Q3 2023 Earnings Prepared Remarks

Minju:

Hello everyone, and welcome to Sea's 2023 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. 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 President, Chris Feng, 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 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.

At our last earnings call, we shared that we would accelerate investment in e-commerce. In the past, our e-commerce business has made some significant shifts in operational focus to adapt to major business environment changes. Before diving into the details of the third quarter results, I would like to first share how the thinking behind each shift has been underpinned by our long-term view of the business.

Our strategy for e-commerce is driven by the principle that maximizing the long-term profitability of the business will generate the greatest returns to our shareholders in the long run. And, maximizing long-term profitability requires scale and strong market leadership.

To achieve this long-term objective, we look at three key operational factors: growth, current profitability, and market share gain. While all are important and positively correlated in the long-run, near-term focus on one can create trade-offs for another. As business conditions change, sometimes rapidly, we need to decide which factor to prioritize for that period.

During the pandemic, we focused on growth first, ramping up rapidly to meet surging demand for e-commerce despite the great operational difficulties created by lockdowns. This allowed us to achieve significant scale and strong market leadership when growth was very efficient. Subsequently, capital became very expensive and less available. So we made a rapid turn to achieve immediate profitability for Shopee as a first priority, while sustaining the platform's scale and market leadership. In both cases, we believe we made the right decisions in response to the shifting business environment.

As we focus on long-term profitability and adapt to changes in the business environment, some short-term fluctuations in our results is inevitable. However, our demonstrated ability to adapt quickly and execute major transitions effectively is a core strength for the long-term success of our business. We are now deploying this strength to realize the next shift in our operational focus in e-commerce.

In this period, we will prioritize investing in the business to increase our market share and further strengthen our market leadership. We made this decision in view of three recent developments.

First, our move to self-sufficiency and profitability has significantly improved both our cash reserves and operational efficiency. Our group cash position has increased by around 600 million dollars from a year ago to more than 7.9 billion dollars at the end of the third quarter. This puts us in a strong position to pursue more competitive and growth-focused strategies, while maintaining financial discipline and a strong balance sheet over the long run.

Second, the entrance of new players has intensified competition in our markets. Competition may accelerate market share consolidation, and when markets stabilize, each remaining player will have sustainable profitability. Investing in market share gain now will position us better with even stronger market leadership when that happens. We thrive in a competitive environment. We competed aggressively and effectively in our markets for years to emerge as the clear market leader from an underdog position. We now have scale, a deep understanding of our markets, and strong localized execution across diverse geographies. This gives us a wide competitive moat, and we intend to grow it further.

Third, live streaming has become increasingly popular among sellers, buyers, and creators in our markets. These tailwinds give us a very good opportunity to build our e-commerce content ecosystem efficiently. We believe live streaming e-commerce will become a sizable and profitable part of our platform and extend our long-term growth potential.

I want to emphasize that in making investment decisions, we are committed to maintaining a strong cash position, not relying on external funding, and investing within our means at a time and pace of our choosing.

At the same time, given that e-commerce penetration remains low in most of our markets, we as the market leader have a responsibility to help grow the whole e-commerce ecosystem. Shopee will remain committed to doing so in a healthy and sustainable way and driving value creation for all stakeholders.

I hope that this brief sharing on the thinking behind our decisions has been helpful. Being nimble and therefore able to do the right thing at the right time remains a core strength and competitive advantage for our business.

With that, I will invite Yanjun to discuss each business segment in more detail.

Yanjun:

Thank you, Forrest. Let me now share more details on the recent performance of each business segment. Beginning with e-commerce.

Just now, Forrest discussed the long-term objectives for our investments in e-commerce. For the immediate period, we assess the effectiveness of our investments by looking at how our market leadership as well as the scale and strength of our e-commerce content ecosystem has been trending. On both fronts, we made strong progress in the past quarter.

In the third quarter, growth in Shopee's users, gross orders and GMV accelerated sequentially. We saw average monthly active buyers growing 11% quarter-on-quarter, with increased order frequency and improved buyer retention. As a result, our gross orders and GMV achieved 24% and 11% sequential growth respectively, further increasing our market share. We also saw a material improvement in NPS scores broadly across the markets quarter-on-quarter and year-on-year. We believe this to be a good early indication of the effectiveness of our investments.

Another key driver of our solid growth during the third quarter was the ramp up of Shopee Live. During this period, we have made a strong push into e-commerce live streaming and increased collaborations with a growing ecosystem of content creators and live streaming sellers. We have also successfully acquired many new buyers and deepened our engagement with existing buyers. For example, in Indonesia, one out of five daily active users watched live streaming in October on average.

