Q2 2022 Earnings Prepared Remarks

Minju:

Hello everyone, and welcome to Sea's 2022 second quarter earnings conference call. I am Minju Song, from Sea's Group Chief Corporate Officer's Office.

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 the discussion of certain non-GAAP financial measures such as adjusted EBITDA and net loss excluding share-based compensation and impairment of goodwill. 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 with me Sea's Chairman and Group Chief Executive Officer, Forrest Li, Group Chief Financial Officer, Tony Hou, and Group Chief Corporate Officer, Yanjun Wang.

Our management will share strategy and business updates, operating highlights, and financial performance for the second quarter of 2022. 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 all for joining us today.

I am going to start with an update on our plan to further focus on efficiency and strengthen our ecosystem for long-term profitability and competitiveness. I will also share a few highlights across our businesses as we made steady progress towards these objectives.

During the pandemic lockdowns, we rapidly scaled our businesses to answer to the fast-rising market demand for online consumption and services. As a result, we significantly expanded our businesses and total addressable markets and strengthened our market leadership, while improving growth efficiency. We were able to achieve these results by focusing on doing the right thing at the right time in setting our direction, and being agile and adaptable in our execution.

Now, we are in an environment of increased macro uncertainty, with rising inflation, rising interest rates, local currency depreciations against the US dollar, and ongoing reopening trends. In this environment, being agile and adaptable is even more crucial to the long-term success of our business. We believe the right thing to do at this unprecedented time is to focus even more on self-sufficiency, long-term profitability, and defensibility in our business operations. Our results for the second quarter demonstrate the early success of these efforts.

Because of our strong execution in the quarter, Shopee's unit economics improved significantly, driven by efficiency gains across our markets. In particular, adjusted EBITDA loss per order before allocation of HQ costs in our Asia markets combined was less than 1 cent, and we are on track to achieving positive adjusted EBITDA before HQ costs allocation in this region. At the same time, Shopee continued to grow at healthy rates, despite the tough year-over-year comparisons, with GAAP revenue up 51% year-on-year, or 56% year-on-year adjusting for currency fluctuations.

For Garena, quarterly active users were stable quarter-on-quarter. This positive outcome was a result of our efforts around user retention to serve our large games community through more engaging experiences. We will continue to focus on user engagement around our existing franchises especially Free Fire. Indeed, we are encouraged by Free Fire retaining its top-ranking position as the highest grossing mobile game in Southeast Asia and Latin America during the quarter based on data.ai.

Synergies between Shopee and SeaMoney also expanded as we continue to cross-sell more financial products and services to our underserved user base across more markets. Close to 40% of Shopee's quarterly active buyers in Southeast Asia used SeaMoney products or services during the quarter. SeaMoney's revenue has enjoyed strong growth and its adjusted EBITDA loss has also continued to narrow during the quarter.

With the solid performance across our businesses, group GAAP revenue was 2.9 billion dollars, up 29% year-on-year, in the second quarter. Gross profit grew 17% from last year to reach 1.1 billion dollars for the quarter.

Let's now discuss each business segment beginning with e-commerce.

Shopee continues to appeal to more buyers and sellers across our markets, as evidenced by continued leadership in active user and engagement metrics as well as record operational and financial metrics.

In the second quarter, Shopee's GAAP revenue grew 51% year-on-year to reach 1.7 billion dollars, driven by GAAP marketplace revenue growing close to 62% over the same period. Gross orders were 2 billion, up 42% from last year, and GMV grew 27% year-on-year to reach 19 billion dollars. The currency fluctuations negatively impacted both GAAP revenue and GMV year-on-year growth rates by more than 4 percentage points.

We also drove further improvements in monetization during the quarter as we delivered more value to our sellers. Across the board, sellers are investing more with us to pursue growth on our platform.

These efforts continue to translate into positive financial results. For the period, GAAP marketplace revenue as a percentage of total GMV increased both year-on-year and quarter-on-quarter to reach 7.7%. The increase was mainly driven by increases from high margin revenue streams like transaction-based fees and advertising, which underscores the success of our platform in driving greater economics for our sellers. As a result, there was strong fall through to the bottom line with the better monetization contributing directly towards better profitability.

In the second quarter, gross profits for Shopee grew by close to 85% year-on-year and gross margins continued to improve sequentially from the last quarter. Shopee's overall adjusted EBITDA loss also improved sequentially by 13% quarter-on-quarter. Moreover, in Southeast Asia and Taiwan, adjusted EBITDA loss per order before allocation of HQ costs for the quarter was less than 1 cent, which shows that we are well on track towards achieving positive adjusted EBITDA before HQ costs allocation in our Asia markets combined. In Brazil, Shopee is also driving greater efficiencies while growing revenue rapidly. The adjusted EBITDA loss per order before allocation of HQ costs there was 1 dollar and 42 cents, improving quarter-on-quarter. At the same time, GAAP revenue in the market grew more than 270% year-on-year.

