

Cloud Music (9899 HK)

Solid core music business and margin expansion outlook

Cloud Music announced FY23 financial results: total revenue dropped by 13% YoY to RMB7.87bn in FY23, in line with our/consensus estimate. 2H23 total revenue was down by 16% YoY to RMB3.96bn, mainly due to the adjustment of social entertainment business (-42% YoY). Cloud music recorded adjusted net income of RMB819mn in FY23, beating our/consensus estimate of RMB686/629mn, thanks to the solid GPM improvement (+12.3ppt YoY). We expect social entertainment business to remain under pressure, and thus lower FY24-25E revenue forecast by 6-8%. However, we are positive on the core music business growth and GPM expansion, supported by the growing paid user base. We raise FY24-25E adjusted net income forecast by 1-2%, and lift our DCF-derived target price to HK\$106.5 (previous: HK\$99.5). Maintain BUY.

- **Positive on core music business outlook.** Online music revenue was up by 22% YoY to RMB2.3bn and accounted for 59% of total revenue in 2H23 (1H23: +13% YoY), driven by solid growth of subscription business (+24% YoY) and strengthened ad monetization capabilities. Average monthly paying users grew by 15% YoY to 44.1mn in 2023, with paying ratio rising by 1.2ppt YoY to 21.4% in 2023. For 2024, we expect online music revenue to grow by 17% YoY, driven by 16% YoY growth in monthly paying users. Social entertainment business was under pressure, with revenue down 42% YoY to RMB1.6bn in 2H23, due to operating strategy adjustment. In 1Q24, Cloud Music launched a comprehensive product upgrade to focus more on its core music business, which however may impact live streaming user traffic and revenue in FY24. We forecast social entertainment revenue to decline by 18% YoY in 2024E.
- **Driving quality development of music ecosystem.** Average MAUs recorded steady growth of 9% YoY to 205.9mn in 2023, with DAU/MAU consistently above 30%. Cloud music leverages AI capability to further enhance users' music discovery and consumption experience in 2023, with an increasing percentage of music streams from the platform's recommendation. The company continues to expand its content library, with no. of music tracks up by 28% YoY to 149mn as of 2023-end. In addition, Cloud Music enriched the long-form audio offerings on its platform, with total listening time of audio content up by 71% YoY in 2023.
- **Solid margin expansion ahead.** Overall GPM expanded by 12.8ppt YoY to 28.7% in 2H23, due to the improved music monetization, optimized content cost and revenue sharing ratio. We forecast GPM will rise to 31.0/33.7/35.5% over FY24-26E. We are upbeat on Cloud Music earnings growth outlook supported by its solid core music business and economies of scale. We forecast adjusted net income to grow at a CAGR of 28% over FY24-26E, and view its current valuation of 18x FY24E PE attractive.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	8,992	7,867	8,001	8,566	9,067
YoY growth (%)	28.5	(12.5)	1.7	7.1	5.9
Gross margin (%)	14.4	26.7	31.0	33.7	35.5
Adjusted net profit (RMB mn)	(114.6)	818.5	988.6	1,373.1	1,705.3
YoY growth (%)	na	na	20.8	38.9	24.2
EPS (Adjusted) (RMB)	(0.55)	3.89	4.70	6.53	8.10
Consensus EPS (RMB)	(0.55)	3.89	4.26	5.98	6.85
P/E (x)	ns	21.6	19.4	13.6	10.9

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **HK\$106.50**

(Previous TP) **HK\$99.50**

Up/Downside **17.7%**

Current Price **HK\$90.45**

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Stock Data

Mkt Cap (HK\$ mn)	19,031.9
Avg 3 mths t/o (HK\$ mn)	5.8
52w High/Low (HK\$)	103.00/59.95
Total Issued Shares (mn)	210.4
Source: FactSet	

