# 1Q 2019 Earnings Prepared Remarks

**Yanjun:**

Good morning and good evening everyone, and welcome to Sea's 2019 first quarter earnings conference call. I am Yanjun Wang, Sea's Group Chief Corporate Officer and General Counsel.

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 and adjusted EBITDA. 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.

Building on our very strong performance in 2018, we have kicked off 2019 on an even stronger note, with very healthy growth across our businesses.

For Sea as a whole, our adjusted revenue for the quarter was 578.8 million dollars, almost triple that of the same quarter last year. It is mainly attributable to strong revenue growth of both our digital entertainment and e-commerce businesses.

Moreover, we saw significant improvements on the bottom line this quarter. Total adjusted EBITDA was negative 32.0 million dollars, which improved from negative 144.7 million dollars for the first quarter of 2018 and negative 203.6 million dollars for the fourth quarter of 2018.

We believe this is a strong indication of the potential profitability of our group businesses.

Let's look first at Garena.

Garena had a stand-out quarter. Adjusted revenue for the digital entertainment business grew 169% year-on-year and 70% quarter-on-quarter to 393.3 million dollars. Adjusted EBITDA increased 311% year-on-year and 115% quarter-on-quarter to 225.8 million dollars. In addition, adjusted EBITDA margin increased to 57.4%, from 37.7% for the first quarter of 2018 and 45.5% for the fourth quarter of 2018.

The strong results are mainly attributable to the following:

- First, strong user growth. The number of quarterly active users reached 271.6 million, an increase of 114.4% year-on-year and 25.6% quarter-on-quarter.

- Second, deepening paying user penetration with sustained, strong average revenue per paying user. Our pay ratio reached 7.6% for the first quarter, compared to 5.7% for the same period a year ago, and 5.5% for the previous quarter.

- Third, continued outstanding operating and financial performance of our first self-developed game Free Fire. It contributed significantly to the margin improvement as no developer royalty is payable by us for the title.

We are particularly pleased to see that the key metrics for the digital entertainment business showed healthy growth and improvements in the quarter. We believe this is a result of

- first, our proven strategies of pushing further into self-development and new markets globally,

- second, our relentless efforts to keep bringing new and engaging content to our users,

- third, our constant focus on enhancing game and monetization features based on a deep understanding of local preferences and conditions, and

- last but not least, our strong efforts in esports and community-building.

Free Fire is a great example.

This smash hit is our first self-developed title. It recently surpassed 450 million registered users, and 50 million peak daily active users, in over 130 markets globally, making it one of the most popular mobile games in the world. It was also the second most downloaded mobile game globally across the Apple App Store and Google Play Store combined in the first quarter, according to App Annie.

Moreover, we have been working hard to enhance monetization of the game. We further localized our offerings and pricing to appeal to users of different markets, and introduced new content that incentivizes users to convert to paying users through personalized discounts and rewards.

On the esports front, we held the first Free Fire World Cup and recorded over 27 million online views in total. At its peak, we had more than one million people globally watching the competitions online at the same time.

For the rest of the year and beyond, we will continue to focus on growing this first self-developed title of ours into a top-ranking and long-living global franchise.

At the same time, we are highly focused on bringing high quality games from top global developers to our users, which also further strengthen our game portfolio and pipeline.

For example, Speed Drifters, the first game we launched early this year under our right-of-first-refusal arrangement with Tencent, has quickly become one of the best performing games in some of our key markets, in terms of both user growth and financial performance. Our efforts in this car racing game delivered meaningful contributions to Garena's strong results for the quarter, and helped us gain further experience and expertise in more casual genres. This can, in turn, help us further broaden our game portfolio over the long run.

Speed Drifters' success is a great example of why global top-quality IP holders choose to work with Garena - because they recognize that we deliver top results. On that note, in April we announced that Garena is partnering with Tencent and Activision to publish Call of Duty Mobile in our core markets in Southeast Asia and Taiwan. Call of Duty Mobile brings the classic characters and game play of this much-loved FPS series to mobile for the first time. We will share more information on this game in due course.

Looking to the rest of the year, I believe Garena is in a strong position with an excellent stable of games, as well as lots of opportunities for growth for the top games in our portfolio and pipeline.

Last quarter, we provided adjusted revenue guidance for our digital entertainment business of 1.2 to 1.3 billion dollars for the full year of 2019. This represents 81.5% to 96.7% growth year-on-year, which is a highly ambitious goal for the size of our business by any measure. Still, we are confident that we are well-placed to meet or even beat this ambitious target. We may choose to revise our full-year Digital Entertainment guidance upwards next quarter when we have more data.

Now we turn to Shopee.

At the end of 2018, we outlined some very clear objectives for 2019 – to continue to capture the growth opportunity ahead, ramp up our monetization efforts, and do so with growing efficiency.

And I'm pleased to say that in the first quarter we have delivered across all three fronts.

