

TME (TME US)

Multiple challenges ahead

TME delivered mixed 2Q21 and soft guidance, with revenue/adj. net income +15.5%/0.5% YoY, -1%/+7% against consensus. FY21E rev was guided down to +10% YoY, 7% below consensus due to prudent social and ads outlook amid COVID-19 and tightening regulations. Music subs momentum continues, with subscribers +40.6% YoY despite soft music MAU (-4.3% YoY). With regulations against exclusive music copyright, TME focuses more on content & innovations and anticipates short-term GPM dilution in 2H21E. We cut its earnings by 11%/30%/44% in FY21/22/23E to reflect lower social rev mix, increasing content investment and intensified competition, and lowered DCF-based TP to US\$12.

- Mixed 2Q21 with soft guidance.** 2Q21 rev was RMB8.0bn, +15.5% YoY, 1% below consensus on soft social and ads rev. Adj. net income grew 0.5% YoY, 7% above consensus. **Mgmt guided down FY21E rev to +10% YoY, 7% below consensus, with music +30% YoY and flat social entertainment.** Music/ social entertainment MAU -4.3%/-13.3% YoY and paying user +40.6%/-12.7% YoY. Despite music copyrights regulations, mgmt. guided strong music subs momentum with 4-5mn subscriber net add in coming quarters with effective paywall execution.
- Soft ads and social entertainment ahead, while music subs intact.** Music subs rev +36% YoY, mainly on subs growth at +40.6% YoY albeit soft ARPPU (-3.2% YoY). 2Q21 music subs paying ratio was at 10.6% (vs. 7.2% in 2Q20 and 9.9% in 1Q21). Other music/ social entertainment +28%/ 7% YoY, due to regulation headwinds and COVID-19 pressure. Looking ahead, we expect music subs momentum to continue in 2H21E but trimmed ads and social forecast, anticipating subs/other music/ social +31%/+28%/-9% YoY in 3Q21E.
- Expecting content + platform flywheels despite short-term GPM dilution.** Content + platform initiatives include cross-app karaoke campaigns (Jun and Sep 2021), Tencent ecosystem synergies in content creation (movies, variety shows, etc.) and distribution (video account), and content creator support. We cut our GPM forecast by 1-5ppts in FY21-23E to factor in lower social rev mix, increased content investment, and intensified competition. Despite short-term headwinds, we believe TME's long-term growth prospects are intact with Tencent synergies and LFA to unlock TAM.
- Maintain BUY.** We cut its earnings by 11%/30%/44% in FY21/22/23E to reflect margin dilution and lowered DCF-based TP to US\$12.

Earnings Summary

(YE 31 Dec)	FY19A	FY20A	FY21E	FY22E	FY23E
Revenue (RMB mn)	25,434	29,153	32,136	35,372	38,949
YoY growth (%)	34.0	14.6	10.2	10.1	10.1
Adj. net income (RMB mn)	4,903	4,971	3,777	4,055	4,541
Adj. EPS (RMB)	2.9	3.0	2.2	2.4	2.7
YoY growth (%)	11.3	1.0	(24.1)	7.4	12.0
Consensus EPS	NA	NA	2.5	3.1	4.1
P/E (x)	19.5	19.3	25.5	23.7	21.2
P/B (x)	3.8	3.3	3.0	2.7	2.5
Yield (%)	0.0	0.0	0.0	0.0	0.0
ROE (%)	11.2	9.4	6.5	6.5	6.9
Net gearing (%)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company data, Bloomberg, CMBIS estimates

BUY (Maintain)

Target Price	US\$12.0
(Previous TP)	US\$20.0)
Up/Downside	+34.8%
Current Price	US\$8.9

China Internet Sector

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Stock Data

Mkt Cap (US\$ mn)	15,098
Avg 3 mths t/o (US\$ mn)	197.46
52w High/Low (US\$)	32.25/ 8.88
Total Issued Shares (mn)	835

Source: Bloomberg

Shareholding Structure

Pacific Alliance	6.01%
Baillie Gifford	5.46%
BlackRock	3.34%

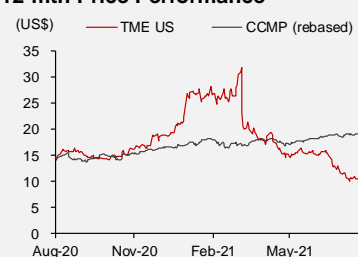
Source: Bloomberg

Share Performance

	Absolute	Relative
1-mth	-23.8%	-25.6%
3-mth	-41.4%	-46.8%
6-mth	-68.5%	-70.1%

Source: Bloomberg

12-mth Price Performance



Source: Bloomberg

Auditor: Ernst & Young

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Figure 1: 2Q21 financial review

