

Tencent Music

Expect solid music growth trend to continue in 2024E, raise PO

Reiterate Rating: BUY | PO: 10.50 USD | Price: 9.04 USD

Solid music business with positive growth outlook

We expect TME to report 4Q23 results in early or mid- March and expect its 4Q23 results to be on track. We also expect a positive 2024 growth outlook for its music business and see TME as one of our preferred names in the Internet sector in 2024E, driven by the following: 1) Stabilized competition environment and user trends. Questmobile data indicated largely stabilized mobile user trends, and we also expect IOT and Weixin video account to be complementary channels that drive user reach. 2) Resilient music business with dual engines from subscribe and ARPU, supported by content expansion and pricing optimization. We believe that 3m net additions are achievable and that ARPU growth should continue in 2024E. 3) Margin expansion on the structural change in music content cost. The company recently renewed its multi-year strategic licensing agreement with Universal Music Group (UMG), and we see more premium benefits been added (e.g., high-quality sound), which is likely to continue driving the engagement of music core users. We reiterate our Buy rating.

Fine-tune estimates and raise PO

As a result of the above factors, we fine-tune our estimates and model above-consensus adj net profit for 2024E (RMB6.7b versus consensus' RMB6.4b) and raise our PO to US\$10.50/HK\$41 (from US\$9.00/HK\$35) on 20x 2024E GAAP P/E (versus 18x previously), implying 18x adj P/E. The updated multiple is in line with the average P/E of digital entertainment peers with similar exposure to internet user growth and better represents the mix of subscription, virtual gifting and advertising business models that TME also operates. Our recent investor feedback also indicated good interest in TME, and we expect more color on profit growth to drive further upside.

4Q23: expect in-line results on solid music business

We expect 4Q total revenue to be RMB6.8bn, down 9% YoY and up 3% QoQ, largely in line with consensus' RMB6.7bn. We see online music revenue growth of 37% YoY to RMB4.9bn on 3.3mn quarterly net subscription adds and increased monthly ARPU to RMB10.44. We expect social entertainment revenue to decline by 51% YoY and 5% QoQ due to business adjustments. We expect GM to be 37% (versus 33% in 4Q22), in line with consensus of 37% on optimized music content cost. We expect non-GAAP net profit to be RMB1.6bn, with net margin improving to 23.1% (from 19.4% in 4Q22) on effective cost controls, in line with consensus' RMB1.6bn.

Estimates (Dec) (CNY)	2021A	2022A	2023E	2024E	2025E
Net Income (Adjusted - mn)	3,029	3,677	4,930	5,717	7,066
EPS	1.80	2.27	3.08	3.55	4.31
EPS Change (YoY)	-27.1%	25.6%	36.0%	15.3%	21.1%
Dividend / Share	0	0	0	0	0
Free Cash Flow / Share	3.06	4.60	3.02	6.40	5.28
Common EPS (CNY)	0.902	1.13	1.54	1.78	2.15
Common Dividend / Share (CNY)	0	0	0	0	0
Valuation (Dec)					
P/E	31.92x	27.71x	20.79x	18.24x	15.05x
EV / EBITDA*	12.00x	10.48x	8.98x	7.60x	6.14x
Free Cash Flow Yield*	8.87%	12.91%	8.34%	17.75%	14.94%

* For full definitions of *IQmethod*SM measures, see page 6.

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Refer to important disclosures on page 7 to 10. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.

12644844

Timestamp: 11 January 2024 11:53AM EST

11 January 2024

Equity

Key Changes

(CNY)	Previous	Current
Price Obj.	US\$9.00	US\$10.50
2023E EPS	3.07	3.08
2025E EPS	4.22	4.31

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Stock Data

Price (ADR / Common)	9.04 USD / 35.40 HKD
Price Objective	10.50 USD / 41.00 HKD
Date Established	11-Jan-2024 / 11-Jan-2024
Investment Opinion	C-1-9 / C-1-9
52-Week Range	5.70 USD-9.20 USD
Market Value (mn)	7,988 USD
Shares Outstanding (mn)	883.6 / 1,767.2
Average Daily Value (mn)	68.14 USD
Free Float	0.1%
BofA Ticker / Exchange	TME / NYS
BofA Ticker / Exchange	XWFWF / HKG
Bloomberg / Reuters	TME US / TME.N
ROE (2023E)	9.8%
Net Dbt to Eqty (Dec-2022A)	-8.2%

