

TME (TME US)

Strong earnings beat on improvement in GPM and operating efficiency

TME reported its 3Q22 financial results on 15 Nov. Total revenue declined by 5.6% YoY but grew by 6.7% QoQ to RMB7.4bn in 3Q22, largely in line with consensus/CMBI estimate of RMB7.1/7.1bn. 9M22 revenue was down 11.5% YoY due to the soft performance of social entertainment business. Nonetheless, non-IFRS net profit grew by 35.9% YoY to RMB1.4bn in 3Q22 and beat consensus/CMBI estimate of RMB1.1/1.2bn, driven by better-than-expected GPM improvement and effective control on S&M expenses (-58% YoY). For 4Q22E, we expect total revenue decline to further stabilize (-2.9% YoY in 4Q22E vs. -11.5% YoY in 9M22), supported by solid growth of music subscription business and gradual recovery of advertising business. We forecast 4Q22E non-IFRS net profit to deliver strong growth of 67.4% YoY due to effective cost control and low base. We revise up FY22/FY23/FY24E non-IFRS net income forecast by 8.1/7.2/3.0% to reflect solid improvement in GPM and operating efficiency. We raise our DCF-derived TP by 3.6% to US\$6.84. Maintain BUY.

■ **Robust online music business, while social entertainment business remained under pressure.** Online music service revenue grew by 18.8% YoY to RMB3.4bn in 3Q22 (1Q22/2Q22: -4.8/-2.4% YoY), primarily due to robust subscription revenue growth (+18.3% YoY), strong digital album sales (c.7mn Jay Chou's new albums were sold in 3Q22), recovery of ad business from the COVID-19 impact. Number of music subscribers was up 19.8% YoY with net add of 2.6mn in 3Q22. Looking forward, TME will continue to focus on quality growth of subscribers, with further sequential growth in ARPPU driven by less promotions and offerings of super VIP services. Social entertainment business remained negatively impacted by weak consumption sentiment and competitive pressure, with revenue down by 20.0% YoY to RMB3.9bn in 3Q22 (1Q22/2Q22: -20.6/-20.4% YoY). The number of paid users was down by 29.5% YoY in 3Q22. TME will continue to develop new initiatives like audio live streaming and overseas expansion to offset the negative impacts from intensive domestic competition.

■ **Strong earnings growth on effective expense control.** GPM improved by 3.0ppt YoY and 2.8ppt QoQ to 32.6% in 3Q22 (vs. consensus 30.0%), attributable to rationalizing music content costs and control in revenue sharing fees for the live streaming business. Management expects online music GPM to further expand QoQ in 4Q22E, due to control in content costs and recovery of ad business. TME managed its S&M expenses down by 58% YoY in 3Q22, and will continue to optimize its marketing spending. Non-IFRS net margin was up 5.7ppt YoY and 3.8ppt QoQ to 18.7% in 3Q22, and the management expects net margin expansion in 2023E.

■ **Maintain BUY.** We lift FY22-FY24 earnings forecast by 3-8% to factor in better-than-expected improvement in GPM and operating efficiency. We raise our DCF-derived target price by 3.6% to US\$6.84. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	29,153	31,244	28,304	30,243	32,189
Gross margin (%)	31.9	30.1	31.0	31.6	32.3
Operating profit (RMB mn)	4,710	3,800	4,296	4,392	4,988
Adjusted net profit (RMB mn)	4,949.0	4,146.0	4,699.9	5,062.0	5,645.3
Consensus EPS (RMB)	2.9	2.5	2.6	2.7	3.1
P/S (x)	1.7	1.6	1.8	1.7	1.6
P/E (x)	38.1	48.9	13.7	13.8	12.1

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$6.84

(Previous TP) US\$6.60

Up/Downside 53.7%

Current Price US\$4.45

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Stock Data

Mkt Cap (US\$ mn)	7,148.8
Avg 3 mths t/o (US\$ mn)	4.3
52w High/Low (US\$)	8.59/3.12
Total Issued Shares (mn)	1606.5

Source: FactSet

Shareholding Structure

Tencent	53.2%
Spotify	8.2%

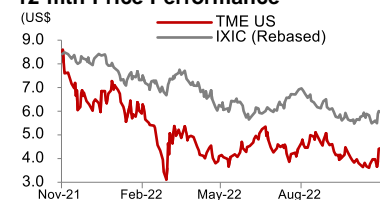
Source: Company data

Share Performance

	Absolute	Relative
1-mth	16.2%	5.9%
3-mth	0.9%	16.3%
6-mth	8.5%	13.2%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: TME: quarterly financial results

