

[TME] - Tencent Music Entertainment Group
Q3 2021 Earnings Conference Call
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Officers

Tony Yip, Chief Strategy Officer
Cussion Pang, Executive Chairman
Ross Liang, Chief Executive Officer
Shirley Hu, Chief Financial Officer

Analysts

Eddie Leung, Bank of America
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Alicia Yap, Citigroup
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Charlene Liu, HSBC

Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group's 2021 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 hand the conference over to your speaker host today, Mr. Tony Yip. Please go ahead.

Tony Yip: Thank you, operator. Hello, everyone, and thank you all for joining us on today's call. TME 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 Executive Chairman, who will start the call with an overview of our recent updates. Next, Mr. Ross Liang, our CEO, and I, Tony Yip, as the CSO, will offer additional thoughts on our product strategies, operations and business developments. Finally, 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 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 IFRS 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 pleased to turn over the call to Cussion, Executive Chairman of TME. Cussion?

Cussion Pang: Thank you, Tony. Hello, everyone, and thank you for joining our call today. In the third quarter, we continued to implement our dual-engine content-and-platform strategy, which reinforces one another. Guided by our goal of becoming a leading provider of high-quality content, we are working to expand our all-round capability in music creation, discovery, promotion and monetization, while strengthening our platform's infrastructure and actively collaborating with the broader Tencent ecosystem. These efforts will enable us to unlock greater potential in each component of the music industry value chain, and continue to promote the healthy and sustainable development of the music industry in China.

With respect to content, our accelerated expansion to music production has delivered promising results. We have designed an innovative and comprehensive process that leverages on our proprietary technology and deep understanding of music trends to systematically create, evaluate and promote music. This process accentuates compounding benefits as we integrate, first, our comprehensive music composition library; second, blended machine and manual analytics for artists and repertoire discovery; third, a middle platform that enables refined matching for artist collaboration; fourth, a technical system to demo and evaluate trials to improve ROI; and fifth, flexible promotion channels and resources to enhance promotion efficiencies.

By utilizing this process, we aim to produce better music, achieve a shortened creation cycle and better hit rate, and realize meaningful cost savings from economies of scale and composition tools.

I want to share some recent examples that illustrate this point. First, in the third quarter, through our proprietary process of matching repertoire with suitable singers and producers, and promoting on multiple TME and external platforms, we produced It's Better To, a hit song which reached the #1 on multiple music charts, with streaming volume of over 0.5 billion within the 3 months of its launch. Secondly, we also produced the chart-topping theme song The Peerless King by artist G.E.M. for the popular game Honour of Kings. The song was released for the game's 2021 annual competitions and the World Champion Cup, and has been well received by both music and game lovers.

Cultivating the original works and enriching the indie musician ecosystem through our Tencent Musician Platform is another key source of our content differentiation. We empower our indie musicians with useful tools and collaborative opportunities to realize their full potential, and create, grow, engage and monetize their art and fan base. We do this in part by providing them access to valuable resources, including TME Live performances, incentive plans, promotion channels, education platform, copyright support and more.

Our ongoing support to indie musicians has been gaining traction. By the end of the third quarter, the number of indie musicians on the Tencent Musician Platform reached 260,000, extending its growth streak with double-digit year-over-year increases. Meanwhile, the streaming volume of their original works continues to record healthy growth.

Following our December 2020 talent discovery plan, Bo Le Plan, we introduced our Riding on the Wind Plan in August 2021 to inspire new music content creation by efficiently pairing musicians with top songwriters and lyricists. With this plan, we have also upgraded our platform's artists and repertoire discovery, and promotional capability to become a consistent source of hits. As a result, within just 1 month of its launch, the plan generated 8 hits in multiple categories, such as Stars in My Dream by the virtual idol, Hua Xiaolou, Galaxy into the Sea by the internet influencer Yin Ximian, and Ripe Plums by the broadcasting celebrity Nice Ah, enabling these musicians to grow their fan bases by 26%.

Tencent Musician Platform has also established the sustainable and diverse monetization models for musicians and the industry, which help indie musicians to earn a better living while they focus on honing their craft. In the third quarter, we launched an upgraded 100 Million Yuan Incentive Plan, which incentivizes eligible musicians to collaborate with us in music creation, as well as provide comprehensive incentive mechanisms to help high-quality content and artists gain exposure across our platforms. Within 2 weeks of the plan's launch, we discovered an original hit song, Mutual Deletion by Heat J. This is just one of our early successes, and we expect many more hits to follow.