Shareholding Structure

NetEase	61.4%
Alibaba	9.9%

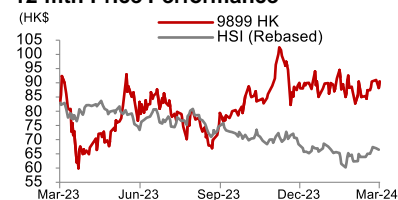
Source: Company data

Share Performance

	Absolute	Relative
1-mth	4.5%	-1.9%
3-mth	2.7%	4.2%
6-mth	14.0%	29.5%

Source: FactSet

12-month Price Performance



Source: FactSet

Figure 1: Cloud Music: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	8,001	8,566	9,067	8,524	9,281	NA	-6.1%	-7.7%	NA
Gross profit	2,477	2,889	3,219	2,469	2,943	NA	0.3%	-1.8%	NA
Operating profit	661	1,048	1,356	654	1,048	NA	1.1%	0.0%	NA
Adjusted net profit	989	1,373	1,705	974	1,365	NA	1.5%	0.6%	NA
Adjusted EPS (RMB)	4.7	6.5	8.1	4.6	6.5	NA	1.9%	1.0%	NA
Gross margin	31.0%	33.7%	35.5%	29.0%	31.7%	NA	2.0 ppt	2.0 ppt	NA
Operating margin	8.3%	12.2%	14.9%	7.7%	11.3%	NA	0.6 ppt	0.9 ppt	NA
Adjusted net margin	12.4%	16.0%	18.8%	11.4%	14.7%	NA	0.9 ppt	1.3 ppt	NA

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	8,001	8,566	9,067	8,742	9,792	10,438	-8.5%	-12.5%	-13.1%
Gross profit	2,477	2,889	3,219	2,501	3,022	3,045	-1.0%	-4.4%	5.7%
Adjusted net profit	989	1,373	1,705	932	1,339	1,592	6.1%	2.6%	7.1%
Adjusted EPS (RMB)	4.7	6.5	8.1	4.3	6.0	6.8	10.4%	9.1%	18.4%
Gross margin	31.0%	33.7%	35.5%	28.6%	30.9%	29.2%	2.3 ppt	2.9 ppt	6.3 ppt
Adjusted net margin	12.4%	16.0%	18.8%	10.7%	13.7%	15.3%	1.7 ppt	2.4 ppt	3.6 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\$106.5, which implies 21x FY24E Non-IFRS PE.

Figure 3: Cloud Music: DCF valuation

(RMB mn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Adjusted EBITDA	712	1,097	1,400	1,533	1,642	1,731	1,814
Free cash flow	552	910	1,135	1,241	1,262	1,318	1,366
NPV of FCF	5,030						
Discounted terminal value	5,074						
Enterprise value	10,103						
Net cash	10,507						
Equity value	20,610						
Number of shares (diluted, mn)	210.4						
Exchange rate (HKD/RMB)	0.92						
Valuation per share (HK\$)	106.5						
WACC	14.7%						
Terminal FCF growth (%)	2.5%						

Source: CMBIGM estimates

Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	6,998	8,992	7,867	8,001	8,566	9,067
Cost of goods sold	6,855	7,699	5,764	5,524	5,677	5,848
Gross profit	143	1,293	2,103	2,477	2,889	3,219
Operating expenses	1,490	1,678	1,772	1,816	1,841	1,863
Selling expense	431	635	758	840	874	879
Admin expense	264	172	165	160	158	159
R&D expense	869	1,011	869	864	860	883
Others	(75)	(140)	(20)	(48)	(51)	(58)
Operating profit	(1,347)	(385)	330	661	1,048	1,356
Investment gain/loss	2	(3)	(0)	(0)	(0)	(0)
Other gains/(losses)	(755)	0	0	0	0	0
Interest income	48	183	438	402	460	536
Interest expense	0	(0)	(0)	0	0	0
Pre-tax profit	(2,051)	(204)	768	1,062	1,507	1,892
Income tax	(5)	(17)	(33)	(159)	(226)	(284)
After tax profit	(2,056)	(221)	734	903	1,281	1,608
Net profit	(2,056)	(221)	734	903	1,281	1,608
Adjusted net profit	(1,044)	(115)	819	989	1,373	1,705

BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	8,769	10,475	11,323	12,191	13,610	15,348
Cash & equivalents	853	2,917	4,020	4,748	5,882	7,309
Account receivables	674	558	923	845	860	865
Prepayment	1,345	662	775	719	703	706
ST bank deposits	5,528	6,192	5,485	5,759	6,047	6,349
Financial assets at FVTPL	241	0	0	0	0	0
Other current assets	128	139	98	98	98	98
Non-current assets	619	416	287	247	236	234
PP&E	44	46	33	23	17	15
Right-of-use assets	11	8	6	6	6	6
Investment in JVs & assos	93	79	79	79	79	79
Other non-current assets	471	283	169	138	133	134
Total assets	9,388	10,891	11,611	12,437	13,846	15,583
Current liabilities	1,948	3,010	3,100	2,937	2,967	2,995
Account payables	0	0	0	0	0	0
Tax payable	0	6	4	5	7	9
Other current liabilities	56	53	76	76	76	76
Lease liabilities	3	3	3	3	3	3
Contract liabilities	605	714	1,001	1,018	1,090	1,154
Accrued expenses	1,284	2,235	2,015	1,835	1,791	1,753
Non-current liabilities	58	61	70	71	76	80
Convertible bonds	0	0	0	0	0	0
Other non-current liabilities	58	61	70	71	76	80
Total liabilities	2,006	3,071	3,170	3,008	3,043	3,075
Share capital	0	0	0	0	0	0
Retained earnings	(10,600)	(10,824)	(10,091)	(9,189)	(7,907)	(6,299)
Other reserves	17,982	18,644	18,532	18,618	18,710	18,807
Total shareholders equity	7,382	7,820	8,441	9,429	10,803	12,508
Total equity and liabilities	9,388	10,891	11,611	12,437	13,846	15,583

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(2,051)	(204)	768	1,062	1,507	1,892
Depreciation & amortization	15	23	16	13	9	5
Tax paid	(6)	(20)	(35)	(159)	(224)	(282)
Change in working capital	177	2,102	(222)	3	40	20
Others	957	(58)	(353)	(316)	(368)	(439)
Net cash from operations	(908)	1,843	174	604	965	1,196
Investing						
Capital expenditure	(40)	(26)	(4)	(3)	(3)	(3)
Acquisition of subsidiaries/ investments	(11,544)	(13,619)	707	(274)	(288)	(302)
Net proceeds from disposal of short-term investments	7,681	13,650	0	0	0	0
Others	40	153	438	402	460	536
Net cash from investing	(3,862)	159	1,141	124	169	231
Financing						
Proceeds from share issues	2,679	0	0	0	0	0
Share repurchases	0	(31)	0	0	0	0
Others	(65)	28	(0)	0	0	0
Net cash from financing	2,614	(3)	(0)	0	0	0
Net change in cash						
Cash at the beginning of the year	3,006	853	2,917	4,020	4,748	5,882
Exchange difference	4	64	(211)	0	0	0
Cash at the end of the year	853	2,917	4,020	4,748	5,882	7,309
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	42.9%	28.5%	(12.5%)	1.7%	7.1%	5.9%
Gross profit	na	806.3%	62.6%	17.8%	16.6%	11.4%
Operating profit	na	na	na	100.1%	58.6%	29.4%
Net profit	na	na	na	23.0%	41.9%	25.5%
Adj. net profit	na	na	na	20.8%	38.9%	24.2%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	2.0%	14.4%	26.7%	31.0%	33.7%	35.5%
Operating margin	(19.2%)	(4.3%)	4.2%	8.3%	12.2%	14.9%
Adj. net profit margin	(14.9%)	(1.3%)	10.4%	12.4%	16.0%	18.8%
Return on equity (ROE)	(198.2%)	(2.9%)	9.0%	10.1%	12.7%	13.8%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.9)	(1.2)	(1.1)	(1.1)	(1.1)	(1.1)
Current ratio (x)	4.5	3.5	3.7	4.2	4.6	5.1
Receivable turnover days	35.1	22.7	42.8	38.6	36.6	34.8
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	ns	ns	21.6	19.4	13.6	10.9
P/E (diluted)	ns	ns	21.6	19.4	13.6	10.9
P/B	3.8	1.8	1.9	1.9	1.6	1.4

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

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