

**[TME] - Tencent Music Entertainment Group
Third Quarter 2020 Earnings Conference Call
Tuesday, November 10, 2020, 8:00 PM ET**

Officers

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Tony Yip, CSO
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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 2020 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. Millicent T. Please go ahead, ma'am.

Millicent T.: Thank you, Matt. 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. 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.

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 the 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 measures, and other non-IFRS measures are uniformly defined by all companies, including those in the same industry.

With that, I'm now 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. In the third quarter, we continued our healthy trajectory of unlocking opportunities in China's online music entertainment services through various monetization models. Our online music services recorded well-rounded outstanding performance, while social entertainment services moved further along its path of recovery.

First and foremost, our online music services recorded well-rounded outstanding performance. To begin with, subscription revenues maintained robust growth, increasing by 55% year-over-year. This was attributable to the strong growth in paying users of 4.6 million, a new record of quarterly net increase which took our number of online music paying users to 51.7 million.

Paying ratio reached 8.0%, up by 2.6 percentage points year-over-year and 0.8 percentage points quarter-over-quarter.

While we recorded 46% year-over-year growth in online music paying users, its ARPPU expanded by 5.6% year-over-year, demonstrating our philosophy of quality growth.

For non-subscription revenues, we recorded outstanding performance from advertising, delivering a revenue growth rate of triple digits year-over-year. Shirley will provide more

color later on.

Additionally, we maintained the top one position and a leading market share in digital album releases, thanks to our increasing promotional capability and ability to monetize the idol-fan based economy. Our digital album release and fan-idol operation services help not only super stars, but also emerging artists. For example, sales of Sunnee Yang's (Speaking foreign language) first solo album, "How's the Weather Today" (Speaking foreign language), and "Smile" by Katy Perry on our platform, ranked No. 1 in digital sales nationwide.

"No Turning Back," (Speaking foreign language), the title song of the 14th album of JJ Lin, (Speaking foreign language), not only ranked the first in digital sales among all online platforms, but also quickly took the number one spot on 8 of QQ Music's top charts on the second day of its release.

Furthermore, online music services had positive impact on overall margin again in the third quarter, benefiting from strong subscription and advertising revenue growth, and demonstrating the scalability of our businesses and our commitment to win-win cooperation.

Second, we also continued to strengthen our music content leadership through forming more partnerships with additional domestic and international music labels in various genres, covering different regions. We formed in-depth strategic cooperation with renowned indie music partners, including peermusic and Merlin Network.

Moreover, we directed more resources to support indie musicians and promote original music. Our Tencent Musician Platform has become an essential driving force to enrich our music and entertainment content ecosystem, provide support to artists at all stages of their careers, and drive the growth of the industry. We continued to see triple-digit year-over-year growth in both the number of participating indie musicians on the platform and the number of original songs uploaded to it. We saw the number of indie musicians exclusive to us increased by more than 20 times compared with a year ago, boosted by a series of financial incentives and technology-based support services.

Third, we are both pleased and humbled to say that more and more younger users are embracing our platform, trusting our services and contributing to our increasingly interactive environment. In return, we continued to add more trend-setting content, including more music-centric variety shows that are popular among the younger demographic, which successfully attracted younger users on our platform.

Putong Community, the innovative feature we introduced in QQ Music Version 10.0 in July, has also received tremendous endorsement, particularly from younger users. We are pleased to see that user penetration continues to improve, community engagement is increasing and the number of video views per user is also on the rise. It not only has helped us foster the cultural cohesiveness of our user communities, through facilitating reviews and updates on music and industry trends, but has also become a new promotion channel for labels and artists.

Within a few months of its release, Putong Community has become home to more than 100 artists and artist groups and that number is still growing. In October, QQ Music Putong Community was chosen by the famous K-Pop female band, BLACKPINK, for their new album debut.

Last but not least, our new initiatives have been tracking well and serve as an important foundation for long-term sustainable growth. We continued to win share in the growing long-form audio market in China. During the third quarter, we have further enriched our content offering, quadrupling the number of licensed titles year-over-year. The enhanced content library has resulted in increasing MAU penetration, reaching 11.7% in the third quarter, compared to 9.4% in the second quarter and 4.7% for the same quarter of last year.