We are also optimizing spend around our HQ costs. During the quarter, total HQ costs for Shopee increased by 28 million dollars quarter-on-quarter driven by an increase in research and development staff and server hosting cost, as we expanded our technological capabilities and service offerings. This represents a deceleration in costs increases compared to the last quarter. While we will continue to invest to enhance our products, we have been able to strengthen our teams significantly in the past periods, and plan to be prudent in further expanding the team.

Meanwhile, Shopee continued to achieve top rankings globally and in our region. In the second quarter, Shopee ranked first in the Shopping category globally by total time spent in app and second by average monthly active users on Google Play, according to data.ai. We also remained as the top ranked app in the Shopping category by average monthly active users and total time spent in app in each of Southeast Asia, Indonesia, and Taiwan. In Brazil, we further strengthened our leading position with Shopee ranking first by average monthly active users in the second quarter, while continuing to rank first by total time spent in app for the Shopping category during the quarter.

Besides engaging consumers, we are also working closely to support our sellers. We continue to empower our merchants through education and training, in addition to providing them better tools and services. This remains a key area of focus for us. Across the Shopee seller platform, resources including our Shopee University and Master Classes have been especially helpful to the local entrepreneurs and MSMEs. We are also growing our brand partners on ShopeeMall through closer collaboration to enable greater engagement with their customers. Staying close to and collaborating with our sellers has enabled Shopee to grow and thrive together with them.

For example, in Brazil, we estimate that Shopee has become the main source of income for over 300 thousand local entrepreneurs and has brought 430 thousand new digital entrepreneurs to e-commerce. This has been partly driven by our investments behind training our Brazilian sellers with more than 60 thousand sellers attending classes at the Shopee Education Center.

Now I would like to discuss our decision to suspend the full year revenue guidance for Shopee driven by the highly volatile and unpredictable macro environment. As shared earlier, while we think the right thing to do during the pandemic lockdown was to prioritize growth with improving efficiency, we think the right thing to do in this time of continuing heightened macro volatility is to prioritize efficiency and self-sufficiency.

As we have always maintained, we think about managing our businesses as more like marathons rather than sprints. Adjusting our pace to match the moment is therefore highly important. Our ability to navigate changing times will help us win this long race ultimately. Given our strategic shifts, coupled with the various macro factors that are hard to predict as mentioned before, we believe it is prudent to maximize our focus on efficiency across our business rather than over-committing which we believe would be ill-advised at this time of uncertainty. As such, we are suspending the full year guidance for Shopee, which we last provided in May. Even though we have stopped providing guidance, our focus for the rest of the year remains very clear, which is to continue to improve efficiency by both deepening monetization and optimizing our cost structure. We will be more tightly managing our operating expenses, such as marketing costs and logistics costs, while also gradually increasing monetization across various income streams with a focus on the high margin ones.

More importantly, I want to emphasize that the current macro volatility does not affect our highly positive long-term outlook for our region. Current macro uncertainties do not change the fact that our markets remain some of the areas with the highest long-term growth potential in the world, with positive demographic features and deepening digitalization.

The current macro uncertainties also do not change our demonstrated track record in capturing some of the largest opportunities across the consumer internet industry in our markets. We believe our strong market leadership position will continue to allow us to disproportionately benefit from the long-term industry growth. And our strategic decisions and operational focuses today are all directed at best positioning us to capture these long-term opportunities.

Turning to digital entertainment.

In the second quarter, Garena's GAAP revenue was 900 million dollars and bookings were 717 million dollars.

Free Fire remained the most downloaded mobile game globally during the second quarter based on data.ai. It was also the highest grossing mobile game in Southeast Asia and Latin America during the quarter, maintaining this leading position for 12 consecutive quarters. It is encouraging to see that Free Fire continued to perform well within the mobile game industry. Moreover, Free Fire showed some early signs of active user stabilization with quarterly active users reaching 619 million, compared to 616 million in the first quarter.

We continue to focus on investing in user engagement around the Free Fire franchise and platform, ensuring a consistent cycle of fresh and new content for our communities. As an example, we celebrated Ramadan with our local communities in the second quarter. During Ramadan, we worked with local celebrities, introduced more themed items, and hosted a number of community gatherings. These highly localized efforts allowed us to better engage our local users and enjoyed strong monetization during the Ramadan season.

