

**[TME] - Tencent Music Entertainment Group
Second Quarter 2020 Earnings Conference Call
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Officers

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Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group's 2020 Second Quarter Earnings Conference Call.

Today, you will hear discussions from the management team of Tencent Music Entertainment Group, followed by a question-and-answer session. Please be advised that this conference is being recorded today.

Now I will hand the conference over to your speaker host today, Ms. Millicent T. Please go ahead, ma'am.

Millicent T.: Thank you, operator. Hello, everyone, and thank you all for joining us on today's call. Tencent Music announced its quarterly financial results today after the market close. An earnings release is now available on our IR website at ir.tencentmusic.com, as well as via newswire services.

Today, you'll hear from Mr. Cussion Pang, our CEO, who will start the call with an

overview of our recent achievements and our growth strategies. He will be followed by Mr. Tony Yip, our CSO, who will offer more details on our operations and business developments. Lastly, Ms. Shirley Hu, our CFO, will address our financial results before we open the call for questions.

Before we proceed, please note that this call may contain forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties and other factors not under the Company's control, which may cause actual results, performance or achievements of the Company to be materially different from the results, performance or expectations implied by these forward-looking statements.

All forward-looking statements are expressly qualified in their entirety in the cautionary statements, risk factors and details of the Company's filings with the SEC. The Company does not assume any obligation to revise or update any forward-looking statements as a result of new information, future events, changes in market conditions or otherwise, except as required by law.

Please also note that the Company will discuss non-IFRS measures today, which are more thoroughly explained and reconciled to the most comparable measures reported under the International Financial Reporting Standards in the Company's earnings release and filings with the SEC. You are reminded that such non-IFRS measures should not be viewed in isolation, or as an alternative to the equivalent IFRS measure, and other non-IFRS measures are not uniformly defined by all companies, including those in the same industry.

With that, I'm now very pleased to turn over the call to Cussion, CEO of Tencent Music. Cussion?

Cussion Pang: Thank you, Millicent. Hello, everyone, and thank you for joining our call today. As the industry leader of China's online music market, we continue to shape the development and flourishing of the music industry by continuous promotion of the pay-for-streaming model, deeper cultivation of indie musicians, further expansion of our capabilities to promote digital albums and our innovative online concert, TME Live.

For the second quarter, we are pleased to report a stronger than first quarter performance. Our online music revenues increased 42% year-over-year, accelerating from a 27% growth rate in the first quarter.

Most notably, online music subscription revenues continued their rapid growth, increasing nearly 65% year-over-year in the second quarter, driven by improving user retention, effective paywall strategy execution, and expanding personalized recommendation capabilities.

Online music paying ratio rose significantly to 7.2%, up from 4.8% in the same quarter of last year, allowing us to maintain our leading position in monetization amongst domestic online music platforms. As the early advocate, and now, the absolute leader in China's

digital music industry, our digital album sales also achieved a strong performance in the second quarter.

Our successes not only included outstanding achievements for global superstars, but also extended to new-generation artists such as Sean Xiao, whose new single, Spotlight, set a new record of digital music sales on a single platform.

Moving onto content, we continued to strengthen our content leadership by forming new strategic partnerships with a broad range of music labels, including those in the top, mid-level and long-tail categories, as well as adding various forms of content including trendy and original music from indie musicians, in order to provide the most comprehensive content offering to our users. This ultimately further solidified our content leadership and improved our core competitive strengths.

We recently completed a contract renewal with Universal Music Group, successfully signing a multi-year contract with them. In addition, we will form a jointly-owned music label with UMG to deepen our cooperation. The new partnership, apart from creating mutually beneficial long-term potentials for both parties, will also enable us to improve efficiency and profitability through our economy of scale, while unlocking massive monetization opportunities for many years to come.

Based on our extensive user insights and in-depth knowledge on content, we are proactively adding new verticals in emerging, long tail and popular genres to provide an even better content offering to our users. Particularly, in response to younger users' demands, we continued investing in more popular content such as more ACG genre.

In the second quarter, we also added music copyright for trend-setting variety shows, such as The Chuang 2020, Youth with You 2, and Sisters who Make Waves.

In the first half of 2020, we covered over 80% of music content for variety shows aired in China. Our focus on new hit songs also began to yield positive results.

Also in the first half of 2020, 9 out of the Top 10 most popular songs, according to Baidu Index, could be found in our music library, of which 7 were exclusive to us. All of these efforts have led to further penetration into the younger demographic.

In July, we celebrated the 3-year anniversary of our Tencent Musician Platform. We are proud to say we have made strong achievements on several fronts. First, we have committed significant resources in nurturing indie musicians, which has led to impressive growth in income for indie musicians.

Second, we have experienced exponential growth in scale over the past few years. By the end of the second quarter, both the number of indie musicians and original songs uploaded to our platform achieved triple-digit year-over-year growth rates, while exclusive indie musicians increased by nearly 10 times year-over-year.

Third, we have emerged as a leading and preferred platform for indie musicians, attracting the largest number of new indie musicians over the past several consecutive months.

