

[TME] - Tencent Music Entertainment Group
Q3 2022 Earnings Conference Call
November 15, 2022 6:00 AM ET.

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
Lei Zhang, Bank of America Merrill Lynch
Lincoln Kong, Goldman Sachs
Alicia Yap, Citigroup
Xueqing Zhang, CICC
Wei Xiong, UBS
Thomas Chong, Jefferies & Co.
Lee Charlotte, HSBC

Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group Third 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.

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 IFRS in our earnings release and SEC filings.

With that, I'm pleased to turn over the call to Mr. Cussion, Executive Chairman of TME. Cussion?

Cussion Pang: Thank you, Tony. Hello, everyone, and thank you for joining our call today. I'd like to begin by acknowledging all the hard work that went into our successful listing on the Main Board of the Stock Exchange of Hong Kong under Stock Code 1698 on September 21, in addition to our primary listing on the New York Stock Exchange. We are truly grateful to our users, employees, partners and investors who have been with us along the way and helped us reach this important milestone.

From this vantage point, we plan to further advance our dual engine content-and-platform strategy to support original content on our platform, expand our innovative business models, work with more partners to tap into the music market's potential, and fulfill our social responsibilities, thereby comprehensively promoting the healthy, diverse, and sustainable development of China's music industry.

Providing differentiated content, particularly by way of original content production, is our bread and butter, and further expands our already large and diverse content library that appeals to cross-generational audiences. To that end, in the third quarter, we rolled out a voice synthesis technology, Lingyin Engine, to quickly and vividly replicate the singer's voice for use in original songs of any style and language.

Utilizing this patented technology, we have developed the synthetic voices in memory of legendary artists such as Teresa Teng, the [Legend] and Anita Mui (Speaking foreign language), and created an AI singer lineup with the voices of trending stars such as Yang Chaoyue, among others.

As of the end of the third quarter, we have launched over 1,000 songs with AI synthetic voices. Notably, the female song's version of Today, (Speaking foreign language), has become the first song by an AI singer to be streamed over 100 million times across the internet. Additionally, we paid tribute to Anita Mui by creating an AI voice based on hers for the 2022 theme charity song of the New Sunshine Charity Foundation, May You Be Treated Gently by the World, (Speaking foreign language), which is also the hold music for today's earnings call. It was well received by a wide range of listener cohorts, showing the broad reach of our social commitment through technology and music.

As the digital music industry thrives, music lovers' tastes in music have grown increasingly varied. We are thrilled that the concept album Endless Farewell, (Speaking foreign language), by our indie musician Akini Jing, (Speaking foreign language), was recognized as the monthly pick by Pitchfork, a worldwide authority in music reviews.

In the third quarter, we also produced a number of original singles which went viral on the internet and each raked in over 100 million streams, such as Heard from You,

(Speaking foreign language), by Dongran. All these achievements demonstrated our ability to expand the influence of our original works by bringing them to both domestic and overseas audiences.

Furthermore, in deep collaboration with the broader Tencent ecosystem, we explored the chemistry between music and popular IPs, including League of Legends: Wild Rift, (Speaking foreign language), QQ Speed Mobile, (Speaking foreign language), and Assault Fire, (Speaking foreign language), along with renowned artists, such as Stefanie Sun, (Speaking foreign language), Angela Zhang, (Speaking foreign language) and Jason Zhang, (Speaking foreign language), to create themed gaming music in the third quarter. Through these stimulating collaborations as well as both online and offline promotions, we have further raised the popularity of gaming music on our platform.

Next, let's look at the Tencent Musician Platform. Leveraging our robust technology to innovate and augment our one-stop service offerings for musicians, in the third quarter, we launched a new feature, TME Artists' Albums, (Speaking foreign language). This feature helps musicians release digital albums on all TME platforms at the prices they set with automatically-generated sales pages. By the end of the third quarter, 281 of our musicians had utilized this new feature and received the income generated by their album sales, shortening the release time and lowering the barrier for them to forge closer connections with their audience.

Second, we continued to launch a broad array of activities and initiatives to support our musicians and help them shine on stage. In the third quarter, we discovered Enoch Wang, (Speaking foreign language), a young hi-po musician, provided him with comprehensive guidance from song selection to wardrobe, styling, and personal expression, and signed him up for the Sing! China, (Speaking foreign language), variety show, jumpstarting his career as a musician within just 2 months.

