

Q1 2023 Earnings Prepared Remarks

Minju:

Hello everyone, and welcome to Sea's 2023 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. 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 2023. 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.

On May 8th, we celebrated our 14th birthday. It is a chance to remind ourselves of our humble beginnings, and the culture of entrepreneurship, creativity, and adaptability that has made Sea what we are today. It also gives us an opportunity to reflect on the year gone by.

The last year has been testing for our teams. And I want to take this opportunity to thank all of our employees for the dedication and determination they have shown. I am proud of how our teams pivoted rapidly, in difficult circumstances, to achieve our goal of self-sufficiency. We have innovated to do more with fewer resources, while never losing sight of our commitment to our users, and never letting our service standards fall. Our results for the quarter are a testament to their commitment and creativity.

I also want to take this opportunity to thank our investors and partners for your ongoing support over the last fourteen years.

The first quarter of 2023 was another strong quarter for us. Across our businesses, we are focused on maximizing operational efficiency and improving user experiences. We continued to make meaningful progress on both fronts.

We deepened our commitment to achieving strong cost leadership for our ecosystem. We believe this will reinforce our structural advantages in driving profitable long-term growth in our markets. As a result, we continued to see significant year-on-year improvement in profitability of both Shopee and SeaMoney. We also achieved positive total cash flow for the quarter. Our cash, cash equivalents, short-term investments, and other treasury investments increased by 258 million dollars from the previous quarter.

In addition, we made solid progress in elevating user experiences across our businesses. At Shopee, we are driving improvements in both logistics service level and speed, while enhancing experiences at key points of the customer journey. As a result, user engagement deepened. At Garena, we are working to optimize

various aspects of gameplay and game mechanics based on user feedback, ensuring that players continue to enjoy the highly engaging and highly social experiences they associate with our games. In the quarter and into April, we started to see some initial signs of recovery in the active user base of our largest game, Free Fire. At SeaMoney, we are expanding the product offerings and features within each product, so that our users can enjoy a more comprehensive suite of products and services that meet their underserved financial needs.

We are pleased with the progress we have made so far to strengthen the fundamentals of our business. As we continue to fine-tune our operations and navigate near-term macro uncertainties, we remain highly confident in the long-term opportunities in our markets and our ability to capture those profitably.

Now, let's discuss each business segment in more detail.

Beginning with e-commerce. We are very pleased to report that Shopee has delivered another strong quarter.

Despite the macro volatility, Shopee's business remained resilient. And we have made significant progress in deepening our competitive moat by strengthening our cost leadership and uplifting the user experience.

In the first quarter of 2023, GAAP revenue was 2.1 billion dollars, up 36% year-on-year, driven by deeper monetization. Core marketplace revenue increased by 54% year over year to 1.2 billion dollars, due to an increase in transaction-based fees and advertising revenue. Adjusted EBITDA was 208 million dollars, improving from a loss of 743 million dollars from last year. The improvement was driven by increased monetization and greater operating cost efficiencies.

For our Asia markets, we achieved an adjusted EBITDA of 276 million dollars during the quarter, improving substantially from a loss of 408 million dollars in the same period last year. In our other markets, the adjusted EBITDA loss was 68 million dollars, narrowing meaningfully from last year, when losses were 335 million dollars. Contribution margin loss per order in Brazil improved by 77% year-on-year to reach 34 cents, reflecting better monetization and higher efficiency in our sales and marketing spend. As we see significant opportunities in the market, we plan to continue to invest in capturing more of these opportunities in Brazil.

Let me talk through a few specific areas we focused on during the quarter. Firstly, we continue to enhance our logistics cost leadership and delivery experience by improving the capacity and integration of our in-house logistics arm while continuing to work closely with our third-party logistics partners. We introduced more automation to our delivery services. Thanks to these efforts, we have managed to bring down average delivery time by more than half a day across our markets within the first quarter.

We are also expanding the buyer coverage of our logistics services across our markets. In our largest market, Indonesia, which consists of more than 10 thousand islands, 95% of our buyer base is now covered by our delivery services. In Brazil, we already have eight distribution and sorting centres, with the most recent expansion in Northeast Brazil. We have also been working to expand our first and last mile hubs in the market. In recent months, we opened 50 new hubs to further strengthen our logistics capabilities.

In addition, we are looking carefully at every stage of the customer journey, and improving our processes, policies and services to enhance the user experience. We started to pilot on-the-spot returns in some markets for better services to our buyers. We have also started handling returns on behalf of some sellers, with our teams directly engaging with the buyers instead of putting this burden on the sellers. This improves the experience for our buyers, who can deal with our trained teams, and frees up our sellers to focus on growing their business.

