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,540	4,632	3,632	4,298	4,701	5,634
Depreciation & amortization	583	824	1,001	559	582	606
Tax paid	(564)	(637)	(589)	0	0	0
Change in working capital	982	(497)	579	(983)	194	(456)
Others	659	563	616	(561)	(705)	(845)
Net cash from operations	6,200	4,885	5,239	3,314	4,771	4,939
Investing						
Capital expenditure	(286)	(501)	(2,758)	(411)	(399)	(427)
Acquisition of subsidiaries/ investments	(45)	(540)	(2,078)	(250)	(250)	(250)
Net proceeds from disposal of short-term investments	36	6	(877)	0	0	0
Others	(7,807)	(13,171)	(286)	(716)	(735)	(754)
Net cash from investing	(8,102)	(14,206)	(5,999)	(1,377)	(1,383)	(1,431)
Financing						
Net borrowings	0	5,400	0	0	0	0
Proceeds from share issues	12	(134)	0	0	0	0
Others	(43)	26	(3,710)	10	11	11
Net cash from financing	(31)	5,292	(3,710)	10	11	11
Net change in cash						
Cash at the beginning of the year	17,356	15,426	11,128	6,591	8,538	11,937
Exchange difference	3	(269)	(67)	0	0	0
Cash at the end of the year	15,426	11,128	6,591	8,538	11,937	15,456
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Revenue	34.0%	14.6%	7.2%	(9.6%)	4.6%	7.7%
Gross profit	19.2%	7.3%	1.1%	(7.0%)	12.2%	12.8%
Operating profit	126.7%	1.9%	(19.3%)	14.6%	10.6%	19.1%
Net profit	117.1%	5.0%	(23.0%)	16.3%	6.9%	19.9%
Adj. net profit	17.6%	0.8%	(16.2%)	15.2%	13.4%	16.1%
PROFITABILITY	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Gross profit margin	34.1%	31.9%	30.1%	30.9%	33.2%	34.8%
Operating margin	18.2%	16.2%	12.2%	15.4%	16.3%	18.0%
Adj. net profit margin	19.3%	17.0%	13.3%	16.9%	18.3%	19.8%
Return on equity (ROE)	9.8%	8.7%	6.3%	7.2%	7.1%	7.9%
GEARING/LIQUIDITY/ACTIVITIES	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Net debt to equity (x)	(0.3)	(0.1)	(0.0)	(0.1)	(0.1)	(0.2)
Current ratio (x)	3.2	3.3	2.6	3.6	3.3	4.3
Receivable turnover days	26.4	31.3	37.4	36.4	35.4	34.4
Payable turnover days	47.8	56.3	66.0	64.0	62.0	61.0
VALUATION	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Non-IFRS P/E	19.8	19.7	23.5	20.4	18.0	15.5
P/B	3.9	3.0	3.1	1.8	1.7	1.5

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

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CMB International Global Markets Limited

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

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