

Q4 & FY 2019 Earnings Prepared Remarks

Yanjun:

Good evening and good morning everyone, and welcome to Sea's 2019 fourth quarter and full year 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.

2019 has been an extremely successful year for Sea, and a year when we achieved a number of significant milestones.

In particular, we celebrated our tenth anniversary last year. This milestone gave us an opportunity to look back at just how far Sea has come over the last decade. Our business has grown rapidly, and has been constantly evolving.

In just ten years:

- we have grown from being a PC game publisher to a leading game publisher and developer with a diverse mobile and PC game portfolio;
- we have evolved from being a game platform to a consumer internet platform that covers digital entertainment, e-commerce and digital financial services; and
- we have expanded from our humble beginnings as a startup in a small shophouse in Singapore to become a regional leader with strong footprint across global high growth markets.

Observers might be surprised by the pace and extent of Sea's growth and evolution over the last few years. While we benefited from economic and technology tailwinds in our markets, we believe the key reason for Sea's success is our firm focus on identifying what we see as the largest opportunities in the consumer internet industry, and our relentless efforts to capture these opportunities with the right business model, timing and execution.

We started our digital entertainment business Garena in 2009, because we passionately believed that gamers in our region deserved a better way to access and enjoy top quality games and esports. Over the past ten years, Garena has evolved from a PC game publisher in Southeast Asia and Taiwan to a leading global game publisher and developer. Our first self-developed mobile game, Free Fire, is a global hit and was ranked the

world's most downloaded mobile game in 2019. The success of Free Fire has significantly expanded our total addressable markets globally. For example, the Latin America, or LATAM, markets, with their large and fast-growing populations and fast deepening mobile penetrations, have become the second largest regional market for our digital entertainment business after Southeast Asia and Taiwan. Collectively, the LATAM markets and the other fast-growing frontier markets such as India, Russia and the Middle East already accounted for about half of our digital entertainment adjusted revenue for the fourth quarter of 2019.

Our proven capabilities in both game publishing and development, as well as our strong track record in global growth markets which are highly complex and diverse, have driven sustained, strong financial performance. In 2019, our digital entertainment adjusted revenue grew by over 167% year on year to reach 1.8 billion dollars, while our adjusted EBITDA grew by over 289% to over one billion dollars.

More importantly, we believe we have built a very strong foundation, and developed core strengths that position us very well for continued growth globally. Looking to the decade ahead, our focus for Garena is to continue to bring top quality content and more billion-dollar games to our global users through both our own development capabilities and our stable of top-tier publishing partnerships. We will also focus on strengthening our in-house capabilities with global top talent through both organic growth and strategic acquisitions and partnerships.

Just as Garena's success was built on addressing the unmet needs of gamers in our markets, Shopee was built on addressing the unmet needs of consumers and small businesses in our markets. Shopee was also able to grow quickly thanks to the local operational strengths we developed through our digital entertainment business. We launched Shopee in all seven markets in Southeast Asia and Taiwan simultaneously in late 2015. Within a short period of time, Shopee has grown to become the leading e-commerce platform across our region. In 2019, just about four years from its inception, Shopee achieved over 17 billion dollars in GMV with over 1.2 billion orders, it was the world's fifth most downloaded shopping app, and it ranked first in key user engagement metrics of monthly active users and downloads across Google Play and the iOS App Store combined in both Southeast Asia and Taiwan. Meanwhile, we have significantly deepened monetization over the last year. In 2019, Shopee generated more than 942.1 million dollars of adjusted revenue, representing more than 224% of year over year growth, while adjusted revenue as a percentage of total GMV reached 5.4%. Benefiting from an increasing economy of scale with growing market leadership, we also saw rapidly improving unit economics for Shopee. For example, adjusted EBITDA loss per order decreased significantly year on year - from one dollar and 34 cents in the fourth quarter of 2018 to 70 cents in the fourth quarter of 2019.

We believe that Shopee's strong track record is attributable to our managerial, organizational and executional capabilities. These strengths have enabled us to:

- quickly identify and gain a deep understanding of the emerging trends of social commerce among the mobile-native generation;
- determine the right business model and timing to enter the right markets;
- build and rapidly scale a new business across diverse complex markets with high efficiency to achieve market leadership enjoying strong network effect and economy of scale; and
- constantly focus on high quality decision-making and execution with hyper-localized operations.

