

Cloud Music (9899 HK)

Solid core music business outlook on enriching content library

Cloud Music is on the right track of improving monetization and expanding margin. Announced on 1 January, Cloud Music added licensing agreement with the leading Taiwan music label Bin-Music which further enriched its content library and represented another milestone since the end of exclusive licensing. We remain bullish on the company's music subscription business, supported by its enriching content library and rising paying ratio. We lower FY22/FY23/FY24 total revenue by 2/7/9% to RMB8.9/10.8/12.8bn to reflect more conservative view on social entertainment business, which faces macro headwinds and intensifying competition. We lower our FY23/FY24E adjusted net income forecast to -RMB59mn/+RMB529mn (previous: +RMB75/+535mn). We now expect the company to achieve a quarterly breakeven by end-FY23E, supported by its gross margin improvement. We roll forward our valuation to FY23E and derived our target price of HK\$108.6 (previous: HK\$110.0) based on DCF method. Maintain BUY.

- **Online music business to accelerate from 2H22 onwards.** We forecast online music revenue to grow by 15/23/19% YoY to RMB1.9/4.6/5.4bn in 2H22/FY23/FY24E (1H22: +11% YoY), driven by the solid music subscription growth and recovery of ad business. On 1 Jan, the company announced licensing agreement with Bin-Music, the copyright holder of several top singers such as Mayday and Jonathan Lee. The enriching content library could help on user traffic and subscriber growth in our view. We estimate MPUs to increase by 37/22/18% YoY in FY22/FY23/FY24E, with paying ratio rising to 28.5% in FY24E (FY21: 15.8%). For non-subscription business, Cloud Music launched the freemium mode in 4Q22 to revitalize its ad business. Driven by recovery of ad demand and new initiatives, we expect ad revenue will return to positive growth in FY23/FY24E.
- **Expect social entertainment business to recover in 2023.** Social entertainment business faces intensifying competition from other entertainment formats. The resurgence of COVID-19 and the macro impact in 4Q22 also pressure social entertainment revenue growth. We expect decelerating revenue growth from 4Q22 onwards. We forecast the segment revenue to grow 40/20/18% YoY to RMB5.2/6.2/7.3bn in FY22/FY23/FY24E, with its monthly ARPPU normalizing from RMB452 in FY21 to RMB286 in FY24E.
- **Steady margin expansion may help reaching the profitability target.** We expect Cloud Music's gross margin to expand steadily from 2.0% in FY21 to 13.7/17.1/21.1% in FY22/FY23/FY24E, thanks to the optimized cost structure. Cloud Music's gross margin still has ample potential compared to that of TME (30.1% in FY21). The improving gross margin will support adjusted net margin to improve from -14.9% in FY21 to -4.0/-0.5/+4.1% in FY22/FY23/FY24E, based on our estimate. Cloud Music is trading at 1.7x 2023E PS, at an attractive discount compared with TME (3.5x 2023E PS).

Earnings Summary

(YE 31 Dec)	FY20A	FY21A	FY22E	FY23E	FY24E
Revenue (RMB mn)	4,896	6,998	8,889	10,789	12,769
YoY growth (%)	111.2	42.9	27.0	21.4	18.4
Gross margin (%)	(12.2)	2.0	13.7	17.1	21.1
Adjusted net profit (RMB mn)	(1,568.0)	(1,043.7)	(352.3)	(59.2)	528.7
EPS (Adjusted) (RMB cents)	(1,283.90)	(502.37)	(169.39)	(28.48)	254.18
Consensus EPS (RMB cents)	(1,283.90)	(502.37)	(264.67)	36.14	257.32
P/S (x)	3.7	2.6	2.1	1.7	1.4
P/E (x)	na	na	na	na	45.7

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price HK\$108.60

(Previous TP) HK\$110.00

Up/Downside 8.6%

Current Price HK\$100.00

China Internet

Saiyi HE, CFA

(852) 3916 1739

hesaiyi@cmbi.com.hk

Wentao LU

luwentao@cmbi.com.hk

Ye TAO

franktao@cmbi.com.hk

Stock Data

Mkt Cap (HK\$ mn)	20,799.5
Avg 3 mths t/o (HK\$ mn)	69.2
52w High/Low (HK\$)	145.70/53.15
Total Issued Shares (mn)	208.0

