

**[TME] - Tencent Music Entertainment Group
Fourth Quarter 2019 and Full Year Earnings Conference Call
Monday, March 16, 2020, 8:00 PM ET**

Officers

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Presentation

Operator: Ladies and gentlemen, good evening and good morning, and thank you for standing by. Welcome to the Tencent Music Entertainment Group 2019 Fourth Quarter and Full Year 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 call over to your speaker host today, Ms. Millicent T. The floor is yours, 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 our 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, and hello, everyone, and thank you for joining our call today. 2019 marked an important year for TME. We made significant contribution to upholding music copyright protection, supporting original content creation and designing innovative monetization models to unlock the intrinsic value of music, all of which are beneficial to the long-term sustainable growth of the industry.

Our strategic transition to pay-for-streaming service, continuous investment in premium self-produced and licensed content, product upgrades and technological enhancements have led to better user retention, attracting more subscribers, content creators, performers and users to our vibrant ecosystem.

One of the significant highlights is the accelerating year-over-year growth of our online music subscription revenues to 48% and 60% in the third and fourth of 2019, up from 26% and 32% in the first two quarters of 2019.

Online music paying users reached 39.9 million, growing 48% year-over-year with 4.5 million net adds, the largest net increase since 2016.

The paying ratio reached 6.2% during the fourth quarter of 2019, up significantly from 4.2% and 3.2% for the same quarter of 2018 and 2017 respectively, showing a recognizable trend of acceleration. Such a great outcome was primarily driven by continuous efforts to improve paying user retention and our effective content paywall strategy, as the proportion of our music streams behind the paywall expanded further.

Looking forward into 2020, our paywall content will be further enriched, and is expected to grow at a similar pace compared with 2019 as we add more genres, including those from big three music labels.

Another important highlight is our unique fan-based economy, which connects fan-to-fan and fan-to-idol, is gathering strong momentum. We have helped many artists, whether international, domestic, established or up-and-coming, promote their music and expand their fan base.

In 2019, we recorded an impressive high-double-digit year-over-year growth in the number of users buying digital albums. As a highlight, KUN's (Speaking Foreign Language) first personal digital album, YOUNG, sold more than 12 million copies on our platform by February 2020, breaking digital albums' sales record on a single platform with an absolute dominance, and setting a new milestone in the industry.

All of these achievements would have been impossible without the dedication of every single TME staff, and their passion to bring personalized, engaging and interactive music entertainment services to over 800 million monthly active users on our platform.

Our commitment to enriching content offering has continued to strengthen our content leadership. Not only do we offer the most comprehensive music library in China, but also expand to various forms of music-centric content, including more short-form videos, long-form audio, variety shows, and high-quality user-generated content on our platform.

For 2019, to cater to user demands, particularly for the younger demographic, we added more popular genres including J-Pop, K-Pop, Chinese Ancient style and ACG music to our library. We are also seeing further penetration of the younger demographic in 2019, especially generation Z, as a percentage of total online music users.

We continued to cooperate with producers of films, videos, games, variety shows, and literature, to co-produce high-quality original soundtracks to capture user demand. As example, in 2019, the digital album of The Tamed (Speaking Foreign Language), a web drama series produced by Tencent Video, broke the sales record of the domestic OST of films and drama series.

The theme song for the hit mobile game Honor of Kings (Speaking Foreign Language) was among the top rankings of multiple music charts. Our library now covers over 90% of OST for films and drama series, and all OST copyright of the most popular variety shows launched in 2019.

Additionally, in 2019, we were committed to nurturing and promoting original music content through our indie musician program. We are glad that more independent

musicians have chosen to join our musician program in recognition of our strong promotional capabilities, industry reputation, copyright protection and better financial supports. For 2019, we are proud to say that through concerted promotion efforts, the number of users listening to our musicians' original content reached almost 1 billion.

Additionally, both the number of participating musicians and original songs created more than doubled year-over-year by January 2020. And streaming of these original works, as a proportion of all streams, also nearly doubled from a year ago, with even more explosive growth for our exclusive indie musicians.

Our stepped-up effort in supporting young and talented musicians has also yielded many successful cases. Our platform served as a powerful launching pad for Hai Lun, a male grassroot singer. The streaming volume of his original new song titled Girl by the Bridge (Speaking Foreign Language), became viral quickly after release, achieving over 1.1 billion streams on our platform as of February 2020, and attracting hundreds of KOLs to perform cover versions.