Additionally, the robust expansion of both licensed and UGC content has continued to enhance average user time spent in the third quarter. We also started to make headway in growing long-form audio paying users through effective subscription plans ranging from a high-value standalone one to our cross-sales packages that leverage great synergies between our music and long-form audio businesses.

Our online concert, TME Live, is growing from strength to strength. This innovative performance venue continued to attract more high-profile domestic and international artists such as Andy Lau (Speaking foreign language), Eason Chan (Speaking foreign language), Charlie Zhou (Speaking foreign language), Jessie J, among others. Since its launch in March this year, we have hosted more than 30 live online concerts for domestic and international iconic artists of different genres and styles, representing 4 to 5 live events on average per month.

We also made further progress in exploring monetization opportunities, including attracting sponsorships from well-recognized domestic and international brands across different industries. Separately, the growing paying user base via TME Live underpins significant scalability and monetization potentials, which was evidenced by the recent online concert of Richie Jen (Speaking foreign language).

This concludes my prepared remarks. And now, Tony will discuss other highlights and important areas 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 will provide additional highlights for online music services before I move on to the discussion of our online social entertainment services.

In terms of product upgrades, we continued to innovate and optimize products to make our online music streaming experience more visual and personalized, leading to enhanced user satisfaction. On video enrichment, we added more music-centric short-form videos, MVs, as well as other UGC content, which has contributed to improved average time spent and total video streams on Kugou Music.

For QQ Music, users are more engaged with video content creation, and we have seen sequentially increased daily published UGC. We continued to make the music discovery

journey more fun and immersive for our users with personalized recommendation accounted for an increasing proportion of streaming volume on our platform.

Now turning to our social entertainment services, overall, it continued to recover steadily in the third quarter, resulting in a faster revenue growth rate compared to the second quarter of this year. We are also pleased to see its ARPPU expanding both on a year-over-year as well as on a quarter-over-quarter basis, driven by users' improving willingness to spend following the COVID-19 pandemic for both live streaming and online karaoke.

Our music-centric live streaming services maintained healthy growth. The key operational targets are twofold: One, growing and maintaining the number and the quality of live performers to solidify our advantage in music-centric live streaming content; and two, growing a fan-based economy by drawing on the strength of our popular content and interactive features. As of the end of third quarter, the number of live streaming performers on Kugou Live grew by over 40% year-over-year, and the number of exclusive performers increased at a healthy pace compared to the same period of last year.

We are in a good momentum recovering from the pandemic, and our paying users have seen sequential improvement in terms of retention rate, driven by effective and targeted operational initiatives, as well as personalized recommendations.

To meet users' demand, particularly younger ones born after 1990s, we continued to expand our live streaming categories to include more ACG, Chinese ancient style and cosplay to enrich content offering. We are pleased to say that our efforts are paying off, illustrated by increasing user time spent on newly-added categories.

Fan Live, the separate live streaming application for QQ Music launched in June, has also shown good traction. In the third quarter, we saw more musicians joining the platform, and we started to introduce interactive features to facilitate more interactions. We are on track to scale it up and expect more meaningful revenue contributions from Fan Live in 2021.

Next, let me discuss our online karaoke services. While we strive to provide better services to core users who are loyal to our platform, we continue to proactively tackle the competitive pressure on user time spent from other forms of entertainment. Over the past few months, we have been making significant investments into improving WeSing's product experience, which are beginning to yield encouraging results.

Most recently, we launched a fresh UI design of the recommendation feed on the home page of the app, as well as enhanced recommendation algorithm to make browsing content more immersive and engaging, and allow users to see a greater variety of interesting content, instead of just content posted by their friends. These efforts have resulted in increased content consumption by users on WeSing compared to the second quarter, which in turn incentivizes content creators to publish more content, and thereby creates a virtuous cycle of content creation and consumption.

As a result of these product improvements, WeSing has recorded faster advertising revenue growth within the revenue mix compared to virtual gifting among friends, which

led to healthy ARPPU expansion and healthy revenue expansion with an understandable decline in the number of paying users in the third quarter. In addition, we are also pleased that these product improvements have contributed to growing average daily user time spent on WeSing since September.

