

[TME] - Tencent Music Entertainment Group
Q1 2022 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

Alicia Yap, Citigroup
Alex Poon, Morgan Stanley
Xueqing Zhang, CICC
Eddie Leung, Bank of America
Wei Jiang, UBS
Ronald Keung, Goldman Sachs
Thomas Chong, Jefferies
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 First Quarter 2022 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, Mr. Tony Yip. Please go ahead, sir.

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 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.

Before we continue, I refer you to our safe harbor statement in our earnings press release, which applies to this call, as we will make forward-looking statements. 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. The 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 an era of increasing entertainment choices amid an evolving market landscape, a sustained competitive advantage is awarded to those who offer users a differentiated experience. With this in mind, in the first quarter of 2022, we continued to build new professional and personal use cases and interactions around our dual engine content-and-platform strategy, as well as expand our efforts to augment the scale and fortify the quality and competitiveness of our music catalog.

Meanwhile, we strove to enhance user experience through innovations built on our 4 pillars of music entertainment, namely, listen, watch, sing and play, driving momentum for our long-term success and promoting the healthy development of the music industry. First and foremost, we remain committed to energizing original content production, leveraging our technology-driven production capabilities and strength in mobilizing promotional resources.

The benefits of our overall content ecosystem are increasingly manifest. With our Xingyao Plan (Speaking foreign language) and Galaxy Plan (Speaking foreign language), we empowered original content production, leveraging a technology-driven solution to add value across demo and singer discovery throughout the production, distribution and promotion phases of these original works.

Our high hit rate for original content blockbusters is supported by our middleware platform, which integrates, first, algorithm-driven screening of lyrics, songs and demos; second, AI voice-matching capability built upon a stored library of hundreds and thousands of voices; and third, a targeted promotion system based on real-time data analysis to help artists and songs reach the right audience and go viral.

Empowered by these advanced technologies, our artists have created quality pieces as well as trendy ones, serving a wide range of users' tastes. Notable standouts in the first quarter include Mirage (Speaking foreign language) by San Shu and Drown (Speaking foreign language) by Chuan Qing, two sweeping successes that topped multiple music charts and both achieved peak daily streams in excess of 13 million.

Meanwhile, we continued to refine our original content catalog, focusing on key verticals such as gaming, Chinese Ancient Style and pop music. In the first quarter, we collaborated with Tencent Games' popular titles, including PUBG Mobile (Speaking foreign language), Honor of Kings (Speaking foreign language), League of Legends: Wild Rift (Speaking foreign language) and several more, to produce original themed music content. These songs by leading artists such as Hua Chenyu, Chen Linong, Mao Buyi and Z.TAO, have made their way to the top of various music charts, and have also been embedded with the sales of ads and game props, further driving our revenues.

What's more, an inspirational Chinese Ancient Style hit song Flying Snow (Speaking foreign language) became the background music of choice for many official media outlets during the Beijing Winter Olympics, generating tremendous social media buzz of over 2 billion views and catapulting it to the top of TME's 12 music charts.

Moreover, our Tencent Musician Platform continues to provide systematic support for musicians, enabling us to partner with musicians at any stage and in all aspects of their careers to provide a launch pad for more musicians to showcase their talent, passion and music for the broadest possible audience.

We have been making resolute efforts to optimize and upgrade Tencent Musician Platform's all-round services for musicians, so that being active on our platform becomes not only a preference, but also a habit for creators. For starters, in the first quarter, we launched a brand-new behind-the-scenes music production service, with an initial group of over 50 industry well-known professionals and more than 100,000 creators who are well versed in music composition, mixing, recording, and more joining the roster to provide our musicians with production support.

Additionally, we have strengthened our platform infrastructure to support musicians with a customized self-service productivity toolkit to analyze data, host concerts and manage their artwork catalog, profile page, and photo albums. Taken together, these tools empower musicians to create and promote their works more efficiently and reach a higher audience, ultimately helping to build a constructive and active musician ecosystem.

Second, the Tencent Musician Platform motivates musicians with an array of creative scenarios and rich promotion resources, both on-and offline, helping them break through to a larger audience. Aided by our platform's toolkit, Liu Shuang's Rose Thief (Speaking foreign language), climbed to the upper top echelons of the trending chart with cumulative social media buzz reaching over 200 million views.

