Q1 2022 Earnings Prepared Remarks

Minju:

Hello everyone, and welcome to Sea's 2022 first 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. 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 first 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 for joining today's call.

I am pleased to share that we have made a strong start to 2022. We recorded solid results across our business in the first quarter of 2022, despite challenging comparisons to the same period last year during heightened COVID-related restrictions. As a result, we are well on track to achieve our previously shared projections of profitability in our Asia markets, while continuing to scale our businesses and capture market share globally.

During the first quarter, our group GAAP revenue grew 64% year-on-year to reach 2.9 billion dollars and we generated gross profits of 1.2 billion dollars, an increase of 81% year-on-year. Shopee and SeaMoney continued to enjoy operating leverage and efficiency gain as they scale and strengthen their market leadership positions. In particular, Shopee's adjusted EBITDA loss per order before allocation of HQ costs in Southeast Asia and Taiwan improved by more than 70% year-on-year to 4 cents. This shows that Shopee is well on track to achieve positive adjusted EBITDA before allocation of HQ costs in the region. In addition, we currently expect Shopee to achieve positive adjusted EBITDA even after allocation of HQ costs by the end of next year for this region. At the same time, Shopee enjoyed very strong growth, even against tough comparisons last year. Its gross orders grew more than 70% year-on-year and GAAP marketplace revenue increased by more than 75% year-on-year, further extending Shopee's market leadership both in terms of transaction volume and commercialization capability.

SeaMoney's adjusted EBITDA loss also narrowed both quarter-on-quarter and year-on-year, while GAAP revenue grew close to 360% compared to last year. Quarterly active users grew more than 78% year-on-year. This is also a strong indication of SeaMoney being on track to achieve positive cashflow as we previously projected while at the same time continuing to scale rapidly with efficiency.

With the significant scale, strong leadership and clear synergies achieved by Shopee and SeaMoney in Southeast Asia and Taiwan, our consumer internet ecosystem in the region is naturally approaching a stage of long-term profitable growth.

While Garena experienced headwinds in its growth post-COVID, we saw some preliminary positive effects from our efforts to improve user engagement in Free Fire. In particular, the monthly user trends for Free Fire began to show some early signs of stabilizing toward the end of the first quarter. We are assessing the long-term trends in user engagement post-COVID to better tailor our strategies and areas of focus. Building ever more engaging content within Free Fire and strengthening our pipeline of new games remain our key priorities.

In the past two years, we successfully navigated the major uncertainties brought by the pandemic to capture the significant growth opportunities presented to us across all businesses. As we enter a new period, we recognize that the current macro trends and uncertainties could affect our region and the world in the near to mid-term. The experiences, capabilities, resources and further strengthened leadership positions we managed to accumulate and achieve during the past period have put us in a stronger than ever position to navigate such uncertainties and, more importantly, capture opportunities that may also arise in our regions.

As always, we will continue to focus on being humble, pragmatic, and agile while consistently driving strong execution in serving the large, underserved communities in our regions.

With that, let me now discuss each business individually.

In the first quarter, Shopee continued to significantly improve its unit economics while capturing market share and extending its leadership position across our markets. Online consumption continued to grow on our Shopee platform, resulting in strong year-on-year growth.

Shopee's GAAP revenue was 1.5 billion dollars, up 64% year-on-year, in the first quarter, and gross orders grew 71% from last year to reach 1.9 billion. GMV was 17.4 billion dollars, an increase of 39% year-on-year and growing at a 68% CAGR from the first quarter of 2020, before the pandemic.

Monetization also saw improvement with GAAP marketplace revenue as a percentage of total GMV rising to 7.2% during the quarter compared to 5.7% last year.

It was great to see that Shopee's gross profit margin improved year-on-year due to the faster growth of transaction-based fees and advertising income, which have higher profit margin compared to revenue generated from other value-added services. At the same time, gross profit margin of revenue generated from other value-added services also improved quarter-on-quarter.

