

Q1 2020 Earnings Prepared Remarks

Yanjun:

Good evening and good morning everyone, and welcome to Sea's 2020 first quarter earnings conference call. I am Yanjun Wang, Sea's Group Chief Corporate Officer.

Before we continue, I would like to remind you that we may make forward-looking statements, which are inherently subject to risks and uncertainties and may not be realized in the future for various reasons as stated in our press release.

Also, this call includes discussion of certain non-GAAP financial measures such as adjusted revenue, adjusted EBITDA and net loss excluding share-based compensation and changes in fair value of the 2017 convertible notes. We believe these measures can enhance our investors' understanding of the actual cash flows of our major businesses when used as a complement to our GAAP disclosures. For a discussion of the use of non-GAAP financial measures and reconciliation with the closest GAAP measures, please refer to the section on "non-GAAP Financial Measures" in our press release.

I have here with me Sea's Chairman and Group Chief Executive Officer, Forrest Li and Group Chief Financial Officer, Tony Hou.

Forrest and Tony will share strategy and business updates, operating highlights, and financial performance for the quarter. This will be followed by a Q&A session in which we welcome any questions you have.

With that, let me turn the call over to Forrest.

Forrest:

Hello everyone and thank you as always for joining today's call. I hope that you are all in good health and staying safe. On behalf of all of us at Sea, I would like to thank you for your ongoing support during this exceptional period.

These are times of significant change and disruption for communities, economies and businesses around the world. Against this challenging backdrop, we are proud that we have been accelerating growth and we are reporting very strong results for the first quarter.

Our communities are increasingly relying on our platforms during the pandemic. Our users are turning to Garena to enjoy interactive entertainment and socialize with their friends during the social isolation of the lockdown. Shopee is becoming a more integral part of the commercial ecosystem in each of our markets, with consumers now relying on our platform for their staples, daily essentials, and other consumption needs. At the same time, more sellers are migrating to, or relying more on, Shopee to sustain and grow their business. As our economies become more online and contactless, the digital payment and financial services that SeaMoney provides are becoming an ever more important part of the infrastructure in our region.

The coronavirus crisis is driving a step change in the growth of the digital economy globally, particularly in the markets and segments where Sea operates. It has materially accelerated a shift to online lifestyles that is broad, deep, and, in our view, irreversible. Building on our market leadership in some of the key and largest segments of the digital economy, we believe we are gaining - and will continue to gain - a disproportionate share of that growth. Our growth is also well supported by a strong balance sheet and cash flow from operations, and we will continue to invest in a highly prudent way to maximize efficiency.

Sea was born in the middle of the Global Financial Crisis. We believe that certain key qualities like humility, focus, commitment, resilience, adaptability, and prudence helped us survive and thrive in those difficult days when we first started our business. We believe that these qualities still define us today, and, in fact, are more valuable to us in the current climate than ever before. As businesses are stress tested by the crisis, our

resilience and adaptability have enabled us to respond well to surges in user demands while we navigate the physical constraints and disruptions caused by the coronavirus crisis.

For example, in all of Shopee's key markets we have launched and dramatically scaled up our offerings of groceries, health and hygiene products, and essential household items in a matter of days. We are also doing everything we can to support economic recovery across our markets. We launched a regionwide Shopee Seller Support Package to help merchants to get back on their feet. This includes a number of initiatives localized for the specific needs of merchants and on-the-ground conditions in each of our markets. These range from training and support programs to help new sellers move online or assist existing sellers to grow their business, to free or discounted access to our services like advertising and marketing that enable sellers attract new customers online. Furthermore, we are providing fee relief for some of our seller services to ease the financial burden on them during this difficult period.

Meanwhile, our Garena team has quickly scaled up our capacity to meet record surges in customer demand. We have also worked hard to create new ways for our users to engage online, from creating dedicated online esports events so that our communities can interact with each other even as they play apart, to using our platform to raise awareness of health and safety best practices in fun and creative ways.

Our adaptability ensures that our platforms can support our customers and ecosystem partners when they need us most. This is helping us build strong bonds of affinity with them that will outlast this crisis. Just as importantly, this ensures that we can continue to grow our businesses and extend our leadership, even in the most testing circumstances.

I am equally proud to see how our teams have come together to get aid to where it is needed most. Across our markets, we have worked with local authorities to provide financial support, as well as essential medical equipment such as ventilators, masks, and personal protective equipment, to the hospitals and healthcare workers on the frontline of the battle against the coronavirus.

Sea's mission is to better the lives of consumers and small businesses through technology. And it has never been more important for us to live up to that mission.

Let me now turn to our results for the first quarter.

