Q2 2023 Earnings Prepared Remarks

Minju:

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

In the second quarter of 2023, we delivered strong results, building upon many of the key initiatives we shared previously. We are pleased to see positive developments across all three segments of our business during the quarter. Shopee continued to enjoy significant improvement in margins and strong growth in revenue year-on-year. As we started to ramp up growth for Shopee, it saw double-digit increase in gross orders quarter-on-quarter. Garena showed sequential active user and paying user growth with bookings demonstrating more signs of stabilization. Moreover, Free Fire also started to see quarter-on-quarter growth in bookings. SeaMoney continued to achieve both strong growth and profitability while maintaining a relatively stable risk profile. As a result, at the group level, we saw not only top-line growth but also significant bottom-line improvement from the previous year, with our cash balance, which includes certain short-term and treasury investments, further strengthened to 7.7 billion dollars.

In the past couple of quarters, we have not only achieved self-sufficiency, but also demonstrated the profitability of our model and our ability to manage fast and significant shifts in operational focus as we see fit. Given this, we have strengthened our execution capabilities and increased the stickiness of our ecosystem. We believe we are now on firmer footing to better serve our communities.

Meanwhile, the economies of our region have remained resilient with inflation largely under control. This further boosts confidence in the long-term growth prospects of our markets. We are also excited to see recent ecosystem developments in diversified user engagement through live streaming and short form videos as well as affiliate programs, which already brought new growth to Shopee. Such developments in our ecosystem offer us further opportunities to expand our long-term profitable TAM.

Given these positive developments and trends, we have started, and will continue, to ramp up our investments in growing the e-commerce business across our markets. Such investments will have impact on our bottom-line and may result in losses for Shopee and our group as a whole in certain periods. However, this does not change our unwavering emphasis on self-sufficiency and improving cost efficiency as a key competitive moat. Moreover, we believe that the efficiency gains and stronger footing we have achieved through our past efforts have further strengthened our ability to invest efficiently in growth. Most importantly, we will remain highly agile and prudent by closely monitoring the conditions of each market and adapting our focus and pace accordingly from period to period. As I discuss Shopee's performance later, I will further elaborate on some of our focus areas in the near-term.

With that, let us now discuss each business segment in more detail.

Starting with e-commerce. As we mentioned in past quarters, we have been highly focused on reducing our ecosystem's cost to serve and improving the user experience for both our buyers and sellers. During the second quarter we made important progress on both fronts.

In the quarter, we further improved the efficiency of our logistics operations and expanded our network and capabilities across our markets. New initiatives such as improved digitalization of scheduling and tracking of orders also enhanced the user experience. More delivery options have been launched to address user preferences as well. For example, in Singapore, we have recently added an additional 600 collection points across a variety of retail locations to the existing 1,000 self-collection lockers to offer more delivery options to users. In Taiwan, we installed lockers with 24-hour access at around 150 convenience stores with plans to scale this pick-up option across the market. These efforts have resulted in lower logistics costs including manpower costs, and better delivery experience across our markets. We believe that a highly cost-effective and seamless logistics operation can serve as a key competitive advantage for us. Our efforts certainly go beyond logistics and include all parts of our users' e-commerce journey, which have become our competitive moats as the leading integrated marketplace in our region. We will remain highly focused on lowering the cost to serve for the entire ecosystem while continuing to improve user experience over the long run.

We also improved our user engagement metrics this quarter, further cementing Shopee's position as the e-commerce platform of choice. For example, we have focused on growing our live streaming feature, driving significantly higher participation from buyers, sellers and creators in the second quarter. The feedback from our efforts was highly positive, reflecting the strong demand and high satisfaction for this feature from our users. Indeed, during July's 7.7 live streaming focused campaign in Indonesia, we recorded a 12X growth in transaction volume and a 10X increase in the number of buyers during the campaign, as compared to a normal day. For the 8.8 shopping campaign, around one quarter of our Indonesian buyers watched live streams on Shopee Live and made close to 5 million orders in a single day. In fact, Shopee has already become the leading live streaming e-commerce platform in Indonesia based on a report by Populix.

