

**[TME] - Tencent Music Entertainment Group
Second Quarter 2019 Financial Results Conference Call
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Officers

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Presentation

[Technical Difficulty]

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group's Second Quarter 2019 Earnings Conference Call. At this time, all participants are in listen-only mode. (Operator Instructions).

Today you will hear discussions from the management team of Tencent Music Entertainment Group, followed by a question-and-answer session. (Operator Instructions). Please be advised that this conference is being recorded today. If you have any objections, you may disconnect at this time.

Now, I will turn the conference over to your speaker host today, Ms. Millicent Tu. Please go ahead.

Millicent Tu: Thank you, operator. Hello, everyone, and thank you all for joining us on today's call. Tencent Music Entertainment Group announced its financial results for the second quarter of 2019 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 will hear from Mr. Cussion Pang, our CEO, who will start off the call with an overview of our recent achievements and growth strategy. He will be followed by Mr. Tony Yip, our Chief Strategy Officer, who will offer more details on our business development. 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 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 a result of new information, future events, changes in market conditions or otherwise, except as required by law.

Please 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 Mr. Cussion Pang, CEO of Tencent Music. Cussion?

Cussion Pang: Thank you, Millicent. Hello, everyone, and thank you for joining our call today. In the second quarter of 2019, TME recorded solid financial results with revenue growth of 31% year-over-year, and healthy operational performances in both online music and social entertainment services.

In our online music services, first of all, one of the most recognizable achievements in the second quarter was the re-acceleration of growth in both paying users and subscription revenues.

As the largest online music services platform in China, we added 2.6 million paying users on a sequential basis, the highest number over the past five quarters. Paying users increased by 33% year-over-year, up from 27% year-over-year from last quarter. And subscription revenues increased 32% year-over-year, up from 26% year-over-year for the first quarter of 2019.

This was driven primarily by an improved monthly retention rate and progress in pay-for-streaming. Paying users driven by the pay-for streaming model tend to be of high quality, and we have seen that it started to attract more first-time paying users, another angle illustrating that our users have positive reception to the new model.

As we continue to enrich our content offering behind the paywall, in the future, we will roll out membership privileges and differentiated services to paying users, improving user experience and bringing our services to a new level.

Our status as the largest online music services platform in China comes with a duty to uphold copyright protection, and unlock the intrinsic value that our content has to hundreds of millions of music lovers in China. This will take time, but we are committed to this journey of educating users. With the right approach and effective strategies in place, we firmly believe that our pursuit of this endeavor will open tremendous opportunities for us to grow paying users.

Second, we continued to diversify our content offering. We expanded our content leadership through cooperation with a greater number of music labels, and the addition of more music-centric variety shows, short-form videos and long-form audio, including audio books and podcasts.

In terms of content diversification, we have also expanded content partnerships within the Tencent ecosystem, including Tencent Games, Tencent Pictures and Tencent Video. Our goal is to create and distribute a greater selection of high-quality music for games, films, and television shows in China.

We're working closely with Tencent Games to build a holistic ecosystem for the joint development of game music, including upholding copyright standards, increasing the efficiencies of distribution and promoting the healthy development of the game music industry.

In the second quarter, we successfully developed a song called Wake Me Up for a virtual male band of the hit mobile game Honor of Kings, which resonated strongly with users. Within a week of its release, it secured a top five spot on both our most popular and new songs charts. In the future, we will continue to work together to create more original songs for this hit mobile game.

Also, since late last year, we formed various partnerships, including with Tencent Pictures, and have launched almost 100 songs for over 20 films and television programs. During the second quarter of this year, we further deepened our partnership with Tencent Pictures, and we will look to develop more high-quality original soundtracks with them in the future.

After two years of hard work, I am pleased to say that our Tencent Musician Program has become the biggest online music platform for original music in China, and has accumulated approximately 400,000 original songs. Through coordinated promotional efforts across our three music platforms, the total number of streams of these songs has reached over 100 billion. On a year-over-year basis, we have seen the number of original songs streamed per day increase by almost 200%. These are great examples of how we are incubating talented musicians and bringing their high-quality original works to hundreds of millions of music lovers in China.

