Q3 2022 Earnings Prepared Remarks

Minju:

Hello everyone, and welcome to Sea's 2022 third 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 third 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 us today.

We recently passed our five-year IPO anniversary. The rest of the management team and I have learnt a lot from running Sea as a public company, a journey that has seen steep highs and lows. I am grateful for the support and advice all of you have given us over the years, and thank you for your patience and faith in us.

Given the significant uncertainties in the macro environment, we have entirely shifted our mindset and focus from growth to achieving self-sufficiency and profitability as soon as possible, without relying on any external funding. We are adapting quickly to the changing climate because we believe that companies that fail to do so may not survive.

All our efforts are directed to ensure that Sea not only survives the macro storms but emerges stronger, more efficient, and more resilient – and as a long-term winner in our markets. This positions us to continue capturing the long-term potential of our businesses and markets, and to deliver strong and sustained shareholder returns over time.

Over the last quarter, we took decisive actions to improve margins, and set clear goals and priorities for the quarters to come. In addition, to emphasize our commitment to the stated goal, I announced in mid-September that the management team will stop receiving cash compensation until we achieve self-sufficiency.

To share more color on our plan to achieve self-sufficiency, I would like to discuss our current view of a few financial metrics at the group level that we believe may have relatively important effects on our bottom line and cash position.

First, adjusted EBITDA. Our group total adjusted EBITDA improved by 29% quarter-on-quarter. This meaningful improvement was a result of better profitability from both our e-commerce and digital financial services businesses. I will discuss this in greater detail later.

Second, capital expenditure. Historically, our capex has mainly related to servers, office space related spending, as well as logistics-related real estate and equipment. In the third quarter, our group capex was 232 million dollars, consisting mainly of servers and logistics related spending. This may fluctuate from period to period due to the nature of the expense. For example, during some earlier periods, we committed to a heightened level of investments in our server capacity. This was done in anticipation of future business needs while considering potential delays in server procurement due to the supply chain disruptions earlier. These earlier commitments were partly reflected in our capex for the third quarter and may continue to impact our financials for the coming quarters. However, in line with our current focus, we have taken strong measures to tighten our capex budget and will manage it with a strong focus on efficiency and investment returns over the long run.

Another metric that may cause fluctuations in our cash flow from period to period is changes in working capital. This may continue to fluctuate due to many factors such as timing of billing and payment collection cycles. However, in the long run, the direction is also clear for us to focus on improving working capital management.

Last but not least, it goes without saying that we are very focused on our cash position. As at the end of the third quarter, cash, cash equivalents and short-term investments was 7.3 billion dollars, representing a net reduction of 485 million dollars from the end of the second quarter. We aim to continue to maintain a net cash position, after budgeting for the full retirement in cash of the outstanding convertible bonds, and assuming no external funding.

I am confident in our ability to execute well against our stated goals, as we have demonstrated so many times in the past. Let me now take a moment to talk about some of the specific steps we have taken to improve our bottom line.

We have completely overhauled our budgeting practice, to consistently and comprehensively review our spending. Across all businesses and markets, we reviewed and reduced headcount, decreased existing spending and future investment commitments on office space and logistics facilities, and tightened travel and entertainment policies. On top of that, we improved procurement policies and procedures, reduced spending on computer hardware, and stopped all new financial equity investments.

We have also accelerated cost saving initiatives in our business operations. For example, at Shopee, we have meaningfully scaled back marketing expenses, especially around shipping subsidies. At Garena, we are now focused on running our existing key franchises as efficiently as possible, and are taking a more selective approach to developing and launching new games, to prioritize the highest potential titles in our pipeline. Finally, at SeaMoney, we have deprioritized offline adoption of ShopeePay and are further diversifying funding for our credit business across multiple sources.

Our current initiatives are designed to further fortify our leading positions and enable us to continue to win in our key markets over the long run. In the coming quarters, we will continue to focus on improving key financial metrics for the long-term health of our business. While our results may fluctuate and are affected by the macro environment and many other factors, we are currently working towards adjusted EBITDA breakeven for Shopee overall by the end of 2023.