With relentless exploration and experimentation, Tencent Musician Platform will drive our success in the original music industry, and continue to create benefits and opportunities for indie musicians, encouraging original music creation while unlocking the musicians' potential.

Expanding our licensed content library is also a crucial component of our content strategy. We are working to cement our leadership position in trendy categories like the Chinese ancient style, as well as provide full coverage of top hip-hop variety shows such as Girls Like Us and Shuo Chang Ting Wo De 2. With our presence in diverse genres catering to the younger generation, we are establishing our platform as the go-to place for enthusiasts in each genre with branding such as QQ Music's Rappers Alliance and Kugou Music for New Hits.

We prioritize copyright protection to protect musicians' rights and promote the healthy and sustainable development of the music industry. To this end, we leveraged our understanding of the industry's copyright pain points and launched the TME Music Cloud. Under this brand, in the third quarter, we introduced a SaaS-based music authorization service for the live streaming industry, which offers copyright licensing service whereby live streaming platforms and live streaming performers can pay licensing fees to properly obtain legitimate music licenses for commercial use in live streaming.

In addition, we are helping music rights holders and musicians distribute their works, and expand their influence worldwide by collaborating with Apple Music. Going forward, we plan to expand such copyright licensing services to other online applications that require legitimate music licensing for commercial use, and continuously contribute to copyright protection in China by establishing a smart music copyright infrastructure.

We are also optimizing our internal and external promotion channels to create a more comprehensive promotion system. We continued to embrace external resources like Weixin, QQ and Weixin Video Account to create new social connection-based models for music promotion. And we are creatively combining music resources such as variety shows, films, videos, and performance events to strengthen our content's influence. For example, Wang Jing Wen, a rising musician we nurtured, entered the industry-acclaimed singing competition show SING!CHINA 2021 and won second place, propelling the popularity of her songs to a new record with a total of 1.9 billion streams on our platform in the third quarter.

We began testing a new business model by commercializing some of our promotional capability to enable content providers to purchase promotional resources on our platform. We are also making substantial progress with promotion via external smart IoT devices.

Last but not least, we are more confident than ever in the ability of TME Live to drive new online-merge-offline music scenarios with immersive experiences. In terms of its efforts online, TME Live held 26 diverse live performances in the third quarter, including the 2021 Tomorrowland. TME Live's series of mind-blowing electronic music performances sponsored by e-commerce, automotive and other advertisers, helped brand owners dynamically resonate with users and maximize their brands' emotional impact, while simultaneously fostering new business models.

To satisfy younger users' booming demand for live performances as they seek new social outlets in the pandemic's ebb, TME Live has expanded downstream. In the third quarter,

TME Live collaborated with the Tencent Musician Platform to showcase live performances in key cities via the 2021 Force Stage Plan, offering talented musicians the chance to participate in nationwide tours to reach a broader audience both online and offline.

We also rolled out a series of music festivals across multiple cities in the third quarter and pioneered an indoor music festival IP, Electronic Music Festival. The first event debuted in Chengdu, a cultural hot spot for music entertainment and home to a vibrant party scene for younger generations. Motivated by these trailblazing successes, we look forward to creating more events that will rock our users' lives.

Having updated you with our progress in content, I would like to turn the call over to Ross, who will share more about our platform strategies. Ross, please go ahead.

Ross Liang: Thank you, Cussion. Hello, everyone. Moving on to our platform strategy, we are strengthening our platform's capability to enable music lovers to enjoy more video-based content, share their passion for music within our community and have a more socially-engaging experience.

To inspire creation and innovation of video content on our platform, we continued to build shared middleware and infrastructure. First, QQ Music's short video tab featuring immersive feeds and Kugou Music's embedded MVs on its streaming page achieved sequential increases in their user penetration. Early indications of our video functionality are very positive. By the end of the third quarter, QQ Music's daily video views and daily unique visitors on our platform reached 100 million and 18 million respectively, representing triple-digit growth rates year-over-year. We are very enthusiastic about its monetization potential via advertising and other avenues going forward, as video views ramp up.

Second, to better cooperate with Weixin Video Account, we are now supporting the one-click video publishing feature across Weixin Video Account, QQ Music, Kugou Music, Kuwo Music and WeSing, making it easier for musicians to reach a broader audience. Within 1.5 months of its launch, the one-click video publishing feature was adopted by more than 20,000 musicians on our platform. In addition, QQ Music's collaborative indie musician live streaming initiative with Weixin Video Account held 633 events and attracted over 10 million viewers in the third quarter.

