
Tencent Music Entertainment Group
2023 Third Quarter Earnings Webinar

IR: Good evening and good morning, welcome to Tencent Music Entertainment Group's third quarter 2023 earnings webinar. I am Millicent Tu, head of IR at TME.

TME announced its quarterly financial results today before the U.S. market opened. An earnings release is now available on our IR website and via newswire services.

Today, you'll hear from Mr. Cussion Pang, our Executive Chairman, who will start the call with an overview of our company strategies and business updates. Next, Mr. Ross Liang, our CEO, will share additional thoughts on our platform strategies and developments. Finally, Ms. Shirley Hu, our CFO, will discuss our financial results before we open the call for questions.

Before we continue, I refer you to our safe harbor statement in our earnings release, which applies to this call, as we will make forward-looking statements.

Please 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 prepared remarks, 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, Millicent. Hello, everyone, and thank you for joining our call today.

We are pleased to report another quarter of strong growth in our online music services, despite the topline headwinds from the social entertainment business. While adjusting certain industry-wide live-streaming interactive features presented some challenges for the quarter, it ultimately placed us on even stronger footing for our long-term sustainable development. As a case in point, our evolving businesses have become more resilient, illustrated by group-wide margin expansion and strong cash flows for the quarter.

What's particularly worth mentioning is our online music subscriptions. This business has registered accelerated year-over-year revenue growth. Growth momentum carried into the third quarter with expansion in both our subscriber base and ARPPU. Our paying user base grew further to 103 million, a strong testament to the broad appeal and high value of our music products and services. Our impressive content offerings, compelling subscriber privileges and interactive product features, together with strong execution, enabled us to attract new subscribers while retaining existing ones. We are also pleased to see that monthly ARPPU expanded to RMB10.3, thanks to disciplined promotions, effective member acquisitions and our high subscriber retention rate.

These achievements were results from the solid execution of our dual-engine content-and-platform strategy. It further

unlocks the value of music and paves the way for our long-term success. I'd like to share a few highlights:

First, we cultivated deeper, mutually beneficial partnerships with record labels and artists. Our insights across content and users, as well as our holistic approach to growing the industry, supported our strengthened cooperations with music partners. For instance:

We strengthened our collaboration with TFBOYS on the 30-day head-start release of their 10-year anniversary single See You Tomorrow as well as the sale of their themed album Ten Years. To amplify user engagement and strengthen their bond with the artist, we launched several online song-guessing contests and music-based interactive features for this single.

We expanded our partnership with YG Entertainment into ticketing, where we opened a dedicated channel for users to purchase BLACKPINK's concert tickets, further expanding subscriber privileges.

In addition, we formed a new partnership with CUBE Entertainment, bringing in a prominent lineup of bands and groups, such as BtoB, Pentagon, (G)I-dle, and Lightsum. This collaboration not only enriched our music catalog but also granted us the privileges of a 30-day head-start period on new song releases.

Each of these examples strengthens a virtuous cycle and creates win-win situations. Our evolved relationships with artists and labels fortify our music ecosystem, bringing more intriguing privileges to our users, while also creating prosperity for all stakeholders along the industry value chain.

Second, leveraging TME's integrated resources and expertise, we expanded our industry influence by assisting artists at different stages with their career growth.

With respect to top-tier artists, in August, we hosted an offline concert for Zhou Shen celebrating the 9-year anniversary of his debut, highlighted by sales of sought-after tickets and social media buzz of nearly 2 billion event views in just three weeks. This event generated great excitement and acclaim among users.

As for our strategic partner artists, this quarter, we assisted TIA RAY with her appearance at the Mid-Autumn Festival galas organized by CCTV and Hunan Satellite TV, significantly increasing her influence nationwide.

Among our emerging musicians, we had Wang Yinuo, our indie musician, perform and showcase his talent on the variety show The Treasured Voice. Through music exposure and social media, we helped him attract more users to explore his original songs on our platform. In Q3, we also had over 20 up-and-coming musicians performing at nine music festivals. Many rising musicians from our Tencent Musician Platform showcased their talents at the Coca-Cola-sponsored 2023 Summer Limited Refreshing Music Festival. Such activities with high quality brands also encourage us to further explore sponsorship advertising opportunities.

Third, we enhanced our technology capabilities in content creation, promotion and distribution. Some of this content also recorded initial success overseas.

In the third quarter, Venus introduced its zero-shot AI-powered music production tool, featuring fast and convenient generation of a user's AI voice to produce musical works. Kugou Music's Vocal Producer also upgraded its functions to allow AI-generated music content in multiple languages. Through a brief training session, it can effectively and efficiently

produce songs in Mandarin, Cantonese, English, Korean and Japanese. Both tools substantially boosted creators' creativity.

