

Q2 2020 Earnings Prepared Remarks

Yanjun:

Good evening and good morning everyone, and welcome to Sea's 2020 second 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.

Over the last few months, our teams have continued to work hard to support local consumers and small businesses during these challenging times. At every level of the business, our teams have strengthened their efforts to help our communities to benefit from the digitalization of the economy. We also focused on contributing to economic recovery across our markets through various local initiatives as well as government-led efforts.

Against this backdrop, I am pleased to share that Sea is reporting very strong results for the second quarter. We also enjoyed accelerating growth across all three of the key pillars of our business.

As we noted last quarter, we have been witnessing a profound structural shift to digitalization across our markets. Even as movement restrictions are being loosened or lifted in many markets, we continue to see strong user growth and deepening of user engagement across our platforms. This is well aligned with our view that the structural shift to digitalization will be long-lasting. We further believe that we are very well positioned to capture the accelerated growth opportunities created by the rapid expansion of the digital economy. This is also reflected in our very strong results for the second quarter.

Let me highlight a few key performance metrics for the quarter.

On a group level, I am particularly pleased to note that we recorded positive adjusted EBITDA of 7.7 million dollars. Our quarterly adjusted revenue grew 93% year-on-year to reach 1.3 billion dollars. Our gross profit grew by 106% year-on-year to reach 200.8 million dollars.

We believe the strong topline growth and continued bottom-line improvement demonstrate our ability to deploy our capital in a highly effective and efficient manner. It also speaks to the fundamental strength of our business model, which allows us to fund our rapid growth substantially through cash generated from operations.

Let me talk about each of our business lines, starting with digital entertainment. Garena had another excellent quarter and achieved several historical highs.

We reached more people than ever before, with close to half a billion active users around the globe playing Garena games during the quarter. That represents an increase of 61% year-on-year.

As we rolled out more new content than ever to entertain and engage our users, our paying user ratio improved further to hit 10%. Our quarterly paying user number grew at a very strong rate of 91% year-on-year to reach 49.9 million.

As a result of this strong user and paying user growth, adjusted revenue for the quarter reached 716.2 million dollars, up 62% year-on-year. Our adjusted EBITDA margin also reached a new record high of 61%.

I want to highlight in particular the very strong performance of Free Fire. It continues to set new records in user growth and engagement.

Free Fire recently hit a new record high in terms of peak daily active users of more than 100 million.

According to App Annie, in the second quarter, Free Fire continued to be the top-grossing game in both Latin America and Southeast Asia across both iOS and Android. Thanks to Free Fire's enduring global appeal, it also ranked as the third most downloaded game worldwide across iOS and Android in the quarter.

A key driver of Free Fire's success is our ability to create captivating content that engages our global user community.

For example, we have observed that users enjoy the unique creative themes and storylines we deploy for each of Free Fire's Elite Pass seasons. One of the most popular Elite Pass concepts of the last few months was Rampage II: Uprising. This was a reboot of Rampage, one of the best-received in-game campaigns of last year. For this year's Rampage event, we introduced a new 4v4 strategy mode, which proved very popular with our users. We are excited to see the positive user sentiment around the return of Rampage. We believe that recurring events with new creative content such as this help to build user affinity with our game and sustain long-term user engagement.

We are also partnering with other global IP holders to create memorable content experiences for our users. For example, in July we announced a partnership with Netflix for a special in-game crossover with its global hit show, Money Heist. For this, we have worked with Netflix to create a Money Heist-themed in-game takeover, which is expected to be launched in September. Users will be able to enjoy a new game mode inspired by the plot of Money Heist, and can purchase virtual skins modelled after the iconic outfits in the TV series.

To further enhance user engagement, we have successfully migrated our esports activity online over the last few months. For example, in recent months we held large scale esports events in both Asia and Latin America. In June, we held the Free Fire Asia All-stars event, featuring both professional players and popular online influencers from India, Indonesia, Thailand, and Vietnam competing across several tournaments. In early August, we hosted an online esports event in Latin America called Free Fire Gigantes, featuring the top teams from our pro leagues on the Brazil and Latin America servers.

We continue to see strong momentum in user engagement entering into the third quarter even as many of our markets eased their restrictions on movement recently. In fact, in July, Garena hit a new record high in monthly adjusted revenue. Free Fire also hit a new record in monthly paying users in the same month, which more than doubled year-on-year.