Source: FactSet

Shareholding Structure

NetEase	61.4%
Alibaba	9.9%

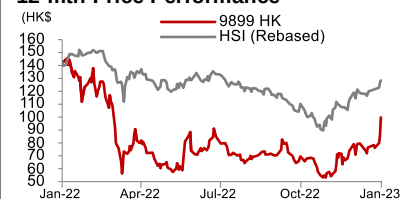
Source: Company data

Share Performance

	Absolute	Relative
1-mth	30.5%	20.9%
3-mth	43.9%	23.5%
6-mth	25.9%	29.4%

Source: FactSet

12-mth Price Performance



Source: FactSet

Business forecasts update and valuation

We lower FY22/FY23/FY24 total revenue by 2/7/9% to RMB8.9/10.8/12.8bn, mainly due to more conservative view on social entertainment business outlook, which faces macro headwinds and intensifying competition. We also lower our FY23/FY24E adjusted net income forecast to -RMB59mn/+RMB529mn (previous: +RMB75/+535mn). We now expect the company to achieve a quarterly breakeven by end-FY23E, mainly supported by its gross margin improvement.

Figure 1: Cloud Music: forecast revision

RMB mn	Current			Previous			Change (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	8,889	10,789	12,769	9,092	11,595	14,006	-2.2%	-7.0%	-8.8%
Gross Profit	1,218	1,846	2,691	1,171	1,971	2,797	4.0%	-6.4%	-3.8%
Operating Profit	(531)	(238)	397	(527)	(112)	388	NA	NA	2.3%
Adjusted net profit	(352)	(59)	529	(346)	75	535	NA	NA	-1.2%
Adjusted EPS (RMB)	(1.7)	(0.3)	2.5	(1.7)	0.4	2.6	NA	NA	-1.2%
Gross Margin	13.7%	17.1%	21.1%	12.9%	17.0%	20.0%	0.8 ppt	0.1 ppt	1.1 ppt
Operating Margin	-6.0%	-2.2%	3.1%	-5.8%	-1.0%	2.8%	-0.2 ppt	-1.2 ppt	0.3 ppt
Adjusted net margin	-4.0%	-0.5%	4.1%	-3.8%	0.6%	3.8%	-0.2 ppt	-1.2 ppt	0.3 ppt

Source: CMBIGM estimates

Figure 2: CMBIGM estimates vs consensus

RMB mn	CMBIGM			Consensus			Diff (%)		
	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E	FY22E	FY23E	FY24E
Revenue	8,889	10,789	12,769	9,215	11,420	13,406	-3.5%	-5.5%	-4.8%
Gross Profit	1,218	1,846	2,691	1,210	1,988	2,848	0.6%	-7.2%	-5.5%
Operating Profit	(531)	(238)	397	(642)	(376)	565	NA	NA	-29.8%
Adjusted net profit	(352)	(59)	529	(393)	(101)	565	NA	NA	-6.5%
Adjusted EPS (RMB)	(1.7)	(0.3)	2.5	(2.6)	0.4	2.6	NA	NA	-1.2%
Gross Margin	13.7%	17.1%	21.1%	13.1%	17.4%	21.2%	0.6 ppt	-0.3 ppt	-0.2 ppt
Operating Margin	-6.0%	-2.2%	3.1%	-7.0%	-3.3%	4.2%	1.0 ppt	1.1 ppt	-1.1 ppt
Adjusted net margin	-4.0%	-0.5%	4.1%	-4.3%	-0.9%	4.2%	0.3 ppt	0.3 ppt	-0.1 ppt

Source: Company data, CMBIGM estimates

Figure 3: Cloud Music: financial summary

(RMB mn)	2020	2021	2022E	2023E	2024E
Online music segment					
Online music MAUs (mn)	180.5	182.6	182.6	191.7	199.4
YoY	22.6%	1.2%	0.0%	5.0%	4.0%
Online music paying users (mn)	16.0	28.9	39.5	48.3	56.8
YoY	85.0%	81.1%	36.8%	22.2%	17.6%
Paying ratio	8.8%	15.8%	21.7%	25.2%	28.5%
Online music revenue	2,623	3,290	3,718	4,568	5,433
YoY	47.6%	25.4%	13.0%	22.9%	18.9%
Subscription revenue	1,604	2,324	3,067	3,861	4,678
YoY	66.1%	44.9%	32.0%	25.9%	21.1%
Non-subscription revenue	1,019	966	651	707	755
YoY	25.6%	-5.1%	-32.7%	8.7%	6.8%
Social entertainment segment					
Social entertainment paying users (mn)	0.3	0.7	1.4	1.7	2.1
YoY	256.7%	108.9%	97.8%	29.3%	22.2%
Social entertainment revenue	2,273	3,708	5,171	6,220	7,336
YoY	319.8%	63.1%	39.5%	20.3%	17.9%
Overall					