Third, on product enhancement and innovation, the newly released QQ Music app

version 9.0 has been well received on social media. Beyond providing a refreshed visual and interactive experience, one important change is that it now features a brand-new personalized recommendation tab, which helps users discover more music. These changes, together with our optimized algorithm, have resulted in almost 40% sequential improvement in terms of the total number of streams driven by our recommendation engine.

In addition, we pioneered product innovation by adding short videos on the Kugou music streaming page, enabling users to watch high-quality PGC and UGC videos while listening to music on the platform. This innovative new function has started to gain traction with users, with average daily stream volume growing rapidly since its launch in May earlier this year.

Moreover, for WeSing, we effectively improved user engagement and broadened our user base through the introduction of new product features and scale-up of its mini-program with simplified functionality that lowers the threshold of use.

In summary, we are pleased to report another solid quarter of financial and operational performance. Our efforts in the second quarter in content diversification, promotional capabilities, product enhancement and technology drove a healthy level of growth across all metrics of both our online music and social entertainment businesses.

We are confident that we have developed the right strategy to drive results and to fulfill our mission of using technology to elevate the role of music in people's lives.

With that, I will turn the call over to Tony to discuss the development of our business in more details.

Tony Yip: Thank you, Cussion. Apart from the encouraging results that we have seen on our online music services, another key highlight of the second quarter was that social entertainment mobile MAU rose almost 5% year-over-year to 239 million, while monthly ARPPU expanded by nearly 17% compared to the same period last year. These increases came after a series of initiatives that we said we would execute on to reinvest in user growth, and we're pleased to see that those efforts have proved effective and helped improved social entertainment MAU growth.

For WeSing, we made efforts to lower the threshold of use and attract prospective entry level users. This included scaling up the WeSing mini-program in WeChat, which has grown rapidly during the quarter. We also introduced a WeSing lite version app, which has streamlined functionality that is designed to attract users in China's lower-tier cities, who may have phones with lower processing capacity or slower internet connections, as well as first-time users who may appreciate a simpler interface.

As Cussion mentioned, we introduced new product features that have proven to deliver solid results. This quarter, we continued to build on the popularity of WeSing's new product feature called *Grab the Mic* 【抢麦】, whereby top scoring users in the Grab the Mic singing game have the opportunity to play with selected celebrities that we invited to

play. The new feature allows the cultivation of fun and engaging interactions between fans and idols, while also promoting social interactions among users.

The new feature has been met with huge success, particularly with the younger demographics. For example, the participation of a Chinese female pop singer attracted millions of users, with nearly 100,000 fans competing to play the Grab the Mic singing game with her.

We also officially introduced the *Quick Sing feature* 【快唱】 , which we mentioned in the last quarter. The new feature selects only the familiar chorus parts of the songs for karaoke singers. This has helped drive the average number of songs sung and published per person by 80% for users who used the Quick Sing feature, compared to users who did not.

On international expansion, we are proactively exploring new opportunities to bring our products and services to a larger audience outside China. Recently, we launched WeSing in South East Asia, and we're seeing encouraging preliminary success in the Philippines in particular, whereby the app has consistently been the most downloaded music-related app on Google Play for the last three months.

Now, turning to our music-centric live streaming business, leveraging the early success that we had in the previous quarter, we scaled up our multi-performer live streaming feature by adding more content and attracting more high-quality live streaming performers. As a result, the feature not only drew in millions of new viewers, but also increased the user time spent by over 50% compared to users who did not use this feature.

In addition, building on the success of last quarter, we added more singing competition features to encourage sing-offs among performers which, in turn, helped improve MAU, paying ratio, as well as ARPPU expansion. These initiatives, coupled with the deployment of data analytics through our personalized recommendation engine, helped increase average user time spent on our live streaming platform by double-digit percentages on a year-over-year basis.

We also continued to leverage our live streaming platform to discover and nurture new artists. In the second quarter, we held over 100 *New Song Release Events* 【首唱会】 , to help emerging artists promote their new songs. Millions of users watched the live broadcasts, with the number of video streams increasing by 77% sequentially.

Now, turning to other strategic initiatives, we are proactively exploring potential new channels for growing our music users through Internet of Things. By partnering with leading manufacturers of internet-connected smart devices, including cars, speakers and watches, our goal is to offer users a consistent, cohesive listening experience in their cars, homes, or wearable devices, essentially allowing them to enjoy our music services wherever they are.

