

[TME] - Tencent Music Entertainment Group
Q2 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

Alex Poon, Morgan Stanley
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Tian Hou, TH Capital

Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group's Second Quarter 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. The Company will discuss non-IFRS measures today, which we believe are meaningful metrics for evaluating our performance. Please refer to our earnings release and SEC filings for a reconciliation of these measures to the most comparable IFRS measures.

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 June 2022, we celebrated the first anniversary of launching our dual engine content-and-platform strategy. Over the past year, TME has continuously innovated business models and improved our all-in-one music entertainment content and product capabilities to better serve our users and partners. Meanwhile, facing the complex and evolving industry landscape, we continue to explore music's intrinsic commercial and cultural value. As always, we strive to nurture our music ecosystem and foster the sustained, healthy development of China's music industry.

On the content side, we steadily enriched our original content production capabilities. To that end, we launched a new smart music assistant functionality in May, enabling creators to quickly make decisions through our proprietary PDM predictive model at key stages of the music production process, such as demo screening, and market appeal potential evaluation.

Each of our tools facilitates more efficient production of high-quality work, evidenced by dozens of original songs produced and streamed more than 100 million times in the second quarter. Notably, Blessing of Three Lifetimes, (Speaking foreign language), a song by Hai Lai A Mu, dedicated to his beloved partner, was a blockbuster that we produced, promoted and helped to enlist on the variety show The Treasured Voice, (Speaking foreign language). It dominated major music charts and generated huge social media buzz comprising over 2.5 billion views and 350 million streams in the second quarter.

Meanwhile, we continued to refine our original content catalog, focusing on key verticals such as gaming and hip-hop music. In the second quarter, we collaborated with popular game titles, including Honour of Kings, (Speaking foreign language), League of Legends Pro League, (Speaking foreign language), and Peacekeeper Elite, (Speaking foreign language), among others, and worked with well-known artists including Angela Zhang (Speaking foreign language), Jam Hsiao (Speaking foreign language) and Shin (Speaking foreign language) to produce 15 chart-topping game songs.

Notably, the theme song of the Honour of Kings' game character Shangguan Waner (Speaking foreign language), sung by Yisa Yu (Speaking foreign language), has achieved the highest number of first-week streams among all QQ Music game songs released in the first half of 2022.

What's more, in the trendy hip-hop genre, we cooperated with the NBA on its 75th anniversary album. The title single, Time to Shine (Speaking foreign language), performed by Chinese artist Lay Zhang (Speaking foreign language) and American pro-basketball star Nick Young, became the first Chinese theme song to appear in the NBA finals.

Next, through Tencent Musician Platform, we spared no effort to cultivate a vibrant community of indie musicians while creating a positive social impact. Tencent Musician Platform continues to empower musicians with a wealth of online and offline promotion capabilities and monetization avenues. In the second quarter, we introduced a new service for our musicians to easily mass-distribute musical works globally to over 150 popular platforms such as Spotify and YouTube with a single click, which has already brought 190,000 songs by over 10,000 musicians to overseas audiences as of the end of the second quarter.

Kugou also now allows musicians to publish their songs easily on mobile phones, and to self-host pay-per-view live events with merchandise sales embedded. For instance, we recently hosted a paid online birthday party for musician Yu Yan (Speaking foreign language), with a rich pipeline of additional parties yet to be unveiled. What's more, as a long-term support program for musicians, our Force Stage 2022 program launched the Open Mic series in April, which has already produced offline performances by over 70 groups of musicians across 7 cities.

Tencent Musician Platform also plays a pivotal role in exploring China's rich, deeply embedded social and cultural values through music works. Notable examples in the second quarter include, first, New Trend in Chinese Ancient Style, (Speaking foreign language), an album birthed by up-and-coming and top musicians who gathered to promote Chinese culture through music; second, My Girls, our music creation plan for female musicians designed to promote female independence and self-awareness; third, a Sino-French album, "MOSAÏQUE (Speaking foreign language), a joint effort between our musicians, French musicians and the French embassy, which was showcased on the front page of Apple Music's recommendation list, further enhancing our musicians' international appeal.

With our finger on the pulse of our users' preferences, we continue to zoom in on both trendy and time-honored music experiences. To further enhance the quality and variety of music on our platform, as well as our reputation as the go-to destination for key music verticals such as classical, DJ and hip-hop, we established strategic cooperative relationships with professional classical art institutions, launched Kuwo's DJ For Everything Plan, (Speaking foreign language), and built up Kugou's new rap brand Rap Trailblazer, (Speaking foreign language), among other initiatives in the second quarter.

