

3Q 2019 Earnings Prepared Remarks

Yanjun:

Good evening and good morning everyone, and welcome to Sea's 2019 third 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.

We are happy to announce a strong set of results for the third quarter.

For Sea as a whole, our adjusted revenue tripled year-on-year to reach 763.3 million dollars. Adjusted EBITDA improved year-on-year to negative 30.8 million dollars, compared to negative 183.8 million dollars a year ago. We continue to fund our growth primarily with cash generated through operations and are in a strong position to further capture the significant growth opportunities ahead.

As we mentioned before, our strategic goal for 2019 has been to strengthen our leadership across different markets and business lines, scale with increasing efficiency, and deepen user engagement and monetization. The results we reported today show that we are making excellent progress with this strategy.

In view of our encouraging performance in Q3 and our strong outlook for the remainder of 2019, we have decided to once again raise our guidance for our full year adjusted revenue for both digital entertainment and e-commerce.

For digital entertainment, we now expect full year 2019 adjusted revenue to be between 1.7 billion dollars and 1.8 billion dollars, representing 157.2% to 172.3% growth from 2018. This compares to the previous guidance of between 1.6 billion dollars and 1.7 billion dollars.

We are also increasing our guidance for full year adjusted revenue for e-commerce to between 880 million dollars and 920 million dollars, representing 202.7% to 216.5% growth from 2018. This compares to the previously stated guidance of between 780 million dollars and 820 million dollars.

I will turn first to our digital entertainment business.

This was another great quarter for Garena, led by the sustained success of our global smash hit, Free Fire, which recently joined the billion-dollar club as one of the highest grossing mobile games in the world.

Let's look at some of our key metrics for the third quarter.

Adjusted revenue for the digital entertainment business grew by 212% year-on-year to 451 million dollars. And we continued to deliver an excellent performance on the bottom line, with adjusted EBITDA increasing 395% year-on-year to 266 million dollars.

The increase in adjusted revenue was mainly driven by an increase in our user numbers and deepening pay user penetration. In particular:

- our quarterly active user number, or QAU, increased by 82% to 321.1 million, compared to 176.1 million a year ago, and
- the pay user ratio, which is quarterly paying users as a percentage of QAUs, increased again in the third quarter to 9.1%, compared to 4.1% a year ago

Turning to our games portfolio, Free Fire celebrated its second anniversary recently and it continues to be one of the world's most popular mobile battle royale games. According to App Annie, in Q3 it ranked among the top five most downloaded mobile games globally for the third straight quarter, and was the highest grossing mobile game in Latin America and Southeast Asia in the quarter.

We believe that Free Fire's continued global popularity also reflects the success of our efforts to build a highly engaged global community around the game, and keep this community engaged by constantly providing fresh, high quality in-game content as well as driving an extremely successful global esports program.

Sustaining this level of community engagement is an important focus for Garena. We are convinced that the huge popularity of Free Fire worldwide gives us an opportunity to build a long-lasting franchise around this IP.

Let me share a few recent examples of our initiatives to drive community engagement.

In terms of content, we rolled out a number of new, experimental modes of play. The response from our community has been overwhelmingly positive. Our Clash Squad mode, for example, allowed teams of four to compete against each other and proved extremely popular with our players.

As Free Fire has increasingly become a national pastime in Latin America, especially for its young and social population, we have further extended the game's reach into the local communities with our network of followers, influencers as well as popular icons. For example, we partnered with DJ Alok, Brazil's most popular DJ and one of the country's best loved music stars, for the game. Alok is now a playable character in our game and will also provide one of his songs for Free Fire and our esports events.

Esports is also a key driver of user engagement and stickiness. Over the past several weeks we have been rolling out our largest ever esports event for Free Fire – the Free Fire World Series. In September, we hosted regional qualifiers across all our markets globally for the World Series. This included hugely successful esports events in our newer markets such as India. India's Sports Minister attended our event as our guest of honor. We also partnered on this event with one of the country's largest media powerhouses, India Today.

We are seeing very strong online engagement with these events. The final match of our Brazil qualifiers recorded over one million concurrent viewers online. To date, our World Series events around the globe have accumulated over 100 million views across all platforms.

The highly anticipated World Series will conclude at the grand finals in Rio in a few days' time.

We are encouraged by the strength, depth, and strong gamer affinity that Free Fire is demonstrating.

By combining this with our unique ability to build and deepen engagement with game communities on a hyper-local level in diverse markets globally, we are confident in Free Fire's long term success for years to come.

Looking at the publishing side of the Garena business, we continue to work with the world's top developers to bring the highest quality titles to our markets. In October, we launched Call of Duty®: Mobile in our core markets in Southeast Asia and Taiwan and the game received an immediate strong reception from our users. It was the most downloaded mobile game on both the Google Play and iOS App Stores in each of our markets for the month of October. For the rest of the year and beyond, we will continue to work closely with Activision and Tencent to enlarge the game's user base and deepen user engagement in our markets.

I'm pleased to note also that we are seeing the strong momentum of the third quarter sustaining into Q4. In October, we hit a new record high for monthly digital entertainment adjusted revenue, which was mainly attributable to the continued growth of Free Fire.

Our strategic goal for Garena for this year has been to enhance our position as a leading global game developer and publisher, to expand our global footprint, and to translate this into sustained business success. Our results for the quarter demonstrate that this strategy is well on-track and we believe that Garena is in a stronger position than ever as we head into the fourth quarter and beyond.

Let's look now at e-commerce.

