

TME (TME US)

Online music business maintains solid growth amid macro uncertainty

TME is making steady progress in online music paying user growth: we expect 4Q23 total revenue to decline by 10% YoY to RMB6.7bn, but non-IFRS net income to grow by 5% YoY to RMB1.5bn, mainly due to continuous improvement in online music GPM and the effective control on opex. Despite macro uncertainty, we expect TME's online music business to maintain solid growth in 4Q23 (+36% in 4Q23E based on our estimate), supported by the steady growth of both paid users and ARPPU. In our view, TME's current valuation of 16x FY24E Non-IFRS PE remains attractive given its resilience against macro uncertainty, unparalleled leadership in online music sector and solid earnings growth outlook (FY23-25E CAGR of 15%). We roll forward our DCF-based valuation to 2024E with our revised TP of US\$9.75 (previously US\$8.90). Maintain BUY.

- **Robust online music business amid macro uncertainty.** We estimate online music revenue to increase by 36% YoY to RMB4.9bn in 4Q23E, driven by solid growth of music subscription revenue (+41% YoY) and recovery of ad business. We expect the number of music subscribers to increase by 20% YoY (net adds of 3.4mn), and the ARPPU to grow by 17% YoY in 4Q23E. For 2024E, TME will continue to focus on the quality growth of paid subscribers and ARPPU. We expect net adds of c.3mn paid subscribers per quarter in 2024E. TME will also continue to strengthen cooperation with Weixin to introduce new music experience in Weixin app, which will help TME further expand its user base and capture new monetization opportunities in the long run.
- **Expect social entertainment revenue to stabilize.** We expect social entertainment revenue to decrease by 53% YoY and 9% QoQ to RMB1.8bn in 4Q23E, primarily due to the enhanced risk control measures. That said, we model the monthly social entertainment revenue to stabilize MoM in 4Q23E, as the operational adjustment was completed in 2H23. Looking into 2024E, we expect social entertainment business will remain under pressure until its revenue growth is rebased in 2H24E.
- **Focus on quality growth.** TME's margin expansion remains on track thanks to its effective control on opex and improvement in the unit economics of music business. We expect overall GPM to improve by 4.1ppt YoY and 1.4ppt QoQ to 37.1% in 4Q23E, and adjusted net margin to rise from 19.4% in 4Q22 to 22.5% in 4Q23E. Looking ahead in 2024E, we expect TME will continue to focus on its quality growth strategy and expand its margin. We forecast non-IFRS net income to grow at a 15% CAGR over FY23-25E, with Non-IFRS net margin up from 17% in 2022 to 24% in 2025E.

Earnings Summary

(YE 31 Dec)	FY21A	FY22A	FY23E	FY24E	FY25E
Revenue (RMB mn)	31,244	28,339	27,549	27,874	29,793
YoY growth (%)	7.2	(9.3)	(2.8)	1.2	6.9
Gross margin (%)	30.1	31.0	35.0	37.6	38.0
Adjusted net profit (RMB mn)	4,144.6	4,743.7	5,812.0	6,347.3	7,183.1
EPS (Adjusted) (RMB)	2.50	2.96	3.66	4.00	4.53
Consensus EPS (RMB)	2.50	2.96	3.81	4.20	4.76
P/S (x)	3.0	3.4	3.4	3.4	3.2
P/E (x)	48.9	14.2	19.0	17.8	16.2
ROE (%)	6.3	7.8	9.9	9.6	9.6

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price US\$9.75
 (Previous TP) US\$8.90
Up/Downside 15.8%
Current Price US\$8.42

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Stock Data

Mkt Cap (US\$ mn)	13,198.2
Avg 3 mths t/o (US\$ mn)	66.5
52w High/Low (US\$)	9.43/6.02
Total Issued Shares (mn)	1567.5

Source: FactSet

Shareholding Structure

Tencent	53.2%
Spotify	8.2%

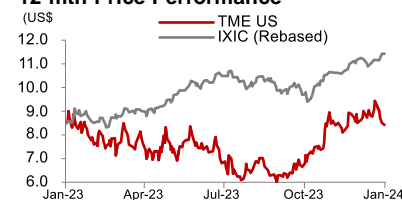
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-1.1%	-3.1%
3-mth	24.0%	5.4%
6-mth	24.9%	14.5%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

