

**[TME] - Tencent Music Entertainment Group
First Quarter 2020 Earnings Conference Call
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Officers

Millicent T., IR
Cussion Pang, CEO
Tony Yip, CSO
Shirley Hu, CFO

Analysts

Eddie Leung, Bank of America
John Egbert, Stifel Nicolaus
Binnie Wong, HSBC
Alex Yao, JP Morgan
Alex Poon, Morgan Stanley
Wendy Chen, Goldman Sachs
Thomas Chong, Jefferies
Ellie Zheng, Macquarie
Zhijing Liu, UBS
Tian Hou, T.H. Capital
Alex Liu, China Renaissance
Hans Chung, KeyBanc Capital Markets

Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group 2020 First Quarter 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, Ms. Millicent Tu. Please go ahead, ma'am.

Millicent T.: Thank you, operator. Hello, everyone, and thank you all for joining us on today's call. Tencent Music 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. Kar Shun Pang, our CEO, who will start the call with an overview of our recent achievements and growth strategies. He will be followed by Mr. Tony Yip, our CSO, who will offer more details on our operations and business developments. Lastly, Ms. Shirley Hu, our CFO, will address our financial results before we open the call for questions.

Before we proceed, please note that this call may contain forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties and other factors not under the Company's control, which may cause actual results, performance or achievements of the Company to be materially different from the results, performance or expectations implied by these forward-looking statements.

All forward-looking statements are expressly qualified in their entirety by the cautionary statements, risk factors and details of the Company's filings with the SEC. The Company does not assume any obligation to revise or update any forward-looking statements as a result of new information, future events, changes in market conditions or otherwise, except as required by law.

Please also note that the Company will discuss non-IFRS measures today, which are more thoroughly explained and reconciled to the most comparable measures reported under the International Financial Reporting Standards in the Company's earnings release and filings with the SEC. You are reminded that such non-IFRS measures should not be viewed in isolation, or as an alternative to the equivalent IFRS measure, and other non-IFRS measures are not uniformly defined by all companies, including those in the same industry.

With that, I'm now very pleased to turn over the call to Mr. Kar Shun Pang, our CEO. Cussion?

Cussion Pang: Thank you, Millicent. Hello, everyone, and thank you for joining our call today. (Inaudible) after we released our 2019 annual results 2 months ago, even though I'm still wearing a mask like last time. But we still have a smiling face under the mask and every one of us at TME remain very positive. It is because we truly believe that what we have been doing is very valuable to our users and society. Music is really the medicine that can heal, and [accompany] with people, no matter what the situation is. I hope to see every one of you well during the pandemic period and we are all together.

In the first quarter of 2020, our online music subscription revenues further accelerated its growth, increasing 70% year-over-year, compared with 60% and 48% in the fourth and third quarter of 2019.

Online music paying users reached 42.7 million, up 50% year-over-year.

Paying ratio expanded to 6.5%, up from 4.3% for the same quarter of 2019.

ARPPU for our online music services increased 13% year-over-year, primarily benefiting from users' increasing willingness to pay for premium subscription package.

Our outstanding online music subscription revenues growth mitigated the softness in other non-subscription revenues primarily from the COVID-19 pandemic, resulting 27% overall year-over-year revenue growth for our online music services.

Some of our key strategic focus during the first quarter include further enriching our leading content offering, sharpening our capabilities in content discovery and promotion, and supporting indie musicians.

In terms of further enriching content, to begin with, we have made significant progress in long-form audio, an under-penetrated but fast-growing market in China that we are committed to serve. Recently, through the strategic partnerships with China Literature and others, we have gained quick access to an extensive library of high-quality IPs, and exclusive licenses for some page-turning online literature series with a tremendous fan base in China. Now, we have obtained the audio adaptation rights of the majority of China Literature's top 100 most favorited online books.

In addition to audiobooks, we will also produce high-quality audio drama to help super IPs to realize more derived value. Such fast progress is starting to position us at the forefront of the game.

As we aggressively scale up content offering, the development of our podcast ecosystem has also achieved initial success. By the end of April 2020, our platform attracted approximately 10,000 new podcasters and many established KOLs, including well-known artists, writers and online broadcasters, to produce more premium UGC audio works. Our self-produced audio programs, our Idol Reads, (Speaking Foreign Language), has achieved over 1 billion total streams by the end of last month and become a very popular audio show, particularly for the young demographic.

On April 23, we launched a new application for long-form audio, Kuwo Changting, taking another important step to provide dedicated audio entertainment services to our users. We also began to roll out a separate long-form audio membership package. All of these developments will help us build a solid foundation for our future development, and realize more valuable synergies between online music and long-form audio business.

Second, we continued to solidify our content leadership with popular genres enjoyed by the younger demographic. The cooperation with Being Group, one of Japan's largest -- one of Japan's highest-selling record companies in the 20th century, enables us to seek more opportunities as we build a closer relationship.

Apart from offering highly popular content by renowned Japanese artists, we also actively explored new interactive gameplays, such as the J-Pop singing contests to bring an interactive and comprehensive music experience of listening, watching, singing and socializing. As a result, our platform has become a popular destination for J-Pop fans in China.