Our diverse promotions for the singer and the song included top variety shows like The Treasured Voice (Speaking foreign language), online joint activities with TMELAND and Weixin Video Accounts, offline stages such as our Tencent Music Entertainment Awards, TMEA, and the Force Stage (Speaking foreign language), as well as a handful of offline brand-sponsored events, providing additional opportunities for Liu Shuang to shine and unlock his potential.

We have established the sustainability and diverse monetization models for musicians, which help them earn a better living while focusing on honing their craft. To this end, we distributed over RMB200 million from our platform to musicians during the past 12 months, supporting a new generation of indie musicians as they propel the industry forward.

Enriching our content library and building our presence across a multitude of music verticals to reinforce our source of competency is another focus, which in turn strengthens our platform's reputation as the go-to destination for enthusiasts and benefits our penetration among high-value heavy users.

Chinese Ancient Style music remains our stronghold. In the first quarter, we presented In China (Speaking foreign language), a variety show that brought together top Chinese musicians and performers from 41 different genres to compose and showcase original music works that creatively combined traditional Chinese cultural elements with trendy styles. The show has received widespread acclaim and over 300 media accolades for its efforts in actively promoting Chinese cultural heritage.

In addition, during the first quarter, we began to expand our focus to the electronic, classical and anime genres. For example, we strengthened operations for electronic music by bringing in musicians, labels and institutional partnerships, and providing a full range of content, including music audio, playlists, videos, and more. By the end of the first quarter, more than half of the world's top-100 DJs had settled on QQ Music, which not only enabled their in-depth communication with Chinese fans, but also promoted the spread of trendy electronic music.

Finally, built upon our commitment to promoting healthy and sustainable industry development, TME seeks to create inclusive, professional music charts that accurately reflect and evaluate China's music industry. Our TME Chart (Speaking foreign language), along with its data-based TME Uni Chart (Speaking foreign language) and its expert review-based TME Wave Chart (Speaking foreign language), serve as a solid music rating infrastructure.

In the first quarter, we released the TME Music Chart Annual Review, which provided a snapshot of the Chinese music landscape in 2021 with ratings and reviews of over 1,800 songs, becoming a bellwether for the latest and hottest in China's music world and attracting a wave of social media buzz including over 900 million views upon release.

To close, we are motivated every day by the differentiated value we can bring to music lovers, music creators and the music industry as a whole. We are committed to earning each of these participants' loyalty and devotion through real empowerment.

With that, I conclude the progress update on our growing content capabilities. Now 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, in the first quarter, we continued to invigorate our ecosystem and innovate around the 4

pillars of our music entertainment experience: listen, watch, sing and play. Beginning with the smallest details, we continuously polish our products to meet the multi-faceted needs of diverse user cohorts and strive to create a sense of belonging, making our products an uncompromising must-have in our users' daily lives.

With respect to listen, our users' core demand, we are providing innovative and professional product features to elevate users' listening experience. Technology is so deeply embedded in our corporate culture that it has become part of our DNA. QQ Music was the first in China to launch advanced listening functions, including the Digital Music Enhancement Engine, which can significantly improve sound quality with one simple click, and Replay Gain and Gapless Playback, which help equalize music volume and deliver a smoother music listening experience between consecutive song plays, particularly compatible with classical music streaming. These new functions have been well received, as millions of users incorporate these features into their daily practice.

We have also optimized our smart recommendation feature and have become more in tune with our users' tastes, as demonstrated by QQ Music's recommendation penetration rate reaching a new record high by the end of the first quarter, along with recommendation streaming volume and time spent both registered strong double-digit growth year-over-year.

In addition, our upgraded QQ Music Popularity Index, with real-time updates on the number of listeners online, expanded music coverage and additional song information, has considerably strengthened users' sense of participation, with their input directly influencing a song or artist's prominence.

The second pillar of our all-around multi-sensory entertainment experience offering is watch. We are deepening our collaboration with Weixin Video Accounts to create vibrant music scenarios and strengthen music promotion capabilities. In March, Tencent Musician Platform held a large-scale live charity concert during the pandemic, Spring Never Ends (Speaking foreign language). It was an 8-hour uninterrupted marathon performance by 141 groups of well-known artists such as Chen Li, the Good Meimei, and a roster of our musicians.

Supported by Weixin Video Accounts' promotion capabilities and our ability to mobilize resources on our platform, the concert attracted millions of viewers, generating over 30% increase in the number of viewers in participating musicians' live streaming rooms on the event day. We are proud to share by the end of the first quarter, daily video views of Weixin Video Accounts of musicians on our Tencent Musician Platform had exceeded 100 million, representing over 70% increase quarter-over-quarter.