Moreover, we continue to be highly focused on efficiency. Here, I would like to share a bit more on our approach to continually improving cost efficiency. Our business model optimizes for unit economics through growing operating leverage across our e-commerce ecosystem with scale. We invest in growing a broad base of buyers and sellers across comprehensive core online marketplace categories and deepening engagement. This promotes user growth, conversion, and retention as well as purchase frequencies which allows us to efficiently grow order volume and density.

With sufficient and continually improving order volume and density, we aim to achieve cost leadership for our ecosystem to profitably serve the broadest base of buyers and sellers as well as the largest range of consumption categories. This also allows us to efficiently cross-sell more products and service offerings, including digital financial services, especially to the underserved mass market – a market segment which we believe represents the largest opportunity in our global markets. We believe this strategy drives significant scale, strong profitability, and deep competitive moats in the long run.

Our track record in Southeast Asia and Taiwan is proving the success of this model and our convictions have only further grown with what we have achieved in Brazil within a short period of time.

I am pleased to note that, thanks to our focus on enhancing monetization and optimizing costs, we have once again recorded significant improvements in unit economics in the first quarter. Adjusted EBITDA loss per order before HQ costs improved both year-on-year and quarter-on-quarter for Shopee overall. In

Southeast Asia and Taiwan, adjusted EBITDA loss per order before allocation of HQ costs was 4 cents, an improvement from 12 cents in the first quarter of 2021. We also made very healthy progress in Brazil in the first quarter where such loss was 1 dollar and 52 cents, an improvement of more than 45% year-on-year.

Our efforts on expanding the total addressable market across our key markets are reflected in Shopee continuing to be ranked highly on key engagement metrics among global peers. According to data.ai, Shopee ranked first in the Shopping category globally by downloads in the first quarter. Shopee also ranked first globally by total time spent in app and second by average monthly active users in the Shopping category on Google Play in the first quarter.

Meanwhile, Shopee was the top ranked app in the Shopping category across both iOS and Google Play by average monthly active users and total time spent in app in each of Southeast Asia and Taiwan, based on data.ai. In Indonesia, we were also ranked the number one app across these same metrics with gross orders up around 77% year-on-year during the first quarter.

In Brazil, Shopee ranked first by downloads and total time spent in app, and second by average monthly active users, for the Shopping category, according to data.ai. In March and April, Shopee Brazil had the highest number of monthly active users in the Shopping category as we further extended our leading position.

We are also growing our local sellers with over 2 million Brazilian sellers registered on the Shopee platform currently. They range from SMEs to established brands and we are working across the board to enable them to serve more buyers across more categories, demographics, and consumption occasions. Our positive traction in Brazil to date underlines our belief that there is a large and highly promising opportunity to serve underserved communities of sellers and buyers in that market. We continue to invest behind this opportunity while delivering more value to our sellers and buyers.

Moreover, across our core markets, Shopee Mall has continued to power the way forward for our brand partners with innovative solutions and tools to support sustained growth. In the recent quarter, our more than 36 thousand brand partners saw strong growth momentum and reached new milestones, accounting for around 15% of GMV, compared to 12% a year ago. We have also onboarded more brand partners such as Kiehl's in Singapore as well as Kate Spade and Marc Jacobs in Thailand.

Looking ahead, our position is stronger than ever before. Across our core markets, real and sustained e-commerce penetration is expected to continue. At the same time, we are extending our leadership and reaching breakeven in Southeast Asia and Taiwan. And, just two years after entering Brazil, the world's sixth largest market by population, we are making rapid progress towards market leadership. We therefore remain focused on high quality execution alongside consistent innovation and investments in our tech capabilities to provide a differentiated experience to our users. This will further enhance our competitive strengths and improve efficiency to best position Shopee for long-term growth and profitability.