What's more, in the third quarter, we also recommended a diverse group of our musicians, including Sunny Lai, (Speaking foreign language), Deng Yujun, (Speaking foreign language), S.I.N.G, (Speaking foreign language), Akini Jing, (Speaking foreign language), Liu Shuang, (Speaking foreign language), Georgina Qian, (Speaking foreign language), and HomeBoy, (Speaking foreign language), to various shows and events hosted by TME and sponsored by Sprite, SAIC Audi and JD, among others, demonstrating our commitment to providing substantial promotion and commercial resources for our musicians. These endeavors empower our musicians to build a full lifecycle career while also facilitating their communication and connection with their fans.

By the end of the third quarter, we had served a total of 350,000 musicians, which also allowed us to attract more active and vibrant creators to our platform, further boosting the prosperity of our ecosystem.

Our content strategy also includes a keen eye toward improving the diversity of collaborations with top music labels and artists, both domestically and internationally. In the third quarter, we teamed up with YG Entertainment, Faye Wong, (Speaking foreign language), Roy Wang (Speaking foreign language), Lay Zhang, (Speaking foreign

language), and others, to provide our users with benefits in the 30-day head start period following the release of their new songs.

Notably, Jay Chou's digital album, Greatest Works of Art, (Speaking foreign language), recorded sales of close to 7 million copies by the end of the third quarter, whereas Lay Zhang's latest EP West, Taylor Swift's new pop album Midnights, and BLACKPINK's digital single Pink Venom and album BORN PINK also achieved dazzling sales, reflecting our users' pent-up demand for user engagement with artists from home and abroad.

Ongoing cooperation with professional institutions and industry partners also helps bolster our reputation as the go-to destination across diverse music verticals such as gaming, classical and electronic music. In the third quarter, we cooperated with the music label of NCPA Classics, (Speaking foreign language), among others, to debut the head start benefits for their releases.

We also collaborated with the world's top 100 DJs and over 30 domestic and international electronic music labels to launch Tomorrow's Drop, (Speaking foreign language), helping to bring electronic music into the limelight as a debut platform for international award-winning and globally-acclaimed electronic music.

Lastly, moving on to TME Live, our comprehensive online-merge-offline performance brand, which has consistently propelled the music entertainment and performance industry forward by exploring innovative interactive formats and monetization avenues. In the third quarter, TME Live hosted 32 online and offline performances by various A-list stars, including Han Hong and Wakin Chau.

At the same time, we unveiled multiple innovations to refresh the user experience. For example, at Wakin Chau's online concert, we pioneered the TME Live Moment interactive activity Vote Your Encore, (Speaking foreign language), marking the first time a livestreaming concert audience was invited to vote on the concert's closing song, creating a customized offline interactive experience for our online users and successfully accumulating close to 15 million unique viewers within the Tencent ecosystem. Going forward, we will incorporate more interactive formats in TME Live Moment during performances.

That concludes the 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, we continued to enhance our users' interactive experience by enabling new ways to listen, watch, sing and play on our platform and offering more satisfying experiences that address their diverse music tastes and nuanced needs. To meet users' core demands, we zeroed in on providing a nimble user interface and a tech-oriented, professional listening experience.

In terms of sound effect improvements in this quarter, we became the first music platform domestically to offer an immersive audio experience with Dolby Surround Sound, (Speaking foreign language), to our Super VIP Membership subscribers and in-car users, as well as indie music releases on our Tencent Musician Platform. In August, QQ Music also debuted Adaptive Sound, (Speaking foreign language), which adjusts the sound volume within a particular song based on human auditory perception characteristics to maintain a smooth listening experience.

To simplify the listening process, QQ Music and Kugou Music launched lock screen widgets on the iOS 16 system, which are essentially one-click shortcuts, as another pioneering move. We also upgraded our playlist function, which allows users to generate playlists in a single click by importing the songs referenced in texts, pictures and web links. QQ Music and Kugou Music now support automatic match in playlists with fitting sound effects and customized playlist posts also to inspire more sharing among users.

To bolster music discovery efficiency, we further optimized our smart recommendation feature with an upgraded algorithm in the third quarter. As a result of these refinements, QQ Music and Kugou Music's recommendation streaming volume and time spent per user both registered year-over-year increases.