Looking ahead, we remain fully focused on bringing innovative content and enjoyable experiences to our users. We are confident that high quality and highly engaging content will strengthen their engagement and affinity with our games. This will continue to be the key driver of Garena's long-term success.

Now let's turn to Shopee.

We recorded accelerated growth across key metrics and in each of our markets, as more consumers and sellers turned to Shopee as their go-to shopping and selling destination.

Last quarter, we spoke about the rapidly changing needs of consumers and sellers in our region who are embracing e-commerce at an unprecedented pace. We also discussed the efforts we were making to quickly adapt and scale up our services to address these evolving needs. Our very strong results for the second quarter further demonstrate the sustained deepening penetration of e-commerce and our ability to capture this growth.

In the second quarter, we recorded accelerated growth in gross orders, which increased by 150% year-on-year to reach 615.9 million, compared to 111% in the first quarter. Moreover, gross orders for Shopee Mall increased at an even faster pace of more than 210% year-on-year, as more and more global and local brands partnered with us to cater to their increasing and evolving demands for online solutions.

In Indonesia, our largest market, our year-on-year growth rate in terms of orders further accelerated. We recorded over 260 million orders for the market in the second quarter, or a daily average of over 2.8 million orders, an increase of over 130% year-on-year.

We also saw significantly accelerated year-on-year growth in GMV, which exceeded 8 billion dollars. This represents a year-on-year growth rate of 110%, compared to 74% in the first quarter.

According to App Annie, in the second quarter Shopee continued to rank first across Southeast Asia by downloads, monthly active users, and total time in app on Android. In Indonesia, Shopee extended its lead and once again ranked first in the shopping category by downloads, monthly active users, and total time in app on Android.

In terms of monetization, adjusted revenue grew by 188% year-on-year to reach 510.6 million dollars. I am pleased to note that our monetization rates have largely recovered to pre-pandemic levels. Adjusted revenue as a percentage of total GMV increased to 6.4% from 5.1% for the previous quarter. Adjusted marketplace revenue as a percentage of total GMV was 4.7% in the second quarter of 2020, compared to 3.8% in the first quarter.

Meanwhile we drove further improvements in operating efficiency even as we significantly scaled up our operations. Adjusted EBITDA loss per order decreased by 51% year-on-year to 50 cents, compared to one dollar and one cent for the second quarter of 2019 and 60 cents in the first quarter.

While we gradually ramped up monetization, we continued to provide strong support to our seller communities most affected by the pandemic through fee relief and other financial and operational assistance. In many of our markets, we have launched or scaled up support programs for local SME sellers during the quarter, offering financial and marketing aid to help them reach new audiences. We have also devoted significant efforts to create more opportunities for local entrepreneurs and small businesses to grow their presence online. In Thailand, for example, we have partnered with the government to develop and roll out training and support programs targeting farmers. Our program aims to reach 1.5 million farmers in the coming years to enable them to start and scale their business on Shopee. Similarly, in Malaysia, we organized a special online sales festival for durian producers to ensure they could get their fruit to consumers while fresh. These are all part of our commitment to driving economic recovery in our local communities.

In terms of engagement with our consumers, in the second quarter we continued to enhance the highly social user experience that Shopee is known for.

Our livestreaming feature is growing in popularity, and we are expanding the types of content that we offer to our users. For example, in late June we partnered with the organizers of KCON, the most popular festival of K-pop music, to stream their hugely popular annual concert series exclusively on Shopee.

At the same time, we are expanding our ability to support the needs of sellers and brands across the region. In July we partnered with Google to launch a new service called Google Ads with Shopee. This integration enables brands on Shopee to create Google shopping ads directly in the Shopee Brands Suite. We also enhanced our in-app Shopee Feed with a new feature called Shopee Stories. This allows brands and sellers to create and share short-form video content with their followers on Shopee Feed.

In summary, the very strong results for the second quarter are underpinned by two key drivers.

First, e-commerce penetration continued to deepen across markets and demographics. This momentum continued into the third quarter even as most of our markets have emerged from lockdowns.