We also continued to enhance social networking attributes of WeSing. Our strength to facilitate the deepening and broadening of social ties with families and friends is a key element that distinguishes us ourselves from other online entertainment platforms. To better cater to the increasing demand for long-distance socializing and capture the opportunities arising from the pandemic, we added Friend KTV (Speaking foreign language) within online singing rooms, which vividly emulates the offline karaoke experiences online to facilitate unique social connections among families and friends. Since its launch in late September, it has been gaining traction among users, and we expect it to further boost the penetration of online singing rooms.

As we stay focused and keep working on the key areas such as video enrichment and social networking attributes for WeSing, we have seen encouraging results in its user metrics, and are optimistic that the social entertainment MAU as a whole would bottom in the fourth quarter and begin to improve into 2021.

Last, but not least, we are expanding our value proposition within the online music entertainment space. Leveraging our deep insights into music trends and strong content promotional capabilities, we will become more engaged in cultivating artists and content production through deeper partnerships with content providers, and proactively explore cross-domain cooperation to capitalize on future monetization opportunities.

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, we achieved outstanding growth in online music services, particularly in music subscriptions and advertising revenues this quarter, and a continued recovery in our social entertainment businesses. We are also very pleased to see our gross margin improvement sequentially.

Our total revenues were RMB7.6 billion, up 16.4% year-over-year.

Our music subscription business continued to grow rapidly with revenues of RMB1.5 billion in the third quarter and year-over-year growth of 55%. On a year-over-year basis, paying users and ARPPU grew 46% and 6%, respectively, resulted from continuous user retention improvements and effective paywall strategy execution.

In addition, our advertising business had significant growth this quarter, as our strategic focus to grow advertising business started showing results this quarter. As a result, our online music revenue reached RMB2.3 billion this quarter, up 26% year-over-year, despite decreases in sublicensing revenues and sales of digital albums.

Social entertainment services and other revenues were RMB5.3 billion, up 12.7% year-

over-year, primarily due to growth from online karaoke and live streaming. ARPPU increased 32%, while paying users dropped 14.6% on a year-over-year basis.

During the quarter, we grew our ads business significantly, and also offered more diversified contents on our platforms, both resulted in higher ARPPU.

We have always been focusing on monetization improvement. Developing advertise business on WeSing platform is one way to improve monetization ability of the platform. This quarter, we balanced between growing number of our paying users and developing advertising business. Furthermore, we reduced incentives that are less efficient in terms of attracting new paying users. Consequently, number of paying users declined this quarter, but our overall monetization on the platforms has improved.

Our gross margin was 32.4% in Q3 2020, up 1.1% sequentially while down 1.6% compared to same period last year. The year-over-year decrease was primarily due to increased investments in new product and content offerings, such as long-form audio and TME live that are still ramping up in terms of revenue generation, as well as increased revenue sharing fees to strengthen our platform's competitiveness this year as compared to same period last year.

Sequential gross margin improvement was as a result of lower revenue sharing ratio in live streaming because we focus on improving efficiency of promotional activities and reduced less efficient incentives for user spending, as our live streaming business recovers.

Online music services have had positive impact on overall margin this year, and this trend is expected to continue as our subscription revenues continue to grow while licensed content costs gradually rationalize as overall music industry evolves.

Now moving on to operating expenses, total operating expenses for Q3 2020 were RMB1.4 billion and was 18.9% as a percentage of total revenues, staying relatively stable compared to 19% in the same period last year.

During the quarter, we increased promotional spending for new and existing products to strengthen our products' competitiveness and solidifying our advantage in music-centric live streaming. Additionally, we continue to invest in R&D for product enhancement and technology innovations, leading to higher employee-related costs in R&D.

Our effective tax rate was 9.3%, decreased from 12.8% last quarter, as one of our operating entities in China became qualified for certain tax benefits this quarter.

Our net profit attributable to equity holders of the Company was RMB1.1 billion. Non-IFRS net profit attributable to equity holders of the Company was RMB1.3 billion and non-IFRS net profit margin was 17.8%.

As of September 30, 2020, our combined balances of cash, cash equivalents and term deposits were RMB27.7 billion, representing an increase of RMB5.4 billion from Q2, which was primarily driven by proceeds received from notes offering.

Looking forward, we'll keep focusing on monetization improvements and diversification, including growing our advertising business, while maintaining core content investments.

As we had said previously, we continue to be optimistic about the future of the broader music industry, and are confident in the overall ecosystem and product pipelines that we are building in the long run.

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

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