What's more, as increasing virtualization takes hold, we have been adding more exciting and fun music entertainment scenarios while unlocking abundant monetization opportunities. In the third quarter, TMELAND, our virtual theme park, teamed up with Pepsi and its virtual idol group, TEAM PEPSI, to host another immersive virtual 3D live show. Enhanced by a 360-degree circular screen and a ground screen, the show registered over 4 million fans joining at TMELAND's newly built Livehouse station, our brand-new landmark venue.

In addition, we debuted Music Zone, a 2D virtual interactive music community for users to listen to purchased albums, play musical instruments, and interact with others at their self-decorated virtual homes.

We also launched an entertainment feature on QQ Music, Tan Go, (Speaking foreign language), which allows users to play with and truly feel the rhythm of selected songs by touching the keypads on the screen following the tempo of the songs.

As a pioneer in the application of our innovative listen, watch, sing and play functions, QQ Music has continued to improve its DAUs year-over-year, indicating healthy user engagement with our flagship products.

Now turning to long-form audio, to supplement the podcast ecosystem, we unveiled the Shengbo app, putting a one-stop audio creation assistant in our podcasters' pockets. On the back of TME's massive library of copyrighted books, our podcasters can now easily join the studio for auditions and distribute their content to all of TME's platforms with a single click, while managing their podcast programs with access to operational data as well as generating income.

In addition, we achieved a breakthrough in Text to Sound, TTS technology, facilitating AI audio creation under multiple roles, increasing word processing efficiency by 12 times, and growing the content synthesis speed of our virtual hosts by 4-fold in the third quarter. As a starting point to deploy the TTS technology, we have launched a lineup of virtual hosts to provide differentiated sleep-aid audio content, which has received wide acclaim from our users.

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. Now, let me walk you through our operating results in the third quarter. This quarter, our online music MAUs were 587 million, down year-over-year primarily due to churn of our casual users amid competition from pan-entertainment platforms, as well as cost optimization measures to focus on boosting monetization efficiency as a platform of scale. Nevertheless, QQ Music DAUs continued to increase year-over-year, indicating healthy user engagement with our flagship products.

Notably, online music paying users, a cohort representing high-quality users, continued to grow at a robust pace, and drove paying ratio to a new record, while ARPPU also kept improving sequentially, driven by our expanding content offerings and product enhancements, as well as broadened sales channels and moderated promotions. As a result, our subscription revenue continued to deliver healthy year-over-year and quarter-over-quarter growth.

Our IoT service MAUs continued to achieve double-digit growth year-over-year, as we enriched established collaborations and added new ones to our partner roster, such as BMW and Didi. We have also broadened our leading auto industry coverage by supporting new EV models, including Li Auto's Li L9, (Speaking foreign language), and BYD's Frigate 07, (Speaking foreign language). To improve users' in-car music experience, we launched updates for our in-car apps in the third quarter, featuring a brand-new user interface and upgrades to sound effects and content.

Our online music services revenues achieved healthy growth in the third quarter, with 19% subscription revenue growth year-over-year. We have been promoting the higher value Super VIP Membership, (Speaking foreign language), with an elevated experience powered by not only Premium Sound features, (Speaking foreign language), and Dolby Surround Sound effects, (Speaking foreign language), but also customized content.

For instance, at Teens in Times' TME Live online concert Endless Summer, (Speaking foreign language), which registered massive social media buzz totaling over 2 billion mentions, users with a Super VIP Membership were entitled to a variety of privileges, such as a Blu-ray playback of the concert at the highest resolution, cache and projection on TV screens, leading to a 20% increase in the number of Super VIP Membership subscribers. Going forward, we will roll out more privileged content and higher sound quality features to drive its membership conversion and retention.

Meanwhile, we strengthened the Artist Subscription offering, (Speaking foreign language), by onboarding more artists, whether up-and-coming, well-established or even AI singers, as well as by expanding the scope of benefits in the package to include privileges such as customized livestreaming events, online chats, and priority access to concerts and album signings. As of the end of the third quarter, we had launched a cumulative 28 artists debuting their subscriptions.

In addition, in the third quarter, we unveiled merchandise related to 21 artists with a total of over 100 SKUs in the Putao Mall, (Speaking foreign language). Accompanying the launch of Jay Chou's digital album Greatest Works of Art, we sold 100,000 pieces of his artist-related merchandise, while at the same time carrying out a series of warm-up promotional activities calling on music lovers to look back on Jay Chou's classics. As a result, 95 out of 100 of Jay Chou's existing songs made their way back onto TME's Popularity Chart, demonstrating our strong promotion capabilities and our skill in rejuvenating our music library.

