

[TME] - Tencent Music Entertainment Group
2018 Fourth Quarter and Full Year Earnings Conference Call
Tuesday, March 19, 2019, 8:00 PM Eastern

Officers

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Cussion Pang; CFO
Tony Yip; CSO
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Analysts

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Presentation

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the Tencent Music Entertainment Group Fourth Quarter and Full Year 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. 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 turn the conference over to your speaker host today, Ms. Millicent Tu. Please go ahead, ma'am.

Millicent Tu: Thank you, operator. Hello, everyone, and thank you all for joining us on today's call. Tencent Music has announced its quarterly financial results today after the market close. An earnings release is now available on our IR website at ir.tencentmusic.com.

Today, you will hear from Mr. Cussion Pang, our CEO, who will start off the call with an overview of our growth strategies and initiatives. He will be followed by Mr. Tony Yip, our CSO, who will offer more details on our recent business developments. Then Ms. Shirley Hu, our CFO, will address our financial results in more detail before we take your questions.

Before we proceed, please note that this call may contain forward-looking statements made pursuant to the safe harbor provisions for 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 by 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 the result of new information, future events, changes in market conditions, or otherwise, except as required by law.

Please also note that today 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 Standard in the company's earnings release and filings with the SEC. You're reminded that such non-IFRS measures should not be viewed in isolation or as an alternative to the equivalent IFRS measure and that non-IFRS measures are not uniformly defined by all companies, including those in the same industry.

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

Cussion Pang: Thank you, Millicent. Hello, everyone. Thank you all for joining our very first earnings conference call as a public company.

2018 was an eventful and extraordinary year for Tencent Music. In 2003, we embarked on a journey to digitalize and transform the music industry in China. After 15 years of hard work, on December the 12th, 2018, we successfully completed our initial public offering on the New York Stock Exchange. The IPO has launched us onto the international stage, elevated global recognition towards our brand, and endorsed our successful track record. It has also intensified our efforts in executing our mission of using technology to elevate the role of music in people's lives.

Our 2018 results were marked with high growth and strong profitability. For the full year 2018, total revenues increased by 72.9% year-over-year. Net profit attributable to equity shareholders increased by 38%, while non-IFRS net profit attributable to equity shareholders increased by 119% year-over-year. Online music services paying users

increased by 39% to 27 million, and social entertainment services paying users increased by 23% to 10.2 million during the fourth quarter of 2018.

As the leader of the Chinese music industry, we are revolutionizing the ways that our users discover, listen, sing, watch, perform and socialize around music. We continue to make relentlessly efforts to innovate our products, launch new features to engage users, and increase the breadth and depth of our content offering to satisfy the ever-evolving demands of the music fans in China.

We are introduce innovative use cases and product features to make the interaction between artists and performers and their followers and friends to engaging to promote social connectivity, resulting in a boost to our user stickiness. Leveraging our platform's unrivaled popularity, we continued to attract an increasing number of content partners and talents, encourage them to produce more high-quality content, and help them cultivate and expand their fan's base. Our innovative multi-format content offering that extends into music variety shows, short videos, artist interviews, and mini concerts and our unparalleled access to an immense audience have rendered us the partner of choice for content partners and artists to promote their creative work within our ecosystem.

Our tremendous volume of data, proprietary analytical algorithm, and deep understanding of content trends have all helped us enhance our personalized targeting, attract and retain more users, generate more interactive reviews, and improve our user experience.

In summary, we achieved robust financial and operational performances in both our online music and social entertainment businesses in 2018. To fuel our growth for the years to come, we are fully committed to investing in content, products, and technology. Going into 2019, we will continue executing relentlessly our mission to use technology to elevate the role of music in people's lives. We are confident that as we continuously develop and promote high-quality content across our platform, we will be able to not only augment on our market leadership, but also foster the growth and development of the overall music industry.

Now I will turn the call over to Tony to discuss our business developments in more details.

Tony Yip: Thank you, Cussion. Hello, everyone. During the fourth quarter of 2018, our operations continued to show substantial growth across both online music and social entertainment services.

In online music services, our paying users increased by 39% to 27 million. We added 2.1 million paying users sequentially, which is substantially higher than 1.1 million for the same period last year. Mobile MAU increased by 7% to 644 million from 603 million a year ago. Paying ratio also improved to 4.2% from 3.2% a year ago.

Our continued operational improvements are driven primarily by enriching our content offering, deepening our user engagement, and increasing promotion capability.

First, to further enrich our content offering, we continue to add strategic partnerships with well-known domestic and international labels, thereby solidifying our industry-leading music library. We also strengthened our multi-format offering such as long-form audio shows and short videos, and thereby broadened our product features and deepened user engagement. In addition, we further improved personalization features to tailor recommendations of songs, playlists, and feeds to better fulfill user preferences, as well as added proprietary audio settings to enhance users' listening experience. As a result, our user engagement increased meaningfully throughout the year.

Secondly, we've established and expanded strategic cooperation to increase our repertoire of high-quality original content. We co-produced Produce 101, a music-related variety show, with Tencent. The show attained significant popularity and enabled us to lock in a strategic partnership with the top-ranked performing band called the Rocket Girls. And we contributed to their rapid rise in popularity. As of December 2018, over two million copies of Rocket Girl's first album were sold on our platform, thus making it China's best-selling digital album in 2018 by volume.