One remarkable success was the 2022 hit single She Can Do Magic, (Speaking foreign language), by DJ Little Fish (Speaking foreign language), which dominated charts on many music platforms after its creator joined the DJ For Everything plan, achieving nearly 700 million streams by the end of the second quarter on TME's platform.

Moving onto TME Live. Our comprehensive online-merge-offline performance brand has presented 132 high-quality live music performances since its debut 2 years ago. In the second quarter, in addition to online live concerts for Roy Wang (Speaking foreign language), among others, TME Live was also proud to breathe new life into two legendary series of recorded concerts by household-name artists Leslie Cheung (Speaking foreign language) and Jay Chou (Speaking foreign language), supporting the ultra-high-definition visual and sound restorations enhanced by AI algorithms for selective events. These 2 huge hits went viral and dominated the top trending list, accumulating over 100 million unique viewers within the Tencent ecosystem, and social media buzz of 6 billion views.

Jay Chou's concert also set a new record in viewership for online concerts in the industry, and his artist merchandise, including 2 action figures, sold through our Putao Mall and Tencent channels, achieved close to 10 million RMB in GMV in the second quarter.

TME Live not only serves as an online stage for artists and musicians, but also demonstrates our game-changing creativity offline. Through our TME Live IN House live house tour, we are providing participating artists and users with immersive, interactive experiences. Early starter artists, including Young Jack (Speaking foreign language), WhitePaper (Speaking foreign language) and KAFE.HU held live events in the second quarter and tickets for some events were sold out in just 2 hours.

In summary, what matters most to music lovers, music creators, and the broader music industry are the primary areas where we will continue to invest and drive innovation, showcasing our ambition to support the sustained growth of the music ecosystem in China.

That concludes 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 second quarter, we continued to innovate our four pillars of entertainment, namely listen, watch, sing and play, to provide our users with a stage to express their musical tastes and build their sense of identity on TME's platform, which in return deepens their recognition of and connection with our products.

In terms of Listen, in the second quarter, we added a variety of refined product features to provide a more professional music streaming experience. For example, we pioneered home page lyrics (Speaking foreign language), which displays synchronous lyrics on the mobile home screen when streaming songs. We also rolled out a premium sound feature (Speaking foreign language) supporting real-time sound quality enhancement, which is now available via our super VIP membership and has been activated by 85% of these subscribers.

What's more, to further improve users' music discovery efficiency, in the second quarter, QQ Music launched Radar Mode (Speaking foreign language) on the home page, which

recommends songs to users based on their favorites with the help of personalized algorithms, contributing to new highs for QQ Music's recommendation penetration.

In addition, Kugou rolled out a new search feature allowing users to easily find different versions, remixes or styles of the same song. We also added features such as looped playback of a selected song section (Speaking foreign language) and self-defined music chart preferences (Speaking foreign language) to create a more personalized music streaming experience.

As for Watch, visuals add another dimension to users' immersive music entertainment experience. Based on our understanding of users' preferences, the music-related video content we provide to Weixin Video Accounts is very popular among users on Weixin, ranking among the best in the music category of Weixin Video Accounts. We also continued to work with Weixin Video Accounts during the second quarter to boost our promotion capabilities, especially for indie musicians. The number of our musicians with connected Weixin Video Accounts continued to grow by double-digits quarter-over-quarter.

Meanwhile, our products also released new updates to strengthen visual experiences, including, one, customized dynamic images on personal playlists, and two, Focus Station (Speaking foreign language), which provides a video-enhanced listening experience across three scenarios: studying, sleeping aid and meditation.

The third pillar of the unique music entertainment experience we provide is Sing. WeSing launched a major version upgrade in July to expand the experience of singing from a mere production of audio works into a multi-dimensional performance experience. In the second quarter, we rolled out a 3D avatar functionality, KK Show, to serve as users' identity card in the virtual world and allow them to generate dance moves when recording and singing in their dressed-up avatars on stage.

Additionally, in the second quarter, we provided innovative singing tools to stimulate users' interest in music creation as participation formats evolve. WeSing pioneered the industry's AI-based voice synthesis technology, allowing music rookies to create a virtual singer based on their own voice, which improves upon its likeness to its owner as it receives additional input. Kugou also unveiled its first AI singer in the voice of Gen Z celebrity Yang Chaoyue (Speaking foreign language), enabling users to customize and synthesize songs with just one click.