On a group level, adjusted revenue grew 58% year-on-year to 913.9 million dollars for the first quarter. Gross profit for the quarter was up 424% year-on-year to reach 206.8 million dollars, compared to 39.5 million dollars in the same quarter of 2019. Adjusted EBITDA was negative 69.9 million dollars, compared to negative 32.0 million dollars in the same period in 2019.

Let's look now at our digital entertainment business. Garena once again broke records in the first quarter.

Adjusted revenue grew by 30% year on year to 512.4 million dollars. This robust top line growth was primarily driven by strong growth in both active users and paying users.

In addition, we hit new highs in terms of quarterly active users. We recorded 48% growth year-on-year to 402.1 million quarterly active users, while our quarterly paying users grew 73% year-on-year to 35.7 million. The quarterly paying user ratio remained strong at 8.9%.

Free Fire saw particularly strong growth in the first quarter, and I am pleased to note that this strong growth extended into the second quarter. The game recently hit a new record for peak daily active users of over 80 million. In April, Free Fire achieved another record high in monthly paying users, which more than doubled year-on-year. In India our monthly paying users as a percentage of monthly active users already exceeded 10% in April.

We believe this growth in our user base is attributable both to the macro trends as well as our constant efforts to engage new and existing users with fresh, creative and highly localized content.

For example, we introduced a new map called Kalahari. It features a desert theme, with faster, more intense game play. The Kalahari map proved very popular with our users when it was first piloted in select events a few months ago, and has since been made a permanent part of the game. We have also rolled out a number of new features based on feedback from our communities, such as a ranked mode for our popular Clash Squad game mode. The Clash Squad mode features teams of four competing against each other in intense, best-of-seven matches that last just 1.5 minutes each. It has been a big hit with the community, and the addition of a ranked mode based on their feedback adds a new competitive element where teams can challenge themselves against the best opponents in their region.

Alongside these global content pushes, our local teams are focused on developing highly localized content for our users. In Indonesia, for example, we have partnered with one of the country's most popular actors and star of Mortal Kombat, Joe Taslim, to create a playable in-game character called Jota modeled after Joe himself. To promote this, we also worked with one of Indonesia's most popular directors to create a short film with Joe showcasing his famous martial arts skills. So far in Indonesia over half of our users have played as Jota. This initiative highlights how these elements of local flavor really resonate with our users. Similarly, in India we partnered up with popular actor, Amol Parashar, to produce a series of light-hearted videos highlighting Free Fire's key features. These videos quickly went viral, and to date have recorded over 37 million views on YouTube.

With offline esports events generally on pause, we have quickly adapted and introduced new ways to sustain our engagement with the Free Fire community. For example, in April we hosted a special one-off global event called Wonderland Peak. This was a week-long celebration featuring special characters, items, and in-game challenges to excite our community around the world and to reward our most loyal users. It was also Free Fire's largest in-game event of the year so far, and we saw significant user number growth as a result.

Moreover, we are working with local celebrity Free Fire fans to create fun and engaging online competitions that have been very popular with our users. In Brazil, our long-term partner DJ Alok, who is one of Brazil's most popular musical artists, took part in an online competition against some of the best known local Free Fire influencers as a warm-up for a hugely popular live set he performed across local social media channels. Meanwhile in Colombia, two of that country's best-known footballers, James Rodriguez and David Ospina, each captained teams of Free Fire influencers in an online charity tournament that attracted over a million views.

In the first quarter, we recorded over 90 million online views for Free Fire's esports events globally. This is a testament to the growing reach and popularity of this game across the world.

Building on this growing and more engaged user base, we will continue to focus on developing Free Fire into a long-lasting IP and a bigger platform. The larger user base also presents greater monetization opportunities over the longer run. We are therefore fully focused on execution and leveraging Garena's strong momentum to further accelerate its growth globally.

Let's turn now to Shopee.

Like Garena, Shopee also recorded stand-out results for the first quarter and into the second quarter. Throughout the quarter and beyond, we have been making every effort to win the hearts and minds of our consumers and merchants during this difficult time for them.

We hit a new record high for GMV of 6.2 billion dollars, representing year-on-year growth of 74.3%. The year-on-year growth rate increased by almost 10 percentage points compared to 64.8% for the last quarter, despite the disruptions of the coronavirus crisis. We also recorded strong growth in orders, up 111% year-on-year to 429.8 million. The year-on-year growth rate of gross orders further accelerated to more than 140% in April as we saw the strong growth momentum on our platform carrying into the second quarter.

In the first quarter, we further extended our market leadership and continued to rank first across Southeast Asia by downloads, monthly active users, and total time in app on Android, according to App Annie. Notably, we were the top ranked app by monthly active users in each of Taiwan, Indonesia, Vietnam, and

Malaysia. As we further expanded our user base, Shopee ranked third in the Shopping category globally by downloads across the iOS and Google Play App Stores combined during the first quarter.