Under our musician program umbrella, in August 2019, we launched a unique program targeting young talents called Produce S. By leveraging our user insights and strong promotional capabilities, it produced many popular hit songs such as Almost Lover (Speaking Foreign Language) and The Boy I Missed (Speaking Foreign Language), and promoted high-potential young artists like Yongbin Ryan.B and Uu to become super rising stars.

With such encouraging results, in 2020, we plan for a strategic upgrade to take our indie musician program to the next level of development by offering more financial and operational support to independent musicians, in order to help them realize their dreams.

Another area that we have made important strides, and will expand more proactively, is long-form audio. Last year, we added rich categories including audiobooks, talk shows, and a diverse set of topics on history, romance, and humanity, etc. And we are pleased to see the proportion of long-form audio users on our platform grew at a healthy pace. An average long-form audio user's daily time spent was more than twice of that for an average user on our platform in December 2019.

In March 2020, we signed a 5-year strategic partnership with China Literature, the leading copyright owner of online literature in China, to expand aggressively to capture huge potentials within China's massive but under-penetrated long-form audio market. China enjoys the world's largest online audio user base, and according to iMedia Research, it is expected to reach over 600 million this year.

Through this strategic cooperation, we will have access to China Literature's broad online library and license to produce certain audiobooks. These audiobooks will be made available on both TME and China Literature's platforms, thus reaching a much broader audience. This cooperation allows us to significantly expand our long-form audio content library very quickly. At the same time, we will encourage the generation of premium UGC, and attract high-quality KOLs, further enriching our content ecosystem.

Based on experience of overseas online music platforms, the penetration ratio of long-form audio users, as a percentage of total monthly active users, could reach mid-teens, suggesting strong user base advantage and growth potential for TME. If we can achieve this penetration ratio, we will have the opportunity to become the number one long-form audio platform in China.

Furthermore, we expect to realize strong synergies between long-form audio and our existing services, and to not only improve user experience and increase the overall user engagement, but also further strengthen our content leadership.

We also advanced our leading industry position by forming strategic partnership with upstream music partners. In December 2019, we announced a proposal to acquire an equity interest in UMG, or Universal Music Group, the largest recorded music company and the second-largest music publishing company globally. As the music industry in China continues marching towards digitalization, we expect our strategic collaboration with UMG to strengthen our position to capture the extraordinary growth opportunity.

We will also leverage our user insights and promotional capabilities to promote music in UMG's vast content library, and bring more of their high-quality international artists to China market.

Overall, we are very pleased with the well-rounded progress that we have achieved during the past year, and there are many new opportunities that we are excited for year 2020. Through the development of indigenous programs, broadening our content categories and formats, deepening cooperation with more partners in the music entertainment industry, we strive to make our content ecosystem more differentiated and self-sustaining.

Lastly, I would like to touch on the recent coronavirus epidemic that has been challenging our nation and now around the world. Like every other company, our thoughts are with people who have been impacted by the outbreak. We have taken effective measures to make sure that our employees are safe for their health and wellbeing.

As a corporation with strong social responsibilities, we leveraged our Tencent Musician Program to help thousands of musicians originate more than 500 songs for charity. We also offered 7-day free memberships for our online music and online karaoke services, making our platform available to people to express their thoughts and good wishes to one another.

As the leading online music entertainment platform in China, TME has been highly recognized by China's mainstream media. During the epidemic, TME was honored to be invited again to participate in the Wuhan News Agency's Sound in China program. The touching melody and lyrics of Wuhan Not Alone achieved more than 100 million times of exposure on the day of its release on our platform.

We also worked with the People's Daily to bring music to the affected areas, strengthening the bond between medical staff and patients to overcome the epidemic.

Next, Tony will discuss fourth 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 our strengthening content leadership, there are a few other areas that we have excelled in, in both our online music and social entertainment services.

For online music, to begin with, our promotional capabilities have been further strengthened. Our comprehensive promotional infrastructure not only leverages TME's online platform, but also through cooperation with external online and offline channels.