Meanwhile, given the current environment of elevated macro uncertainties, we now see a wider range of scenarios and outcomes for Shopee this year. While we believe that our previous guidance is still achievable, we are revising our e-commerce guidance to correspondingly reflect our expectations around the upcoming macro uncertainties. We now expect e-commerce GAAP revenue to be between 8.5 billion and 9.1 billion dollars representing 72% year-on-year growth at the midpoint of the guidance.

Let us turn to digital entertainment.

As we flagged last quarter, we have seen softening in user base and bookings compared to the lockdown periods during the pandemic, which was further impacted by Free Fire continuing to be unavailable across app stores in India. However, despite the pullback from acceleration we saw during the pandemic, when we put our first quarter results into perspective, our quarterly active users have shown strong growth with a CAGR of almost 24% from the first quarter of 2020.

Our view regarding Garena and Free Fire being a long-term platform for digital consumption remains unchanged. Therefore, we remain focused on attracting, retaining, and deepening engagement with our users through investing in enhanced and diversified content, UGC tools, improved accessibility, and other user-friendly features. These investments - alongside with the lower bookings - has led to a year-on-year decline in adjusted EBITDA as a percent of bookings for this quarter, but we will continue to take a long-term view on such investments as they are critical for the sustainability and diversification of our key gaming franchises and platforms.

Moreover, as we navigate this phase of moderation, we are focused on user base stabilization. We saw some preliminary signs that this is starting to bear fruits with the monthly user trends for Free Fire beginning to show some early signs of stabilizing toward the end of the first quarter. While these are encouraging signs, the longer-term impact of reopening around online gaming and Free Fire specifically remains to be seen and we will continue to focus on user engagement and user base stabilization.

We are also very pleased to see that Free Fire continues to be one of the most popular games across the world, as we continue to focus on high quality content and ensuring that Free Fire is accessible to and enjoyable for our large player base. Indeed, according to data.ai, Free Fire remained the number one most downloaded mobile game globally in the first quarter. The game also ranked third globally by average monthly active users for all mobile games on Google Play during the same period.

Our vision of building Free Fire into a long-term gaming franchise and platform remains an ongoing strategy. We are focused on innovating around and investing in Free Fire across more user engagement content and events. Free Fire's recent partnership with BTS, one of the most popular K-pop groups globally, is a success, where we worked closely with the artists to design new eye-catching items, costumes and actions that has resonated well with players and fans alike. Videos featuring BTS artists and content on our social media channels reached over 150 million views.

Additionally, Craftland, our map editor feature, saw strong traction through driving greater engagement and interaction across creators and gamers in our community. In the first quarter, hundreds of millions of gamers played new maps on Craftland across billions of games. User-generated content is a growing key part of Free Fire's ongoing engagement strategy, and we plan to continue improving and extending the Craftland experience.

As shared before, digital entertainment is a key long-term focus of our business with the increasing importance of virtual consumption from the rising digital native generations. We are committed to investing behind our existing top-tier franchises while further diversifying our portfolio of games across more new genres. An example is Moonlight Blade, a third-party massively multiplayer online role-playing game, which will be launching across both mobile and PC in Thailand in the coming months after an earlier launch last year in Taiwan. Our developers have been working on new games across a wide variety of genres. At the same time, we are exploring publishing partnerships and making early investments in game studios across the world.

Turning to our digital financial services business.

SeaMoney continued its strong growth into the first quarter of 2022. We remain focused on driving the adoption of our products and services in a thoughtful and disciplined way while leveraging the multiple synergies across our Shopee and SeaMoney ecosystem.

GAAP revenue for the quarter was 236 million dollars, up 360% year-on-year. Quarterly active users across our SeaMoney products and services grew 78% year-on-year to reach 49 million.

The adoption of SeaMoney financial products and services across credit and digital banking were key drivers of revenue growth during the quarter, and we expect this to continue. As we optimize our models and expand our partnerships with financial institutions, these products are expected to be solid and high-quality value drivers in the long run without the need for significant investments to scale.