Beyond video, our efforts on the visual front also include the use of the graphics and other formats to enrich streaming content. Bodian Music's comment display function and streaming visualizations are just a few of the many examples launched in the first quarter.

In terms of sing, we were the first in the industry to offer sound tuning without requiring ear-buds (Speaking foreign language), an easy-to-use function that can substantially

improve the sound effects of songs recorded without external devices. Another new feature that has inspired widespread accolades among users is our cloud-based sound mixing (Speaking foreign language), which helps produce nearly studio-quality sound mixing in just 2 minutes after the musical work is uploaded to the cloud.

We have also endeavored to expand music entertainment scenarios, adding more fun play elements to the music entertainment experience. We hosted our first virtual earnings call on TMELAND, and are planning to organize additional featured events, such as virtual avatar concerts and customized events on this exciting new virtual music playground in the second quarter.

In addition, we have pioneered dedicated virtual rooms for artists, including recently-launched rooms for Jay Chou and Roy Wang, which provide immersive, interactive social scenarios where fans can listen to their idols' digital albums anytime, anywhere, while posting song reviews, chatting with other fans and displaying self-expressions in virtual avatars.

We are proud to share that through pioneering innovations in the 4 pillars of music entertainment – listen, watch, sing and play – QQ Music has achieved solid initial results, as demonstrated by its continuous year-over-year MAU growth.

Building a complementary component to our music entertainment ecosystem, we continued to grow our long-form audio business with increasingly differentiated content. We are delighted to see mid-and-long-tail podcast hosts flourishing in the TME ecosystem and gaining traction thanks to our large user base. For example, after participating in TME's Podcast Creation Center in 2022, podcast host Lao Shi Qi's audio work of *The Northern Time Raiders* (Speaking foreign language) racked up 23 million streams within 1 month upon its release and shot to the top of TME's charts, leading to substantially higher financial gains for Lao Shi Qi, and inspiring a growing crowd of mid-and-long-tail creators to join our podcast ecosystem.

Secondly, we enhanced our joint content operation with popular IPs, particularly in TV drama series. Through audiobook artists' participation in the Putong community and more channels, we successfully promoted both the audiobooks and the associated IPs with highlights in the first quarter included (Speaking foreign language) *A Lifelong Journey* and (Speaking foreign language) *Challenges at Midlife* and (Speaking foreign language) *The Oath of Love*. During the release of these hit dramas, TME's long-form audio offerings of the same titles saw their streaming volumes surge.

Going forward, we will leverage our memberships to maximize the monetization potential of long-form audio as we also continue to optimize content ROI and DAU monetization efficiency to improve its profitability. As we drive our business' progress, we remain dedicated to undertaking our social responsibilities to create a better world and promote cultural spirits and create a new model of public welfare through music.

To celebrate the 15th World Autism Day, we launched an autism care charity project, "Shape of Music (Speaking foreign language), which presented a series of artworks such

as our first public welfare digital collectable single, The Brightest Star (Speaking foreign language), the music album, Symphony of the Galaxy (Speaking foreign language), and the Shape of Music Art Exhibition, allowing music to not only be heard, but also seen and treasured through the crossover of different content and art forms online and offline. The entire net income from this project was donated to autism institutions to advocate for social connections with autism groups.

With that, I'd like to give the floor to Tony to review our business operations. Tony, please go ahead.

Tony Yip: Thank you, Ross. Hello, everyone. In terms of operating results, in the first quarter, our online music MAUs were 604 million, down slightly year-over-year. Despite churn of casual users who opted for other pan-entertainment platforms, we are encouraged by the progress we've made in our original content production capabilities, music catalog and innovative product features, which continued to strengthen the engagement of our core user cohort.

Our IoT service MAUs continued to witness a double-digit year-over-year increase in the first quarter, which was primarily attributable to our comprehensive IoT entertainment content integrating music, singing, live streaming, long-form audio and more. In the first quarter, we worked with Little Genius Smart Watch (Speaking foreign language) and multiple electric vehicle manufacturers, such as NIO (Speaking foreign language) and XPeng (Speaking foreign language), to provide karaoke functionalities on IoT devices.

Due to macro headwinds, our online music revenue decreased year-over-year in the first quarter. However, our fundamentals remain healthy and we successfully sustained our growth momentum in subscriptions. We achieved a net add of 4 million in the first quarter and a paying user penetration rate of 13.2%. At the same time, user retention remained largely stable.

