
Tencent Music Entertainment Group
2023 Second Quarter Earnings Webinar

Tony: Good evening and good morning, welcome to Tencent Music Entertainment Group's second quarter 2023 earnings webinar.

TME announced its quarterly financial results today before the U.S. market opens. 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 IFRS in the company's earnings release and filings with the SEC.

At this time, all participants are muted. After management's presentation, there will be a Q&A session. And please be advised that today's webinar is being recorded.

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

Cussion:

Thank you, Tony. Hello, everyone, and thank you for joining our call today.

We are pleased to report a solid second quarter, with total revenues increasing by 6% and adjusted net profit up 48% year-over-year. These solid results were once again supported by our online music services' strong momentum.

For many years, TME has been dedicated to driving the healthy development of China's online music industry. Following our longstanding efforts, we are pleased to see users becoming increasingly accustomed and willing to pay for copyrighted music, whether for songs they want to listen to or for the premium listening features they enjoy. Riding this wave, we are happy to see that our online music paying ratio and monthly ARPPU reached an all-time high of 16.7% and RMB9.7, respectively. Such achievements drove revenues from this business pillar in the reported quarter to exceed that of social entertainment services for the first time in our history. This is a strong testament to our progress in developing a robust online music business model and marks a significant step along TME's growth path.

Looking at our social entertainment services, starting from the latter part of the second quarter, we have proactively implemented several service enhancement and risk control measures to provide users with a more music-centric live streaming atmosphere as well as reinforce risk control. While these measures are expected to put pressure on revenues from our social entertainment services throughout the second half of 2023, and thus adversely impact our total revenues for this year, we believe they will provide users with an optimized user experience as well as pave the way for the group's healthier and more resilient development in the long run.

Moving onto our operational progress on content:

As the key component bolstering our music ecosystem, our comprehensive content ecosystem sets us apart from other industry players. During the quarter, we continued boosting the vibrancy of our content ecosystem among artists, creators and labels.

On the front of top-tier labels and artists, we strengthened our partnership with them to expand our industry influence and content appeal.

In July, we held the Tencent Music Entertainment Awards 2023, also known as TMEA, in Macau. It was a two-day event comprising of two music ceremonies and two music festivals, joined by a prominent lineup of over 80 well-known domestic and overseas musical groups and singers, such as JJ Lin (林俊杰), Jolin Tsai (蔡依林), Laure Shang (尚雯婕), Zhou Shen (周深), TIA RAY (袁娅维) and SEVENTEEN. Being able to successfully organize such a large-scale offline performance of four music events over a single weekend, coupled with an exceptional roster of musicians, demonstrates our strong industry influence and organizational capabilities. With an audience of nearly 40,000 people offline participating in our two-day event, our TMEA also inspired social media buzz of over 10 billion views, once again creating a national music sensation.

Furthermore, we remained the partner of choice for famous labels and artists on a wider range of content offerings and merchandise. This enables us to provide music lovers with a rich selection of music content and products as well as a unique and trendy experience at TME. For example, in the second quarter of 2023, we renewed our strategic cooperation with Forward Music, allowing us to offer a wide variety of Chinese pop music to users in China and abroad. In addition, we cooperated with Jackson Yee (易烱千玺) on the release of his new physical album, *Liu Yanfen* (刘艳芬). Featuring a head-start release with TME, this partnership delivered an outstanding sales record for *Liu Yanfen* on our platform. Another highlight was the debut of Chris Lee's (李宇春) brand-new digital album *Have a Nice Weekend* (周末愉快), plus the sales of her album's limited edition merchandise.

In addition, we continued expanding our vertical music content to attract a more younger audience. For example, Mintone Records, a key hip-hop label, recently joined our platform, adding over 440 songs to our hip-hop music library, some of which included 30-day head-start releases.

On the front of up-and-coming musicians, we are helping new artists raise their visibility within the industry by providing critical technological assistance and integrated resources that support their growth throughout their entire music journey.