Looking ahead, we will continue to focus on growing our e-commerce business with efficiency, extending our market leadership to maximize long-term returns, and deepening monetization over time.

More importantly, we believe that the capabilities we have demonstrated in growing Shopee from a standing start to the regional leader will continue to help us to achieve greater success in building up a full ecosystem surrounding our consumer internet platform. This, in turn, presents huge growth opportunities that we are deeply focused on capturing.

Our third core business in digital financial services, SeaMoney, is a key component of this ecosystem and a crucial infrastructure that presents significant long-term growth and monetization opportunities.

We started SeaMoney in 2014 with a firm belief that digital financial services, or DFS, is a key infrastructure for our consumer internet ecosystem, and represents one of the largest growth opportunities in the digital economy of our region. Based on a recent Google-Temasek-Bain report, the DFS industry in the six largest economies of Southeast Asia is expected to grow at a 22% CAGR between 2019 and 2025 to reach 38 billion dollars in revenue. Based on the report, three out of every four adults in Southeast Asia have insufficient access to financial services, and 49% are unbanked. By comparison, just 7% of people in the United States are unbanked, and 20% in China, according to US government and World Bank data respectively. Similarly, the World Bank estimates that just 5% of adults in Southeast Asia have access to credit cards, compared to 66% in the U.S. and 21% in China. This reflects that the region has massive untapped opportunities in DFS, and these opportunities will only continue to grow as the overall digital economy of this region expands.

And we believe that Sea is very well positioned to capture the most significant portion of this growing pie. First, we are building on our core strengths in identifying and capturing market trends and strong execution. And more importantly, we are the market leader in both e-commerce and digital entertainment, which are two of the largest, fastest growing and highest quality and frequency use cases in the digital economy served by DFS. This is well demonstrated by the rapid growth of our SeaMoney business in 2019.

Our quarterly paying users for our e-wallet services have exceeded 8 million in the fourth quarter, as we deepened integration of our e-wallets with the Shopee platform, and further expanded our e-wallet services to third-party online and offline merchants and use cases. In January 2020, about a year after we started integrating our e-wallet with Shopee in Indonesia, more than 30% of Shopee's gross orders in that market were already paid using our own e-wallet services. Such integration has shown clear benefits in reducing payment friction and improving user experience for consumers on Shopee.

To sum up, we believe that our core businesses of e-commerce, digital entertainment and digital financial services represent the three largest opportunities in the digital economy of our region. As we begin a new decade, we will continue to focus on strengthening our market leadership and core competencies across all three segments to position us well for long term continued growth and profitability. More importantly, our leadership and strengths across these businesses provide us an unparalleled opportunity to develop a comprehensive consumer internet ecosystem that generates significant value for the consumers and small businesses on our platforms.

With this reflection on what we have achieved so far in the past decade and the path of growth we will continue to focus on for the future, I will now turn to a more detailed discussion of our strong results for the fourth quarter.

Looking first at Garena's performance, in the fourth quarter, we once again hit new highs for adjusted revenue and EBITDA.

Adjusted revenue was 479.9 million dollars, up 107.4% year-on-year, while adjusted EBITDA was 266.4 million dollars, up 153.2%. This was primarily driven by continued quarterly active user growth and further deepening of paying user penetration, and in particular, the continued strong performance of our self-developed game Free Fire.

Let me highlight some of the key drivers of Free Fire's success this quarter.

First, our user base continued to grow. I am pleased to note that Free Fire recently set a new historical high with over 60 million peak daily active users. According to App Annie, in the fourth quarter Free Fire was ranked among the top 10 games globally by monthly active users, and was the fourth most downloaded game globally on Google Play.

Second, we continued to deepen engagement with our massive user base. Last November, we held our largest ever esports event for Free Fire, the Free Fire World Series, in Rio. According to Esports Charts, this event attracted the most concurrent viewers for any mobile esports event in history, with over two

million viewers watching the live-streamed final at the same time. The success of our esports content is reflected in Free Fire's popularity on streaming sites. Free Fire was the fourth most watched game on YouTube globally in 2019, behind only Minecraft, Fortnite, and Grand Theft Auto. It was also the most watched mobile-only game.