Adjusted revenue grew strongly to 314.0 million dollars, up 111% year-on-year, and marketplace revenue grew even more quickly to 236.7 million dollars, up 132% year-on-year. We believe this indicates the strength and resilience of our platform despite the macro environment. Merchants are willing to keep investing in Shopee even in these tough times because they recognize the value that we offer, our unrivalled reach to consumers, and the return on their investment that Shopee provides.

The slight quarter-on-quarter decrease in our overall and marketplace take rates is mainly due to the lockdowns and other movement restrictions in the first quarter. These disruptions had a particularly significant impact on some of our cross-border merchants. As a result, we saw an impact on revenue derived from sales by those merchants. This includes revenue from cross-border logistics that is recognized on a gross basis. We also provided fee relief to our cross-border merchants who were materially impacted by the coronavirus crisis. Into the second quarter, we have seen meaningful recovery of cross-border transactions on the platform.

Adjusted EBITDA loss per order declined further, falling by 48% year-on-year to 60 cents compared to one dollar and 16 cents for the same period in 2019 and 70 cents last quarter. Our ability to drive sustained improvements in unit economics, even in this difficult environment, highlights our focus on scaling with efficiency and our disciplined approach to growing our business.

In Indonesia, where Shopee is the largest e-commerce platform by orders, Shopee registered over 185 million orders for the market in the first quarter, or a daily average of over 2 million orders. That represents an increase of 123% year-on-year, further extending Shopee's market leadership. Shopee also ranked first in Indonesia by average monthly active users, downloads, and total time spent in app on Android, in the Shopping category during the quarter, according to App Annie.

Our sustained focus on engaging our users continues to be a key driver of platform growth.

As our community has scaled up, we are now able to drive engagement activities in a much more personalized and targeted way. For example, we launched a membership-based service called Shopee Mum's Club across our markets. This service targets mothers who use our platform, and enables them to discover a unique selection of high quality curated products and brands. Some of these products and brands are only available to members. They also enjoy discounts on many common items such as diapers. This targeted group engagement builds stronger user stickiness and activity, and we are rolling out similar targeted offerings in other categories like health and beauty.

From early March onwards, governments in all our markets began to introduce restrictions on movement to curb the spread of the coronavirus. In response to this, our local teams worked extremely hard to quickly launch and scale up our offerings of FMCG, home and living, and other categories of essential and household goods. We rolled out a special program called Shopee From Home in every market. This program was designed to encourage our users to follow government guidelines and stay home by buying their essential needs online.

We also onboarded thousands of new merchants to help them migrate their business online during this difficult time and overcome the significant logistical and operational challenges imposed by the lockdowns.

As Shopee becomes an increasingly vital part of the retail landscape in our markets, more and more of the world's top brands are scaling up their partnerships with us. In early May, we rolled out a region-wide partnership with Proctor & Gamble called "Show Me My Home". For this innovative campaign, Shopee and P&G collaborated to create dedicated microsites for each Shopee market that feature a curated selection of top P&G brands categorized by different rooms of the house. The campaign aims to give consumers a new, fun, and engaging way to find the products that they want from P&G's world famous brands on Shopee.

I am really proud of our team for managing the business through the challenging environment we have faced in recent months. We met the increased demands of our consumers and merchants in spite of significant stress tests on our business and our ecosystem imposed by the pandemic itself, and the various restrictions introduced to curb the spread of the virus. We are well positioned to continue capturing the expanded growth opportunities in the sector and further extending our market leadership. We believe that this strong leadership position, combined with the resilience, commitment and adaptability of our team, will drive accelerated long-term growth.

Finally, SeaMoney continues to experience strong growth, propelled by increased user demand for digital payment and financial services during the pandemic, accelerated growth of our Shopee platform and the deeper integration of our mobile wallet services with the platform.

In the current climate, the overall digital economy is growing rapidly. In particular, more people are spending more of their time and money online, and that is driving an increased need for both online payments services and financial services as well as an increased need for contactless payment options. That in turn means that more people are adopting digital payment and financial services options as one of their primary channels of choice. Building on that, we are encouraged by the progress we have made in driving adoption of SeaMoney's offerings.

In the first quarter, our mobile wallet total payment volume, or TPV, exceeded 1 billion dollars, a milestone achieved in just about a year after we started to integrate the mobile wallet service with our Shopee platform. The quarterly paying users for our mobile wallet services surpassed 10 million. More than 40% of Shopee's gross orders in Indonesia, our largest market for SeaMoney, were paid using our mobile wallet services in the month of April. Moreover, we are rapidly expanding third-party use cases and partnerships online and offline. In March 2020, we joined forces with Google to offer our mobile wallet as a payment option for the Google Play Store in Thailand.

