

**[TME] - Tencent Music Entertainment Group
Third Quarter 2019 Financial Results Conference Call
Monday, November 11, 2019, 8:00 PM ET**

Officers

Heather Diwu, IR
Cussion Pang, CEO
Tony Yip, CSO
Shirley Hu, CFO

Analysts

Eddie Leung, Bank of America Merrill Lynch
John Egbert, Stifel, Nicolaus
Daniel Chen, JPMorgan Chase
Rob Sanderson, Loop Capital Markets
Wendy Chen, Goldman Sachs
Zhijing Liu, UBS
Thomas Chong, Jefferies
Ellie Jiang, Macquarie
Alex Liu, China Renaissance
Tian Hou, T.H. Capital
Binnie Wong, HSBC

Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group 2019 Third 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 turn the conference over to your speaker host today, Ms. Heather Diwu. Please go ahead, ma'am.

Heather Diwu: 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. Kar Shun 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 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 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, or other 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. Kar Shun Pang, CEO of Tencent Music. Cussion, please.

Cussion Pang: Thank you, Heather. Hello, everyone, and thank you for joining our call today.

At TME, CTS is the backbone of our business strategy. As I recently shared at the Music Matters annual conference held in Singapore, CTS represents content, technology and services, which illustrates our commitment to enriching our content offering, deploying proprietary technologies to improve user experiences and providing comprehensive services to partners, artists and users.

With CTS as our core driving force, in the third quarter of 2019, TME achieved a solid financial performance with total revenue increasing 31% year-over-year, which was attributable to accelerated growth from online music subscription and solid growth from social entertainment services.

One of the most recognizable achievements in the third quarter was the continued accelerated growth of our online music services, in terms of both paying users and subscription revenues.

Our online music paying users reached 35.4 million, growing 42% year-over-year, as we

added 4.4 million during the third quarter, picking up further from the strong addition of 2.6 million in the second quarter and 1.4 million in the first quarter of 2019.

More importantly, the high quality of this growth was demonstrated by the ARPPU expansion of 3.5% quarter-over-quarter.

Paying ratio reached 5.4%, up from 4.8% in the last quarter and 4.3% in the first quarter of this year. Achieving an increase of over one percentage point within less than a year demonstrates our strong execution and paves the way for long-term sustainable growth. This impressive performance was primarily attributable to continuous improvement in our user retention rate and the significant increase in the number of paying users driven by pay-for-streaming, as the willingness of users to pay for our premium music service improved substantially.

As the leader in China's online music industry, we have been closely researching user demand trends, particularly among the younger demographic who show an increasing willingness to consume premium content. We extended our network penetration of this younger user group by covering hundreds of universities and higher education institutions.

We also launched targeted programs for students, such as the subscription plan promotional events during summer holiday, and a streaming program called Summer Fan Appreciation 【夏日宠粉季】, inviting the idols they favor. Summer Fan Appreciation is a special edition of our self-produced New Song Releasing Events, which live-streamed artists' releasing events. It boosted the number of video playbacks for New Song Releasing Events to 280 million in the third quarter, higher than that of the first two quarters combined.

On the content front, we also stepped up our investment targeting the younger generation by strengthening genres including Urban, EDM, ACG and Chinese ancient style. Chinese ancient style has enjoyed a rising trend of popularity among young people, as it combines China's traditional culture with popular trends and provides the young demographic a strong sense of cultural identity.

As one example of our investments in trendy content, we recently signed a strategic agreement with Miman Culture Media, the largest Chinese ancient style music label in China.

Finally, during the quarter, we continued to add long-form audio, such as audio books and podcasts, including a rich variety of categories including audio novels, talk shows, and a diverse set of topics on children, education, history, and humanity, etc. We are pleased to see the proportion of long-form audio users on our platform recorded healthy growth year-over-year. In fact, in September, average daily time spent on our platform by audio book users was over 50% higher than an average user.

Another achievement that I would like to highlight was that throughout the third quarter, thanks to our vast user base, deep understanding on music trends and user insights, we continued to improve our platform's promotional effectiveness and emerge as a preferred

destination for artists to build a fan-based economy.

With digital albums, we support artists in the promotion of their music, regardless of whether they are aspiring, up-and-coming, established, domestic or international. We have a lot of success in creating an interactive setting for content consumption, particularly with the younger demographic who are the primary contributors in a fan-based economy.

For example, R1SE, an emerging male band with members selected from a variety show produced by Tencent Video's The Chuang 【创造营 2019】 , a male version of the tremendously popular variety show Produce 101, sold almost 1.5 million copies of its first digital album on the first day of its release.

Another example showcasing the power of our fan operation capabilities is Jay Chou's newly released single Won't Cry 【说好不哭】 . Aside from strong sales, more than 12 million karaoke song recordings were produced by our WeSing users within 10 days after its release. The release also generated a massive amount of social buzz, with more than 470 million page views on external social media by the end of October 2019.