As we aspire to connect people through music, our social and community-building efforts focus on interactions among both strangers and friends. We are pleased to see increasingly vibrant social interactions on our platform, as demonstrated by user utilization of Putong Planet and Kugou's new feature Leap of Heart, which allows users to swipe through visualized user profiles and interact with those who are listening to the same song, as well as our upgraded paired synchronized listening feature, which was originated in QQ and carried over to QQ Music.

During the third quarter, average daily listening time spent by users of the synchronized listening feature was 80% higher than the average; while penetration of young users of

Putong Planet was over 10% higher than that of QQ Music. Our initiatives for WeSing included the virtual live streaming room launched to provide an all-new interactive experience to users, targeting real-time virtual social networking as a new growth engine for user engagement.

We strive to appeal to diverse user groups and their varying tastes with broadened options and features. In the interest of the young generation, we launched BoDian Music, pioneering video-driven music listening experience in China, and helping users better connect with music with a fresh sleek UI design. While for seniors, we launched a large-font mode in QQ Music to provide them an aging-user friendly experience.

For music fans seeking the ultimate sound quality, we upgraded QQ Music and Kugou Music's high-resolution audio library, including millions of musical works by popular artists and domestic and international musicians. This upgrade has proven very attractive to young users.

In addition, QQ Music and Kugou Music both introduced automatic music score generation functions, which generate professional-quality sheet music scores at users' fingertips. For those people -- for those users who prefer a simpler music listening experience, we now have QQ Music Lite, which offers a core set of music streaming functions with a minimalistic user-friendly UI design. These tailored products and options allow us to improve the experience for our users and engage them in a more personalized way.

Most importantly, we are on track to deepen our partnerships with the broader Tencent ecosystem to create new music entertainment experiences. First, in September, QQ Music and Roblox China, a joint venture set up by Tencent and Roblox, collaborated to launch an immersive virtual music concert for an indie musician with exclusive special effects, fireworks, virtual gifts, and music mini-games in a 3D setting, giving the offline audience and online viewers an intimate view of the action. It attracted more than 2 million viewers domestically and abroad with over US\$100,000 worth of in-event purchases, laying a solid groundwork for our future endeavors in creating transformative experiences.

Second, we are working with Tencent Video to enhance content distribution. Tencent Video users can now seamlessly discover and enjoy original soundtracks and other music related to the video content they are watching. This function is currently available in multiple drama series. Third, as another step forward in promoting socialization through singing, users can now update their Weixin status when they sing or finish a recording on WeSing, sharing the experience with their Weixin friends.

We are also making strides with our long-form audio business as a complement for our music products and a value-add to overall user engagement and activeness on our platform. We have made continued efforts to expand and differentiate our long-form audio content and features. First, our heroic fantasy radio drama, Sword Snow Stride, has become a self-produced content blockbuster, accumulating 140 million streams since its launch. Second, in the third quarter, QQ Music launched an open platform to improve

podcasters' creation process and allow them to upload and share their content to TME and other platforms with simple clicks.

Third, to bring users a more immersive, vivid, and smooth listening experience, we deployed the industry's first vocal-emotion-enabled AI reading technology to produce audiobooks, contributing to 30 titles based on well-known literature IPs such as Battle Through the Heavens. Fourth, we further enhanced our content library by offering the audio content from Rock & Roast, Tencent Video's #1 rated variety show.

These efforts led to strong growth of long-form audio MAUs, which exceeded 140 million in the third quarter, growing by 89% year-over-year. Long-form audio paying users reached 5 million by the end of the third quarter, growing by over 100% year-over-year, a majority of which are also online music paying users, as they are attracted by the complementary nature of an integrated music and audio streaming service. While it has been gratifying to see so much enthusiasm for these rollouts throughout the quarter, it's important to remember that we are still in the early stages of long-term development of this business.

Finally, our pioneering digital collectible platform remains at the forefront of innovation. A recent highlight was the vinyl album Monk by Tiger Hu, a renowned Chinese singer and music producer. The lottery for this limited-edition vinyl album, with 2,001 copies pressed, attracted intense fan interest in limited edition artists' works. Its success is a strong endorsement of this cutting-edge collection format, and this is just one example of the substantial creative efforts underway. We are building on this early momentum and will engage more artists by curating a diverse pipeline of collectible works in the upcoming quarters.

