

# TME (TME US)

## 1Q24 beat on strong music business growth and GPM expansion

TME reported 1Q24 results: total revenue declined by 3% YoY to RMB6.77bn, beating consensus estimate by 3% on strong online music revenue growth; non-IFRS net income grew by 21% YoY to RMB1.70bn, 7% ahead of consensus estimate, primarily attributable to the solid GPM expansion (+7.9ppt YoY) and effective control in opex (-8% YoY). TME further enhanced shareholder return on its strong cash generation capability and announced its first annual cash dividend of US\$0.137 per ADS (c.1.0% dividend yield). Looking ahead, we forecast total revenue to decline by 2% YoY, while non-IFRS net income to grow by 20% in 2Q24E on solid music revenue growth and GPM expansion. We raise FY24-26 non-IFRS net income forecast by 10-15% to factor in the stronger-than-expected GPM expansion trend. We raise our DCF-derived TP to US\$16.00 (previous: US\$12.50). Maintain BUY.

- **1Q24 subscriber growth ahead of expectation.** Online music revenue was up by 43% YoY to RMB5.01bn in 1Q24 (74% of total revenue), driven by strong growth of both music subscription and advertising businesses. Music subscription revenue grew by 39% YoY to RMB3.6bn in 1Q24, with paying users up by 20% YoY to 113.5mn (6.8mn QoQ net adds). Monthly ARPPU was up 16% YoY but down slightly QoQ due to the promotion campaigns during Chinese New Year. Other music revenue increased by 54% YoY to RMB1.4bn in 1Q24, as the more diversified and innovative ad formats drove strong ad revenue growth. Social entertainment and others revenue dropped by 50% YoY to RMB1.76bn in 1Q24 (26% of total revenue), due to adjustment of certain interactive functions and intensified competition.
- **Online music revenue growth momentum to continue in 2Q24E.** Looking into 2Q24E, we expect total revenue to decline by 2% YoY to RMB7.16bn, as solid growth of online music revenue (+28% YoY) will be offset by decline in social entertainment revenue (-43% YoY). Music subscriber net add is expected to normalize in 2Q24E after the peak in 1Q24, as per management. On the product innovation front, TME introduced large audio models and a new AI Assistant in 1Q24, further improving the music promotion accuracy and user engagement.
- **Enhancing shareholder return on solid profitability.** GPM rose by 7.9ppt YoY and 2.6ppt QoQ to 40.9% in 1Q24, underpinned by 1) strong growth of music subscription and ad business; 2) the ramp-up of self-produced content; and 3) optimization of revenue-sharing ratio of live streaming business. Non-IFRS net margin was up by 5.0ppt YoY to 25.2% in 1Q24. For 2Q24E, we expect GPM to expand by 8.1ppt YoY and 1.5ppt QoQ to 42.4%. The company continues to enhance shareholder return: 1) announced annual dividend of US\$0.137 per ADS (total amount US\$210mn; c.1.0% of market cap); 2) repurchased 6.9mn ADS for a total consideration of US\$61mn in 1Q24.

### Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	28,339	27,752	28,828	31,836	34,988
Gross margin (%)	31.0	35.3	42.4	43.8	44.7
Adjusted net profit (RMB mn)	4,745.0	5,923.0	7,437.0	8,826.2	10,385.8
EPS (Adjusted) (RMB)	2.96	3.74	4.76	5.65	6.65
Consensus EPS (RMB)	2.96	3.74	4.47	5.32	6.23
P/E (x)	40.2	28.8	22.2	18.8	15.9

Source: Company data, Bloomberg, CMBIGM estimates

**BUY (Maintain)**

**Target Price** **US\$16.00**

(Previous TP) US\$12.50

**Up/Downside** **19.9%**

**Current Price** **US\$13.34**

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### Stock Data

Mkt Cap (US\$ mn)	20,556.9
Avg 3 mths t/o (US\$ mn)	52.0
52w High/Low (US\$)	13.57/6.02
Total Issued Shares (mn)	1541.0