Third, on supporting original content creation, time and again, we demonstrated our unique capability and know-how in talent discovery, cultivation, and promotion. Thanks to our fast-growing indie musician program, the number of participating musicians and original songs produced, doubled year-over-year in the first quarter of 2020. We rolled out an attractive financial incentive plan earlier this year. This has led to impressive growth in the number of indie musicians' songs that are exclusively licensed to us, which increased by more than 800% year-over-year.

We went an extra mile to promote indie music. We launched Program Galaxy, (Speaking Foreign Language), targeting emerging musicians, and also formed a strategic alliance with Bilibili through the launch of Program Gan Bei, (Speaking Foreign Language), to further enhance the cooperation with independent musicians and KOLs.

Additionally, we continuously leverage our profound user insight and powerful promotional capabilities to support indie musicians to reach hundreds of millions of music lovers. Last quarter, we shared the success story of Hai Lun, a grassroots singer and his song Girl by the Bridge, (Speaking Foreign Language).

This quarter, I am pleased to share two more successful stories: The World Is So Big To Meet You, (Speaking Foreign Language), a song from Echo Cheng, (Speaking Foreign Language); and Youth, (Speaking Foreign Language), a song produced by Mira Meng, (Speaking Foreign Language). Both songs were released during the first quarter, and have already achieved almost 5 billion cumulative streams on our platform. Their success is our success.

As a fast-growing and leading indie musician program with the largest music user base, we are very pleased to say, as of March 31, 2020, we have successfully promoted indie musicians' content to hundreds of millions of users on our platform.

While the COVID-19 global pandemic has changed businesses and the ways of lives in different aspects, it has also brought emerging opportunities in the digital era. We have seen some behavioral changes during the lockdown, and observed an increasing number of users listening to music with home appliances, especially TVs and smart devices. As a result, in the first quarter of 2020, our online music MAU from mobile devices and in-home appliances increased by 3.5% on a year-over-year basis. Such behavior patterns could persist even after the life returns to normal post the COVID-19 pandemic, and potentially provide additional avenues for our paying user growth.

The launch of TME Live is a great example of how we quickly and innovatively deploy technology to bring offline concert experience online through live streaming. Within 5 weeks after its launch in March 2020, we successfully held 5 online concerts. These included ones for established artists like JJ Lin, (Speaking Foreign Language), and Rene Liu, (Speaking Foreign Language), and special themes such as an OST concert for the popular web drama series Someday Or One Day, (Speaking Foreign Language). Leveraging our solid partnerships with labels and artists, we are very excited to have built a strong and diversified pipeline to anchor our events. We are also pleased that the user

response TME Live received exceeded our expectations, and affirmed the virtuous cycle between online music and social entertainment services.

This concludes my prepared remarks. And now, Tony will discuss the first quarter results of our social entertainment services, as well as our other focus areas. Tony, please go ahead.

Tony Yip: Thank you, Cussion. Hello, everyone. Apart from what Cussion just mentioned, there are a few other exciting areas that we want to highlight for both our online music and social entertainment services.

For online music services, first, we kept stepping up our efforts to promote video enrichment. We emphasized short videos through upgraded version of Kugou Music. This provides our users an additional dimension of entertainment while increasing the exposure of video content creators on our platform. It has also contributed to improved user engagement, leading to Kugou Music's increased DAU penetration rate and daily average user time spent on video content after the upgrade.

Second, while music streaming used to be a less socially interactive experience, we continued to push boundaries by building and promoting and engaging user community through our fan-based programs. We invited many artists to personally interact with their fans on our platform. Their engagement in online discussions and participation in song reviews, in turn, have contributed to better promotion results and increased stream volumes of certain songs on a daily basis.

Thirdly, we kept sharpening our data analytics capability and refining our personalized recommendation. In particular, the personalized playlist continues to receive positive user response. In the first quarter, the DAU penetration rate and average daily streams of personalized playlists more than doubled on a year-over-year basis.

Now, turning to social entertainment services, while its revenue growth moderated due to the impact from COVID-19, our mobile MAU and paying user growth remained robust, up 13% and 19% year-over-year, respectively, benefiting from the growth initiatives we took to improve user engagement, and positive impact from users spending more time on our online karaoke platform during COVID-19.

With respect to online karaoke services, first, we continued to strengthen WeSing's core karaoke features to make it more user-friendly for users to interact through singing. As such, both MAU penetration rate and average daily user time spent of the song recording function, achieved healthy sequential growth in the first quarter.

In addition, to meet the evolving and expanding user demand, we incubated Kugou Changchang, an online karaoke app designed to better serve Kugou Music's users with deeper integration between music streaming and online singing across the two apps. Despite its relatively early stage, we are pleased to see Kugou Changchang achieving initial success, with MAU growing 800% year-over-year to reach 9 million.

Second, we focused on strengthening WeSing's social attributes. We continue to grow the number of online singing rooms based on diversified music-centric themes. In the first quarter of 2020, we are happy to see the unique real-time social attributes and interactive features built in the online singing rooms resulted in sequential increase in singing room MAU penetration rate and user time spent.