For the remainder of 2022, we are committed to delivering a healthy balance between paying user growth and ARPPU, which reflects the quality of growth of our online music business.

In the first quarter, as the pandemic weighed on our advertising business, we continued to implement innovative, diverse advertising solutions to unlock more ad revenue potential. To fully leverage our large user base, we are testing a free listening mode, where users can listen to songs for 30 minutes for free, with every 15 seconds of video-rewarded ads that they watch.

In addition, our Music Promotion service (Speaking foreign language) and Playlist Bonus Tasks (Speaking foreign language), which allow for accurate targeting of the right audience and increase in streaming volume and popularity of selected songs for a fee, have both achieved early success with strong growth in their daily revenue in-streams.

We also forged ahead with new business models to enrich user experience and monetization avenues. In the first quarter, we launched our Super VIP Membership (Speaking foreign language), which complements the 2 existing tiers of our subscription

plan, and incorporates up to more than 50 privileges, including access to more music and audio content, as well as digital albums for a monthly fee of RMB30.

Additionally, in the first quarter, we continued to explore the tie-ins between celebrity artists with our music pets, digital collectables and Putao Mall.

To captivate more Gen-Z users and cultivate a young and trendy cultural community, we further embraced our deep roots in the college campus scene, and spared no effort in bringing more and more promising voices to be heard with our campus musician cultivation plan Voila! Campus (Speaking foreign language).

In the first quarter, we are particularly proud of the positive impact we have had on female campus musicians included the winner of the First Prize Scholarship of Voila! Campus and Chinese folk-fusion musician Georgina Qian (Speaking foreign language), who created the Chinese Ancient Style original work Mulan (Speaking foreign language) based on the classic heroine. With this song, Georgina bloomed on the CCTV program Sing My Heart (Speaking foreign language), exemplifying female bravery and spiritual power.

We were also instrumental in her collaboration with household names and brands such as the award-winning lyricist Vincent Fang (Speaking foreign language), Lancome (Speaking foreign language), PUBG Mobile (Speaking foreign language), and QQ Speed Mobile (Speaking foreign language) to produce original theme songs, helping her achieve accelerated professional growth and broader recognition.

Now let's turn to our social entertainment services. Both MAUs and paying users were affected during the quarter by seasonality as well as macro headwinds. Facing the fast-changing landscape, we will continue to improve our competitiveness through ongoing product innovations and new initiatives in social entertainment, such as audio live streaming, international expansion and virtual interactive product offerings.

For WeSing, to achieve our goal of making singing more fun and recording more professional, we provided innovative, easy-to-use features and tools to elevate users' singing and playing experience, as well as energize the relationship among our users. Our investments in these innovative singing and playing tools in the past few quarters started to pay off, as the adoption rates of, and the user time spent in our singing room, both improved year-over-year and quarter-over-quarter.

Facing competition for our traditional live streaming services, we will strive to generate more differentiated content and user experiences. Firstly, we continued to make progress in vertical content category expansion. Focusing on the She economy, Kugou Live launched the Goddess Festival event in March, which successfully attracted female users with premium ARPPU to enjoy our audio live streaming rooms.

Our audio livestreaming business achieved a double-digit year-over-year increase in revenues in the first quarter, and will become a key component of our overseas development strategy due to higher monetization efficiency in international markets.

We also broadened WeSing's target user base by adding live streaming educational content addressing seniors' online learning and sharing needs, such as lessons on square dancing, calligraphy and traditional Chinese operas.

Secondly, cross-platform collaboration is another way we can differentiate. For example, our first real-time live singing event, Meet, Let's Sing (Speaking foreign language), cohosted by QQ Music Live Streaming and WeSing, brought premium karaoke content to live streaming. QQ Music Live Streaming advanced steadily with the number of hosts increasing rapidly and daily active hosts reaching a record high of 10,000 during the first quarter.

In conclusion, we kicked off 2022 by facing challenges head on, but we remain confident as we execute our dual engine content-and-platform strategy. We will persist in making our ecosystem, our content and our products differentiated and highly specialized, which in turn will help us capture the hearts and minds of hundreds of millions of music lovers and unlock the massive opportunity in front of us.

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 Q1 2022 were RMB6.6 billion, down by 15% year-over-year and by 12.7% sequentially.

In the first quarter of 2022, our IFRS net profit was RMB649 million and non-IFRS net profit was RMB939 million, which represented a sequential increase of 8%, as a result of our focus on operating efficiency.

