

Cloud Music (9899 HK)

1H23 earnings beat on strong GPM expansion

Cloud Music reported 1H23 financial results: total revenue declined by 8% YoY to RMB3.9bn (in line with consensus estimate), mainly due to the operational adjustment to social entertainment business. Adjusted net income was RMB332mn in 1H23 (1H22: net loss of RMB217mn), beating consensus estimate of RMB96mn, primarily due to the enhanced GPM (+12pct YoY). As social entertainment business continues to face pressure, we lower FY23-25E total revenue forecast by 8-9%; but we raise FY23-FY25E adjusted net income forecast to RMB686/974/1,365mn (previous: RMB194/618/1,065mn) on 1) better content cost saving; 2) optimized live streaming revenue-sharing ratio; 3) enhanced operating efficiency. We fine-tuned our DCF-derived target price to HK\$99.5 (previous: HK\$103.5). Maintain BUY.

- Solid online music business; social entertainment under pressure.** Online music revenue grew by 13% YoY to RMB2.0bn in 1H23 (52% of total revenue), mainly driven by growth of subscription business (+17% YoY). Average monthly paying users grew by 11% YoY to 41.8mn in 1H23, with paying ratio reaching 20.2%. For 2H23E, we estimate online music revenue to increase by 18% YoY to RMB2.3bn, driven by the solid net adds of paying users. Social entertainment services revenue declined by 24% YoY to RMB1.9bn in 1H23 (48% of total revenue), as the business adjusted its operating strategy to enhance internal control and optimize certain live streaming functions. We expect social entertainment revenue will remain under pressure and decline by 40% YoY to RMB1.7bn in 2H23E; the live streaming revenue shall stabilize from 4Q23E onwards, in our view.
- Nurturing healthy user and content ecosystem.** Average MAUs increased by 14% YoY to 206.7mn in 1H23, with DAU/MAU ratio staying above 30%, supported by the enhanced user experience and Cloud Music's more active approach to acquire new users. Cloud Music further enriched its content library in 1H23 through: 1) deepening partnership with top-tier music labels such as B'in Music and Rock Record; 2) supporting healthy development of its independent artist ecosystem, in which the total number of registered independent artists was up 22% YoY to 646k in June 2023.
- Profitability improvement remains on track.** GPM improved from 12.6% in 1H22 to 24.7% in 1H23, primarily driven by optimized licensed content cost and live streaming revenue-sharing ratio. We expect its GPM to further expand to 28.2% in 2H23E. For full-year FY23, we forecast adjusted net income of RMB686mn, with net margin up by 10pct YoY to 8.7% on enhanced GPM. Cloud Music's monetization and profitability improvement remain on track. Its current valuation of 1.7x FY23E PS also offers attractive risk-reward versus its peer (3.0x). Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	6,998	8,992	7,860	8,524	9,281
YoY growth (%)	42.9	28.5	(12.6)	8.4	8.9
Gross margin (%)	2.0	14.4	26.4	29.0	31.7
Operating profit (RMB mn)	(1,347)	(385)	334	654	1,048
YoY growth (%)	na	na	na	95.8	60.3
Adjusted net profit (RMB mn)	(1,043.7)	(114.6)	685.6	973.7	1,364.7
EPS (Adjusted) (RMB cents)	(502.37)	(54.82)	324.62	461.01	646.16
Consensus EPS (RMB cents)	(502.37)	(54.82)	46.00	357.70	490.80
P/S (x)	2.0	1.5	1.7	1.6	1.5
P/E (x)	na	na	22.6	15.4	10.8

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$99.50**
(Previous TP **HK\$103.50**)
Up/Downside **42.1%**
Current Price **HK\$70.00**

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Stock Data

Mkt Cap (HK\$ mn)	14,784.3
Avg 3 mths t/o (HK\$ mn)	5.3
52w High/Low (HK\$)	110.70/53.15
Total Issued Shares (mn)	211.2

Source: FactSet

Shareholding Structure

NetEase	61.4%
Alibaba	9.9%

Source: Company data

Share Performance

	Absolute	Relative
1-mth	-7.9%	-0.3%
3-mth	-16.7%	-13.0%
6-mth	-12.5%	-2.5%

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	7,860	8,524	9,281	8,523	9,340	10,150	-7.8%	-8.7%	-8.6%
Gross Profit	2,079	2,469	2,943	1,962	2,490	3,023	5.9%	-0.8%	-2.7%
Operating Profit	334	654	1,048	36	518	1,023	NA	NA	NA
Adjusted net profit	686	974	1,365	194	618	1,065	NA	NA	NA
Adjusted EPS (RMB)	3.2	4.6	6.5	0.9	3.0	5.1	NA	NA	NA
Gross Margin	26.4%	29.0%	31.7%	23.0%	26.7%	29.8%	3.4 ppt	2.3 ppt	1.9 ppt
Operating Margin	4.2%	7.7%	11.3%	0.4%	5.5%	10.1%	3.8 ppt	2.2 ppt	1.2 ppt
Adjusted net margin	8.7%	11.4%	14.7%	2.3%	6.6%	10.5%	6.4 ppt	4.8 ppt	4.2 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	7,860	8,524	9,281	9,696	11,288	12,745	-18.9%	-24.5%	-27.2%
Gross Profit	2,079	2,469	2,943	2,096	2,890	3,558	-0.8%	-14.5%	-17.3%
Adjusted net profit	686	974	1,365	273	748	1,095	NA	NA	NA
Adjusted EPS (RMB)	3.2	4.6	6.5	0.5	3.6	4.9	NA	NA	NA
Gross Margin	26.4%	29.0%	31.7%	21.6%	25.6%	27.9%	4.8 ppt	3.4 ppt	3.8 ppt
Adjusted net margin	8.7%	11.4%	14.7%	2.8%	6.6%	8.6%	5.9 ppt	4.8 ppt	6.1 ppt

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\$99.5, which implies 2.5x FY23E PS.

