

TME (TME US)

Inline 2Q24 results; focus on balanced growth of music subs and ARPPU in 2H24E

TME announced 2Q24 results on 13 Aug: total revenue declined by 2% YoY to RMB7.16bn, in line with our/Bloomberg consensus estimate of RMB7.16/7.13bn; non-IFRS net income was up by 22% YoY to RMB1.87bn, 2/2% ahead of our/consensus estimate. For 2H24E, management will focus more on balanced growth of music subs and ARPPU, expecting slower music subscriber net adds but continued QoQ ARPPU growth, which has raised certain investor concerns. That said, management reiterated its long-term target (150mn music subscribers & RMB15 in monthly ARPPU). We remain upbeat on TME earnings CAGR over FY24-26E (+21%) fuelled by core music revenue growth and GPM expansion. We keep our FY24-26 non-IFRS net income forecast largely unchanged, and maintain our DCF-derived TP at US\$16.00. Maintain BUY.

- Online music business maintains solid growth momentum.** 2Q24 online music revenue grew by 28% YoY to RMB5.42bn (76% of total revenue), with subscription/non-subscription revenue up by 29/24% YoY respectively. No. of paying users grew by 18% YoY to 117mn in 2Q24, with 3.5mn QoQ net adds, in line with our expectation. Monthly ARPPU grew by 10% YoY and largely flat QoQ at RMB10.7 in 2Q24. Advertising revenue also delivered strong YoY growth in 2Q24, thanks to the solid performance of ad-supported mode, interactive ads and sponsorship ads. Social entertainment and others revenue declined by 43% YoY but stabilized QoQ at RMB1.74bn in 2Q24 (24% of total revenue), as live streaming business continued to face pressure.
- Balancing music subs and ARPPU growth in 3Q24E.** Looking ahead in 3Q24E, we forecast total revenue to grow by 8% YoY to RMB7.06bn, primarily driven by 24% YoY growth of online music revenue, but partially offset by a 29% YoY decline in social entertainment revenue. For 2H24E, we expect a slower pace of music subscriber net adds (1.5-2.0mn per quarter) but continued QoQ growth in ARPPU, underpinned by the solid performance of high-value Super VIP program. Leveraging AI tech, TME continues to improve listening experience and drive growth in music streams. TME has upgraded its recommendation middleware, with c.40% of streams generated from recommendations in 2Q24.
- GPM expansion to sustain in 3Q24E.** Overall GPM expanded by 7.7ppt YoY and 1.1ppt QoQ to 42.0% in 2Q24, owing to 1) online music business margin improvement; 2) ramp up of self-produced content; and 3) enhanced monetization of WeSing. Non-IFRS net margin increased by 5.2ppt YoY to 26.2% in 2Q24. For 3Q24E, we forecast GPM to further expand by 0.8ppt QoQ to 42.8%. For FY24E, we estimate non-IFRS net income to grow by 27% YoY to RMB7.50bn, supported by GPM expansion and opex control. TME's current valuation of 21x FY24E PE remains fair in our view. Maintain BUY.

Earnings Summary

(YE 31 Dec)	FY22A	FY23A	FY24E	FY25E	FY26E
Revenue (RMB mn)	28,339	27,752	28,415	31,447	34,582
Gross margin (%)	31.0	35.3	42.2	44.2	45.1
Adjusted net profit (RMB mn)	4,745.0	5,923.0	7,501.0	8,913.4	10,474.3
EPS (Adjusted) (RMB)	2.96	3.74	4.80	5.71	6.71
Consensus EPS (RMB)	2.96	3.74	4.76	5.70	6.57
P/E (x)	39.3	28.2	21.1	18.0	15.3

Source: Company data, Bloomberg, CMBIGM estimates

BUY (Maintain)

Target Price **US\$16.00**
 Up/Downside **21.9%**
 Current Price **US\$13.13**

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Stock Data

Mkt Cap (US\$ mn)	20,233.3
Avg 3 mths t/o (US\$ mn)	32.1
52w High/Low (US\$)	15.49/6.02
Total Issued Shares (mn)	1541.0