Finally, by leveraging our strong promotional capabilities and well-rounded content knowledge, as well as in-depth user insights, we have helped indie musicians' original content to reach a broader audience. For example, Meet Him Later, a song by Hu Liuli released in March this year, achieved over 1 billion playbacks and inspired over 5 billion short-form videos on the internet by the end of the second quarter.

As the absolute industry leader in China with the largest music user base, we are actively accumulating a wider and deeper understanding of our users in terms of their evolving demands. We are then integrating this information into our product design and upgrades to provide holistic user experience that is increasingly interactive, social-driven and visually stimulating.

One great example is within QQ Music. The recent introduction of Putong Community, which means Heartbeats in Chinese, it is a dynamic community and platform connecting idols and fans, as well as users sharing similar preferences. The platform attracted many artists to join and generated unique and interesting interactions between celebrities and their fans. Through this new feature, total song reviews grew by over a million during the quarter. And we are pleased to see its DAU penetration rate increasing steadily since launch.

Another example is that we are making music streaming more visualized through video enrichment in our apps, which brings brand-new multimedia music experience to our users. In the release of QQ Music 10.0 and the upgrade of Kugou Music, we seamlessly added high-quality music-centric videos for users to enjoy while listening to music. We also incorporated video tab recommendation feeds to distribute more personalized video content as well as encourage user-generated video content, which grew triple-digits from the first quarter on Kugou Music.

Lastly, with our strong financial position, we continue to invest in China's fast-growing but under-penetrated long-form audio market. In the second quarter, we rapidly ramped up our long-form audio services.

On the content side, we quickly added more iconic audio content, further enriching our long-form audio offering, which was illustrated by a 300% year-over-year increase in the number of licensed titles. Particularly, the catalogues for literature, audio drama, and talk show, showed even more rapid growth.

We are also pleased to see an increasing number of users streaming more long-form audio content with its MAU penetration increased to 9.4%, significantly up from 4.6% for the same quarter of last year.

In terms of commercialization, we introduced a high-value standalone long-form audio subscription plan. This is in addition to our cross-sales package with our music subscription plan, which offers pricing advantages.

We expect long-form audio to become a new growth engine for revenue diversification, given the strong synergies that can be achieved with our online music services.

This concludes my prepared remarks. Now, Tony will discuss other important area of focus for our businesses. Tony, please go ahead.

Tony Yip: Thank you, Cussion. Hello, everyone. Apart from the key developments discussed by Cussion just now, I would like to add that our overall promotional capabilities have been expanded, and our enhanced personalized recommendation analytics continue to contribute to improved user experience.

In the second quarter, the DAU penetration ratio of personalized recommendation further increased sequentially. And personalized recommendation accounted for an increasing proportion of streaming volume on our platform.

Furthermore, as a pioneering product in creating a whole new experience to live concerts by bringing them online, our TME Live has gained tremendous recognition, making significant social impact and propelling the industry to flourish.

In the second quarter, we successfully organized 9 influential ultra-live performances for well-known global artists, such as Mayday and Hanazawa Kana, which have earned TME Live a strong brand name.

In July, we went one step further by introducing extended reality technology to online live performances, the first in the industry to do so, which truly demonstrated our commitment to embracing technology and innovation.

As we continue to build our TME Live pipeline, we are exploring different service models for users to enjoy our high-quality live shows, including VIP package, virtual gifting and others, taking another step to unlock the massive value and market potential for online live performances.

Turning to our social entertainment services, overall, we remained very focused in building and sharpening our long-term competitiveness amidst increasing competition on user time spent. During the second quarter, as the COVID-19 situation continued to improve in China, we are pleased to see some recovery, demonstrated by double-digit sequential ARPPU expansion in the second quarter.

To continue to effectively differentiate our live streaming services from other platforms, one of our key focuses has always been on attracting and retaining quality music-centric live streaming performers, and then working with them closely to build, expand and commercialize the unique idol-fan based economy.

In fact, through concerted efforts, we successfully grew the number of performers on Kugou Live by nearly 50% in the second quarter comparing with a year ago. Particularly, the number of exclusive performers quadrupled year-over-year. In addition, the retention rate of live streaming performers improved sequentially as well.

In summary, the growing number and quality of talents have enriched the content offering on our platform, resulting in improving retention rate and consumption patterns among our core user cohort.

Our expansion into new content categories in live streaming, such as gaming and ACG, has further diversified the content on our live streaming platform, as well as enhanced our user acquisition capabilities. Further to the strategic cooperation announced in the first quarter between Kugou Live and Tencent Games, we attracted thousands of gaming live streaming performers in the second quarter. And our ACG category had a double-digit sequential increase in the number of active performers and total user time spent.

In June, as scheduled, we launched Fan Live, our new live streaming brand for QQ music. Although small and at an early stage, we recorded good progress in terms of talent recruitment and interaction between users and performers. Leveraging our massive user base from QQ Music, Fan Live offers a differentiated music live streaming experience to music fans on QQ Music. And we plan to introduce more interactive features and tools to achieve further growth in the future.