In July, we upgraded Venus (启明星), our all-in-one music production and promotion destination, to better help indie musicians improve their efficiency in producing, transacting and promoting songs. Venus' latest iteration integrated our full suite of AIGC music-making tools into Venus, such as AI-enabled music separation, sheet music generation, lyric writing, and creation of covers for songs, significantly improving creators' efficiency at each step of the music creation process and elevating their music quality. Venus also greatly enhances the efficiency of resource consolidation as it gathers a wealth of demos on its platform and empowers convenient music transactions and promotions processes. Having attracted a diverse range of creators and labels, Venus had recorded music transactions with a total value of over RMB10 million as of the second quarter.

Furthermore, we leveraged our differentiated and comprehensive set of resources and opportunities to nurture up-and-

coming musicians and foster creativity. For example, our Tencent Musician Platform strengthened its holistic support system for musicians, which ranges from offering additional exposure for offline performances to launching themed programs to promote creative content production, and even extends to helping musicians find commercial opportunities. In the second quarter, our Emerging Force Program sent several of its emerging artists to seven offline music events. We also offered More Feel, an indie band, the opportunity to produce the theme song for BYD's car sales celebration event.

Our deep involvement across the music value chain enables us to be in a unique position of having extensive insights in China's music industry, which we, in turn, hope to give back to the industry by contributing to its advancement. In June this year, our TME Research Institute released its third consecutive annual edition of *2022 Year-end Report of Digital Music In China*. Through its in-depth data analysis and multi-faceted interpretation, we provided comprehensive and pioneering insights as well as case studies, aiming to promote healthier and more sustainable industry development.

That concludes the overview of our second quarter and the progress we've made across our growing content capabilities. I'll now turn the call over to Ross. He will share more about our platform strategies. Ross, please go ahead.

Ross:

Thank you, Cussion. Hello, everyone.

We are excited to have reached an important milestone of 100 million online music paying users in June. This demonstrates our strength as China's leading online music platform, and reflects our growing appeal to music lovers. As we see an increase in growth potential materializing from users' evolving music consumption mindset, we are continually elevating our music experience to meet users' higher standards and stronger desire for quality.

On top of the progress in our content ecosystem as Cussion shared earlier, we are continuing to optimize user experience on our platform in order to reinforce the traction of our lively and passionate music community among music lovers. Along with ongoing refinements to our distinctive and immersive listening experience, we are also exploring more innovative and personalized means of entertainment and interaction.

In terms of user experience, we optimized premium features and product experience to attract higher user engagement and stickiness to our platform. For example, QQ Music upgraded its series of QQMUSIC AUDIO (臻品音质音效) to ensure optimal sound quality and effects, which are now also available in our in-car service. We also launched "QQMUSIC AUDIO" certification, which sets industry standards for sound quality across hardware devices such as earphones, speakers, music players and car audio speakers, allowing access to superior sound quality among users in their daily lives. QQ Music also expanded its 3D music player offerings such as players customized for subscribers or designed for classical music to boost product attractiveness and thus user use. In Kugou Music flagship app's recent upgrade, we highlighted a more intuitive interface and an engaging unlimited music discovery function. Kugou also unveiled its Viper 3D (蝰蛇全景声), bringing an immersive live concert-like listening experience to users. Furthermore, WeSing introduced a brand-new function in June that enhances users' recording and singing experience, including optimized vocal details, enhanced balance between human voices and accompaniment, and a wider selection of sound effects as well as recording skins. Coupled with these enhancements, we also strengthened our ability to recommend music through refined user preference analysis and optimized algorithms, allowing a convenient and individualized music discovery. All of these efforts contributed to higher DAUs derived from various recommendation scenarios and larger portion of recommendation-related streaming share.