Total revenue	4,896	6,998	8,889	10,789	12,769
YoY	111.2%	42.9%	27.0%	21.4%	18.4%
Gross profit margin	-12.2%	2.0%	13.7%	17.1%	21.1%
S&M expense ratio	6.7%	6.2%	7.5%	7.5%	6.8%
R&D expense ratio	11.8%	12.4%	11.3%	10.8%	10.2%
Adjusted net loss margin	-32.0%	-14.9%	-4.0%	-0.5%	4.1%
Adjusted net loss	-1,568	-1,044	-352	-59	529

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\$108.6, which implies 2.3x/1.9x 2022/2023E PS. Cloud Music currently trades at 1.7x 2023E PS, at an attractive discount compared with TME (3.4x 2023E PS). Its current valuation offers an attractive risk-reward in our view, given Cloud Music's strong revenue CAGR and margin improvement potential over FY21-FY24E.

Figure 4: Cloud Music: DCF valuation

(RMB mn)	2023E	2024E	2025E	2026E	2027E	2028E	2029E	2030E
Adjusted EBITDA	(191)	440	1,009	1,435	1,917	2,344	2,648	2,974
Free cash flow	171	506	931	1,228	1,569	1,873	2,143	2,417
NPV of FCF	5,859							
Discounted terminal value	7,829							
Enterprise value	13,688							
Net cash	6,441							
Equity value	20,130							
Number of shares (diluted, mn)	208							
Exchange rate (HKD/RMB)	0.89							
Valuation per share (HK\$)	108.6							
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

Figure 5: Cloud Music: peer valuation comparison

Companies	Ticker	Price (Local)	Revenue growth (YoY%)			PS(x)			2Q22 MAU (mn)	Market Cap/MAU (US\$)
			2022E	2023E	2024E	2022E	2023E	2024E		
TME	TME US	8.9	(15.3)	4.1	5.0	3.7	3.6	3.4	593	25.7
Spotify	SPOT US	81.6	9.1	15.0	13.7	1.3	1.1	1.0	433	36.2
Bilibili	BILI US	29.2	5.5	21.3	17.7	3.7	3.0	2.6	306	38.2
Kuaishou	1024 HK	79.4	7.0	16.1	15.4	3.2	2.8	2.4	587	74.4
Average						3.0	2.6	2.3		43.6

Source: Bloomberg, CMBIGM

Note: data are as of 5 Jan 2023

Financial Summary

INCOME STATEMENT	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Revenue	2,318	4,896	6,998	8,889	10,789	12,769
Cost of goods sold	3,375	5,491	6,855	7,671	8,943	10,078
Gross profit	(1,057)	(595)	143	1,218	1,846	2,691
Operating expenses	583	929	1,490	1,749	2,084	2,294
Selling expense	223	327	431	667	809	871
Admin expense	55	97	264	169	205	230
R&D expense	363	576	869	1,004	1,165	1,296
Others	(59)	(71)	(75)	(91)	(96)	(103)
Operating profit	(1,639)	(1,525)	(1,347)	(531)	(238)	397
Investment gain/loss	(1)	(4)	2	3	4	4
Other gains/(losses)	(423)	(1,522)	(755)	0	0	0
Interest income	79	101	48	70	67	71
Interest expense	(29)	0	0	0	0	0
Pre-tax profit	(2,014)	(2,950)	(2,051)	(458)	(167)	472
Income tax	(2)	(2)	(5)	(1)	(0)	(71)
After tax profit	(2,016)	(2,951)	(2,056)	(459)	(167)	401
Net profit	(2,016)	(2,951)	(2,056)	(459)	(167)	401
Adjusted net profit	(1,580)	(1,568)	(1,044)	(352)	(59)	529