The total payment volume of our mobile wallet was 5.1 billion dollars in the first quarter, an increase of 49% year-on-year. Over the past few years, we have successfully leveraged the Shopee ecosystem to build leading mobile wallet positions across our markets.

We have also expanded our credit products across more markets accessible to more whitelisted users. Our credit portfolio currently serves both consumers and merchants across a variety of products. Our digital banking initiatives saw strong early traction as well. On a related note, I am proud to share that our application for a digital bank license in Malaysia together with YTL Digital Capital was approved in April. In Indonesia, which has the most comprehensive set of products and services among our markets, over 30% of the quarterly active users have used multiple SeaMoney products or services in the first quarter.

The size of the opportunity for SeaMoney is massive and has only been expanding as we have grown the suite of products and services we offer to the underserved in our markets. We are excited about the growth prospects of the segment as well as strong sustained ecosystem benefits across both Shopee and SeaMoney.

To conclude, we believe that we are in a much stronger position now compared to a couple of years ago when the pandemic just started, with significantly expanded capabilities, more resources, a proven track record and a much clearer and more certain path to achieve our long-term objectives.

With Shopee, we continue to capture market share and deepen our strong bonds with sellers and consumers across our markets. We have highly promising growth opportunities in front of us, and we continue to invest prudently and with discipline while driving ever-improving efficiency across the business.

With Garena, we are leveraging our strengths in content creation and community engagement to ensure the popularity of our platform endures, even as the global games industry faces headwinds from market reopenings. Concurrently, we are focused on broadening our portfolio of games across different genres.

And with SeaMoney, we are scaling up our third growth engine in a highly disciplined and efficient way, ensuring that we are ideally placed to capture the significant growth opportunities ahead of us in this segment.

Building on this strong first quarter performance, we will continue to focus on strong execution with balanced growth and efficiency to deliver solid results.

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 64% year-on-year to 2.9 billion dollars. This was mainly driven by the growing adoption of products and services across our e-commerce and digital financial services businesses, as we continue to leverage the synergies across our various platforms.

On e-commerce, our first quarter GAAP revenue of 1.5 billion dollars included GAAP marketplace revenue of 1.3 billion dollars, up 75% year-on-year, and GAAP product revenue of 0.3 billion dollars, up 27% year-on-year.

E-commerce adjusted EBITDA loss was 743 million dollars as we continued to deepen e-commerce penetration in our core markets and also gain positive traction in newer markets.

Digital entertainment bookings were 0.8 billion dollars, compared to 1.1 billion dollars for the first quarter of 2021. GAAP revenue was up 45% year-on-year to 1.1 billion dollars. The increase in GAAP revenue was primarily due to recognition of accumulated deferred revenue from previous quarters.

Digital entertainment adjusted EBITDA was 431 million dollars, compared to 717 million for the first quarter of 2021.

Digital financial services GAAP revenue was 236 million dollars, an increase of 360% year-on-year from 51 million dollars in the first quarter of 2021. The growth was primarily due to the growing adoption of our financial products and services. Adjusted EBITDA loss was 125 million dollars as we continued our efforts to drive mobile wallet adoption.

Returning to our consolidated numbers, we recognized a net non-operating loss of 6 million dollars in the first quarter of 2022, compared to a net non-operating loss of 23 million dollars in the first quarter of 2021.

We had a net income tax expense of 82 million dollars in the first 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 was 445 million dollars in the first quarter of 2022, as compared to 320 million dollars for the same period in 2021.

Net cash used in investing activities amounted to 1.1 billion dollars for the first quarter of 2022. This was primarily attributable to an increase in loans receivable of 410 million dollars to support the growth of digital financial services businesses, as well as net placement of 333 million dollars into time deposits and liquid investment products for better cash yield management.

At the end of the first quarter of 2022, we had around 8.8 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.