We believe our strong focus on cash flow and achieving self-sufficiency as soon as possible is the right strategy to pursue at this stage, even though we may see no growth or even negative growth in certain operating metrics in the near term. To be very clear, we remain highly confident about the compelling long-term growth prospects of our businesses and markets. Once we achieve self-sufficiency, we will be in a position to decide to reaccelerate growth again in a much more efficient and long-term sustainable manner.

Let's now discuss each business segment in detail.

Beginning with e-commerce, we made significant progress in narrowing Shopee's losses across all regions despite headwinds from ongoing macro uncertainties and reopening trends. Adjusted EBITDA loss in the third quarter was 496 million dollars, improving quarter-on-quarter by 24%. This was driven by strong topline growth, particularly in core marketplace revenue, and meaningful efficiency improvements in operating costs across our markets. These improvements were partially offset by severance and early lease termination related costs, and increases in HQ costs such as shared R&D staffing and shared server hosting expenses. As we began more focused efforts on optimizing HQ costs, including R&D costs, from the later part of the third quarter, we expect savings on shared costs to start to show in the following quarters.

GAAP revenue in the third quarter was 1.9 billion dollars. This includes around 1 billion dollars of core marketplace revenue, mainly consisting of transaction-based fees and advertising revenue and therefore offering higher margins. The core marketplace revenue increased by 54% year-on-year, contributing meaningfully to the improvement in monetization and overall profitability. We aim to continue to create more value for our sellers and buyers and expect monetization to positively correlate to their satisfaction over time.

As mentioned, we also further optimized costs during the quarter, with a positive effect on our bottom-line. For example, Shopee's GAAP sales and marketing expenses in the third quarter decreased by 15% quarter-on-quarter, as we adjusted our free shipping offerings across several markets.

These initiatives have accelerated Shopee's path towards profitability. During the quarter, our Asia markets recorded an adjusted EBITDA loss of 217 million dollars, improving by 31% quarter-on-quarter as a result of profitability improvements across all markets in the region. Additionally, the region combined recorded a positive contribution margin, in line with our previously shared expectations. At the individual market level, we recorded positive contribution margins for most of our Asia markets, including our largest market, Indonesia. Furthermore, Malaysia and Taiwan recorded positive adjusted EBITDA.

For our other markets combined, adjusted EBITDA loss was 279 million dollars, improving by 16% quarter-on-quarter, as a result of increased monetization and cost savings.

In Brazil, we saw continued improvement in unit economics with adjusted EBITDA loss per order before allocation of HQ costs at 1 dollar and 3 cents, an improvement of roughly 40 cents from the previous quarter. Meanwhile, GAAP revenue grew by over 225% year-on-year. We will continue to invest in the exciting opportunities we see in our Brazil market. I recently spent time in the country meeting with local sellers and buyers, and I was reminded once again of Shopee Brazil's strong and clear value proposition in empowering its local communities. This drives a strong and clear business case to continue to invest prudently in that market. Of course, every investment will be made with discipline and a strong focus on continual efficiency improvements to reach profitability.

Overall, as we pivoted towards focusing on monetization and profitability, we have continued to see healthy buyer and seller engagement across our platform. We believe this reflects the value we deliver to our communities. In the third quarter, we observed solid retention rates for our active buyers and maintained our average order frequency and time spent per active user at a stable level compared to the previous quarter. The number of brands on Shopee Mall also continued to grow strongly by 36% year-on-year to over 42 thousand, reflecting more brands recognizing the value Shopee brings to them.

Importantly, we are always looking to further improve the services we offer our sellers and provide a superior shopping experience for our buyers. We want to make sure that incremental monetization is well justified by the additional value we continue to create and deliver in our ecosystem. Over the past few quarters, we have enhanced the efficiency and predictability of our delivery, improved the complaint resolution rate of automated customer services, and reduced refund resolution time. Our sellers now enjoy more features to help them navigate our ecosystem more easily and increase their sales. For example, they have access to pricing recommendations if their item prices are detected as non-competitive, and have self-service access to our many performance-enhancing programs and business management tools.

Moving on to digital entertainment.

Garena continued to be impacted by reopening trends, especially as our gamers returned to fully reopened school and work post-pandemic. At the same time, we are faced with rising global macro uncertainties. We believe this continues to impact consumer discretionary spending, including in games. These headwinds have resulted in weaker engagement and user trends in the third quarter.