Source: FactSet

### Shareholding Structure

Tencent	52.5%
Spotify	8.2%

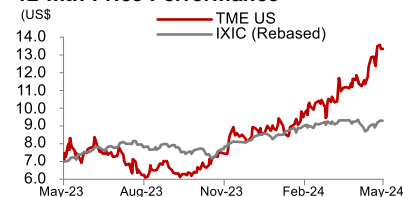
Source: Company data

### Share Performance

	Absolute	Relative
1-mth	12.6%	11.4%
3-mth	38.0%	35.0%
6-mth	81.0%	52.8%

Source: FactSet

### 12-mth Price Performance



Source: FactSet

## Business forecasts update and valuation

Figure 1: TME: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	28,828	31,836	34,988	28,475	31,469	34,225	1.2%	1.2%	2.2%
Gross Profit	12,234	13,936	15,642	11,371	12,910	14,290	7.6%	7.9%	9.5%
Operating Profit	8,495	9,704	11,430	7,174	8,289	9,419	18.4%	17.1%	21.3%
Non-IFRS net profit	7,437	8,826	10,386	6,714	8,033	9,052	10.8%	9.9%	14.7%
Non-IFRS EPS (RMB)	4.8	5.7	6.7	4.2	5.1	5.7	12.4%	11.5%	16.4%
Gross Margin	42.4%	43.8%	44.7%	39.9%	41.0%	41.8%	2.5 ppt	2.7 ppt	3.0 ppt
Operating Margin	29.5%	30.5%	32.7%	25.2%	26.3%	27.5%	4.3 ppt	4.1 ppt	5.1 ppt
Non-IFRS net margin	25.8%	27.7%	29.7%	23.6%	25.5%	26.4%	2.2 ppt	2.2 ppt	3.2 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E	FY24E	FY25E	FY26E
Revenue	28,828	31,836	34,988	28,605	31,983	36,053	0.8%	-0.5%	-3.0%
Gross Profit	12,234	13,936	15,642	11,435	13,023	15,032	7.0%	7.0%	4.1%
Operating Profit	8,495	9,704	11,430	7,192	8,653	10,287	18.1%	12.2%	11.1%
Non-IFRS net profit	7,437	8,826	10,386	6,892	8,205	9,597	7.9%	7.6%	8.2%
Non-IFRS EPS (RMB)	4.8	5.7	6.7	4.5	5.3	6.2	6.5%	6.2%	6.8%
Gross Margin	42.4%	43.8%	44.7%	40.0%	40.7%	41.7%	2.5 ppt	3.1 ppt	3.0 ppt
Operating Margin	29.5%	30.5%	32.7%	25.1%	27.1%	28.5%	4.3 ppt	3.4 ppt	4.1 ppt
Non-IFRS net margin	25.8%	27.7%	29.7%	24.1%	25.7%	26.6%	1.7 ppt	2.1 ppt	3.1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: quarterly financial

(RMB mn)	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	Cons.	Diff%	CMBI	Diff%
Online music	2,878	3,430	3,559	3,501	4,249	4,553	5,022	5,007				
YoY change (%)	-2.4%	18.8%	23.6%	33.8%	47.6%	32.7%	41.1%	43.0%				
Subscription revenue	2,107	2,249	2,352	2,599	2,890	3,193	3,417	3,618				
YoY change (%)	17.6%	18.3%	20.6%	30.4%	37.2%	42.0%	45.3%	39.2%				
Other revenue	771	1,181	1,207	902	1,359	1,360	1,605	1,389				
YoY change (%)	-33.4%	19.7%	29.8%	44.8%	76.1%	15.1%	32.9%	54.0%				
Social entertainment	4,027	3,935	3,866	3,503	3,037	2,016	1,871	1,761				
YoY change (%)	-20.4%	-20.0%	-18.2%	-13.0%	-24.6%	-48.8%	-51.6%	-49.7%				
<b>Total revenue</b>	<b>6,905</b>	<b>7,365</b>	<b>7,425</b>	<b>7,004</b>	<b>7,286</b>	<b>6,569</b>	<b>6,893</b>	<b>6,768</b>	<b>6,554</b>	<b>3.3%</b>	<b>6,577</b>	<b>2.9%</b>
YoY change (%)	-13.8%	-5.6%	-2.4%	5.4%	5.5%	-10.8%	-7.2%	-3.4%				
GPM (%)	29.9%	32.6%	33.0%	33.1%	34.3%	35.7%	38.3%	40.9%				
Adjusted NPM (%)	14.9%	18.7%	19.4%	20.1%	21.0%	21.4%	22.8%	25.2%				
<b>Adjusted net profit</b>	<b>1,029</b>	<b>1,379</b>	<b>1,438</b>	<b>1,411</b>	<b>1,529</b>	<b>1,408</b>	<b>1,575</b>	<b>1,704</b>	<b>1,589</b>	<b>7.3%</b>	<b>1,518</b>	<b>12.2%</b>
YoY change (%)	-7.9%	35.9%	72.8%	57.0%	48.6%	2.1%	9.5%	20.8%				