In terms of continuing growth, despite Q1 being a traditionally low season, we recorded a very strong GMV of 3.5 billion dollars. Compared to the same period a year ago, that represents close to 82% growth. We also recorded strong order numbers of 204 million, an increase of 83% year-on-year. Moreover, in Q1, Shopee was the Number One app by downloads in the Shopping category across Southeast Asia and Taiwan, according to App Annie. As the market leader, we believe Shopee is capturing an outsized proportion of the market growth.

Turning to monetization, we are making excellent progress with our efforts to grow Shopee's revenue. In the first quarter, adjusted revenue increased 342% year-on-year to 149.2 million dollars. Of this, 102.0 million dollars was of marketplace revenue, which was up 363% year-on-year and 16% quarter-on-quarter. This reflects the development in each of our marketplace revenue streams – transaction-based fees, advertising, and value-added services. The increase in revenue is a result of our platform growth as well as the increasing value of our services to better meet the evolving needs of our users.

And finally, let's look at our growth efficiency.

Sales and marketing expenses as a percentage of GMV declined once again to 4.2% in the first quarter. Moreover, sales and marketing expenses in absolute dollar terms declined quarter–on-quarter for the first time in Q1, even as we continued to experience strong growth across the platform. As we have noted in previous quarters, we are benefiting from ever-improving economies of scale as we extend our leadership position.

All of the above is well reflected in our solid bottom line performance. Adjusted EBITDA for e-commerce improved by more than 42 million dollars quarter-on-quarter to negative 235.3 million dollars, compared to negative 277.5 million dollars in Q4. I am also pleased to note that in Taiwan Shopee was EBITDA positive before allocating headquarters costs for this quarter.

Therefore, we believe Shopee is off to a great start this year, and will continue to focus on successfully executing on our stated strategies for e-commerce.

In summary, while we are very encouraged by our results for the first quarter, we believe we still have a lot of work ahead to further enrich and enhance our services to users, and we continue to see significant opportunities to capture an outsized share of the biggest growth opportunities in our region's digital economy. Therefore, while our strong results for the first quarter demonstrated our potential profitability, we will continue to focus on investing prudently and efficiently in growth. Moreover, when we make such investment decisions, we will continue to prioritize sustainable growth and long-term market leadership considerations, as opposed to short-term profitability. This is because, particularly for the e-commerce business, we believe scale and strong market leadership will translate into long term profitability.

Finally, please allow me to take this opportunity to say a few words about our company's tenth anniversary, which we celebrated just on May 8. On behalf of the entire Sea team, I would like to thank our customers, investors, partners and friends for all your support and contributions to this young company's growth over the last decade. We began with very humble roots in a shop house in Singapore. When we started each of our core businesses, we had no prior experience and had to compete head on with many much longer established, bigger and better funded players. Our teams persevered with passion and conviction. We pursued our own path. And we have become the market leader in the areas we chose to focus on. Looking to the decades ahead, we will continue to be humble, to serve our customers, investors and partners to the very best of our ability, and we will strive always to deliver beyond expectations. And I hope we can continue to count on your valued support in the years to come.

With that, I will invite Tony to share more about the 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 first quarter total adjusted revenue was 578.8 million dollars, an increase of 194% year-on-year, and 49% quarter-on-quarter. 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 393.3 million dollars, an increase of 169% year-on-year and 70% quarter-on-quarter. 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 225.8 million dollars, an increase of 311% year-on-year and 115% quarter-on-quarter, thanks to the 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 149.2 million dollars, up 342% year-on-year and 18% quarter-on-quarter. Of this 149.2 million dollars in adjusted revenue, 'marketplace revenue' was 102 million dollars, up 363% year-on-year and 16% quarter-on-quarter, while 'product revenue' was 47.2 million dollars, up 304% year-on-year and 20% quarter-on-quarter.

As highlighted by Forrest earlier, e-commerce adjusted EBITDA loss narrowed to 235.3 million dollars this quarter. We will continue driving high quality growth by serving the users' needs better and focusing on operational efficiencies.

Digital financial services adjusted revenue was 2.8 million dollars, a decrease of 28% year-on-year from 3.9 million dollars in the first quarter of 2018 as we focused our efforts on strengthening the infrastructure to support our existing platforms. Adjusted EBITDA loss was 11.9 million dollars in the first quarter of 2019, compared to a loss of 8.6 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 loss of 442.8 million dollars in the first quarter of 2019. This was primarily due to fair value loss of 436.1 million dollars on the 2017 convertible notes as our share prices during the quarter significantly exceeded the conversion prices of these notes.

We had a net income tax expense of 7.2 million dollars in the first quarter of 2019 which was primarily due to withholding tax and corporate income tax recognized in our digital entertainment segment.

Finally, net loss excluding share-based compensation and changes in fair value of the 2017 convertible notes was 237.3 million dollars in the first quarter of 2019, as compared to 186.7 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.