RMB mn, Dec-YE	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	QoQ	YoY	Consensus	Diff %
Revenue	6,311	6,932	7,575	8,335	7,824	8,008	2.4%	15.5%	8,092	-1%
Operating Profit	815	1,107	1,026	1,018	911	1,035	13.6%	-6.5%	949	9%
Net profit	887	939	1,132	1,197	926	827	-10.7%	-11.9%	810	2%
Adj. net profit	1,103	1,155	1,349	1,364	1,235	1,161	-6.0%	0.5%	1,087	7%
Adj. EPS (RMB)	0.66	0.69	0.80	0.81	0.69	0.66	-5.0%	-4.3%	0.62	6%
Margin (%)										
Gross margin	31.3%	31.3%	32.4%	32.4%	31.5%	30.4%			30.1%	
Operating margin	12.9%	16.0%	13.5%	12.2%	11.6%	12.9%			11.7%	
Adj. net margin	17.5%	16.7%	17.8%	16.4%	15.8%	14.5%			13.4%	
Growth (%)										
Revenue (YoY)	10.0%	17.5%	16.4%	14.3%	24.0%	15.5%			16.7%	
Revenue (QoQ)	-13.5%	9.8%	9.3%	10.0%	-6.1%	2.4%			3.4%	
Operating Profit	-18.0%	24.2%	5.3%	-4.9%	11.8%	-6.5%			-14.2%	
Adj. net profit	-8.1%	2.3%	9.3%	1.8%	12.0%	0.5%			-5.9%	

Source: Company data, Bloomberg

Figure 2: 2Q21 revenue breakdown

RMB mn, Dec-YE	1Q19	2Q19	3Q19	4Q19	1Q20	2Q20	3Q20	4Q20	1Q21	2Q21	QoQ	YoY
Total revenue	5,736	5,898	6,507	7,293	6,311	6,932	7,575	8,335	7,824	8,008	2%	16%
Online music service	1,605	1,562	1,846	2,139	2,044	2,221	2,324	2,760	2,749	2,950	7%	33%
Subscription	710	798	942	1,110	1,207	1,314	1,460	1,580	1,690	1,790	6%	36%
Others	895	764	904	1,029	837	907	864	1,180	1,059	1,160	10%	28%
Social entertainment / others	4,131	4,336	4,661	5,154	4,267	4,711	5,251	5,575	5,075	5,058	0%	7%

Source: Company data

Figure 3: CMBIS estimates vs consensus

RMB mn, Dec-YE	CMBIS			Consensus			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	32,136	35,372	38,949	34,249	40,484	47,684	-6.2%	-12.6%	-18.3%
Gross Profit	9,149	10,017	11,015	10,344	12,603	15,321	-11.6%	-20.5%	-28.1%
Operating Profit	2,240	2,270	2,564	3,851	5,409	7,062	-41.8%	-58.0%	-63.7%
Adj. net profit	3,777	4,055	4,541	4,369	5,670	7,406	-13.5%	-28.5%	-38.7%
EPS (RMB)	2.25	2.41	2.70	2.49	3.09	4.09	-9.7%	-21.8%	-34.0%
Gross Margin	28.5%	28.3%	28.3%	30.2%	31.1%	32.1%	-1.7ppts	-2.8ppts	-3.8ppts
Operating Margin	7.0%	6.4%	6.6%	11.2%	13.4%	14.8%	-4.3ppts	-6.9ppts	-8.2ppts
Net Margin	11.8%	11.5%	11.7%	12.8%	14.0%	15.5%	-1.0ppts	-2.5ppts	-3.9ppts

Source: Company data, Bloomberg, CMBIS estimates

Figure 4: Earnings revision

RMB mn, Dec-YE	New			Old			Diff (%)		
	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E	FY21E	FY22E	FY23E
Revenue	32,136	35,372	38,949	34,349	41,224	49,216	-6.4%	-14.2%	-20.9%
Gross Profit	9,149	10,017	11,015	10,060	12,791	16,151	-9.1%	-21.7%	-31.8%
Operating Profit	2,240	2,270	2,564	2,803	4,217	6,455	-20.1%	-46.2%	-60.3%
Adj. net profit	3,777	4,055	4,541	4,218	5,823	8,107	-10.5%	-30.4%	-44.0%
EPS (RMB)	2.25	2.41	2.70	2.48	3.42	4.76	-9.4%	-29.5%	-43.3%
Gross Margin	28.5%	28.3%	28.3%	29.3%	31.0%	32.8%	-0.8ppts	-2.7ppts	-4.5ppts
Operating Margin	7.0%	6.4%	6.6%	8.2%	10.2%	13.1%	-1.2ppts	-3.8ppts	-6.5ppts
Net Margin	11.8%	11.5%	11.7%	12.3%	14.1%	16.5%	-0.5ppts	-2.7ppts	-4.8ppts