Source: FactSet

Shareholding Structure

Tencent	52.5%
Spotify	8.2%

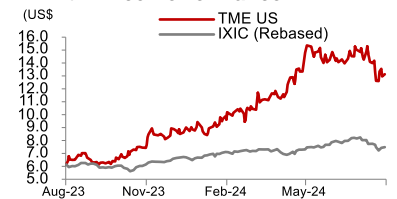
Source: Company data

Share Performance

	Absolute	Relative
1-mth	-13.2%	-4.9%
3-mth	-11.3%	-13.4%
6-mth	36.3%	27.2%

Source: FactSet

12-month 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	28,415	31,447	34,582	28,828	31,836	34,988	-1.4%	-1.2%	-1.2%
Gross profit	12,000	13,912	15,604	12,234	13,936	15,642	-1.9%	-0.2%	-0.2%
Operating profit	8,523	9,883	11,616	8,495	9,704	11,430	0.3%	1.8%	1.6%
Non-IFRS net profit	7,501	8,913	10,474	7,437	8,826	10,386	0.9%	1.0%	0.9%
Non-IFRS EPS (RMB)	4.8	5.7	6.7	4.8	5.7	6.7	0.9%	1.0%	0.9%
Gross margin	42.2%	44.2%	45.1%	42.4%	43.8%	44.7%	-0.2 ppt	0.5 ppt	0.4 ppt
Operating margin	30.0%	31.4%	33.6%	29.5%	30.5%	32.7%	0.5 ppt	0.9 ppt	0.9 ppt
Non-IFRS net margin	26.4%	28.3%	30.3%	25.8%	27.7%	29.7%	0.6 ppt	0.6 ppt	0.6 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	28,415	31,447	34,582	28,891	32,499	35,979	-1.6%	-3.2%	-3.9%
Gross Profit	12,000	13,912	15,604	12,139	14,188	16,039	-1.1%	-1.9%	-2.7%
Operating Profit	8,523	9,883	11,616	8,083	9,722	11,209	5.4%	1.7%	3.6%
Non-IFRS net profit	7,501	8,913	10,474	7,329	8,788	10,127	2.3%	1.4%	3.4%
Non-IFRS EPS (RMB)	4.8	5.7	6.7	4.8	5.7	6.6	1.0%	0.1%	2.1%
Gross Margin	42.2%	44.2%	45.1%	42.0%	43.7%	44.6%	0.2 ppt	0.6 ppt	0.5 ppt
Operating Margin	30.0%	31.4%	33.6%	28.0%	29.9%	31.2%	2.0 ppt	1.5 ppt	2.4 ppt
Non-IFRS net margin	26.4%	28.3%	30.3%	25.4%	27.0%	28.1%	1.0 ppt	1.3 ppt	2.1 ppt

Source: Bloomberg, CMBIGM estimates

Figure 3: TME: quarterly financials

(RMB mn)	3Q22	4Q22	1Q23	2Q23	3Q23	4Q23	1Q24	2Q24	Cons.	Diff%	CMBI	Diff%
Online music	3,430	3,559	3,501	4,249	4,553	5,022	5,007	5,424				
YoY change (%)	18.8%	23.6%	33.8%	47.6%	32.7%	41.1%	43.0%	27.7%				
Subscription revenue	2,249	2,352	2,599	2,890	3,193	3,417	3,618	3,740				
YoY change (%)	18.3%	20.6%	30.4%	37.2%	42.0%	45.3%	39.2%	29.4%				
Other revenue	1,181	1,207	902	1,359	1,360	1,605	1,389	1,684				
YoY change (%)	19.7%	29.8%	44.8%	76.1%	15.1%	32.9%	54.0%	23.9%				
Social entertainment	3,935	3,866	3,503	3,037	2,016	1,871	1,761	1,736				
YoY change (%)	-20.0%	-18.2%	-13.0%	-24.6%	-48.8%	-51.6%	-49.7%	-42.8%				
Total revenue	7,365	7,425	7,004	7,286	6,569	6,893	6,768	7,160	7,129	0.4%	7,160	0.0%
YoY change (%)	-5.6%	-2.4%	5.4%	5.5%	-10.8%	-7.2%	-3.4%	-1.7%				
GPM (%)	32.6%	33.0%	33.1%	34.3%	35.7%	38.3%	40.9%	42.0%				
Adjusted NPM (%)	18.7%	19.4%	20.1%	21.0%	21.4%	22.8%	25.2%	26.2%				
Adjusted net profit	1,379	1,438	1,411	1,529	1,408	1,575	1,704	1,873	1,829	2.4%	1,834	2.1%
YoY change (%)	35.9%	72.8%	57.0%	48.6%	2.1%	9.5%	20.8%	22.5%				

Source: Company data, Bloomberg, CMBIGM estimates

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	8,437	9,320	11,217	12,498	14,066	15,501	17,296
NPV of free cash flow	61,795						
Discounted terminal value	101,176						
Net cash	14,523						
Total TME valuation	177,493						
Number of ADS (diluted, mn)	1,541						
Valuation per ADS (US\$)	16.00						