ARPU: average revenue per user

GM: gross margin

IOT: Internet of things

PO: price objective

TME: Tencent Music

iQprofileSM Tencent Music

Key Income Statement Data (Dec)

(CNY Millions)

	2021A	2022A	2023E	2024E	2025E
Sales	31,244	28,339	27,638	28,065	31,713
Gross Profit	9,404	8,773	9,685	10,848	12,848
Sell General & Admin Expense	(6,687)	(5,557)	(5,047)	(5,184)	(5,597)
Operating Profit	3,270	3,732	4,884	5,976	7,563
Net Interest & Other Income	409	603	908	969	967
Associates	(47)	38	156	0	0
Pretax Income	3,632	4,373	5,948	6,945	8,530
Tax (expense) / Benefit	(417)	(534)	(726)	(848)	(1,084)
Net Income (Adjusted)	3,029	3,677	4,930	5,717	7,066
Average Fully Diluted Shares Outstanding	1,678	1,621	1,598	1,608	1,641

Key Cash Flow Statement Data

Net Income	3,029	3,677	4,930	5,717	7,066
Depreciation & Amortization	1,001	1,160	822	766	780
Change in Working Capital	573	2,221	(635)	4,013	1,117
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	636	423	(66)	(49)	(87)
Cash Flow from Operations	5,239	7,481	5,051	10,447	8,876
Capital Expenditure	(159)	(85)	(276)	(281)	(317)
(Acquisition) / Disposal of Investments	(1,255)	(327)	(570)	(513)	(461)
Other Cash Inflow / (Outflow)	(4,585)	(1,034)	(553)	(520)	(526)
Cash Flow from Investing	(5,999)	(1,446)	(1,399)	(1,313)	(1,304)
Shares Issue / (Repurchase)	0	75	0	0	0
Cost of Dividends Paid	NA	NA	NA	NA	NA
Cash Flow from Financing	(3,710)	(3,419)	3	3	3
Free Cash Flow	5,080	7,396	4,775	10,166	8,559
Net Debt	(1,436)	(4,019)	(7,674)	(16,811)	(24,386)
Change in Net Debt	4,537	(2,964)	(3,655)	(9,137)	(7,575)

Key Balance Sheet Data

Property, Plant & Equipment	243	323	212	139	96
Other Non-Current Assets	40,220	40,127	40,815	41,435	42,002
Trade Receivables	3,610	2,670	3,455	2,764	4,263
Cash & Equivalents	6,591	9,555	13,210	22,347	29,922
Other Current Assets	16,590	14,300	14,513	14,885	15,748
Total Assets	67,254	66,975	72,204	81,571	92,031
Long-Term Debt	5,155	5,536	5,536	5,536	5,536
Other Non-Current Liabilities	594	629	629	629	629
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	10,450	11,717	12,080	15,775	19,253
Total Liabilities	16,199	17,882	18,245	21,940	25,418
Total Equity	51,055	49,127	53,994	59,665	66,647
Total Equity & Liabilities	67,254	67,009	72,238	81,605	92,065

iQmethodSM - Bus Performance*

Return On Capital Employed	6.7%	7.9%	9.8%	10.5%	11.5%
Return On Equity	5.9%	7.5%	9.8%	10.2%	11.4%
Operating Margin	10.5%	13.2%	17.7%	21.3%	23.8%
EBITDA Margin	13.7%	17.3%	20.6%	24.0%	26.3%

iQmethodSM - Quality of Earnings*

Cash Realization Ratio	1.7x	2.0x	1.0x	1.8x	1.3x
Asset Replacement Ratio	0.3x	0.1x	0.7x	0.8x	0.9x
Tax Rate (Reported)	11.5%	12.2%	12.2%	12.2%	12.7%
Net Debt-to-Equity Ratio	-2.8%	-8.2%	-14.2%	-28.2%	-36.6%
Interest Cover	27.0x	34.6x	33.4x	NM	NM

Key Metrics

* For full definitions of iQmethodSM measures, see page 6.

Company Sector

Internet/e-Commerce

Company Description

Tencent Music is a leading online music platform in China. After a merger with China Music Corp, it now operates multiple music apps, including QQ Music, Kogou, and Kowo as well as WeSing, an online karaoke app. The company's monthly active user base reached 800m in 2022. Its business models include membership subscriptions, purchases of digital albums, virtual gifting to live performers and karaoke singers, sublicensing and advertising.