Third, as we mentioned before, we are increasingly building Free Fire into a social platform. For the hundreds of millions of people around the world who play Free Fire, it is not simply a game that they play. It has become a community. Our players meet up with their friends in Free Fire. They watch our esports events and cheer for their favourite teams. They even enjoy music created just for our players. For instance, we launched a music video featuring characters from the game in a virtual band performing a song in multiple languages that we commissioned specially for Free Fire. To accompany the video, we launched special in-game events and promotions, as well as special skins and other in-game items. The launch was a huge success with our players, with the video attracting over 10 million views online within a week. Over the last two years, we have developed a unique ability to build and sustain huge and highly engaged Free Fire communities across diverse markets globally.

We are also seeing that holders of other high quality IP want to work with us to reach these communities. We recently unveiled a partnership with Gravity, the developers of the classic MMORPG game, Ragnarok, to launch a range of exclusive in-game content in Free Fire based on Ragnarok's IP. Generations of gamers across Southeast Asia and Latin America have a strong affinity with Ragnarok and its characters, and the response to this in-game collaboration has been very encouraging.

We will continue to focus on growing the user base and deepening user engagement for Free Fire, with an increasing emphasis on building the game into a well-loved and long-lasting IP, and a highly active social platform serving hundreds of millions of global users. We believe that this will in the longer term translate into sustained strong performance for Free Fire.

Another exciting recent development is our acquisition of Phoenix Labs, one of the top independent game development studios in North America. This brings a team of more than a hundred of the best triple-A developers in the industry into the Garena family, and significantly enhances our in-house content creation capabilities and our ability to serve diverse markets globally. The acquisition also underlines how Garena is increasingly being recognized as a leading industry player worldwide thanks to our strong global footprint.

For Garena as a whole, we are moving into 2020 in a great position and with exciting plans for growth. Our focus for the year ahead will be to continue creating captivating content that will help us grow and engage more deeply with our global communities, and to continue strengthening our game development capabilities and publishing network to bring to market more global hits and top grossing games.

Our digital entertainment guidance for the coming year reflects our confidence in our ability to continue deepening engagement with gamers globally and to build on the momentum that made 2019 a stand-out year for Garena. For the full year of 2020, we currently expect adjusted revenue for digital entertainment to be between 1.9 billion dollars and 2.0 billion dollars.

Turning to Shopee, in the fourth quarter we recorded another impressive set of results. Growth in the e-commerce industry in our region continues to accelerate, and Shopee as the clear market leader is gaining an outsized slice of the pie. Across the region, our order growth is accelerating, with gross orders for the quarter growing about 113% year-on-year to 440.5 million. GMV for the fourth quarter also reached 5.6 billion dollars, an increase of more than 64% year-on-year.

As we continued to extend our market leadership, Shopee saw sustained strong user engagement. In both Southeast Asia and in Taiwan, Shopee ranked number one in the Shopping category by average monthly active users across Google Play and the iOS App Store combined in the fourth quarter according to App Annie. By total time spent on app, which App Annie measures on Android phones, Shopee also ranked number one in Southeast Asia as a whole, and in each of our five largest markets.

In fact, worldwide Shopee was among the top five most downloaded apps in the Shopping category, across Google Play and the iOS App Store combined in both the fourth quarter and the full year of 2019 based on App Annie's estimates.

At the same time, we are seeing that consumers are building an increasing affinity with the Shopee brand. According to YouGov's 2019 Global Brand Buzz ranking, which measures the brands with the most buzz with consumers in different markets around the world, Shopee was the top ranked brand across all categories in each of Indonesia, Thailand, and Malaysia, and the top ranked e-commerce brand in Vietnam.

We are also encouraged to see that Shopee is enjoying strong user retention as we continue to strengthen our market leadership. Shopee's three-year order retention from January 2017 to December 2019 was close to 70%, with the order retention rate in Indonesia, our largest market, even higher than the group rate for the same period.

In Indonesia, Shopee further solidified its market leadership. In the fourth quarter, we recorded an average of 2 million orders a day. That is more than double the number from the same quarter a year ago. In fact, year-on-year growth for Shopee's GMV and orders accelerated each quarter in 2019. Shopee also continued to rank as the top app in the Shopping category in Indonesia by monthly active users and downloads on Google Play and the iOS App Store, as well as time spent in app on Android, in the fourth quarter according to App Annie.