(RMB mn)	3Q20	4Q20	1Q21	2Q21	3Q21	4Q21	1Q22	2Q22	3Q22
Online music	2,324	2,760	2,749	2,950	2,888	2,880	2,616	2,878	3,430
YoY change (%)	25.9%	29.0%	34.5%	32.8%	24.3%	4.3%	-4.8%	-2.4%	18.8%
Subscription revenue	1,460	1,579	1,692	1,791	1,901	1,950	1,993	2,107	2,249
YoY change (%)	55.0%	41.9%	40.2%	36.3%	30.2%	23.5%	17.8%	17.6%	18.3%
Other revenue	864	1,181	1,057	1,159	987	930	623	771	1,181
YoY change (%)	-4.4%	15.1%	26.3%	27.8%	14.2%	-21.3%	-41.1%	-33.4%	19.7%
Social entertainment and others	5,251	5,575	5,075	5,058	4,917	4,727	4,028	4,027	3,935
YoY change (%)	12.7%	8.2%	18.9%	7.4%	-6.4%	-15.2%	-20.6%	-20.4%	-20.0%
Total revenue	7,575	8,335	7,824	8,008	7,805	7,607	6,644	6,905	7,365
YoY change (%)	16.4%	14.3%	24.0%	15.5%	3.0%	-8.7%	-15.1%	-13.8%	-5.6%
GPM (%)	32.4%	32.4%	31.5%	30.4%	29.6%	28.8%	28.0%	29.9%	32.6%
Adjusted NPM (%)	17.8%	16.2%	15.1%	13.9%	13.0%	10.9%	13.5%	14.9%	18.7%
Adjusted net profit	1,346	1,348	1,182	1,117	1,015	832	899	1,029	1,379
YoY change (%)	9.1%	0.4%	7.1%	-3.0%	-24.6%	-38.3%	-23.9%	-7.9%	35.9%

Source: CMBIGM estimates

We raise our FY22/FY23/FY24E total revenue forecast by 2.0/1.7/1.6% to reflect better-than-expected recovery of non-subscription music business. We revise up FY22/FY23/FY24E non-IFRS net income forecast by 8.1/7.2/3.0% to reflect solid improvement in GPM and operating efficiency.

Figure 2: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	28,304	30,243	32,189	27,743	29,724	31,670	2.0%	1.7%	1.6%
Gross Profit	8,760	9,550	10,413	8,335	9,269	10,144	5.1%	3.0%	2.6%
Operating Profit	4,296	4,392	4,988	3,939	4,068	4,875	9.1%	8.0%	2.3%
Non-IFRS net profit	4,700	5,062	5,645	4,346	4,722	5,483	8.1%	7.2%	3.0%
Non-IFRS EPS (RMB)	2.9	3.1	3.5	2.7	2.9	3.4	8.8%	7.9%	3.6%
Gross Margin	31.0%	31.6%	32.3%	30.0%	31.2%	32.0%	0.9 ppt	0.4 ppt	0.3 ppt
Operating Margin	15.2%	14.5%	15.5%	14.2%	13.7%	15.4%	1.0 ppt	0.8 ppt	0.1 ppt
Non-IFRS net margin	16.6%	16.7%	17.5%	15.7%	15.9%	17.3%	0.9 ppt	0.9 ppt	0.2 ppt

Source: CMBIGM estimates

Figure 3: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	28,304	30,243	32,189	27,858	29,453	30,934	1.6%	2.7%	4.1%
Gross Profit	8,760	9,550	10,413	8,240	8,998	9,763	6.3%	6.1%	6.7%
Operating Profit	4,296	4,392	4,988	3,616	4,059	4,535	18.8%	8.2%	10.0%
Non-IFRS net profit	4,700	5,062	5,645	4,134	4,361	4,991	13.7%	16.1%	13.1%
Non-IFRS EPS (RMB)	2.9	3.1	3.5	2.6	2.7	3.1	13.7%	16.1%	13.1%
Gross Margin	31.0%	31.6%	32.3%	29.6%	30.6%	31.6%	1.4 ppt	1.0 ppt	0.8 ppt
Operating Margin	15.2%	14.5%	15.5%	13.0%	13.8%	14.7%	2.2 ppt	0.7 ppt	0.8 ppt
Non-IFRS net margin	16.6%	16.7%	17.5%	14.8%	14.8%	16.1%	1.8 ppt	1.9 ppt	1.4 ppt

Source: Bloomberg, CMBIGM estimates

DCF valuation

Our target price is US\$6.84, based on the DCF valuation methodology (WACC of 11.6% and terminal growth of 2.5%). Our target price translates into 16x 2023E non-IFRS PE.