Investment Rationale

Tencent Music has a large user base that attracts content providers and multiple apps that cater for different user segments. Its social services such as live broadcasting and online karaoke contribute a significant portion of its revenues and hence allow the company to take a prudent and gradual approach to monetize via music subscription, implying further revenue upside in the long term. Growth in paying users and user spending can support profitability despite continuous content investment.

Stock Data

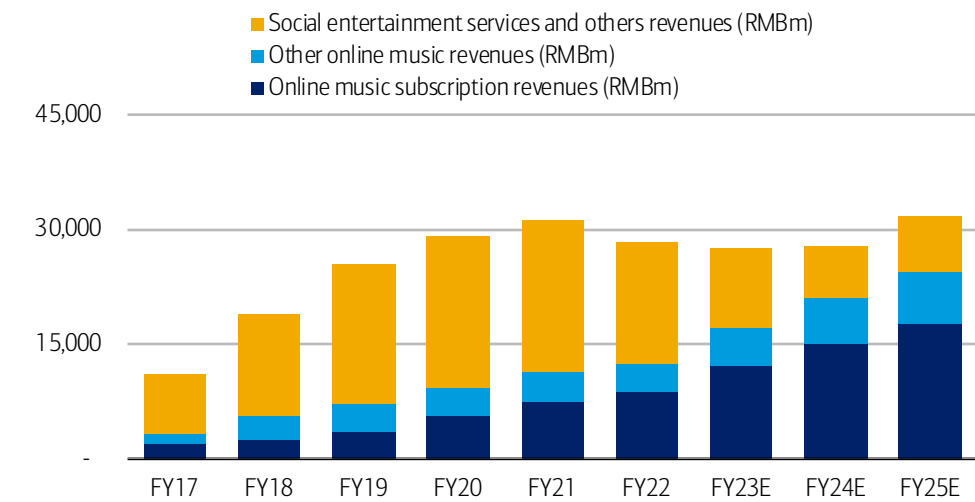
Shares / Common	0.50
Price to Book Value	1.1x

Key Changes

(CNY)	Previous	Current
Price Obj.	HK\$35.00	HK\$41.00
2025E EPS	2.11	2.15

Robust music growth trend

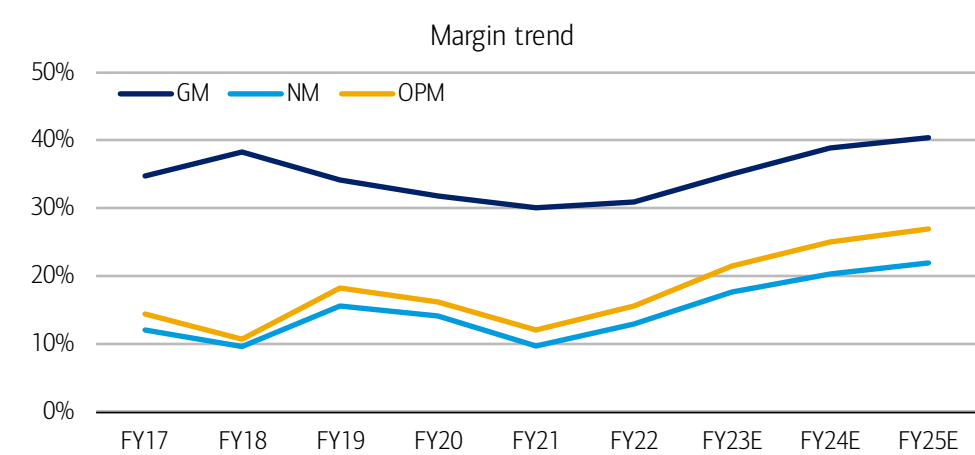
Exhibit 1: Music sub as key driver of 2023-25E revenue growth, while ad, offline music and IOT all have further room for growth
Revenue mix of TME



Source: Company data, BofA Global Research

BofA GLOBAL RESEARCH

Exhibit 2: Expect GPM improvement and cost optimization to drive gradual margin expansion in 2023-25E
Margin trend



Source: Company data, BofA Global Research

BofA GLOBAL RESEARCH



Price objective basis & risk

Tencent Music (TME / XWFWF)

Our PO is US\$10.50 (HK\$41) based on a 2024E GAAP P/E of 20x, which is in line with the average P/E of digital entertainment peers with similar exposure to Internet user growth and representing the mix of subscription, virtual gifting and advertising business models that TME also operates.