We are deepening our AI capabilities to drive a better user experience and operational efficiency. AI helps us recommend more relevant and personalized offerings to our users. This has driven higher order conversion as users discover products more quickly and easily. We have also adopted large language models to improve our AI-powered chatbot's ability to understand users in different languages and return the most

relevant solutions given the context. This improved resolution rates and helped reduce wait times. On top of that, AI is being leveraged to more comprehensively screen and filter items to comply with our marketplace policies.

More recently, we have further stepped up consumer protection efforts to ensure our buyers enjoy a safe, reliable, and hassle-free experience. For example, in Singapore we launched the Shop Safe With Shopee initiative through the adoption of the Consumers Association of Singapore's Standard Dispute Management Framework, among other initiatives.

These and other related initiatives are vital in ensuring that we offer all our buyers and sellers the best possible experience on Shopee. As we enhance these key differentiators, we attract more buyers and sellers, strengthening our overall ecosystem and widening our competitive moat.

Indeed, despite the more uncertain macro environment, we continue to diversify our local seller base and strengthen our relationship with other ecosystem participants, such as influencers. In Brazil, we have reached more than three million registered local Brazilian sellers on our platform, who now account for around 85% of our Brazil orders.

We have also seen strong traction in our Shopee Affiliate Program as we worked to empower influencers and content creators to be part of our ecosystem. This program invites social media influencers to promote our products sold on Shopee. Across our markets, we have more than 4 million registered influencers participating in our affiliate program today. In our largest market, Indonesia, orders generated by our affiliate partners more than tripled in 2022.

Across our markets, we continue to see growth in the number of brands joining Shopee Mall, and in the percentage contribution of GMV from our mall sellers. As a leader in our markets, we have remained focused on creating value for our brand partners through our technological capabilities. Recently, we announced enhancements to Shopee's seller tools that help brands track and understand key trends and buyer behavior, enhance consumer loyalty, and protect their IP rights. All these efforts have further strengthened our relationships with brands. In Thailand, we partnered with the Embassy of Italy and the Italian Commercial Office to bring "Made in Italy" brands closer to Thai consumers. In Vietnam, we have become the exclusive partner of the Government of Canada in launching a campaign to bring high quality Canadian food products to the local consumers.

Looking ahead, while there may be near-term fluctuations driven by the underlying market environment and our fine-tuning of operations, we continue to focus on building up our long-term structural advantages in our e-commerce ecosystem. We believe this strategy will be key in unlocking future growth opportunities, and making sure that we have a growing and wide-reaching positive impact across our local communities.

Now let's discuss digital entertainment.

As previously shared, Garena continued to focus on improving gameplay and creating a stronger community for our games first and foremost. While there was some weakening in monetization, mainly as a result of a lower paying user ratio, we saw some initial signs of improvement in our quarterly active user base, which increased from 485 million last quarter to 492 million in the first quarter. In April, we also observed positive user trends with Free Fire achieving a new peak in monthly active users in the last eight-month period. While we are mindful of seasonality effects, we are pleased to see this as a positive sign for Free Fire, which remains one of the largest mobile games in the world. We will continue to monitor closely for trends going forward.

As we strengthened our efforts in enhancing gameplay and user engagement, we have received positive responses from our user community on a number of initiatives we launched to make the game experience smoother. These initiatives include game packet size optimization and gameplay lag reduction with an emphasis on devices commonly used in our markets. Our users have indicated that these recent changes are highly responsive to their feedback and shared that they are enjoying a better gameplay experience as a result.

Our second largest game, Arena of Valor, showed strong performance, especially during the Lunar New Year period. The game once again achieved a new peak in quarterly active users and bookings after more than six years since its launch. We believe this is a further indication of our ability to engage users for the long-term with solid monetization.

At the same time, our pipeline remains healthy, and we will be launching some new titles in the coming months. We have opened pre-registrations for Undawn, an open-world survival game, which we will publish across Southeast Asia in the coming months. We will also be publishing Black Clover Mobile, a collection RPG mobile title based on the popular anime series “Black Clover,” across a number of markets globally. Pre-registrations are expected to open within the first half of the year, following the conclusion of a closed beta test held last year.

As with the other business segments, we have been very focused on enhancing our operations at Garena with AI. Our current capabilities have allowed us to improve the overall efficiency of our game operations. For example, we are exploring opportunities to leverage AI to localize some of our game content and to further advance our operational capabilities for higher efficiency. We are confident that these initiatives combined with our strong track record in execution and localization will help drive the long-term success of Garena.