In the fourth quarter of 2019, we successfully held the first Tencent Music Entertainment Award, TMEA, in Macau and live-streamed it online on our platform, presenting a strong lineup of top domestic and international singers such as Gem Deng (Speaking Foreign Language), Westlife, and Lay Zhang (Speaking Foreign Language), etc.. This event became a national hot topic and generated tremendous media exposure both online and offline for our artists. Within 2 weeks of TMEA, the cumulative page views of the topic on the internet reached nearly 7 billion.

Second, in order to improve satisfaction of more than 600 million online music users, we constantly strive to find innovative ways to enhance our products. In the second quarter of 2019, we pioneered a product innovation by adding short videos onto Kugou Music's streaming page, to fulfill users' needs to consume music-centric short videos while listening.

By leveraging better algorithms to recommend high-quality content, the average daily streams of short videos increased almost 50% at the end of the fourth quarter of 2019 compared with the end of the third quarter. We have encouraged and attracted users to upload self-produced short videos, and by the end of 2019, over 60% of the streams of short videos were user-generated content.

As you may recall, in the second quarter of 2019, we upgraded our QQ Music app with a more distinct tab for personalized recommendation. We continue to see positive user response and achieved 30% higher streams quarter-over-quarter, driven by the personalized recommendation tab during the fourth quarter of 2019.

We significantly raised the weekly retention rate on the personalized recommendation tab to as high as 90% at the end of 2019 with added new features such as personal song list. Our upgraded features, such as daily recommendation and personalized radio stations, also yielded double-digit percentage increases in average time spent after the upgrade.

Following these, in December 2019, we launched an upgraded version of Kugou Music app with a complete revamp of our user interface, which has a younger image and highlights personalized recommendation, short videos and long-form audio. The new UI design has continued to receive positive feedback, particularly from young users. Two weeks after the added upgrade, DAU for both the personalized playlist and short videos increased by double-digit percentage.

Thirdly, on technology advancement, we recently upgraded QQ Music's song recognition to be able to continuously recognize songs embedded in short videos for various use cases, which helped increase the number of daily active users of song recognition feature by double-digits percentages in the fourth quarter compared to the third quarter of 2019. The core song recognition technology, audio fingerprint extraction, and our audio processing capability, MIDI extraction, won 2 world championships in the Music Information Retrieval Evaluation eXchange Competition in November 2019, breaking 3 world records.

Turning to our social entertainment services, overall, it achieved a nearly 33% year-over-year top line growth, as our paying user base expanded 22%, and ARPPU grew 9% year-over-year, maintaining a steady expansion rate.

One of the highlights during the fourth quarter is our annual flagship social entertainment galas, which provided performers, KOLs and music lovers with captivating and interactive experiences, attracting record high participation, and contributed to the solid paying user growth and average spend expansion, demonstrating its effectiveness to improve user engagement on our platform.

For Kugou Live, in 2019, we continued to attract a growing number of music-centric live-streaming performers onto our platform, resulting in double-digit percentage growth in the number of active performers, while increasing the number of exclusive performers by more than 300% compared to 2018.

One of our key competitive differentiators is the virtuous cycle of value creation between our social entertainment and online music services. For example, we successfully discovered Xiaoqian, a live-streaming performer on our Kugou Live platform, and helped her become an internet celebrity, with 12 of her songs advancing to top 5 on Kugou Music charts in 2019.

We also hosted more than 500 New Song Releasing Events, (Speaking Foreign Language), for emerging artists and performers in 2019, demonstrating the attractiveness and the promotional effectiveness of our integrated online music and social entertainment platforms.

Additionally, to better meet user demand, we expanded live-streaming content categories to include online games, dating, and virtual anchor live-streaming. While still at an early stage, these additional content offerings have achieved good initial user feedback.

For WeSing, during the past quarter, there were a few areas of improvement that we have started to see traction. First on short video, we improved overall conversion from recording to publishing a song by adding various short videos assisting tools. As we transform content format on the platform from audio to video, we strive to make sharing more entertaining.

Secondly, on social attributes, which are quite unique to WeSing, we substantially bolstered user interactions through the function of group messaging and private messaging, leading to a more than 40% sequential increase in the number of users

adopting this feature in the fourth quarter of 2019.

Additionally, we optimized online singing room features by emphasizing user groups with similar interests and profiles, which resulted in sequential improvements on user activeness and penetration, particularly within the younger demographic.