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	28,415	31,447	34,582
Cost of goods sold	21,840	19,566	17,957	16,415	17,535	18,978
Gross profit	9,404	8,773	9,795	12,000	13,912	15,604
Operating expenses	5,604	4,330	3,736	3,477	4,030	3,988
Selling expense	2,678	1,144	897	889	936	979
Admin expense	4,009	4,413	4,121	3,920	4,230	4,535
Others	(1,083)	(1,227)	(1,282)	(1,332)	(1,136)	(1,526)
Operating profit	3,800	4,443	6,059	8,523	9,883	11,616
Share of (losses)/profits of associates/JV	(47)	38	127	144	0	0
Interest expense	(121)	(108)	(141)	(108)	(97)	(87)
Pre-tax profit	3,632	4,373	6,045	8,559	9,785	11,528
Income tax	(417)	(534)	(825)	(1,669)	(1,712)	(2,017)
After tax profit	3,215	3,839	5,220	6,890	8,073	9,511
Net profit	3,215	3,839	5,220	6,890	8,073	9,511
Adjusted net profit	4,146	4,745	5,923	7,501	8,913	10,474
BALANCE SHEET	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Current assets	26,791	26,559	29,936	35,883	44,361	54,471
Cash & equivalents	6,591	9,589	13,598	20,159	28,218	37,893
Account receivables	3,610	2,670	2,918	2,666	2,735	2,771
Inventories	24	14	8	5	3	1
Prepayment	2,731	2,958	3,438	2,777	2,818	2,898
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	46,359	47,134	47,926
PP&E	243	323	490	695	893	1,084
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	1,816	1,607	1,402
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	82,242	91,495	102,396
Current liabilities	10,450	11,717	12,014	11,821	12,974	14,337
Account payables	4,329	4,998	5,006	4,685	5,125	5,676
Tax payable	363	404	567	581	642	707
Other current liabilities	5,666	6,192	6,326	6,437	7,085	7,829
Lease liabilities	92	123	115	118	122	126
Long-term borrowings	5,749	6,165	6,320	6,328	6,356	6,383
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	380	392	403
Total liabilities	16,199	17,882	18,334	18,150	19,330	20,720
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	23,859	31,932	41,443
Other reserves	3,726	6,140	9,658	9,658	9,658	9,658
Total shareholders equity	50,317	48,099	55,907	62,797	70,870	80,381
Minority interest	738	1,028	1,295	1,295	1,295	1,295
Total equity and liabilities	67,254	67,009	75,536	82,242	91,495	102,396

CASH FLOW	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec (RMB mn)						
Operating						
Profit before taxation	3,632	4,373	6,045	8,559	9,785	11,528
Depreciation & amortization	1,001	1,160	724	573	628	685
Tax paid	(589)	(733)	0	0	0	0
Change in working capital	579	2,211	(197)	645	979	1,175
Others	616	470	765	(1,669)	(1,712)	(2,017)
Net cash from operations	5,239	7,481	7,337	8,109	9,680	11,371
Investing						
Capital expenditure	(2,758)	(1,053)	(555)	(563)	(616)	(671)
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)
Net cash from investing	(5,999)	(1,446)	(1,863)	(1,563)	(1,637)	(1,712)
Financing						
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
Net cash from financing	(3,710)	(3,419)	(1,538)	15	16	16
Net change in cash						
Cash at the beginning of the year	11,128	6,591	9,589	13,598	20,159	28,218
Exchange difference	(67)	382	73	0	0	0
Cash at the end of the year	6,591	9,589	13,598	20,159	28,218	37,893
GROWTH	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Revenue	7.2%	(9.3%)	(2.1%)	2.4%	10.7%	10.0%
Gross profit	1.1%	(6.7%)	11.6%	22.5%	15.9%	12.2%
Operating profit	(19.3%)	16.9%	36.4%	40.7%	15.9%	17.5%
Net profit	(23.0%)	19.4%	36.0%	32.0%	17.2%	17.8%
Adj. net profit	(16.2%)	14.4%	24.8%	26.6%	18.8%	17.5%
PROFITABILITY	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
Gross profit margin	30.1%	31.0%	35.3%	42.2%	44.2%	45.1%
Operating margin	12.2%	15.7%	21.8%	30.0%	31.4%	33.6%
Adj. net profit margin	13.3%	16.7%	21.3%	26.4%	28.3%	30.3%
Return on equity (ROE)	6.3%	7.8%	10.0%	11.6%	12.1%	12.6%
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	3.4	3.8
Receivable turnover days	37.4	40.4	36.7	35.9	31.3	29.1
Payable turnover days	66.0	87.0	101.7	107.7	102.1	103.9
VALUATION	2021A	2022A	2023A	2024E	2025E	2026E
YE 31 Dec						
P/E	48.7	39.3	28.2	21.1	18.0	15.3
P/E (diluted)	49.3	39.7	28.6	21.4	18.2	15.5
P/B	3.1	3.1	2.6	2.3	2.1	1.8

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

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