Figure 1: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E	FY23E	FY24E	FY25E
Revenue	27,549	27,874	29,793	27,549	27,874	29,793	0.0%	0.0%	0.0%
Gross profit	9,638	10,483	11,335	9,638	10,483	11,335	0.0%	0.0%	0.0%
Operating profit	5,815	6,416	7,022	5,765	6,363	6,964	0.9%	0.8%	0.8%
Non-IFRS net profit	5,812	6,347	7,183	5,770	6,303	7,134	0.7%	0.7%	0.7%
Non-IFRS EPS (RMB)	3.7	4.0	4.5	3.6	4.0	4.5	0.7%	0.7%	0.7%
Gross margin	35.0%	37.6%	38.0%	35.0%	37.6%	38.0%	0.0 ppt	0.0 ppt	0.0 ppt
Operating margin	21.1%	23.0%	23.6%	20.9%	22.8%	23.4%	0.2 ppt	0.2 ppt	0.2 ppt
Non-IFRS net margin	21.1%	22.8%	24.1%	20.9%	22.6%	23.9%	0.2 ppt	0.2 ppt	0.2 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	27,549	27,874	29,793	27,540	28,051	31,048	0.0%	-0.6%	-4.0%
Gross profit	9,638	10,483	11,335	9,626	10,400	11,805	0.1%	0.8%	-4.0%
Operating profit	5,815	6,416	7,022	5,577	6,290	7,367	4.3%	2.0%	-4.7%
Non-IFRS net profit	5,812	6,347	7,183	5,974	6,591	7,459	-2.7%	-3.7%	-3.7%
Non-IFRS EPS (RMB)	3.7	4.0	4.5	3.8	4.2	4.8	-3.9%	-4.9%	-4.9%
Gross margin	35.0%	37.6%	38.0%	35.0%	37.1%	38.0%	0.0 ppt	0.5 ppt	0.0 ppt
Operating margin	21.1%	23.0%	23.6%	20.3%	22.4%	23.7%	0.9 ppt	0.6 ppt	-0.2 ppt
Non-IFRS net margin	21.1%	22.8%	24.1%	21.7%	23.5%	24.0%	-0.6 ppt	-0.7 ppt	0.1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: key financial data forecasts

(RMB mn)	2022	2023E	2024E	2025E	4Q23E
Online music	12,483	17,157	20,547	22,695	4,854
YoY change (%)	8.9%	37.4%	19.8%	10.5%	36.4%
Subscription revenue	8,701	12,003	14,758	16,402	3,319
YoY change (%)	18.6%	37.9%	23.0%	11.1%	41.1%
Other revenue	3,782	5,155	5,789	6,293	1,535
YoY change (%)	-8.5%	36.3%	12.3%	8.7%	27.2%
Social entertainment and others	15,856	10,392	7,328	7,098	1,836
YoY change (%)	-19.8%	-34.5%	-29.5%	-3.1%	-52.5%
Total revenue	28,339	27,549	27,874	29,793	6,690
YoY change (%)	-9.3%	-2.8%	1.2%	6.9%	-9.9%
GPM (%)	31.0%	35.0%	37.6%	38.0%	37.1%
Adjusted NPM (%)	16.7%	21.1%	22.8%	24.1%	22.5%
Adjusted net profit	4,744	5,812	6,347	7,183	1,504
YoY change (%)	14.5%	22.5%	9.2%	13.2%	4.6%

Source: Company data, CMBIGM estimates

DCF valuation

Figure 4: TME: DCF Valuation

(RMBmn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Free cash flow	5,965	6,929	7,707	8,517	9,326	10,021	9,660
NPV of free cash flow	41,312						
Discounted terminal value	56,505						
Net cash	12,218						
Total TME valuation	110,034						
Number of ADS (diluted, mn)	1,567						
Valuation per ADS (US\$)	9.75						