Risks are 1) competition from online music peers and other entertainment platforms such as short-video that might affect user growth and monetization, 2) copyright & IP protection, 3) regulation such as content censorship and listing policies in US and HK, which might negatively impact liquidity for investors in case of a US delisting before any secondary listing, 4) content costs that might affect margins, 5) user engagement & monetization that determine the sustainability of the platform. Seasonal impact on user growth might also result in share price volatility, 6) further disposal of shares by VCs might have temporary impact on share prices, 7) lack of synergy in investments and acquisitions.

Analyst Certification

I, Lei Zhang, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
BUY				
	Agora	API	API US	Daley Li, CFA
	AiHuiShou	RERE	RERE US	Joyce Ju
	Alibaba Group	BABA	BABA US	Joyce Ju
	Alibaba Group	BABAF	9988 HK	Joyce Ju
	Alibaba Health	ALBHF	241 HK	Miranda Zhuang, CFA
	Baidu.com	BIDU	BIDU US	Miranda Zhuang, CFA
	Baidu.com	BAIDF	9888 HK	Miranda Zhuang, CFA
	Bilibili	BILI	BILI US	Lei Zhang
	Bilibili	BLBLF	9626 HK	Lei Zhang
	CAR Group	CRSLF	CARAU	Sriharsh Singh
	Chinasoft International	CFTLF	354 HK	Daley Li, CFA
	Cloud Music	XWJF	9899 HK	Lei Zhang
	Com2uS Corp	XOYAF	078340 KS	Jeehoon Jeong, CFA
	DBAPPSecurity	XDBAF	688023 CH	Daley Li, CFA
	Delhivery	XDVLf	DELHIVER IN	Sachin Salgaonkar
	Dingdong	DDL	DDL US	Joyce Ju
	East Money	XEQTF	300059 CH	Michael Li
	Grab Holdings	GRAB	GRAB US	Sachin Salgaonkar
	Hello Group	MOMO	MOMO US	Lei Zhang
	Huntsun Technologies	XYTGF	600570 CH	Daley Li, CFA
	HYBE	XBGOF	352820 KS	Susie Lee
	iQIYI	IQ	IQ US	Lei Zhang
	JD Health	JDHIF	6618 HK	Miranda Zhuang, CFA
	JD.com	JD	JD US	Joyce Ju
	JD.com	JDCMF	9618 HK	Joyce Ju
	JYP Entertainment	ALNNF	035900 KS	Susie Lee
	Kingdee International Software	KGDEF	268 HK	Daley Li, CFA
	Kingsoft Corporation	KSFTF	3888 HK	Daley Li, CFA
	Kuaishou	KUASF	1024 HK	Lei Zhang
	Makemytrip Limited	MMYT	MMYT US	Sachin Salgaonkar
	Meituan	MPNGF	3690 HK	Lei Zhang
	Naver Corporation	NHNCF	035420 KS	Susie Lee

APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	NetEase	NETTF	9999 HK	Lei Zhang
	NetEase, Inc	NTES	NTES US	Lei Zhang
	Nine Entertainment Company	NNMTF	NEC AU	Alice Lei, CFA
	Paytm	XUXBF	PAYTM IN	Sachin Salgaonkar
	Pinduoduo Inc.	PDD	PDD US	Joyce Ju
	Plan B Media PCL	XMKTF	PLANB TB	Thititthep Nophaket
	PT Bukalapak.com	BKLPF	BUKA IJ	Sachin Salgaonkar
	PVR-Inox Ltd	PVRLF	PVRINOX IN	Sachin Salgaonkar
	REA Group	RPGRF	REA AU	Sriharsh Singh
	Tencent Holdings	TCTZF	700 HK	Miranda Zhuang, CFA
	Tencent Music	TME	TME US	Lei Zhang
	Tencent Music	XWFWF	1698 HK	Lei Zhang
	Tongcheng Travel	TNGCF	780 HK	Janet Yang
	Trip.com Group	TCOM	TCOM US	Joyce Ju
	Trip.com Group	TRPCF	9961 HK	Joyce Ju
	TUHU Car	XTCRF	9690 HK	Miranda Zhuang, CFA
	Venustech	XVCGF	002439 CH	Daley Li, CFA
	Vipshop Holdings	VIPS	VIPS US	Joyce Ju
	Xero Limited	XROLF	XRO AU	Sriharsh Singh
	YG Entertainment	XYEIF	122870 KS	Susie Lee
	Yonyou Network	XYNIF	600588 CH	Daley Li, CFA
	YY	YY	YY US	Lei Zhang
	Zee Entertainment Enterprises	XZETF	Z IN	Sachin Salgaonkar
	Zomato Limited	XMWRF	ZOMATO IN	Sachin Salgaonkar
NEUTRAL				
	AfreecaTV	WNTHF	067160 KS	Susie Lee
	Autohome	ATHM	ATHM US	Miranda Zhuang, CFA
	Autohome	XXYZF	2518 HK	Miranda Zhuang, CFA
	Baozun	BZUN	BZUN US	Joyce Ju
	Coupang	CPNG	CPNG US	Susie Lee
	Glodon Company	XGCOF	002410 CH	Daley Li, CFA
	GoTo Group	GTOFF	GOTO IJ	Sachin Salgaonkar
	Huya	HUYA	HUYA US	Lei Zhang
	Kakao Corp.	DAUCF	035720 KS	Susie Lee
	KE Holdings	BEKE	BEKE US	Miranda Zhuang, CFA
	KE Holdings	XSQRF	2423 HK	Miranda Zhuang, CFA
	Kingsoft Cloud	KC	KC US	Daley Li, CFA
	Kingsoft Cloud	KCLHF	3896 HK	Daley Li, CFA
	Krafton	XKINF	259960 KS	Susie Lee
	NCSOFT	NCSCF	036570 KS	Susie Lee
	Nykaa	XQQGF	NYKAA IN	Sachin Salgaonkar
	PB Fintech	XPFXF	POLICYBZ IN	Sachin Salgaonkar
	PropertyGuru	PGRU	PGRU US	Sachin Salgaonkar
	Sea Limited	SE	SE US	Sachin Salgaonkar
	Seek Limited	SKLTF	SEK AU	Sriharsh Singh
	Seven West Media	WANHF	SWM AU	Alice Lei, CFA
	The ONE Enterprise	XUJCF	ONEE TB	Thititthep Nophaket
	VGI Public Company Limited	XZQHF	VGI TB	Thititthep Nophaket
	Weimob	WEMXF	2013 HK	Daley Li, CFA
	WiseTech Global Limited	WTCHF	WTC AU	Ware Kuo
	XD Inc.	XDNCF	2400 HK	Lei Zhang
UNDERPERFORM				
	Altium Limited	ALMFF	ALU AU	Ware Kuo
	Appen Ltd	APPEF	APX AU	Ware Kuo
	BEC World	XBJHF	BEC TB	Thititthep Nophaket
	CJ ENM	CJHOF	035760 KS	Susie Lee
	Douyu	DOYU	DOYU US	Lei Zhang
	Indiamart Intermesh Limited	XEITF	INMART IN	Sachin Salgaonkar
	Info Edge	IFOEF	INFOE IN	Sachin Salgaonkar
	Kakao Games	XKKGf	293490 KS	Susie Lee
	Kingsoft Office	XBKOF	688111 CH	Daley Li, CFA
	Ming Yuan Cloud	XWTAF	909 HK	Daley Li, CFA
	NavInfo	XWLHF	002405 CH	Daley Li, CFA
	Netmarble	XLGHF	251270 KS	Susie Lee



APR - Internet, Media and Software Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	PearlAbyss Corp	XEPAF	263750 KS	Susie Lee
	Ping An Healthcare and Technology	PANHf	1833 HK	Miranda Zhuang, CFA
	Qi An Xin	XQTDF	688561 CH	Daley Li, CFA
	Technology One Limited	THNOF	TNE AU	Ware Kuo
	ThunderSoft	XSTSF	300496 CH	Daley Li, CFA
	Weibo Corporation	WB	WB US	Miranda Zhuang, CFA
	Weibo Corporation	WEIBF	9898 HK	Miranda Zhuang, CFA
	Zip Co Limited	ZIZTF	ZIP AU	Ware Kuo
RVW				
	Dada Nexus	DADA	DADA US	Lei Zhang