We now provide music services to eight of China's ten most popular car brands, two of

the top three smart speaker brands in China, as well as China's largest smart watch brand for the children market. This quarter, we were particularly excited as Tesla became the latest auto brand to use our music services in their vehicles, allowing Tesla users to enjoy a personalized listening experience on the road. We see the development of these external partnerships in IoT as an exciting new area which, in the future, will enable us to grow our music users beyond mobile handset.

In summary, from an operational point of view, we executed well for both online music services and social entertainment services. And we are optimistic that our current momentum will continue, allowing us to further grow our user base and paying users. From a strategic point of view, we continue to invest in long-term value creation opportunities such as overseas expansion and IoT.

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. In the second quarter of 2019, our revenues increased by 31% year-over-year to RMB5.9 billion. This increase was driven by the steady growth in both our online music and social entertainment businesses.

Revenues from online music services increased by 20% year-over-year to RMB1.6 billion. The increase was mainly driven by the strong growth in revenues from user subscriptions and the sales of digital music albums, which was partially offset by the decrease in sublicensing revenues from other music service companies. Revenues from music subscriptions were RMB798 million (US\$116 million), up from RMB605 million in the second quarter of 2018.

During Q2, the number of our online music subscribers increased by 2.6 million from Q1, the highest over the past five quarters. The growth was mainly driven by the improved subscriber retention rate and encouraging user acceptance of our trial of the pay-for-streaming model.

In addition to the growth in subscriber numbers, our subscriber ARPPU rose to RMB8.6 in Q2 from RMB8.3 in Q1. This increase was the result of a higher percentage of premium membership subscribers.

Revenues from social entertainment services increased by 35% year-over-year to RMB4.3 billion, primarily driven by revenue growth in our online karaoke and live streaming services. Our ARPPU in social entertainment services increased by 16.8% to RMB130 year-over-year while paying user base increased by 16.5%.

Cost of revenues increased by 46% year-over-year to RMB4 billion. The increase was attributable to higher content expenses and revenue sharing fees. The increase in content expenses was mainly attributable to the increased market price and the amount of licensed and produced music content. The increase in revenue sharing fees reflected the growth in our social entertainment services. In addition, the Company offered users with more professional content and provided users with small incentives to interact on its services.

Our gross margin was 32.9% in Q2 2019. As we firmly execute our strategy of investing in our content offerings and grow the ecosystem with our content providers, we have always emphasized the importance of quality growth and ensured reasonable return on our investments. Although our overall gross margin decreased year-over-year as we increased our content investments and other music service companies reduced sublicensing from us, we were able to improve operating efficiency during the quarter.

Now, let's turn to our operating expenses. While our total operating expenses increased by 26% year-over-year to RMB1.1 billion, we have seen improvement in operating leverage on a year-over-year basis. Operating expenses, as a percentage of total revenues, decreased to 17.9% in Q2 2019 from 18.5% in Q2 2018.

Selling and marketing expenses for Q2 2019 were RMB416 million, representing an increase of 11% year-over-year. The increase was primarily due to increased spending on growing our user base and promoting our brands and contents.

General and administrative expenses increased by 38% year-over-year to RMB634 million in Q2 2019. We have been increasing our investments in research and development to expand our edge in products and technology, for example, our recommendation capabilities.

Our effective tax rate was 12.4% in Q2 2019, compared to 9.5% in Q2 2018. The increase was mainly due to the change in the preferential tax rates of certain subsidiaries.

As a result of the foregoing, our net profit attributable to equity holders of the Company was RMB927 million, and our non-IFRS net profit attributable to equity holders of the Company was RMB1.1 billion. Our non-IFRS net profit margin was 19.1% in Q2 2019.

As of June 30, 2019, our combined balance of cash and cash equivalents and term deposits amounted to RMB19.9 billion, an increase of RMB1.8 billion from RMB18.1 billion as of March 31, 2019. The increase in the balances was primarily due to cash flow generated from operations of RMB1.9 billion.

Overall, we achieved steady growth in our top line and our profitability remained at a healthy level. The strong growth of our online music subscriber base and social entertainment user base proved the effectiveness of our strategy in investing in our products and content offering.

In the second half of 2019, we will build on this momentum of quality growth with effective execution and strive to achieve our annual goal.