International artists also enjoy and benefit from our promotional capabilities, which allow them to connect with music lovers in China. A case in point: The title song of Taylor Swift's new digital album, Lover, sold nearly 6 million copies within 24 hours on our platform after its release.

Another highlight of a fan-based economy on our platform was the successful live-streaming for a highly popular boy band called TFBOYS of their six-year anniversary concert. This concert, called the Fever, was the top live-streamed concert on TME platform in terms of fan participation. Its live feed attracted more than 45 million users, and generated over 300 million real-time user interactions.

These are excellent examples demonstrating our unique strength in building a fan-based economy, inspiring content consumption and providing an additional way for fans to interact with idols and socialize with other fans.

In summary, we were pleased with our solid third quarter results. Our continued innovation and investment to attract a younger demographic, relentless efforts in content expansion and diversification, and our ever-strengthening efficiency in operating a fan-based economy continue to pay off.

Next, Tony will elaborate on how we deploy technology, as well as other areas of focus, which have enabled us to continue enhancing overall user experiences. We are true believers in integrating music into every aspect of people's lives. Tony, please go ahead.

Tony Yip: Thank you, Cussion. Hello, everyone. In addition to the strong results from our online music services, our social entertainment services also maintained steady momentum in the third quarter, with a nearly 33% year-over-year top line growth, as its paying users and ARPPU grew over 23% and 7% year-over-year respectively. Our

healthy third quarter financial results were driven by a combination of concerted efforts focused on product enhancement and improving user experiences through proprietary technology.

First, on product enhancement and innovation, as you may recall during the second quarter, we mentioned we pioneered a product innovation by adding short videos onto the Kugou Music streaming pages, which has enabled users to watch short videos while listening to music. And since then, our short video library has expanded to include a wide range of professionally generated and user-generated videos. Such an innovation has proven to be popular with average daily streams of short videos up almost 40% compared to the previous quarter.

For our social entertainment services, we added new interactive features to build a rich and diverse landscape by bolstering our social and young attributes. We upgraded the universal duet feature 【万能合唱】 , in September, which allows listeners to sing a duet much more easily, and therefore, further lowers the barrier for participation. This has led to an almost 50% increase in the number of duet participants in October compared to September, with nearly half of these new users -- with nearly half them being new users of the duet feature.

In addition, through music-centric social and gamification features, we added new functions within our singing rooms to facilitate social connections among users.

Further, in an effort to cater to the younger demographic's preferences, we introduced WeSing Live House 【全民 K 歌欢唱店】 , allowing users to integrate their offline stage singing experience with online social interaction.

With all these features, we strive to provide a common destination for users of similar interests, age, or locations to gather and interact virtually, or in person, in order to create tighter user communities and improve user time spent on our platform.

Another highlight during this quarter was WeSing's partnership with CCTV and Tencent to launch a singing campaign in conjunction with the celebration of China's 70th National Day. The campaign attracted over 10 million participants, with more than 1 million WeSing users uploading their own karaoke recordings of a national day celebration song through WeSing's Quick Sing 【快唱】 feature. This feature lowers the barrier for campaign participations and improves user engagement. The success of this campaign is a testament to our broad user base, demonstrating our ability to make online karaoke more engaging and entertaining.

And lastly on WeSing, its international expansion we mentioned last quarter continues to show encouraging results, with MAU continuing to grow at a rapid pace of over 30% quarter-over-quarter.

In the third quarter, WeSing consistently ranked number one among music-related apps on Google Play Store in the Philippines, and achieved top two ranking in Indonesia, Thailand, and Malaysia. We will continue to proactively explore new opportunities to

bring our products and services to a larger user base outside China.

Next, I would like to discuss how improved data analytics and the deployment of proprietary technology allow us to offer a superior experience to users. Aided by leading smart-tagging and analytics technology, we have greatly improved our efficiency in content curation and personalized recommendations.

In addition to listening habit-based recommendations, by analyzing audio features with deep learning, and by using data mining to screen songs in our library, we can better curate content for different target user groups. Such efforts have resulted in improved user experiences. In the third quarter, average daily streams from personalized recommendations doubled from the same period last year.

Furthermore, the percentage of song saved, driven by personalized recommendations, also showed meaningful improvement, which is another reflection of the increasing effectiveness of our recommendations.

Similarly, on WeSing, millions of content are generated by our users every day, and our algorithms screens through new and existing content to curate content most suitable for different user groups. The improved content curation and personalized recommendations have led to a 20% increase in both the streaming volume of UGC curated by our algorithms, as well as the number of user-to-follower conversions for these UGC creators.

We also made advancements in deploying data to help live-streaming performers improve their ability to reach a broader audience. For example, we developed a machine-scoring algorithm, which helps high-quality performers differentiate their ranking, and as a result, has helped more users discover these performers and increase user time spent.