Figure 3: Cloud Music: DCF valuation

(RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Adjusted EBITDA	393	698	1,107	1,414	1,738	2,078	2,301	2,549
Free cash flow	580	640	916	1,126	1,354	1,583	1,768	1,958
NPV of FCF	5,694							
Discounted terminal value	6,340							
Enterprise value	12,034							
Net cash	7,301							
Equity value	19,336							
Number of shares (diluted, mn)	211.2							
Exchange rate (HKD/RMB)	0.92							
Valuation per share (HK\$)	99.5							
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	7,860	8,524	9,281
Cost of goods sold	5,491	6,855	7,699	5,781	6,054	6,338
Gross profit	(595)	143	1,293	2,079	2,469	2,943
Operating expenses	929	1,490	1,678	1,745	1,816	1,895
Selling expense	327	431	635	731	784	845
Admin expense	97	264	172	157	162	167
R&D expense	576	869	1,011	912	929	941
Others	(71)	(75)	(140)	(55)	(60)	(58)
Operating profit	(1,525)	(1,347)	(385)	334	654	1,048
Investment gain/loss	(4)	2	(3)	(2)	(3)	(3)
Other gains/(losses)	(1,522)	(755)	0	0	0	0
Interest income	101	48	183	343	394	452
Interest expense	0	0	(0)	0	0	0
Pre-tax profit	(2,950)	(2,051)	(204)	674	1,045	1,496
Income tax	(2)	(5)	(17)	(67)	(157)	(224)
After tax profit	(2,951)	(2,056)	(221)	607	888	1,272
Net profit	(2,951)	(2,056)	(221)	607	888	1,272
Adjusted net profit	(1,568)	(1,044)	(115)	686	974	1,365

BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	6,863	8,769	8,909	9,334	10,400	11,834
Cash & equivalents	3,006	853	548	1,207	1,964	3,036
Account receivables	254	674	736	547	534	552
Prepayment	1,642	1,345	1,428	1,066	1,054	1,047
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	490	459	460
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	339	294	288
Total assets	8,057	9,388	9,546	9,824	10,859	12,294
Current liabilities	2,173	1,948	2,206	1,785	1,839	1,902
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	707	767	835
Accrued expenses	1,640	1,284	1,370	1,018	1,013	1,008
Non-current liabilities	11,192	58	73	86	93	101
Convertible bonds	11,162	0	0	0	0	0
Other non-current liabilities	29	58	73	86	93	101
Total liabilities	13,364	2,006	2,279	1,871	1,932	2,003
Share capital	0	0	0	0	0	0
Retained earnings	(8,372)	(10,600)	(10,822)	(10,215)	(9,326)	(8,054)
Other reserves	3,066	17,982	18,089	18,167	18,253	18,345
Total shareholders equity	(5,307)	7,382	7,267	7,953	8,926	10,291
Total equity and liabilities	8,057	9,388	9,546	9,824	10,859	12,294

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(2,950)	(2,051)	(204)	674	1,045	1,496
Depreciation & amortization	22	15	32	35	19	25
Tax paid	(2)	(6)	(17)	(67)	(157)	(224)
Change in working capital	531	177	114	289	131	65
Others	1,429	957	(76)	(264)	(309)	(359)
Net cash from operations	(969)	(908)	(151)	667	730	1,003
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	343	394	452
Net cash from investing	3,406	(3,862)	(154)	(8)	28	68
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	1,207	1,964
Exchange difference	(21)	4	0	0	0	0
Cash at the end of the year	3,006	853	548	1,207	1,964	3,036
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	111.2%	42.9%	28.5%	(12.6%)	8.4%	8.9%
Gross profit	na	na	806.3%	60.7%	18.8%	19.2%
Operating profit	na	na	na	na	95.8%	60.3%
Net profit	na	na	na	na	46.4%	43.2%
Adj. net profit	na	na	na	na	42.0%	40.2%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	(12.2%)	2.0%	14.4%	26.4%	29.0%	31.7%
Operating margin	(31.1%)	(19.2%)	(4.3%)	4.2%	7.7%	11.3%
Adj. net profit margin	(32.0%)	(14.9%)	(1.3%)	8.7%	11.4%	14.7%
Return on equity (ROE)	na	(198.2%)	(3.0%)	8.0%	10.5%	13.2%
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)	(0.9)
Current ratio (x)	3.2	4.5	4.0	5.2	5.7	6.2
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	22.6	15.4	10.8
P/E (diluted)	na	na	na	22.6	15.4	10.8
P/B	na	3.8	2.0	1.7	1.5	1.3

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

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