Source: Company data, CMBIGM

## DCF valuation

Our target price of US\$16.00 is based on the DCF valuation methodology (WACC of 11.6% and terminal growth of 2.5%).

**Figure 4: TME: DCF Valuation**

(RMBmn)	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Free cash flow	8,480	9,256	11,069	12,356	13,934	15,573	17,370
NPV of free cash flow	61,555						
Discounted terminal value	101,603						
Net cash	14,383						
Total TME valuation	<b>177,541</b>						
Number of ADS (diluted, mn)	1,541						
<b>Valuation per ADS (US\$)</b>	<b>16.00</b>						

Source: Company data, CMBIGM estimates

## Financial Summary

INCOME STATEMENT	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Revenue	31,244	28,339	27,752	28,828	31,836	34,988
Cost of goods sold	21,840	19,566	17,957	16,594	17,901	19,346
Gross profit	9,404	8,773	9,795	12,234	13,936	15,642
Operating expenses	5,604	4,330	3,736	3,739	4,232	4,212
Selling expense	2,678	1,144	897	889	934	976
Admin expense	4,009	4,413	4,121	4,146	4,464	4,784
Others	(1,083)	(1,227)	(1,282)	(1,296)	(1,167)	(1,548)
Operating profit	3,800	4,443	6,059	8,495	9,704	11,430
Share of (losses)/profits of associates/JV	(47)	38	127	(72)	0	0
Interest expense	(121)	(108)	(141)	(120)	(108)	(97)
Pre-tax profit	3,632	4,373	6,045	8,303	9,596	11,333
Income tax	(417)	(534)	(825)	(1,619)	(1,679)	(1,983)
After tax profit	3,215	3,839	5,220	6,684	7,917	9,349
Net profit	3,215	3,839	5,220	6,684	7,917	9,349
Adjusted net profit	4,146	4,745	5,923	7,437	8,826	10,386
BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	26,791	26,559	29,936	35,812	44,222	54,172
Cash & equivalents	6,591	9,589	13,598	20,019	27,986	37,505
Account receivables	3,610	2,670	2,918	2,705	2,769	2,804
Inventories	24	14	8	5	3	1
Prepayment	2,731	2,958	3,438	2,807	2,877	2,954
ST bank deposits	12,769	11,291	9,937	10,235	10,542	10,858
Other current assets	1,066	37	37	41	45	49
Non-current assets	40,463	40,450	45,600	46,367	47,149	47,947
PP&E	243	323	490	699	900	1,094
Right-of-use assets	283	398	367	367	367	367
Deferred income tax	346	347	352	370	388	407
Investment in JVs & assos	3,599	4,330	4,274	4,324	4,374	4,424
Intangibles	2,829	2,368	2,032	1,820	1,614	1,413
Goodwill	19,121	19,493	19,542	19,792	20,042	20,292
Financial assets at FVTPL	7,302	3,168	6,540	6,671	6,804	6,940
Other non-current assets	6,740	10,023	12,003	12,325	12,660	13,009
Total assets	67,254	67,009	75,536	82,179	91,371	102,118
Current liabilities	10,450	11,717	12,014	11,961	13,210	14,580
Account payables	4,329	4,998	5,006	4,736	5,232	5,786
Tax payable	363	404	567	589	650	715
Other current liabilities	5,666	6,192	6,326	6,518	7,206	7,953
Lease liabilities	92	123	115	118	122	126
Long-term borrowings	5,749	6,165	6,320	6,332	6,359	6,386
Bond payables	5,062	5,536	5,636	5,636	5,636	5,636
Obligations under finance leases	205	306	297	312	327	344
Other non-current liabilities	482	323	387	384	395	406
Total liabilities	16,199	17,882	18,334	18,293	19,568	20,966
Share capital	2	2	2	2	2	2
Capital surplus	32,395	29,905	29,278	29,278	29,278	29,278
Retained earnings	14,194	12,052	16,969	23,653	31,570	40,919
Other reserves	3,726	6,140	9,658	9,658	9,658	9,658
Total shareholders equity	50,317	48,099	55,907	62,591	70,508	79,857
Minority interest	738	1,028	1,295	1,295	1,295	1,295
Total equity and liabilities	67,254	67,009	75,536	82,179	91,371	102,118