Additionally, our advertising business continues to improve sequentially from the second quarter thanks to our innovative and diverse advertising product offerings, demonstrating solid resilience. For example, we made headway with our ad-based free-listening mode, which showed initial success with mutually-reinforcing growth in revenue and user engagement. Going forward, we plan to expand the free-listening mode's user coverage while enhancing engagement and boosting its revenue instream.

Moreover, we made further progress in innovative commercial advertising formats on TME Live and TMELAND, securing extensive sponsorships from well-known domestic and international advertisers across the e-commerce, food and beverage, auto and banking industries, among others, as we help them raise the value and influence of their brands.

In the third quarter, we also continued to explore various business models. First, on the sublicensing side, our SaaS-based music copyright licensing service has expanded from the livestreaming vertical to other use cases that require legitimate music licensing, such as short videos, supermarket ambiance music, offline public performance and advertising soundtracks.

Second, we launched the industry's first professional data platform, TME Business Intelligence Platform, (Speaking foreign language). With high-frequency data updates totaling 150 times per day, this tool can assist music label partners in tracking the performance, popularity and listener profiles of their singers and copyrighted songs, equipping music professionals with a deeper understanding of the business value behind the data.

Now let's turn to our social entertainment services. Its MAUs and paying users declined year-over-year due to macro headwinds. We will continue to innovate our products and explore initiatives such as audio live streaming, international expansion and virtual interactive product offerings.

For WeSing, we continued to provide differentiated tools and content to help our users enjoy the singing experience. In the third quarter, we implemented an upgrade of privileges and benefits for WeSing's VIP users by launching the Sound Quality Enhancement feature in backing tracks, (Speaking foreign language), as well as Super Remix, (Speaking foreign language), and Smart Chorus, (Speaking foreign language), sound effects to create an authentic and fun singing experience.

What's more, as an important social platform, WeSing caters to diverse real-time communication scenarios. During the third quarter, WeSing launched multi-person singing and chat rooms in both video and audio settings, further driving growth in the penetration rate and user time spent in these rooms. We also brought our experience in these areas overseas to boost our international business development.

For livestreaming services, we continued to expand our differentiated content offerings and user experience. Benefitting from our streaming format innovations and deeper cooperation with our music content, revenues from audio livestreaming rose double-digit year-over-year in the third quarter to reach a new high.

What's more, leveraging our audio livestreaming business, combined with our know-how in artist incubation, we are providing ample space and support for our musicians to grow. For instance, our leading musicians and live streamers Mars, (Speaking foreign language), Shu Ze and Fan Ru started their careers via audio livestreaming. With TME's support in one-stop musician services, they released songs and earned copyright income with their music, adding another layer to their live streaming revenues. Their songs The Stars Are Not as Good as You, (Speaking foreign language), and Where Did You Go, (Speaking foreign language), became blockbusters during the third quarter and topped multiple TME's music charts.

Last but not least, while pursuing business growth, we have endeavored to fulfill our social responsibilities by creating an innovative model of music-empowered charity programs. On 99 Giving Day, (Speaking foreign language), we partnered with artists including Mao Buyi and Tencent Charity to launch Hear the Light of Music, (Speaking foreign language), a philanthropic album, and Surprised by Music, (Speaking foreign language), a charity concert, to raise awareness and funds for environmental protection, as well as young and elderly groups in rural areas. These events were well attended and garnered coverage from over 100 authoritative media outlets resulting in huge buzz, with over 600 million mentions on social media.

In summary, we are actively expanding and making connections through music. Powered by innovation and technology, we are introducing more products and services to China's dynamic music market, elevating the industry as a whole and reinforcing our business's competitive edge and resilience.

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. In the third quarter of 2022, our total revenues were RMB[7.4] billion, up by 7% sequentially. With the success of our effective cost control and improved operating efficiency, our profit position continued its growth trajectory since Q4 last year.

IFRS net profit for Q3 2022 was RMB1.1 billion. Non-IFRS net profit for Q3 2022 was RMB1.4 billion, up by 33% year-over-year and by 32% sequentially.

In Q3 2022, music subscription revenues grew to RMB2.2 billion, up by 18% year-over-year and by 7% sequentially.