In the first quarter of 2022, music subscription business continued healthy growth with revenues of RMB1.99 billion and year-over-year growth of 18%, as we benefitted from expanded sales channels and paying user loyalty due to high-quality content and services we provide. Online music paying users grew to 80.2 million, up 32% year-over-year, representing 4 million net adds sequentially.

Monthly ARPPU was RMB8.3 this quarter, compared to RMB9.3 in the same period last year, as we offered more effective promotions to attract users. Taking out the impact from fewer calendar days in Q1, ARPPU maintained stable sequentially, as we focus on the quality growth of our overall subscription revenues.

Revenues from advertising dropped on year-over-year and sequentially as our advertising business continued to be negatively impacted by the industry adjustment and seasonality. Our advertising revenues were also impacted by the outbreak of Covid-19 and lockdown in some major cities. We are proactively expanding the ad inventories, optimizing ad display, and rolling out innovative advertising formats to manage these challenges.

While we expect ad growth will continue to be impacted in the short term due to headwinds from regulation on splash ads and regional Covid-19 outbreak, we remain

confident about the long-term growth potentials, and expect advertising revenue to start recovering in the second half of 2022.

Sublicensing revenues also dropped on a year-over-year basis and sequentially due to restructuring of agreements with certain music labels.

Social entertainment services and other revenues were RMB4 billion, down by 21% year-over-year, as we faced an evolving macro environment and intense competitions from other pan-entertainment platforms. To adapt to the changing environment and to stabilize revenue scale, we have differentiated our content offerings by enriching our virtual interactive product offerings and enriching cross-platform collaboration. And we are also expanding our international footprint as discussed earlier.

Gross margin in Q1 was 28%, down by 3.5% year-over-year due to the following factors: First, given the continuous growth in music subscription revenues, our revenue mix shifted, with revenues from online music, which generally have a lower gross margin, accounting for a higher percentage of revenues. Second, revenues from audio live streaming, whose gross margin was relatively lower, also grew faster and accounted for a higher percentage of revenues. In addition, the decrease of advertising and sublicensing revenues also impacted the margin.

Meanwhile, our tight control on content costs with increased ROI requirements, as well as lower revenue-sharing ratios for social entertainment business, had a favorable impact on gross margin on a sequential basis.

Now moving on to operating expenses, total operating expenses for Q1 2022 were RMB1.3 billion or 20% as a percentage of total revenues, which was relatively stable comparing with last year. Taken out the impact from acquisition of Lazy Audio, operating expenses, as a percentage of revenues, would have been slightly lower year-over-year.

Selling and marketing expenses were RMB330 million, down by 51% year-over-year. During the quarter, we took measures to improve efficiency, closely monitored on the ROI of each promotion channel, better utilized external promotion channels, and leveraged our internal traffic to attract users and promote our brands.

General and administrative expenses were RMB1 billion, up by 15% year-over-year. Excluding the impact of approximately RMB44 million from the acquisition of Lazy Audio, G&A would have increased by 10% year-over-year. The increase was driven by a higher number of employees in R&D as we invested in product enhancements, technology innovations and more diversified product offerings.

Meanwhile, we have been closely monitoring employee-related expenses, and taking actions to improve headcount efficiency, which started bearing fruits this quarter and resulted in a decrease in G&A expenses on a sequential basis.

Our effective tax rate for Q1 2022 was 12.2% compared to 11.5% in the same period of 2021. The increase in effective tax rate was mainly due to some of our entities are entitled to different tax benefits in 2021 and 2022.

Our net profit was RMB649 million and net profit attributable to equity holders of the Company for Q1 2022 was RMB609 million. Non-IFRS net profit was RMB939 million and non-IFRS net profit attributable to equity holders of the Company was RMB899 million. Non-IFRS net profit margin was 14.1%.

As of March 31, 2022, our combined balances of cash, cash equivalents, term deposits and short-term investments were RMB25.9 billion, representing an increase of RMB1.2 billion from December 31, 2021.

Looking forward, we will continue to focus on our core business, and invest mindfully in new products and services, including long-form audio and international business, with a focus on investment returns and future growth potentials. Meanwhile, we will continue to effectively control headcount-related costs and selling and marketing expenses to improve the overall operational efficiency.

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 today, Mr. Tony Yip, for closing remarks.

Tony Yip: Thank you, everyone, for joining us today. If you have further questions, please feel free to contact our Investor Relations team. And this concludes the call today. We look forward to speaking with you again next quarter. Thank you and bye for now.

Cussion Pang: Thank you, bye.

Shirley Hu: Thank you, bye.

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