In terms of listening scenarios, we expanded our music services to additional use cases, such as various IoT scenarios, to serve a larger audience in a more immersive way. Specifically, for the in-car use case, we improved user experience across sound quality and effects, music recommendation and interactive functions. For example, QQ Music launched its in-car version 2.0 in June this year and forged partnerships with more car makers, such as SAIC Volkswagen (上汽大众), FAW-Volkswagen (一汽大众) and Volvo, among others. We also expanded cooperations with more car makers and embedded our in-car offerings in more car models, potentially tapping into a wider base of users who then can enjoy a seamless, native in-car music listening experience. Alongside the recovery of offline tourism, driving times have lengthened, thus increasing the use of in-car music services. As a case in point, during the Labor Day holiday period and summer vacations, we saw a notable uptick in user activeness and stickiness for our in-car service.

In terms of user engagement and interaction, we created a highly individualized and differentiated music entertainment experience for users through our AIGC endeavors, while fulfilling their desires for trendy features to keep up with the AIGC boom. On the online music side, we started testing “AI-enabled Listening Together” that allows Xiaoqin, our AI music companion, to join users’ music-listening journey, share a variety of topics including her views on music, and recommend songs or playlists based on their real-time interaction. This new function will offer users an interactive, fun way of discovering music as well as a more personalized and engaging music listening experience. On the live streaming side, we innovated AIGC-empowered virtual gifts to facilitate a more trend-setting interaction between users and anchors. Such virtual gifts can be automatically visualized quickly as users input text descriptors, promoting a more creative and unique user-performer bonding during live streaming. All these efforts have, in turn, reinforced our platform’s traction among users.

As we continue exploring opportunities and possibilities in China’s online music arena, our dedication to copyrighted music will position us to better ride the wave of users’ changing music consumption habits, promoting greater prosperity across the music industry while creating long-term value for our shareholders.

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

Tony:

Thank you, Ross. Hello, everyone.

For online music services, our efforts over the years to cultivate users’ copyright awareness are bearing fruit. Paralleling users’ increased willingness to pay for premium music content and optimal listening experience, we continued to see exciting growth in online music subscriptions. The number of paying users reached a record high of 99.4 million in the second quarter, driven by a combination of operational measures, such as refined operation strategies which explore opportunities associated with trending topics or special occasions, more subscriber privileges and additional attractive music content. These factors translated into new paying users, returning churned subscribers and improved user retention. In addition, we launched a premium package tailored to couples in June, promoting customized features and privileges between couples. In terms of paying users’ spending, we witnessed a monthly ARPPU increase for the fifth consecutive quarter to reach an all-time high at RMB9.7 in the second quarter. The ongoing uptick was mainly a result of effective promotional activities, a consistently high user retention rate and the increased appeal of our subscriber privileges, among others. In addition, we made notable progress in our in-car music service as well, seeing expanded user base and enhanced monetization primarily as a result of our extensive relationships with more car makers and its application in more car models.

Online music services other than subscriptions also delivered robust growth as we further enhanced monetization. For advertising, our diversified product portfolio and innovative ad format remained highly attractive to advertisers across different industry verticals. Advertisers from e-commerce, gaming and travel industries were outperforming on the advertising spend list. Ad-supported mode continued outperforming our overall advertising services, with penetration steadily improving and revenues significantly increasing. Sponsorship advertising also attracted various types of brand advertisers as our IP mix provided them with a broad and diverse target audience, such as our campus music contest “NEXT SINGER 2023,” our signature music event “Wave Maker,” QQ Music’s “DIANFENG MUSIC FESTIVAL” and Kuwo Music’s music festivals with barbeque-related themes. Such a portfolio of music IPs attracted Sprite, Tongyi Shuangcui (统一双萃) and JD.com to sponsor, among others. As for artist merchandise, we also saw an exciting performance, driven by our strong relationships with well-known artists which normally gives us a head start in the release of their albums or sales of various merchandise.