Online music paying users grew to 85.3 million, up by 20% year-over-year, representing a 2.6 million net adds sequentially.

Monthly ARPPU in Q3 2022 was RMB 8.8, up from RMB 8.5 in the second quarter of this year.

These evidenced our strategy to grow music business healthily and sustainably has shown initial success. Our ongoing efforts to cultivate users' willingness to pay for music and high-quality content and services we provide, optimized product functionality and improved operation are bearing fruits. We believe increasing willingness to pay for music will drive healthy growth in music subscription services in the future.

Revenues from advertising grew both on a year-over-year basis and sequentially, as both online and offline markets began to recover from the impact of Covid-19. In addition, we have launched new advertising products, such as ad-based free-listening mode, to reinforce user engagement with improved monetization. We remain confident about the long-term growth potentials in advertising business.

In addition, with the launch of new digital albums, especially the successful launch of digital album for Jay Chou, and our strong promotional capability, we had revenues growth in sales of digital albums both on a year-over-year basis and sequentially.

Social entertainment services and other revenues were RMB 3.9 billion, down by 20% year-over-year due to the 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 livestreaming and expand our international footprint for long-term growth.

Gross margin in Q3 was 32.6%, up by 3% year-over-year and 2.7% sequentially. The increase was primarily due to our effective control on revenue sharing fees and content royalty costs, as well as improved operational cost efficiencies. These were all resulted from the implementation of our full spectrum cost control measures this year. The growth in advertising revenues and revenues from sales of digital albums also contributed to the growth in gross margin. We will continue to take measures to manage costs effectively and improve overall efficiency.

Now moving on to operating expenses, total operating expenses for Q3 2022 were RMB1.4 billion or 19.5% as a percentage of total revenues, down by 1.5% from 21% 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 2% year-over-year.

Selling and marketing expenses were RMB 245 million, down by 58% year-over-year, and this is our 3rd quarter with more than 50% cut in selling and marketing expenses on a year-over-year basis. Although the reduced spending on user acquisition had impacted on our MAUs, our core music subscription services continued its rapid growth trajectory. We continued to take measures to improve efficiency, closely monitor the ROI of each promotion channel, better utilize external promotion channels, and leverage our internal traffic to attract users and promote our brands. When evaluating the healthiness of business and assessing ROI, we focused more on measures such as level of engagement, user retention rate, etc.

General and administrative expenses were RMB1.2 billion, up by 13% year-over-year. Excluding the impact from approximately RMB 44 million of expenses related to our application for secondary listing, G&A would have increased by 9% year-over-year, mainly due to increased investment in research and development. We continued to closely manage employee-related expenses by improving headcount efficiency.

Our effective tax rate for Q3 2022 was 12.2% compared to 11.5% in the same period of 2021. The increase in effective tax rate was mainly because some of our entities are entitled to different tax benefits in 2021 and 2022.

For Q3 2022, our net profit and net profit attributable to equity holders of the Company were RMB1.1 billion. Non-IFRS net profit and non-IFRS net profit attributable to equity holders of the Company were RMB1.4 billion. Non-IFRS net profit margin was 19.2%.

For the third quarter of 2022, basic and diluted earnings per ADS were RMB0.67 and RMB0.66, respectively, up 49% on a year-over-year basis. Non-IFRS basic and diluted earnings per ADS were RMB0.87 and RMB0.86, respectively, up 41% on a year-over-year basis. Such results demonstrated our commitment and initial success on operating efficiency improvement, as well as the impact from share repurchase program.

We are endeavoring to provide high-quality investment returns for our investors and shareholders, and remain confident about our financial performance, the development of our business, and the overall industry.

As of September 30, 2022, our combined balances of cash, cash equivalents, term deposits and short-term investments were RMB25.4 billion, as compared with RMB25.8 billion as of June 30, 2022. 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 grow our core business with innovative and diverse products and services for our users, 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 our focus on operating efficiencies and adhere to tightened controls on costs and expenses to achieve healthy financial performance.

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

Operator: Thank you. And ladies and gentlemen, we are now approaching the end of the conference call. I will now turn the call over your speaker host today, Mr. Tony Yip, for closing remarks.

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

Operator: Thank you. This concludes today's conference call. We thank you all for attending today's presentation. You may now disconnect your lines, and have a wonderful day.