Riding on the trend of virtualization, we've also enhanced our Play element by extending our use cases and monetization opportunities across music-based virtual interactions. In the second quarter, TMELAND, our immersive virtual theme park, teamed up with Adidas Originals and hosted China's first virtual rap concert Landing on the OZ Future (Speaking foreign language), including sensational avatar performances by popular rappers Jay Park (Speaking foreign language) and MC Jin (Speaking foreign language), as well as a virtual, shoppable fashion show. The sponsored event registered over 7 million views, setting a new record in viewership for TMELAND.

We also continued to upgrade our VR album rooms, which combine listening to songs with a virtual exhibition hall for artists. A total of 13 stars have settled in our VR album rooms since launch, including singer and actress Cyndi Wang (Speaking foreign language) and musician Liu Shuang (Speaking foreign language), who joined in the second quarter. As a pioneer in the application of our innovative listen, watch, sing and play functions, QQ Music has continued to improve its MAUs year-over-year, a testament to our young content operations and advanced feature iterations.

Our long-form audio serves to round out our music portfolio while simultaneously differentiating our content. Notably, we have been strengthening our brand appeal in sleeping aid content, one of the fastest-growing categories on QQ Music. We have teamed up with professional organizations, music labels, musicians, hotels and other ecosystem partners to provide diverse professional sleeping aid content read by AI or real-world celebrities, and delivered sequential growth in user scale, streaming volume and time spent in this vertical.

In addition, in the second quarter, we continued to enhance our collaborations with Tencent Video to successfully promote popular audiobooks and associated IPs, such as the third season of (Speaking foreign language) and (Speaking foreign language). As these beloved dramas hit the airwaves, TME's long-form audio offerings of the same titles enjoyed a massive upswing in their streaming volumes.

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 the second quarter, our online music MAUs were 593 million, down year-over-year primarily due to reduced marketing spend. However, subscription revenue continued to deliver robust year-over-year and quarter-over-quarter growth, along with paying user growth and a sequential rebound of ARPPU. Meanwhile, we continued to strengthen engagement among our core user cohorts by deploying richer content, innovative product features and continual new iterations.

Our IoT service MAUs continued to achieve double-digit growth year-over-year, as we enriched the use cases of our products and established collaboration with a broader group of partners. For example, we now partner with the top 50 passenger vehicle and top 15 electric vehicle manufacturers by sales, bringing car owners the ultimate in-vehicle music enjoyment through new features such as Dolby surround sound and thousands of customized sound effects.

In addition, through our partnership with Little Genius Smart Watch (Speaking foreign language), which is mostly used by students, WeSing's MAUs in the smart watch segment grew triple-digits year-over-year.

Despite the macro headwinds that weighed on our online music services revenue in the second quarter, subscriptions maintained its growth trajectory, with 18% subscription revenue growth year-over-year. We are also confident we can sustain the ongoing

rebound of our ARPPU while continuing to boost paying user growth during the remainder of this year.

As a result of macro changes and the resurging Covid-19 outbreak in the second quarter, our advertising revenue softened year-over-year. However, it rebounded quarter-over-quarter, driven by the June 18 e-commerce sales promotions, as well as ad sponsorship opportunities arising from TME Live and TMELAND.

In addition, we consistently innovated to build a diversified advertising portfolio. Our incentive ad-based free-listening mode is making good progress, and during the second quarter, we launched a host of new advertising formats and inventories on music charts, search pages, banners and playlists, among others. As we have strengthened our advertising monetization with additional avenues, we also successfully attracted well-known brands such as Sprite, Beijing-Hyundai and Pepsi to sponsor a variety of customized online and offline live events recently, attracting participation by dozens of popular artists and aspiring musicians in these highly engaging events.

We continued to deepen our content partnership to enrich the user experience and explore additional monetization avenues in digital music. First, accompanying the launch of Jay Chou's (Speaking foreign language) latest digital album, Greatest Works of Art (Speaking foreign language), we tailored diverse activities for his fans, such as a customized vinyl record player interface and sound effects, artist merchandise, and interactions in Jay Chou's virtual room. Copies sold exceeded 6 million by the end of July, marking another digital album blockbuster on our platform.

Next, in the second quarter, we entered into strategic partnerships with Time Fengjun Entertainment, the music label of TFBOYS and Teens in Times (Speaking foreign language), avex China and the talented female artist XIN Liu (Speaking foreign language), among others, where our platform has a head-start period on their latest music, customized artist merchandise or unique artist-fan interaction events.