Third, we further strengthened video enrichment within WeSing, with more types of video content now dynamically integrated, and more video tools deployed to make sharing easier and more eye-catching. This has boosted the amount of video content and average daily video users on WeSing.

Now, for our live-streaming services, against the impact caused by the COVID-19 pandemic, we worked tirelessly on many fronts to pave the way for faster recovery in the second half of 2020. We continued to expand content categories such as games, ACG and matchmaking. In the first quarter of 2020, over 30,000 gaming hosts joined Kugou Live, and its DAU penetration rate of game live streaming has been increasing consistently.

In particular, Kugou Live recently launched -- reached a cooperation agreement with Tencent Games, obtaining the right to live broadcast the full range of Tencent games. We'll also add more interactive activities and privileges to further incentivize user spending, and continue broadening our live-streaming content categories to attract more new users.

And finally, to boost our promotional capabilities offline, in April 2020, we acquired an equity stake in Radio Music Warehouse, (foreign language), RMW in short, a leading provider of licensed music-streaming service to public venues in China. From system design and integration to content curation and support, RMW is an integrated solution provider of licensed music in public venues, including hotels, restaurants, supermarkets, convenience stores and more.

Compared with Europe and the U.S., this market in China is still at a nascent stage, with promising long-term prospects. For TME, this investment serves as another important step to expand our comprehensive music entertainment platform from online to offline.

And with that, I would like to turn it over to our CFO, Shirley Hu, for a closer review of our financials.

Shirley Hu: Thank you, Tony. Hello, everyone. In the first quarter of 2020, our revenues were RMB6.3 billion, up 10% year-over-year, driven by 27% growth in online music service revenues and 3% growth in social entertainment service revenues.

Online music service revenues were RMB2 billion, up 27% year-over-year. The increase was mainly driven by sustained outstanding performance from music subscriptions, supplemented by strong growth in advertising services despite impact from COVID-19, partially offset by decrease in sublicensing revenues.

Music subscription revenues were RMB1.2 billion, up 70% year-over-year, driven by continued growth of subscribers and improvement in ARPPU. Specifically, number of

subscribers increased 50%, and the subscriber ARPPU grew 13% year-over-year, reflecting continuous success of paying user retention and content paywall strategy.

Social entertainment service and other revenues were RMB4.3 billion, up 3% year-over-year, primarily driven by growth in online karaoke and live-streaming services, despite negative impacts from COVID-19, adjustments to interactive features in live streaming and change in timing of WeSing annual gala.

On a year-over-year basis, paying users grew 19%, demonstrating the strength of our products. ARPPU decreased 13%, which was primarily due to impact from COVID-19, as users reduced spending to manage the uncertainties. Adjustments to interactive features also had a short-term impact on ARPPU in live streaming.

Cost of revenues were RMB4.3 billion, up 17% year-over-year, driven by higher revenue sharing fees and content expenses.

Our gross margin was 31.3% in Q1 2020 and decreased 4.1% from 35.4% in Q1 2019. This was mainly attributable to higher revenue sharing fees, resulted from additional promotions to live streaming paying users to mitigate the impact from COVID-19 and adjustments to interactive features in live streaming, as well as increased revenue sharing ratio to online karaoke performers to strengthen our platform's competitiveness.

Gross margin for online music businesses has improved in Q1 2020, and is expected to keep improving over time as our music subscription revenues grow.

Total operating expenses were RMB1.2 billion, up 12% year-over-year. Total operating expenses, as a percentage of total revenues, was 18.4% in Q1 2020, increased slightly from 18.1% in Q1 2019. The increase was mainly due to increases in R&D employee-related costs, as we continue to invest in R&D to expand our products' competitive advantage and technology innovations.

Our sales and marketing expenses, as a percentage of total revenues, remain relatively unchanged from Q1 2019 as a result of our ongoing focus on operating efficiency.

Our effective tax rate was 12.8% in Q1 2020.

Our net profit attributable to equity holders of the Company was RMB0.9 billion. Non-IFRS net profit attributable to equity holders of the Company was RMB1.1 billion and the non-IFRS net profit margin was 17.5%.

As of March 31, 2020, our combined balances of cash and cash equivalents, term deposits were RMB21.9 billion, representing a decrease of RMB1 billion from RMB22.9 billion as of December 31, 2019. The decrease in the balances was primarily due to investment in a consortium to purchase an equity interest of Universal Music Group during the quarter.

Overall, despite the impact from COVID-19, we achieved strong growth in online music services, particularly in music subscriptions, as well as healthy growth in social entertainment businesses in the first quarter of 2020.

We expect to see accelerating year-over-year growth in the next few quarters, as the COVID-19 pandemic is under control and the businesses started getting back to normal in China.

From long-term perspective, we continue to be optimistic about the future of the broader music industry, and are confident in the overall ecosystem and product pipelines that we are building. We'll continue to focus on enhancing and expanding our product and service offerings, including long-form audio while maintaining core content investments.

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

Operator: And ladies and gentlemen, this will conclude today's conference. We thank you for attending. If you have any further questions, please feel free to contact TME's Investor Relations team. We look forward to speaking with you again next quarter. Thank you and goodbye.