We also launched a series of live streamed video talk shows, which promote singers through videos and serve as an ideal launch pad for artists to release their new songs.

In addition, we leveraged our ecosystem's strong distribution and promotion capabilities to cultivate aspiring music talents. For example, our Tencent Musician Program offers a full suite of services to nurture and promote up and coming independent artists. This open platform not only significantly simplified the process for artists to upload and manage the soundtrack across our entire platform, but we also share with them our data analytics and equipped them with actionable intelligence on music trends. In addition, we provide independent artists with offline stages, including music festivals and live house shows, to showcase their performance and attract followers.

Our comprehensive online and offline resources combined with our strong capabilities in distribution and promotion have garnered significant recognition across the industry. As a result, songs from Tencent Musician Program generated more than 70 billion total streams on our platform in 2018.

Turning to our social entertainment services. During the fourth quarter of 2018, paying users increased by 23% to 10.2 million. We added approximately 300,000 paying users sequentially, which is a healthy number in line with the same period last year, when social entertainment services were experiencing a very rapid ramp up.

Mobile MAU increased by 9% to 228 million from 209 million a year ago. Paying ratio also improved to 4.5% from 4.0 % a year ago.

Such growth in social entertainment resulted from our achievements in engaging and empowering users through our broader set of use cases, attracting an increasing number

of live streaming talents, and diversifying our content with high-quality original music performed by our certified singers.

For WeSing, we focused on expanding the breadth and depth of its business operations in both online and offline. We launched new multilateral interactive features, such as multi-mic singing room. We also added proprietary technology features for smart sound adjustment to correct off-key high-pitch sounds during performances, including both one-button correction to maximize convenience or targeted individual fragment correction to optimize performance. We rolled out offline mini karaoke booths as well as WeSing television editions to allow users to easily share what would otherwise be offline karaoke experience with their friends online.

We also added more short-form video features to enable users to easily produce short videos using the music they love. WeSing's innovative model has successfully improved interactions across our music users and social entertainment users, strengthened their social connections, increased their engagement, and further differentiated us from our competition.

For live streaming, we continued to focus on improving the quality of music content offered to our users. We screened and selected thousands of talented live streaming performers as certified singers, where we not only distributed their music on our platform, but also arranged approximately 600 mini concerts in 2018, and attracted millions of viewers to help increase the popularity of these certified singers among a broader audience.

We will continue to empower our live streaming performers to help them launch their music career. And in turn, they continue to provide quality content that is highly complementary to our industry-leading content library.

In summary, we continued our strong growth trajectory across all of our business lines and made further progress in content enrichment and user engagement. Looking forward, we believe our premium content offering, innovative product features, and advanced data technology will enable us to increase user traction, enhance user experience, and improve our monetization opportunities.

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

Shirley Hu: Thank you, Tony. Hello, everyone. Let me go through our financial highlights. We delivered a strong fourth quarter and full year results for 2018.

For the fourth quarter of 2018, revenues increased by 51% year-over-year to RMB 5.4 billion. The increase was driven by the robust growth from both our online music and social entertainment services.

Revenues from online music services increased by 45% year-over-year to RMB 1.5 billion. The growth mainly comes from subscriptions, sublicensing, and the sales of digital music albums. Subscription revenue was RMB 695 million, up 38% year over year. In the fourth quarter, we continued to offer promotional subscription packages with automatic renewal and more users enrolled in this program.

Revenues from social entertainment services increased by 53% year-over-year to RMB 3.9 billion. We introduced the new functions and ways for users to interact with their friends and their idols on our platforms in 2018. Our users' willingness to pay continued to improve. Therefore, both our paying user base and the user spending expanded in the quarter.

Cost of revenues increased by 63% year-over-year to RMB 3.6 billion in the fourth quarter. The increase was mainly due to the increase in content fees and revenue sharing fees. We continued to invest in our content offering. We produced more in-house content and partnered with more music labels to meet user demands for diverse forms of music entertainment.

Turning to the operating expenses. Total operating expenses increased by 58% year-over-year to RMB 1.4 billion. The increase was mostly due to higher employee benefit expenses and the professional fees incurred from our IPO last December. Employee benefit expenses were higher in the quarter due to increased headcount and the employee incentives. We also increased spending on promoting the company's brands and the content in quarter.

We recorded an operating loss of RMB 970 million in the fourth quarter, mostly due to one-off RMB 1.5 billion share-based accounting charge from the share issuance to Sony Music and Warner Music in October 2018. Excluding this one-off charge, operating profit would be RMB 549 million. Non-IFRS net profit attributable to equity holders of the company increased by 37% year-over-year to RMB 916 million.

As of December 31st, 2018, cash and cash equivalents were RMB 17.4 billion compared to RMB 5.2 billion as of December 31st of 2017. The increase was mainly due to strong operating cash flow and the proceeds from share issuance, including our IPO in 2018. We generated operating cash flow of RMB 1.9 billion in the fourth quarter and RMB 5.6 billion in the full year of 2018.

Going into 2019, with our strong profit and balance sheet, we will increase investments in our products, technology, and the content offering. We plan to accelerate our investment in content to meet users' demands for more diverse forms of music-related entertainment. Although such investments may put downward pressure on our margins in the short term, they are vital to the continuous expansion of our user base and improvement of user engagement.

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