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
<b>Operating</b>						
Profit before taxation	3,632	4,373	6,045	8,303	9,596	11,333
Depreciation & amortization	1,001	1,160	724	573	629	686
Tax paid	(589)	(733)	0	0	0	0
Change in working capital	579	2,211	(197)	720	1,050	1,186
Others	616	470	765	(1,619)	(1,679)	(1,983)
<b>Net cash from operations</b>	<b>5,239</b>	<b>7,481</b>	<b>7,337</b>	<b>7,977</b>	<b>9,596</b>	<b>11,222</b>
<b>Investing</b>						
Capital expenditure	(2,758)	(1,053)	(555)	(571)	(624)	(679)
Acquisition of subsidiaries/ investments	(2,078)	(165)	(250)	(250)	(250)	(250)
Net proceeds from disposal of short-term investments	(877)	1,055	0	0	0	0
Others	(286)	(1,283)	(1,058)	(750)	(770)	(791)
<b>Net cash from investing</b>	<b>(5,999)</b>	<b>(1,446)</b>	<b>(1,863)</b>	<b>(1,571)</b>	<b>(1,644)</b>	<b>(1,720)</b>
<b>Financing</b>						
Net borrowings	0	0	0	0	0	0
Proceeds from share issues	0	0	0	0	0	0
Others	(3,710)	(3,419)	(1,538)	15	16	16
<b>Net cash from financing</b>	<b>(3,710)</b>	<b>(3,419)</b>	<b>(1,538)</b>	<b>15</b>	<b>16</b>	<b>16</b>
<b>Net change in cash</b>						
Cash at the beginning of the year	11,128	6,591	9,589	13,598	20,019	27,986
Exchange difference	(67)	382	73	0	0	0
<b>Cash at the end of the year</b>	<b>6,591</b>	<b>9,589</b>	<b>13,598</b>	<b>20,019</b>	<b>27,986</b>	<b>37,505</b>
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	7.2%	(9.3%)	(2.1%)	3.9%	10.4%	9.9%
Gross profit	1.1%	(6.7%)	11.6%	24.9%	13.9%	12.2%
Operating profit	(19.3%)	16.9%	36.4%	40.2%	14.2%	17.8%
Net profit	(23.0%)	19.4%	36.0%	28.0%	18.4%	18.1%
Adj. net profit	(16.2%)	14.4%	24.8%	25.6%	18.7%	17.7%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	30.1%	31.0%	35.3%	42.4%	43.8%	44.7%
Operating margin	12.2%	15.7%	21.8%	29.5%	30.5%	32.7%
Adj. net profit margin	13.3%	16.7%	21.3%	25.8%	27.7%	29.7%
Return on equity (ROE)	6.3%	7.8%	10.0%	11.3%	11.9%	12.4%
GEARING/LIQUIDITY/ACTIVITIES	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Net debt to equity (x)	(0.0)	(0.1)	(0.1)	(0.2)	(0.3)	(0.4)
Current ratio (x)	2.6	2.3	2.5	3.0	3.3	3.7
Receivable turnover days	37.4	40.4	36.7	35.6	31.4	29.1
Payable turnover days	66.0	87.0	101.7	107.1	101.6	103.9
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	49.8	40.2	28.8	22.2	18.8	15.9
P/E (diluted)	50.4	40.6	29.2	22.5	19.0	16.1
P/B	3.2	3.2	2.7	2.4	2.1	1.9

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

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