Overall, we started to see positive results from the efforts that we have deployed to make online singing an engaging, social and fun experience to retain users, and improve their stickiness on the WeSing platform. WeSing's average user time spent, its user activities, and the penetration rate of its monthly active users for the online singing room feature all improved sequentially in the fourth quarter of 2019.

The engagement of paying users was further strengthened by our UGC reward system, resulting in solid growth of monthly retention rate of paying users throughout 2019. During the 2020 Chinese New Year holiday, we saw the average daily time spent per person increased by 30% compared to pre-holiday period, and the number of users with song recordings increased by more than 35%. We are confident that we will continue to see healthy improvements in user engagement, and further increase in the core user group activities and loyalties throughout 2020.

Looking ahead, to leverage the expertise and operational track record that we have built over the past decade, we are very excited to share with you that QQ Music will be officially launching its live-streaming services within the QQ Music app in the first half of 2020, and gradually ramping up in the course of the next few quarters. This product will focus on the discovery and cultivation of star performers and artists, as we leverage QQ Music's powerful promotional capabilities, massive organic traffic and dynamic fan-based ecosystem.

In conclusion, we ended 2019 on a strong note, and are excited that the new initiatives, including long-form audio expansion and QQ Music live-streaming, will provide new growth avenues for TME in the years to come.

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. We achieved strong financial results throughout 2019. For full year 2019, our total revenues were RMB25.4 billion, up 34% year-over-year. Our non-IFRS net profit was RMB4.9 billion.

In the fourth quarter of 2019, our revenues were RMB7.3 billion, up 35% year-over-year, driven by 41% growth in online music service revenues and 33% growth in social entertainment service revenues.

Online music service revenues were RMB2.1 billion, up 41% year-over-year. The increase was mainly driven by outstanding performance from music subscriptions, supplemented by growth in advertising services and the sales of digital music albums, partially offset by decrease in sublicensing revenues.

Music subscription revenues were RMB1.1 billion, up 60% year-over-year, driven by record high growth of subscribers and improvement in ARPPU. Specifically, number of subscribers increased 48% and the subscriber ARPPU grew 8% year-over-year, reflecting success of our pay-for-streaming service strategy and premium membership offering. Consequently, we have seen continued improvement in user retention rate and increasing user willingness to pay for premium content.

Social entertainment service and other revenues were RMB5.2 billion, up 33% year-over-year, primarily driven by growth in live-streaming and online karaoke services. In the fourth quarter of 2019, our flagship annual social entertainment galas contributed solid paying user growth and user spend expansion, resulting in paying user growth of 22% and ARPPU growth of 9% on a year-over-year basis.

Cost of revenues were RMB4.8 billion, up 35% year-over-year, driven by higher revenue-sharing fees and content expenses.

Our gross margin was 34.1% in Q4 2019 and improved slightly from Q4 2018, driven by gross margin improvements in online music services as a result of revenue growth, despite ongoing margin pressure from increased revenue-sharing ratio in social entertainment services.

Total operating expenses were RMB1.4 billion, up 5% year-over-year. Total operating expenses, as a percentage of total revenue, was 19.4% in Q4 2019, down 5.7 percentage points from 25.1% in Q4 2018, part of which was due to the fact that IPO-related expenses incurred in the fourth quarter of 2018 did not recur in 2019. The decrease also reflected success of our continued efforts on operation efficiency in various areas such as user growth spending and brand and content promotion expenses.

Our effective tax rate was 12.4% in Q4 2019.

Our net profit attributable to equity holders of the Company was RMB1 billion. Non-IFRS net profit attributable to equity holders of the Company was RMB1.3 billion and non-IFRS net profit margin was 18.4%.

As of December 31, 2019, our combined balances of cash and cash equivalents, term deposits were RMB22.9 billion, representing an increase of RMB1.8 billion from RMB21.1 billion as of September 30, 2019. The increase in the balances was primarily due to cash flow generated from operations of RMB2.0 billion in the fourth quarter of 2019.

Overall, we achieved strong growth across our online music and social entertainment businesses in both the fourth quarter and full year 2019, driven by strengths of our products and contents.

Looking forward, we will remain focused on content investments to further enhance user engagement and monetization, and continue to expand our product and service offering such as live-streaming in QQ Music and long-form audio.