Source: Company data, CMBIS estimates

Financial Summary

Income statement

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Net revenues	25,434	29,153	32,136	35,372	38,949
Online music service	7,152	9,349	12,275	14,751	17,162
Subscription	3,560	5,561	7,419	8,423	9,316
Others	3,592	3,788	4,856	6,328	7,846
Social entertainment	18,282	19,804	19,861	20,622	21,786
COGS	(16,761)	(19,851)	(22,988)	(25,355)	(27,933)
Gross profit	8,673	9,302	9,149	10,017	11,015
S&M	(2,041)	(2,475)	(3,128)	(3,714)	(4,090)
R&D	(1,370)	(1,859)	(2,089)	(2,264)	(2,415)
Admin.Exp.	(1,333)	(1,242)	(1,692)	(1,769)	(1,947)
Operating profit	3,929	3,726	2,240	2,270	2,564
Other income, net	611	906	823	1,161	1,335
Pre-tax Income	4,540	4,632	3,063	3,432	3,898
Income Tax	(563)	(456)	(374)	(412)	(468)
Net profit	3,977	4,176	2,690	3,020	3,430
Adj. net profit	4,903	4,971	3,777	4,055	4,541

Cash flow summary

YE 31 Dec (RMB mn)	FY19A	FY20E	FY21E	FY22E	FY23E
Pre-tax Income	4,540	4,632	3,063	3,432	3,898
D&A	410	464	510	572	650
Change in WC	1,135	(314)	414	295	320
Others	(1,200)	57	580	842	3,474
Operating CF	4,885	4,840	4,568	5,141	8,343
Capex	(286)	(330)	(364)	(400)	(441)
Investments	37	6	-	-	-
Others	(7,853)	(13,882)	(2,111)	(1,844)	(1,787)
Investing CF	(8,102)	(14,206)	(2,475)	(2,245)	(2,228)
Equity raised	12	-	-	-	-
Change of debts	-	-	-	-	-
Others	(43)	5,292	-	-	-
Financing CF	(31)	5,292	-	-	-
Net change in cash	(1,933)	(4,029)	1,831	2,323	2,912
Cash (beg of yr)	17,356	15,426	11,128	12,959	15,282
FX	3	(269)	-	-	-
Cash (end of yr)	15,426	11,128	12,959	15,282	18,194

Balance sheet

YE 31 Dec (RMB mn)	FY19A	FY20A	FY21E	FY22E	FY23E
Non-current assets	25,764	36,586	40,657	42,495	44,266
Intangible assets, net	1,622	2,020	1,520	1,463	1,394
Goodwill	17,140	17,492	19,640	20,890	22,140
Financial assets	4,461	9,771	9,771	9,771	9,771
Others	2,541	7,303	9,726	10,371	10,961
Current assets	26,914	31,687	34,187	37,148	40,765
Cash, restricted cash	15,426	11,128	12,959	15,282	18,194
Accounts receivable	2,198	2,800	3,434	3,780	4,162
Other current assets	2,220	2,846	2,805	3,087	3,400
Term deposits	7,000	14,858	14,858	14,858	14,858
Others	70	55	131	141	152
Current liabilities	8,490	9,602	10,761	11,797	12,936
Accounts payables	2,559	3,565	3,464	3,821	4,209
Other payables	3,782	3,881	3,856	4,245	4,674
Deferred revenue	1,694	1,608	2,892	3,184	3,505
Others	455	548	548	548	548
Non-current liabilities	510	5,940	5,940	5,940	5,940
Notes payable	-	5,175	5,175	5,175	5,175
Deferred tax liability	297	265	265	265	265
Others	213	500	500	500	500
MI	88	486	486	486	486
Total Equity	43,678	52,731	58,143	61,906	66,155
Shareholders' equity	43,590	52,245	57,657	61,420	65,669

Key ratios

YE 31 Dec	FY19A	FY20A	FY21E	FY22E	FY23E
Sales mix (%)					
Online music service	28.1	32.1	38.2	41.7	44.1
Subscription	14.0	19.1	23.1	23.8	23.9
Others	14.1	13.0	15.1	17.9	20.1
Social entertainment	71.9	67.9	61.8	58.3	55.9
Total	100.0	100.0	100.0	100.0	100.0
Growth rate (%)					
Revenue	34.0	14.6	10.2	10.1	10.1
Gross profit	19.2	7.3	(1.6)	9.5	10.0
EBIT	18.9	(5.2)	(39.9)	1.3	12.9
Adj. net profit	17.8	1.4	(24.0)	7.4	12.0
P&L ratios (%)					
Operating margin	15.4	12.8	7.0	6.4	6.6
Pre-tax margin	17.9	15.9	9.5	9.7	10.0
Adj. net margin	19.3	17.1	11.8	11.5	11.7
Effective tax rate	(12.4)	(9.8)	(12.2)	(12.0)	(12.0)
Returns (%)					
ROE	11.2	9.4	6.5	6.5	6.9
ROA	9.3	7.3	5.0	5.1	5.3
Per share					
EPS (RMB)	2.9	3.0	2.2	2.4	2.7
DPS (RMB)	0.0	0.0	0.0	0.0	0.0
BVPS (RMB)	15.8	20.3	22.3	23.7	25.3

Source: Company data, CMBIS estimates

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