New content we introduced in the form of game modes have also helped to diversify the experiences that our gamers can enjoy on the Free Fire platform. Alongside the Battle Royale mode, we are increasingly seeing solid long-lasting retention and engagement around other game modes like Clash Squad, which is a 4v4 game mode, and Lone Wolf, which is a 1v1 or 2v2 game mode. Besides being highly engaging and social experiences, these game modes are also shorter and more fast-paced which are preferred by some gamers, especially as time available for entertainment is more fragmented with reopening.

While short-term gaming industry trends remain relatively uncertain due to reopening trends as well as the potential impact from macro volatility, we are highly confident in the long-term structural tailwinds of the segment. We expect this to be even more apparent across our markets where we are well positioned and the growth runway for digital entertainment is substantial. We also expect this to support the long-term sustained life span of our existing franchises and platforms.

Lastly, our digital financial services business.

In the second quarter, the synergies between both Shopee and SeaMoney continued to expand, driving revenue and value across the ecosystem. SeaMoney's GAAP revenue for the quarter was 279 million dollars, an increase of 214% year-on-year. Quarterly active users across our SeaMoney products and services reached close to 53 million, growing 53% from last year. Our mobile wallet total payment volume also grew healthily at 36% year-on-year to reach 5.7 billion dollars during the quarter.

With the stronger adoption of our growing portfolio of financial products and services across our Shopee and SeaMoney ecosystem, we are driving greater efficiency across platforms. As such, SeaMoney's adjusted EBITDA losses continued to improve quarter-on-quarter.

A significant population in our markets is still underserved around digital financial products and services. And we are well positioned with our strong ecosystem to serve the largest segment of our markets through the direct relationships and insights we have accrued. At the same time, we are working closely with our partners and other local stakeholders to build a healthy and sustainable environment for the long-term.

In closing, as we navigate an increasingly uncertain market environment, the need for us to be more thoughtful, prudent, and disciplined has only grown. While we have ample resources to achieve self-sufficiency, as a business, we are nevertheless rapidly prioritizing profitability and cash flow management. In this current volatile environment, we believe our focus on these areas will be key in setting the business up for long-term sustained success. We are also confident that our ability to execute to achieve our objectives during this period will be further supported by our scale, leadership positions and proven business models. We have articulated clear commitments and are well on track to achieving them. We also continue to be highly optimistic about the long-term potential of the opportunities and markets we are addressing.

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 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 relevant metrics.

For Sea overall, total GAAP revenue increased 29% year-on-year to 2.9 billion dollars. This was mainly driven by the growth in our e-commerce and digital financial services businesses, as we continue to leverage the synergies across our platforms.

On e-commerce, our second quarter GAAP revenue of 1.7 billion dollars included GAAP marketplace revenue of 1.5 billion dollars, up 62% year-on-year, and GAAP product revenue of 0.3 billion dollars, up 14% year-on-year.

E-commerce adjusted EBITDA loss was 648 million dollars. Adjusted EBITDA loss per order was 33 cents, compared to 41 cents for the second quarter of 2021, as we further improved our growth efficiency and unit economics.

Digital entertainment bookings were 0.7 billion dollars and GAAP revenue was 0.9 billion dollars for the second quarter of 2022. Adjusted EBITDA was 334 million dollars. The slowdown compared to the second quarter of 2021 was mainly due to moderation of user base and user trends post-COVID.

Digital financial services GAAP revenue was 279 million dollars, an increase of 214% year-on-year from 89 million dollars in the second quarter of 2021. The growth was primarily due to the growing adoption of our financial products and services. Adjusted EBITDA loss was 112 million dollars, compared to 155 million dollars for the second quarter of 2021 as we further improved on our growth efficiency.

In the second quarter of 2022, we recorded an impairment of goodwill of 177 million dollars. The goodwill impairment was primarily due to the change in carrying amount of goodwill associated with our prior acquisitions, mainly driven by the lower valuations amid the market uncertainties.

We recognized a net non-operating loss of 33 million dollars in the second quarter of 2022, compared to a net non-operating loss of 25 million dollars in the second quarter of 2021. The non-operating loss in the second quarter of 2022 was primarily due to investment losses recognized amid lower valuations in the broader market.

We had a net income tax expense of 65 million dollars in the second quarter of 2022 which was primarily due to corporate income tax and withholding tax recognized in our digital entertainment business.

As a result, net loss excluding share-based compensation and impairment of goodwill was 570 million dollars in the second quarter of 2022, as compared to 321 million dollars for the same period in 2021.

Net cash used in investing activities in the second quarter of 2022 was primarily attributable to an increase in loans receivable and purchase of property and equipment to support the growth of our businesses.

At the end of the second quarter of 2022, we had 7.8 billion dollars of cash, cash equivalents and short-term investments on our balance sheet.

With that, let me turn the call to Minju.

Minju:

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