That covers our platform's progress and innovative initiatives.

Now I'd like to pass the call to Tony to discuss our business highlights. Tony, please go ahead.

Tony Yip: Thank you, Ross. Hello, everyone. As we continued to execute on our dual-engine content-and-platform strategy in the third quarter, our online music services MAUs grew quarter-over-quarter to 636 million, maintaining the progressive recovery trend which began in the second quarter, and bolstering our confidence in the underlying health of our user funnel.

Our IoT MAUs reached 74 million in the third quarter with a year-over-year growth rate of 42%, benefitting from the rich and growing variety of products and services we provide on a broad range of IoT devices. We are pleased to see IoT devices becoming an increasingly important and influential music content distribution channel for our platform.

Despite some impact on advertising due to recent regulations on splash screen ads, our online music revenues demonstrated strong momentum in the third quarter, as users continue to be attracted by our enhanced music streaming experience. With a net add of 5 million during the quarter, the number of paying subscribers to our online music services

reached 71.2 million, increasing by 38% year-over-year and resulting in a paying ratio of 11.2%.

To weather the decelerated growth in advertising, we expanded our advertising products by enabling advertisers to better appeal to audiences within music streaming page and search sections. We also rolled out a new monetization model to help artists boost their earnings by sharing advertising revenue with them on streaming page advertisements.

To rejuvenate our brand and expand our communication channels with Gen-Z users, in the third quarter, we fostered a new culture around Chinese Ancient Style and hip-hop through multiple themed events. We also livestreamed Ariana Grande's Rift Tour Concert hosted by the popular online game Fortnite, creating an immersive virtual reality experience including elements of both popular music and games.

In addition, we grew our on-campus influence with events such as Young Music Summer Party and Music for the Future, as well as a record label for students, Voila! College, among other initiatives.

Turning now to social entertainment services. Due to recent regulatory changes and industry competition, social entertainment services MAUs and paying users were lower year-over-year and quarter-over-quarter. We will continue to invest to strengthen the operations of our social entertainment services to better engage users.

We continued to establish WeSing as a social entertainment platform with singing at its core. This year, we are focusing on engaging users by demonstrating the power of singing in socializing, celebrating and supporting our community in a meaningful way, and creating tools that deliver a more personalized and enjoyable user experience.

We have worked to popularize the music creation process within WeSing, encouraging more WeSing users to become content creators. To this end, we have launched multiple features including Large Group Chorus, Acapella Chorus and Multivariant Adaptation in recent quarters, which have engaged more than 15 million cumulative users.

We are also proud to share that many musicians who are currently active on larger stages, such as Curley G from BONBON GIRLS, were loyal and frequent users of WeSing, and accumulated their initial fan bases on our platform before they were discovered by the wider public and had the opportunities to shine on larger stages.

Amidst increasing competition, we strove to differentiate our live streaming services through audio live streaming, QQ Music Live Streaming, cross-platform events, content category expansion and our foray into exploring the Metaverse concept, which promises a new era in entertainment.

We have made solid progress in expanding audio live streaming, which is a complementary use case to our core listening experience, as demonstrated by incremental growth in both user base and revenues quarter-over-quarter and year-over-year.

Going forward, we will continue to strengthen our audio live streaming business in China, as well as leverage our experience to further expand its presence in overseas markets where we have seen strong growth and monetization potential.

By the end of the third quarter, QQ Music Live Streaming had attracted approximately 10,000 musicians to live streaming. These broadcasts enabled musicians to connect and interact with their fans via live streaming on our platform, amplify their music's influence and establish deeper bonds with fans, which ultimately drives audience growth and improves monetization of their fan base. This in turn drove the number of performers and active users on QQ Music's platform.

Kugou Music, QQ Music and WeSing's live streaming services also joined forces in another cross-platform live streaming event in September, fostering improved paying user engagement.

We believe the metaverse concept represents a sea-change opportunity for future entertainment innovation as well as category expansion. Kugou Live launched Cool Dimension, a virtual ACG live streaming social platform. It targets users different from those on Kugou Live, with the generation born in the 2000s and female users, both accounting for 60% of the user base respectively. Cool Dimension creates an exclusive community for ACG fans through seamless integration of virtual reality, live streaming and social interactions. We will explore more opportunities to leverage the metaverse concept for innovative interactive entertainment experiences going forward.