Third, we joined hands with YH Entertainment Group (Speaking foreign language), a well-known artist management company, to launch Artist Subscription (Speaking foreign language) packages for its 13 well-known artists such as Meng Meiqi and Justin Huang (Speaking foreign language), providing customized audio and video content for their subscribing fans.

We also doubled down on our efforts to build a young and trendy cultural community to expand our Gen Z user base. In the second quarter, our campus musician cultivation plan, Voila! Campus (Speaking foreign language) organized the Wish For A Happy Graduation (Speaking foreign language) event, and teamed up with artist Mao Buyi and campus musician Yang Ge to release the song Small World (Speaking foreign language). These initiatives brought inspiring messages to the first group of graduates born in the 2000s, resonating strongly with the new-graduates demographic.

What's more, we began to bring offline music festivals back to our audiences in the second quarter, such as Kugou's Cool Fun (Speaking foreign language) live performance

parade, which debuted in Hangzhou in May, and the first WAVE Music Festival partnered with SAIC Audi (Speaking foreign language) in June, encouraging online live streaming and offline interactions between fans and musicians. These events are just the beginning of our return to live performances. We have an exciting lineup of offline experiences planned for the coming quarters.

Now let's turn to our social entertainment services. Its MAUs sequentially improved while paying users declined year-over-year due to competition and industry adjustments. We will continue to improve our competitiveness through ongoing product innovations and new initiatives, such as audio live streaming and virtual interactive product offerings.

For WeSing, we launched its latest version with tools to energize the singing experience while lowering the barrier to participate. For instance, the upgraded one-click voice enhancement feature (Speaking foreign language) customizes voice improvement based on the song's rhythm as well as users' voice volume and timbre, producing a more natural effect. Along with other upgrades mentioned earlier, these efforts paid off, as evidenced by the strong double-digit year-over-year expansion in karaoke room penetration and user time spent in the second quarter, in addition to the year-over-year growth in recording's penetration and user time spent.

In the second quarter, WeSing also capitalized on the success of the hit song Lonely Warrior (Speaking foreign language), which debuted on TME and achieved 4 billion streams across our platform since its launch, with a nationwide cover contest to convey positive cultural power to school students, attracting a broad group of participants online.

In response to the competition faced by traditional live streaming services, we continued to expand our content verticals and bring more differentiated content to improve user experience.

QQ Music Live Streaming continued to expand the scale of its audio livestreaming content offerings, where its expanded content across sleeping aid, studying and commuting use cases received wide user acclaim. In the second quarter, it also collaborated with Tencent Musician Platform to organize 39 sessions of the real-time live singing event Meet, Let's Sing (Speaking foreign language), connecting musicians and their fans and gaining over 10 million viewers. These efforts contributed to double-digit growth in the average daily number of hosts and viewers, as well as a year-over-year increase in QQ Music Live Streaming's revenue in the second quarter.

We were also successful in exploring overseas markets with audio live streaming activities such as chat rooms, leading to strong revenue growth in overseas markets in the second quarter.

We also delved into the virtual idol and animation live streaming verticals favored by the young generation. WeSing added a new Live2D function, which captures hosts' expressions and movements in real time, and allows the host to use an avatar for live streaming and multi-person interactions. Additionally, Kugou's live streaming hosts, together with its self-owned virtual idol Shanbao and Tencent Animation and Comics

(Speaking foreign language), jointly organized a number of events to recommend popular comic IPs to ACG fans through live streaming, during which the events' participating hosts recorded triple-digit growth in user time spent and the number of viewers of their live streaming rooms.

Last but not least, I'd like to close with a word about our social responsibility initiatives. On Children's Day, we worked with Tencent to launch the Little Red Flower Charity Concert (Speaking foreign language), uniting over 30 groups of artists and musicians in a heartwarming live concert for children with special needs. We also partnered with La Mer to host a special public welfare concert for World Oceans Day, launching a welfare song Blue New Life (Speaking foreign language) by Mao Buyi to create environmental awareness around the marine ecosystem. We are proud of these efforts to leverage the emotional power of music to advance our social commitment.

To conclude, as our dual engine content-and-platform strategy moves forward, we will continue to use technology to elevate the role of music in people's lives and support the sustainable development of the music industry with our strong and growing toolkit.

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 Q2 2022 were RMB6.9 billion, down by 14% year-over-year and up by 4% sequentially.

In the second quarter of 2022, our IFRS net profit was RMB892 million and non-IFRS net profit was RMB1.07 billion, which represented a sequential increase of 13%, as a result of our effective cost control and improved operating efficiency.