In the third quarter, Shopee sustained its strong growth momentum, and continued to extend its lead at the forefront of the very promising e-commerce opportunity in Southeast Asia and Taiwan. The recent Google and Temasek report projected that e-commerce GMV in Southeast Asia will grow from 38.2 billion US dollars in 2019 to 153 billion US dollars by 2025. As the market leader, we believe Shopee is in an ideal position to capture an outsized share of this growth opportunity.

And our results for the quarter underline how Shopee's clear leadership is translating into business success. During the quarter, the pace of growth in total orders further accelerated to a year-on-year rate of 103% to reach 321.4 million orders. Meanwhile, GMV increased to 4.6 billion dollars, up 70% year-on-year.

In the third quarter we also extended our lead as the most popular e-commerce platform in our region. According to App Annie, Shopee was once again the leading e-commerce platform in both Southeast Asia and Taiwan by average monthly active users and downloads across the Google Play and iOS App Stores combined, and the top ranked app in Southeast Asia as a whole and in each of our five largest markets by Total Time in App on Android. Shopee is now one of the most popular and fastest-growing e-commerce platforms globally. In the third quarter, it was ranked the fifth most downloaded app in the Shopping category worldwide, across both Google Play and iOS app stores, according to App Annie.

In our largest market, Indonesia, Shopee continues to solidify its market leadership as the shopping platform of choice. Orders in Indonesia grew 118% year-on-year to 138 million orders in the third quarter, which we believe makes Shopee the clear leader by orders in that market. That is a daily average of more than 1.5 million orders, compared to a daily average of 1.2 million orders in the second quarter.

Shopee was also the number one ranked app in the Shopping category in Indonesia by all key metrics in terms of average monthly active users and downloads across the Google Play and iOS app stores combined, as well as in terms of Total Time in App on Android, according to App Annie.

Our leading market position across the region is reflected in our very strong performance during our recent shopping festivals. Building on our successful branding campaign featuring the football icon Cristiano Ronaldo, we recorded three times more orders on September ninth alone than we did a year ago during our 9.9 shopping event. Our 11.11 Big Sale, which we concluded yesterday, was also a huge success, with approximately 70 million items sold during the 24 hours of November 11. We saw very strong user

engagement during the 11.11 festival period, with our Shopee Live streams recording approximately 65 million views during the three weeks of the sales campaign.

At the same time, our growing scale and efficiency is translating into improvements in both revenue and our key bottom line metrics.

We continued to ramp up monetization during the quarter. In the third quarter, our overall take rate, in terms of e-commerce adjusted revenue as a percentage of GMV, increased from 2.6% for the same period a year ago to 5.6%, with adjusted revenue rising by 261% year-on-year to 257.2 million dollars.

Our overall unit economics for Shopee also improved further this quarter. Adjusted EBITDA loss per order further declined by 41.9% to 79 cents, compared to 1 dollar and 36 cents in the same period last year. In Taiwan, we recorded positive adjusted EBITDA even after allocation of the headquarters' common expenses in the third quarter.

To conclude, Shopee is well on track with our strategy to scale with efficiency, capture increasing market share across our region, and deepen monetization. It is now firmly established as the clear market leader, and in a better than ever position to benefit from the rapid growth of e-commerce in our region.

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. So, I will focus my comments on the key financial metrics.

For Sea overall, our third quarter total adjusted revenue was 763.3 million dollars, an increase of 214% year-on-year. This was mainly driven by the growth of our digital entertainment business, especially our self-developed game, Free Fire, and our continuous monetization efforts in our e-commerce business in the past quarters.

Digital entertainment adjusted revenue was 451 million dollars, an increase of 212% year-on-year. The growth was primarily driven by the enlarged paying user base as we continue to improve the monetization of our games, especially Free Fire.

Digital entertainment adjusted EBITDA was 266.0 million dollars, an increase of 395% year-on-year, mainly due to strong top line growth and our self-developed game accounting for an increased share of revenue. The increase was also partially due to the improved operating efficiencies as shown by the lower sales and marketing expenses, as well as general and administrative expenses, as a percentage of adjusted revenue.

E-commerce adjusted revenue was 257.2 million dollars, up 261% year-on-year. Within this, 'marketplace revenue' was 208.1 million dollars, up 314% year-on-year, while 'product revenue' was 49.2 million dollars, up 135% year-on-year.

E-commerce adjusted EBITDA loss was 253.7 million dollars as we continued our investment to fully capture the market opportunity in the region. We will continue driving the high quality growth by serving the users' needs better and improving operational efficiencies in the long run.

Digital financial services adjusted revenue was 2 million dollars, a decrease of 35% year-on-year from 3.1 million dollars in the third quarter of 2018 as we focused our efforts on strengthening the infrastructure to support our existing platforms. Adjusted EBITDA loss was 33.6 million dollars in the third quarter of 2019, compared to a loss of 7 million dollars in the same period of 2018. This was primarily due to our continued efforts to integrate our AirPay and Shopee platforms.

Returning to our consolidated numbers, we recognized a net non-operating income of 9.8 million dollars in the third quarter of 2019, compared to a net non-operating income of 30.9 million dollars in the third quarter of 2018.

We had a net income tax expense of 27.4 million dollars in the third quarter of 2019 which was primarily due to withholding tax and corporate income tax recognized in our digital entertainment business.

Finally, net loss excluding share-based compensation and changes in fair value of the 2017 convertible notes was 175.2 million dollars in the third quarter of 2019, as compared to 237.6 million dollars for the same period in 2018.

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.