In summary, we see both challenges and opportunities in our operating environment. We'll meet them with determination, passion and persistent efforts to differentiate TME, expand our capability for creators, and optimize user experience.

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

Shirley Hu: Thank you, Tony. Hello, everyone. Next, I'll discuss our results from financial perspective. Our total revenues for Q3 2021 were RMB7.8 billion, up 3% year-over-year. Our online music revenues were RMB2.9 billion this quarter, up 24% year-over-year.

In the third quarter of 2021, our music subscription business continued to grow rapidly, with revenues of RMB1.9 billion and year-over-year growth of 30%. These resulted from our continuous improvements in products and content, expanded sales channels and effective marketing campaigns.

Monthly ARPPU was RMB 8.9 this quarter, compared to RMB 9.4 in the same period last year, as we solidify our competitive advantages and offered more effective promotions to cultivate users' willingness to pay for music.

Our Q3 advertising continued to grow on a healthy pace. During the quarter, we added more advertising product options to mitigate the impact from the new guidance on splash

ads issued by the regulator in the second quarter this year. We also partnered more closely with Tencent to reach more advertisers and improve eCPM.

Social entertainment services and other revenues were RMB4.9 billion, down by 6% year-over-year, as we faced more intense competition from other pan-entertainment platforms and tightened regulatory environments. To cope with the competition, we are making efforts in retaining existing and attracting new performers, better utilizing our internal cross-platform traffic to attract more users, and keep revamping product features and launching new initiatives to maintain steady revenue scale.

Gross margin was 29.6% in Q3 2021, down by 2.8% year-over-year, which was better than expected. The decline was due to the following reasons. Firstly, with the continuous growth in subscription revenues, revenues mix shifted as revenue from online music accounts for a higher percentage of revenue, whose gross margin were generally lower.

Secondly, revenue-sharing ratio for WeSing increased on a year-over-year basis, and remained relatively stable quarter-over-quarter. Thirdly, audio live streaming accounted for a higher percentage of revenue with relatively lower gross margin.

Lastly, increased investments in new products, such as long form audio, that are still ramping up in terms of revenue generation, also had a negative impact on gross margin this quarter.

Now moving on to operating expenses. Total operating expenses for Q3 were RMB1.6 billion and was 21% as a percentage of total revenues, as compared to 19% in the same period last year.

Selling and marketing expenses were RMB587 million, down by 8.6% year-over-year, mainly because we managed external promotion channel's efficiency well and better utilized internal traffic to attract users.

General and administrative expenses were RMB1.1 billion, up by 33% year-over-year, driven by higher number of employees in R&D as we invest in product enhancement, technology innovations and more diversified product offerings.

Additionally, share-based compensation expenses, post-acquisition awards for previous management team and amortization of intangible assets, arising from the acquisition of Lazy Audio of approximately RMB 66 million also contributed to higher general and administrative expenses this quarter. Excluding the impact from the acquisition of Lazy Audio, G&A would have increased by 24.7% year-over-year.

Our effective tax rate for Q3 was 11.5%.

Our net profit was RMB 788 million and net profit attributable to equity holders of the Company was RMB740 million. Non-IFRS net profit was RMB 1.06 billion and non-IFRS net profit attributable to equity holders of the Company was RMB1.02 billion. Non-IFRS net profit margin was 13.6%.

As of September 30, 2021, our combined balances of cash, cash equivalents, term deposits and short-term investments were RMB24.5 billion, representing a decrease of RMB1.3 billion from Q2, primarily driven by payment for stock repurchase. Cash generated from operating activities had a positive impact on the combined balances.

Looking forward, we'll continue to invest in content, especially in self-produced content through various channels such as Tencent Musician Platform and collaboration with Tencent Group.

We will also keep focusing on new initiatives, including improving monetization for audio products and revamping products' features through socialization, videolization and community building for our long-term healthy growth. Meanwhile, as discussed earlier, we will continue to effectively manage our spending in selling and marketing expenses and enhancing operating efficiencies.

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

Operator: We are now approaching the end of the conference call. I will now turn the call over to your speaker-host, Mr. Tony Yip, for closing remarks.

Tony Yip: Thank you, everyone, for joining us today. If you have any further questions, please feel free to contact TME's Investor Relations team. This concludes today's call, and we look forward to speaking with you again next quarter. Thank you, and goodbye. Thank you.

Cussion Pang: Thank you.

Ross Liang: Thank you.

Shirley Hu: Thank you.