Lastly, moving on to our digital financial services business. We are enhancing our operations and risk management capabilities, while improving the user experience for SeaMoney. We have also been working to diversify our fintech product offerings, both on and off the Shopee platform, and across different markets to enhance user stickiness.

SeaMoney’s GAAP revenue was 413 million dollars in the first quarter of 2023, up 75% year-on-year. Adjusted EBITDA was 99 million dollars during the quarter, a substantial improvement from a loss of 125 million dollars in the first quarter of 2022. This was driven by both strong topline growth and our ongoing effort to optimize costs and improve efficiency, particularly around sales and marketing expenses.

On digital wallet, we continued to expand ShopeePay’s use cases. For instance, it recently became a payment method for Apple services in our Southeast Asia markets.

On credit, as of the end of the first quarter of 2023, the total loans receivable on our balance sheet was 2 billion dollars, net of allowance for credit loss of 281 million dollars. Non-performing loans past due by more than 90 days as a percentage of our total gross loans receivable remained stable at around 2%. During the quarter, we continued to diversify the sources of funding for our credit business. In addition to funding through our own bank deposits, we have seen increased volume funded through channeling arrangements or bilateral asset-backed facilities with local and regional banks. We are working to further diversify our funding sources to broader financial investors. Currently, a large part of our loan book is already funded by alternative sources as opposed to cash on our balance sheet.

To further strengthen our risk management capabilities, we are using AI to help us to assess the fraud risk and credit risk of our users as well as to enhance the KYC process of our products. This enables us to offer our financial products to more users while tightly controlling risk.

We are also diversifying and enriching our product offerings at SeaMoney. We piloted new insurtech products and expanded use cases, features and services in our banking apps. This has provided even greater convenience and accessibility to financial products for our users. In addition, we have further integrated many of these products into our broader ecosystem making the user experience seamless across Shopee and SeaMoney.

We remained focused on evaluating opportunities in digital financial services across our markets and enriching our product and service offerings. We are confident in SeaMoney’s long-term potential, and are very carefully managing the business amid the macro uncertainties. We believe we are well positioned to capture the significant and underserved opportunities available in our markets.

To conclude, our results for the quarter once again demonstrate the fundamental strength and resilience of our business model, and our ability to drive efficiency improvements while maintaining our leadership position. We are confident that we can continue to create value for our ecosystem participants, as well as delivering long-term growth and sustainable returns to our shareholders.

Separately, as we noted in our press release earlier today, David Ma has joined our board of directors as of May 15th, and will no longer serve as the Chief Investment Officer of Sea Capital. David has played an invaluable role as a member of our leadership team. I would like to express our sincere thanks to him for his contributions in this position. I am very glad that we will continue to benefit from his expertise and experience in his new role as a member of our board.

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 5% year-on-year to 3 billion dollars. This was primarily driven by the improved monetization in our e-commerce and digital financial services businesses, partially offset by lower GAAP revenue in our digital entertainment business.

On e-commerce, our first quarter GAAP revenue of 2.1 billion dollars included GAAP marketplace revenue of 1.8 billion dollars, up 46% year-on-year, and GAAP product revenue of 0.2 billion dollars. Within GAAP marketplace revenue, core marketplace revenue, mainly consisting of transaction-based fees and advertising revenues, was 1.2 billion dollars whereas value-added services revenue, mainly consisting of revenues related to logistics services, was 0.7 billion dollars.

E-commerce adjusted EBITDA was 208 million dollars in the first quarter of 2023, compared to an adjusted EBITDA loss of 743 million dollars in the first quarter of 2022.

Digital entertainment bookings were 462 million dollars and GAAP revenue was 540 million dollars. Adjusted EBITDA was 230 million dollars.

Digital financial services GAAP revenue was up by 75% year-on-year to 413 million dollars. This was mainly driven by the growth in our credit business. Adjusted EBITDA was 99 million dollars in the first quarter of 2023, compared to an adjusted EBITDA loss of 125 million dollars in the first quarter of 2022. Improvements in the bottom-line were driven by both strong topline growth and optimization of sales and marketing spend.

We recognized a net non-operating income of 23 million dollars in the first quarter of 2023, compared to a net non-operating loss of 6 million dollars in the first quarter of 2022. The higher net non-operating income was mainly due to higher interest income from higher yields.

We had a net income tax expense of 62 million dollars in the first quarter of 2023, compared to net income tax expense of 82 million dollars in the first quarter of 2022.

As a result, net income was 87 million dollars in the first quarter of 2023, as compared to net loss of 580 million dollars in the first quarter of 2022.

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. As usual, our Group Chief Corporate Officer, Yanjun Wang, will lead this part.