When it comes to online Karaoke services, we are the biggest online singing platform in China, and are committed to providing seamless, interactive, visual and sociable singing experiences for our users. Recently, we launched WeSing 7.0 and our key areas of focus have been to introduce more tools that can stimulate video content generation and consumption, which then lead to more sharing and boost the platform's social attributes.

We are pleased to say that through upgraded singing experience, in the second quarter, the number of users publishing videos increased almost 70% compared to the first quarter. Through KOL incentive system, and cooperating with external platforms, we recorded an almost 300% sequential increase of KOLs, which is critical to boost content creation and build a closer user community on our platform.

Social attributes continued to be strengthened as we launched interactive features to boost the popularity of online singing rooms, which enjoy unique social connections among friends. We will remain focused on sharpening such key areas over the next few quarters, and by doing so, it will enable us to continue to build a self-reinforcing virtuous ecosystem which starts the journey with online singing, then goes on to content generation, sharing and socializing.

As we build on our long-term competitiveness, it will open up tremendous opportunities for monetization including advertising in different forms and settings.

Lastly, let me quickly discuss Kugou Changchang, an online karaoke product we designed to better serve Kugou Music's users through integrated online music streaming and online singing. We introduced interactive features to encourage sing-offs, successfully attracting users from upper-tier cities, as well as a younger demographic who are no strangers to the sharing of their online singing experience.

For the second quarter, we are pleased to see that Kugou Changchang achieved rapid year-over-year growth in MAU and paying user, providing a strong complement to WeSing in our karaoke services product matrix.

With that, I would like to turn it over to our CFO, Shirley Hu, for a closer review of our financials.

Shirley Hu: Thank you, Tony. Hello, everyone. Next, I'll discuss our results from financial perspective. Overall, I am very pleased with our second quarter financial results. We achieved strong growth in online music services, particularly in music subscriptions revenues, as well as healthy growth in social entertainment businesses.

Our total revenues were RMB6.9 billion, up 17.5% year-over-year. Online music revenues were RMB2.2 billion, up 42% year-over-year, driven by music subscription revenues, digital album sales and advertising revenues, despite a decrease in sublicensing revenues. In particular, our music subscription revenues were RMB1.3 billion, up 65% from same period last year. On a year-over-year basis, paying users and ARPPU grew 52% and 8%, respectively, resulted from user retention improvements and effective paywall strategy execution, as Cussion discussed earlier.

Additionally, we saw strong growth in both advertising revenues and digital album sales. Advertising revenues continue to be an important growth driver for us. We are optimistic about the growth potentials in this area, and are proactively taking procedures to grow advertising business effectively. Growth in digital album sales this quarter was driven by new digital album releases of a few very popular artists.

Social entertainment services and other revenues were RMB4.7 billion, up 9% year-over-year, driven by growth in online karaoke and live streaming services. Paying users grew 12% year-over-year. ARPPU decreased 3% year-over-year, while increased 13% quarter-over-quarter as we continue to recover from COVID-19 situation.

Our gross margin was 31.3% in Q2 2020 and decreased 1.6% from 32.9% in the same period of last year. Gross margin decrease was mainly resulted from investments in newer products such as long-form audio, as well as higher revenue sharing fees in social entertainment to strengthen our platform's competitiveness. Online music services had a positive impact on overall margin in Q2 2020, and this trend is expected to continue as our subscription revenues continued to grow, while licensed content costs are gradually rationalizing as overall music industry evolves.

Now, moving on to operating expenses. Total operating expenses for Q2 2020 were RMB1.3 billion, and was 18.8% as a percentage of total revenues, representing an increase of 1% compared to same period in 2019, with promotion expenses and R&D employee-related costs being the largest drivers. During the quarter, we incurred expenses to promote newer products such as long-form audio, Kugou Changchang, and TME Live that are still ramping up in terms of revenue generation, but we are investing for their long-term growth potential.

We also increased promotional spending for existing products to strengthen our products' competitiveness. Additionally, we continue to invest in R&D for product enhancement and technology innovations, leading to higher employee-related costs in R&D.

Our net profit attributable to equity holders of the Company was RMB0.9 billion. Non-IFRS net profit attributable to equity holders of the Company was RMB1.15 billion and non-IFRS net profit margin was 16.7%.

As of June 30, 2020, our combined balances of cash, cash equivalents and term deposits were RMB22.3 billion, representing an increase of RMB0.4 billion from Q1, which was primarily driven by cash flow generated from operations of RMB1.44 billion and cash paid for investments.

In conclusion, we continue to be optimistic about the future of the broader music industry, and are confident in the overall ecosystem and the product pipelines that we are building in the long run. We'll continue to focus on enhancing and expanding our product and service offerings such as long-form audio, Fan Live and TME Live while maintaining core content investments.

This concludes our prepared remarks. Operator, we are ready to open the call for questions.

Operator: The conference call has now concluded. Thank you for attending today's presentation. You may now disconnect.