Moving to social entertainment services. As Cussion mentioned, starting from the latter part of the second quarter of 2023, we have implemented several service enhancement and risk control measures across our live streaming services to provide users with more music-centric user engagement experience, such as adjusting certain live streaming functions and adopting more stringent compliance procedures. Such measures led to a weaker-than-expected performance in our social entertainment services for the reported quarter, and will bring continued adverse effects on its revenues throughout the rest of this year. As a result, we expect our total revenues for the Company to experience a low-to-mid teens percent decrease year-over-year for the third quarter of 2023 and a low-to-mid single-digit percent decrease for the full year 2023 as compared with 2022. Nevertheless, we remain confident that we will deliver year-over-year bottom-line growth for 2023, driven by the continued strong performance of online music services. We also believe all these efforts will lay a more solid foundation for TME’s sustainable and resilient development in the long run. Meanwhile, we are also trying out new interactive features, such as AIGC-empowered virtual gifts and functions of bullet chats, in our live streaming services to enhance user interaction experience while increasing our product competitiveness. In addition, we continue to explore overseas opportunities leveraging our operational experience in the domestic market. For example, we further enhanced user experience in overseas singing rooms and introduced new localized features to boost engagement, showing satisfactory initial results in both penetration rate and time spent.

Last but not least, TME continued to fulfill its social responsibilities in a unique and distinctive way, through its strong commitment to music-based social welfare activities. In the second quarter of 2023, we cooperated with Tencent Charity and other public welfare organizations and held two “Little Red Flower Charity Concerts” (小红花公益音乐会) for children. In May, we hosted the first concert to raise public’s support for children with hearing impairment. We helped seven hearing-impaired children replicate their own voices with our Linyin Engine’s (凌音引擎) AI capabilities, then utilized their AI-generated voices to create and perform a concert along with several musicians. On Children’s Day in June, we hosted another concert for children in rural areas, offering them a platform to express themselves through music while showcasing music aesthetic education in those villages. These programs not only raise the public’s emotional resonance, they also allow us to explore music’s possibilities and impact across different areas.

Going forward, we will continue to drive progress across our content and platform, to bring users a differentiated, superior music entertainment experience that can only be obtained on TME’s platform while sharing the fruit of industry development with all other stakeholders across the music value chain. I am so proud of the progress we have made, both as a company and as an architect of the online music industry’s future. Thank you once again for allowing me to be a part of this incredible journey.

Now, I would like to turn the call over to Shirley, our CFO, for a closer look at our financials.

Shirley:

Thank you, Tony. Hello everyone.

Next, I'll discuss our results from financial perspective. In the second quarter of 2023, driven by significant growth in our music subscription and advertising business, our total revenues reached RMB7.3 billion, up by 6% year-over-year. Revenues from online music services contributed 58% of total revenues, surpassing the revenue contribution from social entertainment services for the first time in our history and marking a significant milestone for us. IFRS and Non-IFRS net profit were RMB1.3 billion and RMB1.6 billion, respectively. Non-IFRS net profit margin reached 21.7% this quarter.

Music subscription revenues in Q2 2023 reached RMB2.9 billion, up by 37% year-over-year and by 11% sequentially, with rapid expansion of online music paying users and continued increase in monthly ARPPU. Specifically, number of online music paying users grew to 99.4 million, up by 20% year-over-year, representing net adds of 5 million users sequentially. Monthly ARPPU has grown for five consecutive quarters and reached a record high of RM 9.7 this quarter, up by 14% year-over-year and 5% sequentially. Our optimized user operations, more appealing member privileges, attractive music contents, and disciplined promotions have driven the growth and will continue to strengthen the foundation for sustainable growth in our music subscription business.

Additionally, revenues from advertising achieved strong growth on a year-over-year basis due to strong performance from our ad-based mode, as well as lower advertising revenues for comparison in Q2 2022. The annual 618 e-commerce sales event generated higher demand for advertising and contributed to a sequential increase in advertising revenues. We continue to explore new products and formats to offer more diversified options for our advertisers and remain confident about the long-term growth potentials in our advertising business.