Source: Company data, CMBIGM estimates

Financial Summary

INCOME STATEMENT	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Revenue	29,153	31,244	28,339	27,549	27,874	29,793
Cost of goods sold	19,851	21,840	19,566	17,911	17,391	18,458
Gross profit	9,302	9,404	8,773	9,638	10,483	11,335
Operating expenses	4,592	5,604	4,330	3,823	4,067	4,313
Selling expense	2,475	2,678	1,144	877	879	939
Admin expense	3,101	4,009	4,413	4,181	4,195	4,483
Others	(984)	(1,083)	(1,227)	(1,235)	(1,006)	(1,110)
Operating profit	4,710	3,800	4,443	5,815	6,416	7,022
Share of (losses)/profits of associates/JV	19	(47)	38	120	0	0
Interest expense	(97)	(121)	(108)	(150)	(135)	(122)
Pre-tax profit	4,632	3,632	4,373	5,785	6,281	6,901
Income tax	(456)	(417)	(534)	(786)	(942)	(1,035)
After tax profit	4,176	3,215	3,839	4,998	5,339	5,866
Net profit	4,176	3,215	3,839	4,998	5,339	5,866
Adjusted net profit	4,949	4,145	4,744	5,812	6,347	7,183
BALANCE SHEET	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Current assets	31,687	26,791	26,559	30,027	34,852	41,048
Cash & equivalents	11,128	6,591	9,589	13,091	17,754	23,419
Account receivables	2,800	3,610	2,670	2,902	2,783	2,811
Inventories	18	24	14	8	5	3
Prepayment	2,846	2,731	2,958	2,355	2,287	2,427
ST bank deposits	14,858	12,769	11,291	11,630	11,979	12,338
Other current assets	37	1,066	37	41	45	49
Non-current assets	36,586	40,463	40,450	40,853	41,273	41,722
PP&E	176	243	323	274	246	235
Right-of-use assets	311	283	398	398	398	398
Deferred income tax	303	346	347	364	383	402
Investment in JVs & assos	2,255	3,599	4,330	4,380	4,430	4,480
Intangibles	2,020	2,829	2,368	2,167	1,946	1,721
Goodwill	17,492	19,121	19,493	19,743	19,993	20,243
Financial assets at FVTPL	9,771	7,302	3,168	3,231	3,296	3,362
Other non-current assets	4,258	6,740	10,023	10,296	10,582	10,882
Total assets	68,273	67,254	67,009	70,881	76,125	82,770
Current liabilities	9,602	10,450	11,717	10,591	10,489	11,248
Account payables	3,565	4,329	4,998	4,318	4,240	4,551
Tax payable	445	363	404	393	397	425
Other current liabilities	5,489	5,666	6,192	5,754	5,720	6,138
Lease liabilities	103	92	123	127	130	134
Long-term borrowings	5,940	5,749	6,165	6,164	6,173	6,192
Bond payables	5,175	5,062	5,536	5,536	5,536	5,536
Obligations under finance leases	218	205	306	321	337	354
Other non-current liabilities	547	482	323	307	299	302
Total liabilities	15,542	16,199	17,882	16,755	16,661	17,440
Share capital	2	2	2	2	2	2
Capital surplus	34,910	32,395	29,905	29,905	29,905	29,905
Retained earnings	11,111	14,194	12,052	17,050	22,389	28,254
Other reserves	6,222	3,726	6,140	6,140	6,140	6,140
Total shareholders equity	52,245	50,317	48,099	53,097	58,436	64,301
Minority interest	486	738	1,028	1,028	1,028	1,028
Total equity and liabilities	68,273	67,254	67,009	70,881	76,125	82,770

CASH FLOW	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	4,632	3,632	4,373	5,785	6,281	6,901
Depreciation & amortization	824	1,001	1,160	622	623	634
Tax paid	(637)	(589)	(733)	0	0	0
Change in working capital	(497)	579	2,211	(853)	(16)	491
Others	563	616	470	(786)	(942)	(1,035)
Net cash from operations	4,885	5,239	7,481	4,766	5,946	6,990
Investing						
Capital expenditure	(501)	(2,758)	(1,053)	(372)	(374)	(398)
Acquisition of subsidiaries/ investments	(540)	(2,078)	(165)	(250)	(250)	(250)
Net proceeds from disposal of short-term investments	6	(877)	1,055	0	0	0
Others	(13,171)	(286)	(1,283)	(658)	(676)	(694)
Net cash from investing	(14,206)	(5,999)	(1,446)	(1,279)	(1,300)	(1,342)
Financing						
Net borrowings	5,400	0	0	0	0	0
Proceeds from share issues	(134)	0	0	0	0	0
Others	26	(3,710)	(3,419)	15	16	17
Net cash from financing	5,292	(3,710)	(3,419)	15	16	17
Net change in cash						
Cash at the beginning of the year	15,426	11,128	6,591	9,589	13,091	17,754
Exchange difference	(269)	(67)	382	0	0	0
Cash at the end of the year	11,128	6,591	9,589	13,091	17,754	23,419
GROWTH	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Revenue	14.6%	7.2%	(9.3%)	(2.8%)	1.2%	6.9%
Gross profit	7.3%	1.1%	(6.7%)	9.9%	8.8%	8.1%
Operating profit	1.9%	(19.3%)	16.9%	30.9%	10.3%	9.5%
Net profit	5.0%	(23.0%)	19.4%	30.2%	6.8%	9.9%
Adj. net profit	0.8%	(16.3%)	14.5%	22.5%	9.2%	13.2%
PROFITABILITY	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Gross profit margin	31.9%	30.1%	31.0%	35.0%	37.6%	38.0%
Operating margin	16.2%	12.2%	15.7%	21.1%	23.0%	23.6%
Adj. net profit margin	17.0%	13.3%	16.7%	21.1%	22.8%	24.1%
Return on equity (ROE)	8.7%	6.3%	7.8%	9.9%	9.6%	9.6%
GEARING/LIQUIDITY/ACTIVITIES	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
Net debt to equity (x)	(0.1)	(0.0)	(0.1)	(0.1)	(0.2)	(0.3)
Current ratio (x)	3.3	2.6	2.3	2.8	3.3	3.6
Receivable turnover days	31.3	37.4	40.4	36.9	37.2	34.3
Payable turnover days	56.3	66.0	87.0	94.9	89.8	86.9
VALUATION	2020A	2021A	2022A	2023E	2024E	2025E
YE 31 Dec						
P/E	38.1	48.9	14.2	19.0	17.8	16.2
P/E (diluted)	38.7	49.5	14.3	19.2	18.0	16.4
P/B	3.0	3.1	1.1	1.8	1.6	1.5

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

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