In Q2 2022, we are more focused on the return of the promotions for subscription services and continued to strengthen content operations. We achieved quality growth in subscription services. Music subscription revenues grew to RMB2.11 billion, up by 18% year-over-year and by 6% sequentially.

Online music paying users grew to 82.7 million, up by 25% year-over-year, representing a 2.5 million net adds sequentially as we benefitted from expanded sales channels and paying user loyalty resulted from the ongoing efforts we made to cultivate users' willingness to pay for music and high-quality content and services we provide.

Monthly ARPPU was RMB8.5, representing a decrease from RMB9 in the same period last year and an increase from RMB8.3 in the first quarter of this year. Our strategy to grow our music business in a healthy and sustainable way has started to bear fruit and contribute to the continuous growth in music subscription revenues.

Revenues from advertising decreased year-over-year as advertising business continued to be negatively impacted by the industry adjustment and the outbreak of Covid-19. However, advertising revenues grew sequentially as advertising business began to recover moderately from the outbreak of Covid-19 since June.

The June 18 e-commerce sales promotions also contributed to the sequential increase in advertising revenues. We are proactively expanding ad inventories, optimizing ad display, and rolling out innovative advertising formats to manage these challenges. We remain confident about the long-term growth potentials and expect advertising revenue to continue to recover moderately in the second half of 2022.

Social entertainment services and other revenues were RMB4 billion, down by 20% year-over-year, as we faced an evolving macro environment and intense competition from other 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.

Meanwhile, we continued to invest in audio live streaming and expand our international business, resulting in growth in revenues from audio live streaming and oversea business year over year and sequentially.

Gross margin in Q2 2022 was 29.9%, down by 0.5% year-over-year because the decrease in our total revenues outpaced the decrease in our total cost of revenues, as some of them remained fixed in nature. Gross margin improved sequentially, resulted from our effective control on content costs, including revenue sharing fees for live streaming business, and improved operational cost efficiencies. We will continue to take measures to manage costs effectively and improve overall efficiency.

Now moving on to operating expenses, total operating expenses for Q2 2022 were RMB1.4 billion or 20.5% as a percentage of total revenues, down by 0.4% from 20.9% as a percentage of total revenues in the same period last year. Excluding the impact from the expenses related to our application for secondary listing, operating expenses as a percentage of total revenues would have decreased by 1% year-over-year.

Selling and marketing expenses were RMB303 million, down by 55% year-over-year. During the quarter, we continued to take measures to improve efficiency, closely monitored the ROI of each promotion channel, better utilized external promotion channels, and leveraged our internal traffic to attract users and promote our brands. The reduced marketing spend resulted in loss of some casual users and impacted our music MAUs negatively. However, our music subscription services continued to grow rapidly with healthy growth in paying users and level of user activities.

General and administrative expenses were RMB1.1 billion, up by 11% year-over-year. Excluding the impact of approximately RMB44 million from the expenses in Q2 related to our application for secondary listing, G&A would have increased by 6% year-over-year. We continued to invest in product enhancements, technology innovations and more diversified product offerings, as well as closely manage employee-related expenses by improving headcount efficiency.

Our effective tax rate for Q2 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.

For Q2 2022, our net profit was RMB892 million and net profit attributable to equity holders of the Company was RMB856 million. Non-IFRS net profit was RMB1.07 billion and non-IFRS net profit attributable to equity holders of the Company was RMB1.03 billion. Non-IFRS net profit margin was 15.4%.

As of June 30, 2022, our combined balances of cash, cash equivalents, term deposits and short-term investments were RMB25.8 billion, compared with RMB25.9 billion as of March 31, 2022. During the 3 months ended June 30, 2022, net cash generated from operations was RMB1.2 billion and cash used in share repurchases was RMB969 million.

We also incurred a net cash outflow of RMB497 million for acquisition of shares in various subsidiaries and associates. Such combined balance was also affected by the change in the exchange rate of RMB to USD at different balance sheet dates.

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, to maximize our investment returns and future growth potentials. Meanwhile, we will continue to implement cost controls in areas including revenue sharing fees for social entertainment business, content royalties, operation costs, headcount-related costs and selling and marketing expenses to improve our 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: Okay. Well, thank you very much for joining our second quarter earnings call. If you have further questions, please feel free to contact the Investor Relations team. And this concludes today's call. We look forward to speaking with you all again next quarter. Thank you, and goodbye.

Cussion Pang: Thank you so much. Goodbye.

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