Social entertainment services and other revenues were RMB3.0 billion, down by 25% year-over-year. Starting from the latter part of the second quarter of 2023, we have proactively implemented several adjustments to live streaming functions and certain risk control measures, including more stringent requirements for compliance, intended to offer better music-centric user experience. These measures have negatively impacted our live streaming revenues this quarter and we expect the negative impact to continue in the second half of 2023 resulting in a lower than previously expected revenues for full year 2023. Nonetheless, we believe these measures are necessary and are beneficial to our users, which will help lay down a healthier and more sustainable foundation for our long-term growth.

Gross margin in Q2 was 34.3%, up 4.4 percentage points year-over-year, primarily due to the following factors. First, online music services have shown strong growth momentum, with high-quality growth of music subscription revenues, driven by the continued uptick in the online music paying user base and ARPPU, and robust growth in advertising revenues. Second, as we gradually ramp-up our own content, it has a positive impact on the margin and will continue to be a favorable factor for our margin. In addition, the continuous improvement of operational cost efficiencies also contributed to the increase in gross margin this quarter.

Now moving on to operating expenses, total operating expenses for Q2 were RMB1.3 billion or 17.2% as a percentage of total revenues, down by 3.3% from 20.5% as a percentage of total revenues in the same period last year.

Selling and marketing expenses were RMB211 million, down by 30% year-over-year, as we have optimized our

promotion strategies by reducing user acquisition spending, monitoring the ROI of each promotion channel and being more focused on high-quality paying user growth. With the effective promotion measures, we have seen significant growth in subscription revenues this quarter.

General and administrative expenses were RMB1.0 billion, down by 6% year-over-year. This decrease was primarily due to decrease in employee related expenses as a result of improved headcount efficiency. Expenses related to our application for secondary listing last year also contributed the year-over-year decrease. We continue to closely manage employee related expenses by improving headcount efficiency and invest in research and development to further empower music-related content creation, enhance production efficiency, and improve sound quality and effects.

Our effective tax rate for Q2 was 12.2%.

For Q2 2023, our net profit and net profit attributable to equity holders of the Company were RMB1.3 billion. Non-IFRS net profit and non-IFRS net profit attributable to equity holders of the Company were RMB1.6 billion and RMB1.5 billion respectively.

Diluted earnings per ADS was RMB0.82, up 55% on a year over year basis. Non-IFRS diluted earnings per ADS was RMB0.97, up 54% on a year over year basis.

As of June 30, 2023, our combined balances of cash, cash equivalents and term deposits were RMB30.5 billion, as compared with RMB28.5 billion as of March 31, 2023. The increase was primarily due to strong cash flow generated from operations of RMB2.1 billion for the second quarter of 2023. Such combined balance was also affected by the change in the exchange rate of RMB to USD at different balance sheet dates.

In conclusion, our music subscription business has demonstrated significant growth trajectory propelled by quality growth in both ARPPU and paying users, and we expect such momentum to continue. With a keen focus on user experience and monetization, we will continue to invest in new products and services, including high-quality contents, differentiated premium packages with appealing privileges, and new technologies such as AIGC, through organic development and M&A, to solidify our foundation for long term growth.

This concludes our prepared remarks. With that, I'll turn the call back to Cussion.

Cussion:

Thanks, Shirley. Before we enter the Q&A session, I'd like to take a few minutes to express our gratitude to Tony. During his tenure, Tony played a key role in our two successful public listings and contributed his professional expertise to advance TME's prosperous development, we really appreciate Tony's years of excellent work and invaluable contributions to the group. Thank you, Tony.

Now, we are ready for questions. Operator, please.

Operator:

We are approaching the end of the conference call. I will now turn the call over to our host, Mr. Tony Yip, for closing remarks.

Tony:

This closes our conference today, I just wanted to send my personal thank you to all the senior management team at TME, as well as the Company, and the board for the trust in me throughout the years. It's been an incredible journey, and I'm incredibly proud of everything we've achieved together over the past 5 years. Thank you, everyone.