Figure 4: TME: DCF Valuation (WACC of 11.6% and terminal growth of 2.5%)

(RMBmn)	2022E	2023E	2024E	2025E	2026E	2027E	2028E
Net revenue	28,304	30,243	32,189	34,129	36,169	38,222	40,146
Free cash flow	2,336	4,622	3,980	5,978	5,861	8,053	7,947
NPV of free cash flow	26,534						
Discounted terminal value	46,488						
Net cash	3,421						
Total TME valuation	76,443						
Number of ADS (diluted, mn)	1,621						
Valuation per ADS (US\$)	6.84						

Source: CMBIGM estimates

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	25,434	29,153	31,244	28,304	30,243	32,189
Cost of goods sold	16,761	19,851	21,840	19,544	20,693	21,776
Gross profit	8,673	9,302	9,404	8,760	9,550	10,413
Operating expenses	4,051	4,592	5,604	4,464	5,158	5,425
Selling expense	2,041	2,475	2,678	1,216	1,360	1,448
Admin expense	2,703	3,101	4,009	4,468	4,695	4,915
Others	(693)	(984)	(1,083)	(1,220)	(897)	(938)
Operating profit	4,622	4,710	3,800	4,296	4,392	4,988
Share of (losses)/profits of associates/JV	(18)	19	(47)	30	0	0
Interest expense	(64)	(97)	(121)	(101)	(115)	(103)
Pre-tax profit	4,540	4,632	3,632	4,225	4,277	4,884
Income tax	(563)	(456)	(417)	(550)	(642)	(733)
After tax profit	3,977	4,176	3,215	3,675	3,636	4,152
Net profit	3,977	4,176	3,215	3,675	3,636	4,152
Adjusted net profit	4,908	4,949	4,146	4,700	5,062	5,645
BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	26,914	31,687	26,791	27,034	33,450	34,590
Cash & equivalents	15,426	11,128	6,591	8,483	11,835	14,501
Account receivables	2,198	2,800	3,610	2,042	3,831	2,243
Inventories	26	18	24	32	43	57
Prepayment	2,220	2,846	2,731	2,153	2,905	2,417
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	40,987	41,499	42,025
PP&E	179	176	243	234	234	239
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	2,691	2,517	2,337
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	68,021	74,949	76,615
Current liabilities	8,490	9,602	10,450	7,569	10,847	8,348
Account payables	2,559	3,565	4,329	2,521	4,505	2,769
Tax payable	386	445	363	329	351	374
Other current liabilities	5,476	5,489	5,666	4,624	5,893	5,104
Lease liabilities	69	103	92	95	98	101
Long-term borrowings	510	5,940	5,749	5,721	5,736	5,750
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	448	450
Total liabilities	9,000	15,542	16,199	13,290	16,583	14,098
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	17,869	21,505	25,657
Other reserves	2,156	6,222	3,726	3,726	3,726	3,726
Total shareholders equity	43,590	52,245	50,317	53,992	57,628	61,780
Minority interest	88	486	738	738	738	738
Total equity and liabilities	52,678	68,273	67,254	68,021	74,949	76,615

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,540	4,632	3,632	4,225	4,277	4,884
Depreciation & amortization	583	824	1,001	559	582	607
Tax paid	(564)	(637)	(589)	0	0	0
Change in working capital	982	(497)	579	(975)	516	(669)
Others	659	563	616	(550)	(642)	(733)
Net cash from operations	6,200	4,885	5,239	3,260	4,734	4,090
Investing						
Capital expenditure	(286)	(501)	(2,758)	(412)	(408)	(432)
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)	(1,378)	(1,392)	(1,436)
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	8,483	11,835
Exchange difference	3	(269)	(67)	0	0	0
Cash at the end of the year	15,426	11,128	6,591	8,483	11,835	14,501
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Revenue	34.0%	14.6%	7.2%	(9.4%)	6.8%	6.4%
Gross profit	19.2%	7.3%	1.1%	(6.8%)	9.0%	9.0%
Operating profit	126.7%	1.9%	(19.3%)	13.1%	2.2%	13.6%
Net profit	117.1%	5.0%	(23.0%)	14.3%	(1.1%)	14.2%
Adj. net profit	17.6%	0.8%	(16.2%)	13.4%	7.7%	11.5%
PROFITABILITY	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Gross profit margin	34.1%	31.9%	30.1%	31.0%	31.6%	32.3%
Operating margin	18.2%	16.2%	12.2%	15.2%	14.5%	15.5%
Adj. net profit margin	19.3%	17.0%	13.3%	16.6%	16.7%	17.5%
Return on equity (ROE)	9.8%	8.7%	6.3%	7.0%	6.5%	7.0%
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)	(0.1)
Current ratio (x)	3.2	3.3	2.6	3.6	3.1	4.1
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						
P/E	42.6	38.1	48.9	13.7	13.8	12.1
P/E (diluted)	41.7	38.7	49.5	13.8	14.0	12.2
P/B	3.9	3.0	3.1	0.9	0.9	0.8

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

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