We also significantly grew the pool of influencers and content creators through our Shopee Affiliate Program. This in turn enables us to efficiently attract more buyers to our platform. These affiliate partners are carefully recruited by our team and can choose to work with us directly or with the sellers on Shopee to promote products to their communities. Feedback from our efforts has been very positive and we are starting to see a tangible boost to our GMV and revenue from this initiative. Indeed, over the course of the second quarter, over one million influencers registered with the program.

Meanwhile, we have been attracting more new users to our platform, especially including those from the less accessible areas of our markets. We believe we are unique in having the full capabilities to service the mass market with the broadest coverage with our low cost to serve and strong owned infrastructure. We have also broadened our assortment of products for our core categories such as fashion, health and beauty to further enhance our competitive moat in the long tail categories. As a result of our user-focused efforts, buyer net promoter score on Shopee improved by 10% over the course of the second quarter.

For sellers, we continue to improve support by upgrading our services and tools to provide a more seamless onboarding process, more attentive seller management and better seller tools and services. We also provide our sellers with more upskilling and training opportunities to improve their competitiveness. For example, we have conducted hundreds of daily classes and camps to train our sellers, and organized knowledge sharing events this year in Malaysia. Our "Shopee on the Road" initiative brings free in-person training to sellers across Brazil. We partnered with Thailand's Creative Economy Agency and other industry participants to help introduce artisan products produced by local Thai communities to our global buyers and provided business training and marketing support to these Thai sellers.

In summary, as we look back on the past few quarters, I am very pleased and highly encouraged by the progress made. Having significantly improved our efficiency and unit economics over the past few quarters, we have become the first and only e-commerce marketplace in Southeast Asia with a proven profitability record at scale. This track record shows our ability to manage profitability and growth in each market as we see appropriate, based on market conditions. More importantly, this ability puts us on a much stronger footing and positions us well for maximizing our long-term potential in each market. We now have a more adaptive and efficient organization, supported by our strong market leadership and financial position, and underpinned by a resilient macro-outlook.

As shared earlier, we believe now is the right time to start reaccelerating our investments in growth. The early signs are encouraging. Gross orders in the second quarter grew by more than 10% quarter-on-quarter driven by growth in both active buyers and buyer purchase frequency.

Looking ahead, as we reaccelerate investments in growth, our strategic focus to build cost leadership and continually improve user experience remains key to our long-term success. We believe that the learnings from the past help us to be even more effective in executing our strategy. We plan to stay highly agile in adapting to user preferences as well as the ever-evolving industry and competitive trends to strengthen our leading position.

Moving on to digital entertainment.

Garena's performance in the second quarter was encouraging as the positive trends in the previous quarter continued to play out. During the second quarter, both quarterly active users and quarterly paying users grew quarter-on-quarter as Free Fire showed sustained signs of improvement in user retention and engagement. Bookings for the game also grew quarter-on-quarter for the first time in the past seven quarters. These recent trends are encouraging signs of Free Fire stabilizing while remaining one of the largest mobile games worldwide and we will continue to closely monitor if this is the beginning of a longer-term stabilization of the game.

In recent months, we have continued to improve core user experience and optimize features and content to ensure a more seamless gaming experience for all users. We also refreshed the gameplay of Free Fire, particularly around characters and maps. We recently celebrated Free Fire's sixth anniversary with many community events that our growing user base found highly engaging.

There have been sustained healthy trends across our existing long-running franchises, and we will continue to build upon these successes. One of Garena's key competitive advantages is our ability to bring best-in-class game experiences to users across diverse markets. We have repeatedly demonstrated how we build deep, lasting engagement with our users, particularly through games involving complex genres and gameplay, even if they are using low spec devices. And we are confident that we can further capitalize on this as we bring more new games to our key markets.

Lastly, on our digital financial services business.

SeaMoney's second quarter performance was strong as we continued to expand our features and product offerings across the business. We are also increasingly seeing growing benefits from the synergies between the Shopee and SeaMoney ecosystems. More importantly, our progress has enabled us to provide underserved segments of our markets with better access to financial services and products.

In the second quarter, GAAP revenue grew 53% year-on-year, driven by our credit business. Profitability in terms of adjusted EBITDA also continued to improve meaningfully on both a year-on-year and quarter-on-quarter basis to reach 137 million dollars, while we maintained a stable and healthy risk profile with non-performing loans past due by more than 90 days remaining at around 2% of our total gross loans receivable.