BALANCE SHEET	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Current assets	8,256	6,863	8,769	8,662	9,075	9,924
Cash & equivalents	911	3,006	853	326	347	698
Account receivables	374	254	674	727	750	799
Prepayment	1,447	1,642	1,345	1,411	1,463	1,579
ST bank deposits	5,167	817	5,528	5,804	6,094	6,399
Financial assets at FVTPL	339	971	241	265	291	320
Other current assets	18	172	128	128	128	128
Non-current assets	781	1,195	619	631	617	606
PP&E	24	21	44	49	48	62
Right-of-use assets	0	0	11	11	11	11
Investment in JVs & assos	74	89	93	93	93	93
Other non-current assets	683	1,085	471	479	465	440
Total assets	9,037	8,057	9,388	9,293	9,691	10,529
Current liabilities	1,211	2,173	1,948	2,192	2,605	2,895
Account payables	126	1	0	0	0	0
Tax payable	1	1	0	0	0	0
Other current liabilities	239	146	56	56	56	56
Lease liabilities	0	0	3	3	3	3
Contract liabilities	175	385	605	768	971	1,149
Accrued expenses	670	1,640	1,284	1,365	1,575	1,686
Non-current liabilities	10,772	11,192	58	72	116	136
Convertible bonds	10,764	11,162	0	0	0	0
Other non-current liabilities	8	29	58	72	116	136
Total liabilities	11,983	13,364	2,006	2,264	2,721	3,030
Share capital	0	0	0	0	0	0
Retained earnings	(5,423)	(8,372)	(10,600)	(11,059)	(11,226)	(10,825)
Other reserves	2,478	3,066	17,982	18,088	18,196	18,324
Total shareholders equity	(2,946)	(5,307)	7,382	7,029	6,970	7,499
Total equity and liabilities	9,037	8,057	9,388	9,293	9,691	10,529

CASH FLOW	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	(2,014)	(2,950)	(2,051)	(458)	(167)	472
Depreciation & amortization	14	22	15	32	35	19
Tax paid	(2)	(2)	(6)	(1)	(0)	(71)
Change in working capital	(86)	531	177	130	396	169
Others	381	1,429	957	36	40	57
Net cash from operations	(1,706)	(969)	(908)	(260)	304	646
Investing						
Capital expenditure	(15)	(21)	(40)	(36)	(35)	(33)
Acquisition of subsidiaries/ investments	(9,265)	(6,534)	(11,544)	(300)	(317)	(334)
Net proceeds from disposal of short-term investments	6,816	10,045	7,681	0	0	0
Others	24	(85)	40	70	67	71
Net cash from investing	(2,440)	3,406	(3,862)	(267)	(284)	(296)
Financing						
Proceeds from share issues	7,324	0	2,679	0	0	0
Share repurchases	0	0	0	0	0	0
Others	(2,836)	(321)	(65)	0	0	0
Net cash from financing	4,488	(321)	2,614	0	0	0
Net change in cash						
Cash at the beginning of the year	551	911	3,006	853	326	347
Exchange difference	18	(21)	4	0	0	0
Cash at the end of the year	911	3,006	853	326	347	698
GROWTH	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Revenue	101.9%	111.2%	42.9%	27.0%	21.4%	18.4%
Gross profit	na	na	na	753.4%	51.6%	45.8%
PROFITABILITY	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Gross profit margin	(45.6%)	(12.2%)	2.0%	13.7%	17.1%	21.1%
Operating margin	(70.7%)	(31.1%)	(19.2%)	(6.0%)	(2.2%)	3.1%
Adj. net profit margin	(68.2%)	(32.0%)	(14.9%)	(4.0%)	(0.5%)	4.1%
Return on equity (ROE)	na	na	(198.2%)	(6.4%)	(2.4%)	5.5%
GEARING/LIQUIDITY/ACTIVITIES	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
Net debt to equity (x)	na	na	(0.9)	(0.9)	(0.9)	(0.9)
Current ratio (x)	6.8	3.2	4.5	4.0	3.5	3.4
Receivable turnover days	58.9	19.0	35.1	29.9	25.4	22.8
VALUATION	2019A	2020A	2021A	2022E	2023E	2024E
YE 31 Dec						
P/E	na	na	na	na	na	45.7
P/E (diluted)	na	na	na	na	na	45.7
P/B	na	na	3.8	2.6	2.6	2.4

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

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CMB International Global Markets Limited

Address: 45/F, Champion Tower, 3 Garden Road, Hong Kong, Tel: (852) 3900 0888 Fax: (852) 3900 0800

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