iQmethodSM Measures Definitions**Business Performance**

Return On Capital Employed

Return On Equity

Operating Margin

Earnings Growth

Free Cash Flow

Numerator

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income

Operating Profit

Expected 5 Year CAGR From Latest Actual

Cash Flow From Operations – Total Capex

Denominator

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill

Amortization

Shareholders' Equity

Sales

N/A

N/A

Quality of Earnings

Cash Realization Ratio

Asset Replacement Ratio

Tax Rate

Net Debt-To-Equity Ratio

Interest Cover

Numerator

Cash Flow From Operations

Capex

Tax Charge

Net Debt = Total Debt – Cash & Equivalents

EBIT

Denominator

Net Income

Depreciation

Pre-Tax Income

Total Equity

Interest Expense

Valuation Toolkit

Price / Earnings Ratio

Price / Book Value

Dividend Yield

Free Cash Flow Yield

Enterprise Value / Sales

Numerator

Current Share Price

Current Share Price

Annualised Declared Cash Dividend

Cash Flow From Operations – Total Capex

EV = Current Share Price × Current Shares + Minority Equity + Net Debt +

Other LT Liabilities

Enterprise Value

Denominator

Diluted Earnings Per Share (Basis As Specified)

Shareholders' Equity / Current Basic Shares

Current Share Price

Market Cap = Current Share Price × Current Basic Shares

Sales

EV / EBITDA

Basic EBIT + Depreciation + Amortization

iQmethodSM is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of *iQmethod* are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

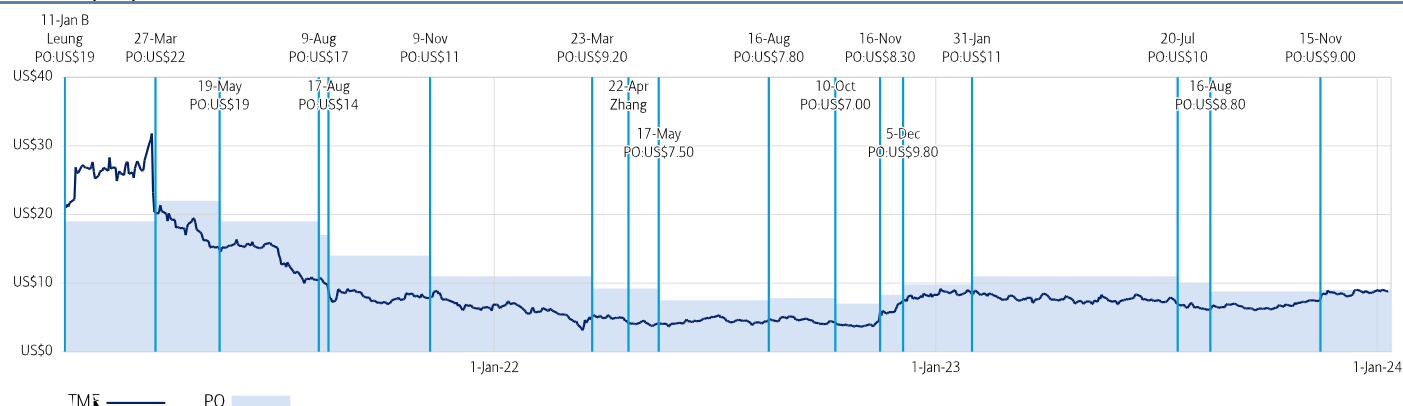
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Disclosures

Important Disclosures

Tencent Music (TME) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

Tencent Music (XWFWF) Price Chart



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Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships ^{R1}	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

^{R1} Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.



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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster ^{R2}
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

^{R2} Ratings dispersions may vary from time to time where BofA Global Research believes it better reflects the investment prospects of stocks in a Coverage Cluster.

INCOME RATINGS, indicators of potential cash dividends, are: 7 - same/higher (dividend considered to be secure), 8 - same/lower (dividend not considered to be secure) and 9 - pays no cash dividend. **Coverage Cluster** is comprised of stocks covered by a single analyst or two or more analysts sharing a common industry, sector, region or other classification(s). A stock's coverage cluster is included in the most recent BofA Global Research report referencing the stock.

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The issuer is or was, within the last 12 months, a non-securities business client of BofAS and/or one or more of its affiliates: Tencent Music.

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