In addition, with our pairing algorithm, we are able to find and match more relevant and compatible live-streaming performers, facilitating these performers to perform together, or engage in a sing-off to make the live-streaming session more engaging, which in turn, garners more appreciation and virtual gifts from users.

We are always on the lookout for innovative ways to improve user experience, and meet all kinds of user needs to further strengthen our ecosystem. For example, our song recognition application called Floating Radar 【浮浮雷达】 , enables users, within seconds, to recognize songs embedded in external short videos that they're watching in third-party short video apps, and serves as a gateway to attract incremental users back to the TME platform to listen to the full song when they're consuming short videos elsewhere. Since the official launch of Floating Radar back in June 2018, we are pleased to say that it is gaining momentum as a very useful music tool.

In summary, we delivered strong execution for both our online music and social entertainment services by focusing on product enhancement and improved user experiences through proprietary technology. Persistent focus on this type of overall development and improvement will be key to our sustained ability to grow both our platform's popularity and financial performance.

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

Shirley Hu: Thank you, Tony. Hello, everyone. We delivered a strong financial performance in the third quarter with our top line growth of 31%, along with solid operating margins and cash flow.

Both our online music and social entertainment businesses achieved strong growth in the third quarter, driving our revenues to increase by 31% year-over-year to RMB6.5 billion.

Despite the decrease in sublicensing revenues from other music service companies, our online music services revenue was boosted by the strong growth from user subscriptions and the sales of digital music albums.

Revenues from online music services increased by 26% year-over-year to RMB1.8 billion.

During Q3, the number of our online music subscribers increased by 4.4 million from Q2, a record increase since 2016 when we merged with CMC.

Revenues from music subscriptions were RMB942 million, an increase of 48% from RMB635 million in the third quarter of 2018. The growth was mainly driven by the addition of premium content under our pay-for-streaming model and the continuous improvement in subscriber retention rate.

In addition to the strong growth in subscriber numbers, our subscriber ARPPU rose to RMB8.9 in Q3 from RMB8.6 in Q2, as more subscribers were attracted to our premium memberships.

During Q3, our revenue from sales of digital albums more than doubled from Q3 last year, brought by new and hit releases from top artists and top TV shows. Throughout 2019, we have built up our platform as the go-to destination for top artists to release their digital albums and fans to interact and support their idols.

Revenues from social entertainment services and others increased by 33% year-over-year to RMB4.7 billion, primarily driven by revenue growth in our online karaoke and live-streaming services.

We expanded the paying user base of our social entertainment services by 23.2% and increased ARPPU by 7.4% in Q3 of 2019, compared with Q3 of 2018.

Cost of revenues increased by 43% year-over-year to RMB4.3 billion. The increase was attributable to higher revenue-sharing fees and content expenses. The increase in revenue-sharing fees reflected the growth in our social entertainment services.

In addition, we introduced more professionally generated content into our social entertainment platform through talent agencies and shared a portion of our revenues with these agencies.

The increase in content expenses was mainly attributable to the increased market price and the amount of licensed and produced music content.

Our gross margin was 34% in Q3 2019, improved from 32.9% in Q2. Although our overall gross margin decreased year-over-year as we increased our content investments, we were able to steadily improve operating efficiency. In addition, strong growth from our online music business also helped to increase our gross margin.

Now, let's turn to our operating expenses. We have seen improvement in operating leverage on a year-over-year basis, although our total operating expenses increased by 26.6% year-over-year to RMB1.2 billion.

Operating expenses, as a percentage of total revenue, improved to 19% in Q3 2019 from 19.7% in Q3 2018.

We increased spending on growing our user base and promoting our brands and content in the third quarter. Selling and marketing expenses for Q3 2019 were RMB517 million, representing an increase of 19.1% year-over-year.

We continued to expand our workforce during the quarter, which we believe is an essential investment, and is crucial for expanding our leading edge in products and technology. General and administrative expenses increased by 32.6% year-over-year to RMB720 million in Q3 2019.

Our effective tax rate was 12.4% in Q3 2019, compared to 8.1% in Q3 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 RMB1 billion. And our Non-IFRS net profit attributable to equity holders of the Company was RMB1.24 billion. Our Non-IFRS net profit margin was 19% in Q3 2019.

As of September 30, 2019, our combined balance of cash and cash equivalents, term deposits amounted to RMB21.1 billion, an increase of RMB1.3 billion from RMB19.9 billion as of June 30, 2019. The increase in the balances was primarily due to cash flow generated from operations of RMB1.4 billion.

Overall, we achieved strong growth across our online music and social entertainment businesses, brought by the strength of our products and premium content offering. Our investments in premium content has not only brought in sound financial return, but also solidified the leadership of our platform.

In the coming quarters, we will stay focused on strengthening the synergy between our music platform and social entertainment platform, and continue to invest in long-term growth initiatives.