TME's music promotion and distribution tool kits, such as TME Music Cloud and Kugou's ToMoreMusic platform, made advancements in helping record labels, creators and musicians efficiently promote their musical works. Our deep industry insights and astute data analytics enabled us to successfully promote Chinese songs overseas. For example, we helped Angela Zhang's *Beast* and Yang Junan's *Summer Love* chart on various popular music lists in Singapore during the quarter.

Moving on to our continued efforts on ESG.

In the third quarter, we joined hands with Tencent's SSV and launched our 2023 Youth Music Tech X program, inviting high school students to explore a technology-inspired music journey. Working side by side with the students, we commissioned a theme song, *The Most Beautiful Sound in the World*, to champion public care and support for hearing-impaired senior citizens. In addition, we organized a special music education project, "Music Garden Space," to help children from ethnic minorities and remote areas appreciate the beauty and power of music. These initiatives demonstrate the value and positive influence we can bring to a wide range of communities.

In summary, our holistic and strategic approach is strengthening and expanding our capabilities, making our platform and ecosystem increasingly robust. We continue to grow our music subscriptions and strengthen our partnerships with labels and artists, enriching our content and perpetuating our virtuous cycle. We are also fostering new talent and leveraging our advanced technology to support our efficient growth. This powerful combination and evolution will drive our company's sustainable development in the long run and support the broader industry's advancement.

Now, I'd like to turn the call over to Ross for more color on our platform development. Ross, please go ahead.

Ross:

Thank you, Cussion. Hello, everyone.

Music is the heart and soul of TME.

I would like to begin by commenting that Q3 results highlighted the efficiency gains across our platforms. Specifically, our ecosystem's strength, platform's scale and AI-empowered technology have enabled us to transition into an increasingly robust music powerhouse.

From the operational level, one key highlight is our effort to expand the application of AI technologies across our products and services, based on our upgraded music LLMs.

This quarter, we iterated our LLM integration platform, allowing third-party models to be better integrated with and adaptive to the music vertical. With the power of AI, we enhanced music discovery and consumption efficiency, creating a more engaging user experience:

First, better content connection and discovery:

This quarter, we continued to upgrade our recommendation middle platform and enhance personalized recommendations on each of our music apps. As a result, we reached a new record in the share of streams from recommendations, as well as an increase in the number of songs added to users' personal favorites.

We also significantly lowered the barriers to music discovery. For example, QQ Music introduced its Quick Listen mode, which allows users to listen to a song's chorus and then quickly locate the full song. Another example is Kugou Music's revamped version, featuring fast discovery of multiple song covers as well as AI-rendered versions played by different instruments.

Second, better facilitating music consumption through more use cases and entertainment scenarios:

In the in-car use case, we extended our mobile-end offerings, such as our seamless user interface, premium sound quality and tailored playlists, to enrich in-cabin music consumption. To increase our coverage, we recently signed additional car models, including Mercedes-Benz SMART and more BYD models. Partnering with hardware manufacturers, we led the industry by leveraging Qualcomm's latest AI computing capabilities to enhance users' music listening experience with richer details and more vivid sensations.

In terms of broadening entertainment content consumption, we customized our music services, including content production, promotion, and data analysis, across the areas of film and television, gaming and animation. Through tailored music works, we create unique touchpoints for original IPs, unlocking their value. For example, we co-produced both the theme and end credits songs for the blockbuster No More Bets (《孤注一掷》). We also produced original soundtracks for mobile games including Peacekeeper Elite, CrossFire and Dungeon and Fighter, all of which have received widespread acclaim.

Third, for our immersive user connections, we have created a thriving community where music lovers can bond, ultimately making their experience on our platform more enjoyable and long-lasting. For example, QQ Music launched over 30 interactive song-guessing contests featuring artists such as Jay Chou, Zhou Shen, BLACKPINK and Teens in Times. These events quickly went viral across social media platforms and our in-app community and fan groups, amplifying TME's influence.

To sum up, these three dimensions of connection inspire us to further unlock music's value. AI-powered technology is supporting us to provide better user experience and making the platform increasingly efficient. Our online music business has become a diversifying and crucial growth pillar. Social entertainment services remain adaptive as part of our holistic music offerings.

For 2024 and years ahead, we will stay laser-focused on providing enlightening user experiences while driving operational efficiencies across the platform.

With that, I'll turn the call over to Shirley, our CFO, for a deep dive into our financials.