Second, with our strong market leadership and our ability to adapt quickly and effectively, Shopee is capturing – and we believe will continue to capture - an outsized proportion of the growth opportunity.

With that in mind, we will continue to focus on investing with efficiency in the long-term growth of Shopee to further strengthen our market leadership. We continue to firmly believe that this will lead to much greater returns over the long run.

Finally, our digital financial services business, SeaMoney, also enjoyed further accelerated growth in the second quarter.

Accelerating digitalization is driving increased needs for quick and convenient online and contactless payment options, as well as other digital financial services. We further believe that SeaMoney is in an ideal position to capture a significant proportion of that growth opportunity. SeaMoney's focus continues to be leveraging on Sea's strategic leadership positions in some of the largest use cases for digital payments in e-commerce and digital entertainment. We believe its impressive growth in the second quarter underlines the strength of this strategy.

Our mobile wallet total payment volume increased to more than 1.6 billion dollars for the second quarter, compared to more than 1 billion dollars in the first quarter. Quarterly paying users for our mobile wallet services grew by about 50% quarter-on-quarter to more than 15 million. In particular, we are encouraged to see more Shopee users embracing the ease and convenience of our mobile wallets. In the month of July in Indonesia, our mobile wallet services were used to pay for more than 45% of gross orders on the Shopee platform.

As we scale up the SeaMoney business, we are applying the same rigorous discipline and focus on efficiency that is the hallmark of Sea's business. Even as we recorded a huge jump in user numbers and TPV for the quarter, our adjusted EBITDA loss for this segment remained relatively flat quarter-on-quarter.

We see significant growth ahead in the digital payments and digital financial services segment, driven by the rapid expansion of the digital economy in our region. Our results for the quarter clearly demonstrate that SeaMoney is in a great position to address the needs of users across the region. We will continue to invest efficiently in scaling up the SeaMoney business to solidify our leadership position across our markets.

To conclude, we are moving into the second half of 2020 firing on all cylinders.

Each of our businesses is successfully adapting to capture the immediate growth opportunity in front of us. Each of them is also ideally positioned for the long-term with a significant runway ahead.

We saw sustained and growing user engagement across our platforms through the second quarter and beyond. And this gives us further confidence that the rapid shift to digital lifestyles is in fact a permanent and irreversible change that will drive significant growth opportunities for Sea over the long term.

We are very focused on maximizing this opportunity and we will continue to invest in products and services that will win the hearts and minds of our users.

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 93% year-on-year to 1.3 billion 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 62% year-on-year growth in digital entertainment adjusted revenue to 716.2 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 436.2 million dollars, an increase of 65% 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 510.6 million dollars included 'adjusted marketplace revenue' of 378.7 million dollars, up 175% year-on-year, and 'adjusted product revenue' of 131.9 million dollars, up 233% year-on-year. The strong results demonstrated the deepening penetration of e-commerce and our ability to capture these accelerated growth opportunities created by the rapid expansion of the digital economy.

E-commerce adjusted EBITDA loss was 305.5 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 11.9 million dollars, an increase of 328% year-on-year from 2.8 million dollars in the second quarter of 2019. Adjusted EBITDA loss was 110.1 million dollars in the second quarter of 2020, compared to a loss of 18.1 million dollars in the same period of 2019. This was primarily due to our continued efforts to deepen the integration of our mobile wallet services with our Shopee platform across different markets. We have also been expanding the suite of online and offline third-party use cases and partnerships.

Returning to our consolidated numbers, we recognized a net non-operating income of 7.6 million dollars in the second quarter of 2020, compared to a net non-operating loss of 29.2 million dollars in the second quarter of 2019. Non-operating gain in second quarter of 2020 was primarily due to a gain from the sale of a controlling equity stake and remeasurement of our remaining stake in an operating entity in our other services segment, partially offset by higher interest expense. The revenue from the entity disposed of contributed to a large portion of the revenue of our other services segment in the past and the entity is no longer consolidated following such disposal. Our non-operating loss in second quarter of 2019 was primarily due to a fair value loss of 31.8 million dollars arising from the fair value accounting treatment for the 2017 convertible notes.

We had a net income tax expense of 27.8 million dollars in the second 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 317.7 million dollars in the second quarter of 2020, as compared to 215.1 million dollars for the same period in 2019.

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.