As we continued to benefit from our growing regional leadership and deepening monetization, we recorded strong growth on the topline and further improvements in operating efficiency during the quarter.

E-commerce adjusted revenue increased over 182% year on year to 358.3 million dollars in Q4 and increased over 224% year on year to reach 942.1 million dollars for the full year, which meant that we exceeded the high end of our twice-increased guidance for 2019. Adjusted revenue as a percentage of GMV reached 6.3% in the fourth quarter, a new high for Shopee. This strong revenue performance is a result of a dedicated focus to enhance the services we offer to our sellers and buyers and grow the platform to create more value to them. We also recorded a positive gross profit for the fourth quarter of 2019.

During the quarter, we also continued to drive improvements in cost efficiency. Adjusted EBITDA loss per order decreased by 47.8% to 70 cents in the fourth quarter of 2019, compared to one dollar and 34 cents a year ago and 79 cents in the third quarter. I am also pleased to note that Shopee was gross profit positive in the fourth quarter, as we continued to benefit from the economies of scale that come with market leadership as well as our improved operating efficiency. Moreover, in Taiwan, our second largest market, we continued to record a positive quarterly adjusted EBITDA after allocation of the headquarters' common expenses. Adjusted EBITDA margin in Taiwan, before allocation of the headquarters' common expenses, already exceeded 20% in the fourth quarter of 2019.

Looking to the year ahead, Shopee is in an ideal position to continue capturing the lion's share of the growth in our region's e-commerce market. We are increasingly benefiting from the scale and brand recognition we enjoy as the clear industry leader. And we will continue to invest prudently to extend our leadership by continuing to grow our seller and consumer base and building ever-stronger bonds of affinity with them across the region.

Our e-commerce guidance for 2020 underlines our belief that we will continue to scale the platform with speed and efficiency while further deepening monetization. For the full year of 2020, we currently expect adjusted revenue for e-commerce to be between 1.7 billion dollars and 1.8 billion dollars.

As I mentioned at the start, 2019 was a year of major successes for Sea.

We have been fortunate to be in this region at a time when the market has been growing rapidly. We have been in the right place to capture these growth opportunities. But we have also been highly strategic in the areas we have chosen to focus on, highly disciplined in how we built and scaled our businesses, and highly skilled in managing their growth.

We see huge growth opportunities ahead in each of our business lines. Leveraging our proven capabilities in building and scaling businesses with efficiency, and our ability to achieve strong profitability in diverse growth markets, we believe we are in an ideal position to capture these and other global growth opportunities that may present themselves in the coming years.

I am more excited than ever as we move into 2020, and would like to close by thanking our investors and partners, on behalf of all of us at Sea, for your support over the last decade. We have big goals for 2020 and beyond, and we are humbled to have your continued backing.

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 fourth quarter total adjusted revenue was 909.1 million dollars, an increase of 134% year-on-year. This 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.

Digital entertainment adjusted revenue was 479.9 million dollars, an increase of 107% year-on-year. The growth 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 266.4 million dollars, an increase of 153% year-on-year, mainly due to strong top line growth and our self-developed game accounting for an increased share of revenue.

E-commerce adjusted revenue was 358.3 million dollars, up 182% year-on-year. Within this, 'marketplace revenue' was 283.5 million dollars, up 224% year-on-year, while 'product revenue' was 74.7 million dollars, up 90% 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 306.2 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 3.6 million dollars, an increase of 18% year-on-year from 3.1 million dollars in the fourth quarter of 2018. Adjusted EBITDA loss was 49.8 million dollars in the fourth quarter of 2019, compared to a loss of 9.8 million dollars in the same period of 2018. This was primarily due to our continued efforts to integrate our e-wallet services with our Shopee platform across different markets. We have also been expanding the use cases of our e-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 loss of 15.2 million dollars in the fourth quarter of 2019, compared to a net non-operating income of 53.0 million dollars in the fourth quarter of 2018. This was primarily due to a fair value loss of 6.8 million dollars in the fourth quarter of 2019 as compared to a fair value gain of 61.2 million dollars in the fourth quarter of 2018 arising from the fair value accounting treatment for the 2017 convertible notes.

We had a net income tax expense of 36.0 million dollars in the fourth 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 240.2 million dollars in the fourth quarter of 2019, as compared to 321.2 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.