Shirley:

Thank you, Ross. Hello everyone.

Next, I'll discuss our results from financial perspective. In the third quarter of 2023, revenues from online music increased

by 33% to RMB4.6 billion on a year-over-year basis, driven by strong growth in our music subscription and advertising businesses. Our total revenues were RMB6.6 billion, down by 11% year-over-year due to decline of revenues from social entertainment services and other services.

Music subscription revenues in Q3 2023 reached RMB3.2 billion, up by 42% year-over-year and by 10% sequentially, driven by further expansion of both online music paying user base and monthly ARPPU. Specifically, the number of online music paying users grew to 103.0 million, up by 21% year-over-year, representing net adds of 3.6 million users sequentially. Monthly ARPPU was RMB10.3, up by 17% year-over-year and 6% sequentially, marking its six consecutive quarter of growth and another record high amount. These were resulted from our products' more appealing member privileges, interactive product features, attractive music content, and disciplined promotion and member acquisition strategies, as well as high subscriber retention rate.

Additionally, revenues from advertising achieved strong growth on a year-over-year basis as our diversified product portfolio and innovative ad formats, including ad-supported mode and sponsorship advertising, are highly attractive to advertisers. Our campus music contest "QQ Music 2023 YOUNG MUSIC Campus Trend Music Competition" and Coca-Cola-sponsored 2023 Summer Limited Refreshing Music Festival, were two good examples of how our portfolio of music IPs attracted various brand advertisers.

Social entertainment services and other revenues were RMB 2.0 billion, down by 49% year-over-year. The decrease was mainly caused by our adjustments to certain live-streaming interactive functions and more stringent compliance procedures as we implemented several service enhancement and risk control measures. This is in-line with our expectation about live streaming revenues as discussed previously. We believe these measures are necessary and beneficial to our users, which will help pave the way for the long-term sustainable development of our business.

Gross margin in Q3 was 35.7%, up 3.1 percentage points year-over-year, primarily due to the following factors. First, our music subscription revenues had strong growth this quarter. Specifically, expansion in paying user base and improvement in monthly ARPPU both had favorable impact on our gross margin. Second, our advertising revenues also had strong growth which also benefited our gross margin. Third, as we gradually ramp-up our own content, it has positively impacted our margin. As you see here, shifting to win-win relationships with labels and artists, and increasing subscription ARPPU, over the past several years, have enabled us to move to a healthy margin model, and more than offset the impact from decline in live streaming revenues.

Now moving on to operating expenses. Total operating expenses for Q3 2023 were RMB1.3 billion or 19.3% as a percentage of total revenues, down by 0.2% from 19.5% as a percentage of total revenues in the same period last year.

Selling and marketing expenses were RMB219 million, down by 11% year-over-year, as we closely monitored the ROI of each promotion channel and improved the effectiveness of promotions.

General and administrative expenses were RMB1.0 billion, down by 12% year-over-year. This decrease was primarily due to reduced employee-related expenses as a result of improved headcount efficiency and the expenses related to the Hong Kong secondary listing incurred in the same period of 2022.

Our effective tax rate for Q3 2023 was 12.2%.

For Q3 2023, our net profit and net profit attributable to equity holders of the Company were RMB1.3 billion and RMB1.2

billion, respectively. Non-IFRS net profit and non-IFRS net profit attributable to equity holders of the Company were RMB1.5 billion and RMB1.4 billion respectively.

Diluted earnings per ADS was RMB0.74, up 12% on a year over year basis. Non-IFRS diluted earnings per ADS was RMB0.89, up 3% on a year over year basis.

As of September 30, 2023, our combined balances of cash, cash equivalents and term deposits were RMB31 billion, as compared with RMB30.5 billion as of June 30, 2023. Such combined balance was also affected by the change in the exchange rate of RMB to USD at different balance sheet dates.

In March 2023, we announced a Share Repurchase Program of US\$500 million. As of September 30, 2023, we had repurchased 15.8 million ADSs from the open market with cash for a total consideration of approximately US\$103 million.

In conclusion, our music subscription business has demonstrated strong growth trajectory propelled by quality growth in both ARPPU and paying users, and we expect such trend to continue. With keen focus on ROC management and improved efficiencies in operating costs and promotion channels, we expect to continue driving our overall profitability. Last but not least, we will keep investing in new products and services, high-quality content, as well as new technologies, through organic development and M&A, to solidify foundation for our long-term growth.

This concludes our prepared remarks. We are ready to open the call for questions.

Operator:

With that. I will now turn the call over to our Executive Chairman, Cussion, for closing remarks.

Cussion:

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