We see significant growth ahead in the digital payments and digital financial services segment, and we see that growth accelerating as the coronavirus crisis drives more consumer activity online. We also believe that SeaMoney is in an excellent position to capture this growth as we build on our strategic leadership positions in some of the largest use cases in digital payments. We will continue to focus on scaling SeaMoney effectively and efficiently to reach strong leadership positions across our key markets.

To conclude, we are glad to be reporting strong numbers for the first quarter. This performance demonstrates the fundamental strength and resilience of Sea's business, and our position as the market leader in sectors of the economy that are experiencing the strongest growth.

Looking ahead, while we expect to face uncertainty in the near term due to the coronavirus crisis, we believe the step change in adoption of the digital economy that we have seen in recent months is here to stay, and it will experience rapid growth in our markets in the years ahead. More importantly, we believe that Sea's three core businesses, as the leaders in their sectors, will capture an outsized share of that growth.

Sea has been stress tested in recent months due to the coronavirus crisis, and our performance under these conditions has underlined the fundamental strength and resilience of our business. This gives us confidence that we are well-equipped to manage the current external turbulence, and ready to capture the long-term growth opportunities.

We will therefore continue to invest in our future, and focus on winning the hearts and minds of the users across all of our platforms during the time when they need us most. We believe that Sea will emerge from the crisis in an even stronger position and better prepared for our long-term growth.

With that, I will invite Tony to discuss our financials.

Tony:

Thank you, Forrest, and thanks to everyone for joining the call.

We have included detailed quarterly financial schedules together with the corresponding management analysis in today's press release, and Forrest has discussed some of our financial highlights. So, I will focus my comments on the other key financial metrics.

For Sea overall, total adjusted revenue grew by 58% year-on-year to 913.9 million dollars, which was mainly driven by the growth of our digital entertainment business, especially our self-developed game, Free Fire, and our continued monetization efforts in our e-commerce business in the past quarters.

The 30% year-on-year growth in digital entertainment adjusted revenue to 512.4 million dollars was primarily driven by the increase of our active user base and deepened paying user penetration, and in particular, the continued success of our self-developed game Free Fire.

Digital entertainment adjusted EBITDA was 298.4 million dollars, an increase of 32% year-on-year, mainly due to strong top line growth and our self-developed game accounting for an increased share of revenue.

Our e-commerce adjusted revenue of 314.0 million dollars included 'marketplace revenue' of 236.7 million dollars, up 132% year-on-year, and 'product revenue' of 77.3 million dollars, up 64% year-on-year. This growth is a result of our commitment to continue enhancing our service offerings as we seek to create greater value for our platform users.

E-commerce adjusted EBITDA loss was 260.0 million dollars as we continued our investment to fully capture the market opportunity in the region. We will continue to invest prudently and drive high quality growth by serving the users' needs better in the long run.

Digital financial services adjusted revenue was 10.7 million dollars, an increase of 278% year-on-year from 2.8 million dollars in the first quarter of 2019. Adjusted EBITDA loss was 101.6 million dollars in the first quarter of 2020, compared to a loss of 11.9 million dollars in the same period of 2019. This was primarily due to our continued efforts to integrate our mobile wallet services with our Shopee platform across different markets. We have also been expanding the use cases of our mobile wallet services outside of Sea's platforms to include other online and offline merchants, along with a variety of third-party use cases.

Returning to our consolidated numbers, we recognized a net non-operating income of 11.2 million dollars in the first quarter of 2020, compared to a net non-operating loss of 442.8 million dollars in the first quarter of 2019. The net non-operating loss in the first quarter of 2019 was primarily due to a fair value loss of 436.1 million dollars arising from the fair value accounting treatment for the 2017 convertible notes.

We had a net income tax expense of 23.2 million dollars in the first quarter of 2020 which was primarily due to withholding tax and corporate income tax recognized in our digital entertainment business.

As a result, net loss excluding share-based compensation and changes in fair value of the 2017 convertible notes was 239.4 million dollars in the first quarter of 2020, as compared to 237.3 million dollars for the same period in 2019.

From a foreign exchange standpoint, we had seen increased volatility in the exchange rates of some of our local currencies against the US dollar. That meant for us on a constant currency basis the top line metrics would have been neutral to modestly better in some of the cases, but we did not assess the differences to be material.

With that, let me turn the call back to Yanjun.

Yanjun:

Thank you, Forrest and Tony. We are now ready to open the call for questions.