Over the past quarters, we continued to refine our risk policies with respect to customer credit and selection. Alternative funding from third parties for our credit business also grew as a portion of our loan book as we continue to diversify the sources of funding.

We have seen progress made in further developing our digital bank offerings. Our bank in Indonesia has expanded its service offerings, making our services even more convenient for our users. For instance, the bank app is now compatible with QRIS, a local QR code standard, and connected to BI Fast, a real-time simplified bank transfer service, to enable easier and faster payments and transactions for our users. Users can now purchase digital products such as mobile data, and pay utilities or credit card bills through our bank app. Meanwhile, we have further integrated the bank into our broader ecosystem through our direct debit feature where Shopee buyers can make payments on Shopee directly from their bank account with us. As a result of our user-friendly UI and UX design, the rating for our bank app reached over 4.8 stars on both Apple and Google app stores, one of the highest among banks.

With our expanded offerings and products, we continue to focus on serving the underserved financial needs across our markets and collaborating closely with our ecosystem partners to ensure the healthy and sustainable growth of our business over the long run.

To conclude, we have made strong progress over the last quarters in our efforts to enhance our efficiency, improve user experience, and solidify our market leadership.

As we ramp up growth with efficiency, prudence and agility and continue to strengthen our fundamentals, we are better positioned than ever to capture the sustained opportunities across our businesses and markets. We believe our efforts will translate into even greater defensibility and profitability for our business as a whole over the long term.

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. So, I will focus my comments on the key metrics.

For Sea overall, total GAAP revenue increased 5% year-on-year to 3.1 billion dollars. This was primarily driven by the improved monetization in our e-commerce and digital financial services businesses. Our group total adjusted EBITDA was 510 million dollars, compared to an adjusted EBITDA loss of 506 million dollars in the second quarter of 2022.

On e-commerce, our second quarter GAAP revenue of 2.1 billion dollars included GAAP marketplace revenue of 1.9 billion dollars, up 28% 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 up 38% year-on-year and 7% quarter-on-quarter as a result of both increases in advertisement uptake by sellers on our platform and commission rates. Value-added services revenue, mainly consisting of revenues related to logistics services, was 0.6 billion dollars up 11% year-on-year. On a quarter-on-quarter basis, value-added services revenue declined 7% as we began to reaccelerate growth during the quarter and increased investments in shipping subsidies programs.

E-commerce adjusted EBITDA was 150 million dollars in the second quarter of 2023, compared to an adjusted EBITDA loss of 648 million dollars in the second quarter of 2022. The improvement was driven by increased monetization and greater operating cost efficiencies.

For our Asia markets, we achieved an adjusted EBITDA of 204 million dollars during the quarter, improving substantially from a loss of 316 million dollars in the same period last year. In our other markets, the adjusted EBITDA loss was 54 million dollars, narrowing meaningfully from last year, when losses were

332 million dollars. Contribution margin loss per order in Brazil improved by 83% year-on-year to reach 24 cents, reflecting better monetization and higher efficiency in our operations.

Digital entertainment bookings were 443 million dollars and GAAP revenue was 529 million dollars. Adjusted EBITDA was 239 million dollars with quarter-on-quarter growth partly driven by the sequential increase in Free Fire bookings, which has higher margins.

Digital financial services GAAP revenue was up by 53% year-on-year to 428 million dollars. Adjusted EBITDA was 137 million dollars in the second quarter of 2023, compared to an adjusted EBITDA loss of 112 million dollars in the second quarter of 2022.

On credit, as of the end of the second quarter of 2023, the total loans receivable on our balance sheet was 2 billion dollars, net of allowance for credit loss of 279 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%.

We recognized a net non-operating income of 108 million dollars in the second quarter of 2023, compared to a net non-operating loss of 33 million dollars in the second quarter of 2022. The year-on-year increase was mainly due to higher interest income in the second quarter of 2023 and investment losses recognized in the second quarter of 2022.

We had a net income tax expense of 62 million dollars in the second quarter of 2023, compared to net income tax expense of 65 million dollars in the second quarter of 2022.

As a result, net income was 331 million dollars in the second quarter of 2023, as compared to net loss of 931 million dollars in the second 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 to questions. As usual, our Group Chief Corporate Officer, Yanjun Wang, will lead this part.