During the quarter, GAAP revenue was 893 million dollars and bookings were 665 million dollars. Garena's quarterly active users reached 568 million with 52 million quarterly paying users. Our paying user ratio and ARPU remained stable quarter-on-quarter.

Free Fire experienced ongoing moderation in engagement and monetization. Still, relative to the industry overall, Free Fire's performance remained robust.

We are also pleased that Arena of Valor delivered solid growth in active users and bookings for the third quarter. It has been encouraging to see the game's resurgence once again and the strong support from a resilient core user base. Its performance in the past six years since launch is in line with our view that strong operations can have meaningful positive effect on a game, and that a strong mobile game can be built into a long-term franchise with multiple peaks.

For Garena overall, with the worsening macro environment and reopenings having a continuing impact on our markets, we now expect bookings for the full year of 2022 to be between 2.6 billion and 2.8 billion dollars.

Looking ahead, we will focus on stabilizing our large, existing franchises while selectively launching new games, and investing in our pipeline with greater discipline and a stronger focus on efficiency and returns. At the same time, we will be strengthening our organization and carefully optimizing our spending through more efficient marketing and content investments.

Finally, moving on to our digital financial services business.

In the third quarter, SeaMoney's GAAP revenue reached 327 million dollars, up 147% year-on-year. At the same time, adjusted EBITDA loss decreased by 57% year-on-year to 68 million dollars. The improvement was predominantly driven by more targeted sales and marketing spending for the mobile wallet business, and our credit business maintaining its healthy profitability while generating cash for the group.

With the growing volatility across our markets, we are closely monitoring the health of our credit business and our loan book. As of the end of the third quarter, our loan book stood at 2.2 billion dollars, net of allowance for credit losses of 253 million dollars. Non-performing loans past due by more than 90 days represented less than 4% of our total gross loans receivable, and the weighted average tenure of loans outstanding was about four months. We will continue to focus on improving the quality of our underwriting, optimizing risk controls and user experience, diversifying our sources of funding for the credit business, and improving the quality of our other digital financial offerings to users.

In closing, while we have demonstrated our strong execution and ability to scale rapidly in the right market and macro environment, we believe we are also able to adapt to the current conditions swiftly and demonstrate our ability to manage towards profitability. The cadence of bottom line and cash flow improvements may vary quarter-to-quarter, but we are confident that we are becoming a more resilient and efficient business, in a better position to capture the long-term opportunities present in our markets.

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 17% year-on-year to 3.2 billion dollars. This was mainly driven by the increased monetization in our e-commerce business and growth of our credit business.

On e-commerce, our third quarter GAAP revenue of 1.9 billion dollars included GAAP marketplace revenue of 1.6 billion dollars, up 39% year-on-year, and GAAP product revenue of 0.3 billion dollars, up 3% year-on-year. Within GAAP marketplace revenue, core marketplace revenue, mainly consisting of transaction-based fees and advertising revenues, was 1 billion dollars whereas value-added services revenue, mainly consisting of revenues related to logistics services, was 0.6 billion dollars.

E-commerce adjusted EBITDA loss was 496 million dollars, as we continued to improve on monetization by creating more value for our users and further optimized on cost efficiency.

Digital entertainment bookings were 665 million dollars and GAAP revenue was 893 million dollars for the third quarter of 2022. Adjusted EBITDA was 290 million dollars. We continued to experience ongoing moderation in engagement and monetization, with the reopening trends and uncertain macro environment.

Digital financial services GAAP revenue was 327 million dollars, an increase of 147% year-on-year from 132 million dollars in the third quarter of 2021. Adjusted EBITDA loss was 68 million dollars, compared to 159 million dollars for the third quarter of 2021.

We recognized a net non-operating loss of 9 million dollars in the third quarter of 2022, compared to a net non-operating loss of 13 million dollars in the third quarter of 2021.

We had a net income tax expense of 65 million dollars in the third quarter of 2022 which was primarily due to corporate income tax and withholding tax expenses.

As a result, net loss excluding share-based compensation was 374 million dollars in the third quarter of 2022, as compared to 448 million dollars for the same period in 2021.

At the end of the third quarter of 2022, we had 7.3 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.