With our efforts to help our sellers and creators, we saw a significant increase in their participation in Shopee Live. Our number of average daily unique streamers, total daily hours streamed and the number of daily stream sessions for October all grew by more than 3 times compared to June. Our streamers are also becoming more engaged, with the average stream duration per streamer increasing by more than a third during the same period.

In Southeast Asia, our average daily orders from live streaming already reached more than 10% of the total order volume for October.

For our investments in live streaming, we have a targeted focus on key categories, such as fashion, and health and beauty. These categories tend to benefit more from this format of user engagement and tend to enjoy higher margins. This further strengthened our overall market leadership in these key marketplace categories.

Moreover, we have been focused on investment efficiency and driven fast improvement in unit economics. This is well in line with our long-term view that live streaming e-commerce can be both a meaningful part of our platform and profitable.

As shared before, we are consistently focused on reducing cost to serve for our e-commerce ecosystem. We made strong progress in continuing to drive down logistics costs while improving user experience. Our platform logistics cost per order for our Asia markets decreased by 17% year-on-year in the third quarter. Decreases in logistics costs also contributed to the year-on-year decline in our value-added services revenue. We believe this to be an example of scale economics shared, where we drive down logistics costs with scale and pass the benefit of reduced shipping costs to our sellers and buyers. This business model also serves to strengthen the competitive moats of our platform.

As we scale the Shopee platform, we also continue to expand the coverage of our logistics network across our markets to reach more sellers and buyers. This will be done through better routing for more efficient and faster delivery, further expanding our network of sorting centers and improving our last mile coverage.

During the third quarter, Brazil continued to enjoy strong growth. At the same time, our unit economics in Brazil improved. We will continue to invest in category expansion and user acquisition in this market. And we will take a balanced approach of investing in growth while driving improvements in operational efficiency, especially in logistics. Our results in Brazil for the quarter speak to our success on both fronts. While we believe we already achieved sufficient scale and cost efficiency to be profitable in Brazil, our focus remains on capturing the growth opportunity there.

Looking into the fourth quarter, we will continue to invest in the holiday shopping season, which we believe is a good time to acquire users, gain market share, and strengthen our content ecosystem.

Moving on to digital entertainment.

In the third quarter, Garena's bookings grew sequentially, while quarterly active users and adjusted EBITDA remained stable quarter-on-quarter. We view these results positively as this was achieved despite schools reopening across a number of our key markets during the quarter.

We are happy to see that Free Fire maintained stable trends across both user and monetization metrics. Many of our initiatives around improving the user experience this year, such as reducing loading time, have shown continued success. We have also further deepened user engagement. For example, we recently revamped Free Fire's guild system to enhance the social experience for our players. With all these efforts, we saw a higher revival of churned users and better user retention. Indeed, Free Fire was the most downloaded mobile game in the third quarter globally, according to Sensor Tower.

We are also pleased to see healthy trends for our portfolio of published games. We added fresh, exciting content and enhanced the user experience for these games. New content on Arena of Valor received very positive user feedback resulting in a new peak of quarterly active users for the game. Another of our published games, Call of Duty: Mobile, achieved its highest quarterly bookings. This was a result of both our continued efforts to improve the game experience for players through better optimization and successful content collaborations. We will continue to assess new development and publishing opportunities for Garena.

Lastly, on our digital financial services business.

In the third quarter, SeaMoney delivered strong revenue and profit growth, mainly driven by our credit business which grew steadily quarter-on-quarter.

As of the end of the third quarter, we had a total credit portfolio of 2.9 billion dollars, growing 5% sequentially. The portfolio included 2.4 billion dollars of gross loans receivable on our balance sheet. The remaining approximately 0.5 billion dollars of principal amount of loans outstanding were from channeling arrangements, which is lending by other financial institutions on our platform.

In terms of credit product type, 1.4 billion dollars in the total credit portfolio were SPayLater consumption loans, which are used to pay for transactions on or off the Shopee platform. The remaining balance mostly consisted of cash loans to Shopee buyers and sellers.

The quality of our loan book stayed healthy. Loans past due by more than 30 days and 90 days as a percentage of the gross loans receivable on our balance sheet was 5.2% and 1.6%, respectively, improving quarter-on-quarter.

We also continued to expand the funding sources. In fact, the majority of the gross loans receivable on our balance sheet were funded by sources such as deposits in our banks and asset-backed lending from third party financial institutions.

We will continue to further diversify our credit portfolio across markets and products both on and off Shopee platform, and optimize our sources of funding to improve costs and diversify risks.

Our digital bank offerings have made good progress during the quarter. For example, our banks in Indonesia, the Philippines and Singapore have seen strong user adoption of the direct debit services, where buyers can make payments on Shopee directly from their bank accounts with our banks. The service has driven an acceleration in user acquisition for our banks and improved transactional experience on Shopee. This is also another example of our strong ecosystem synergies.

To sum up, SeaMoney has become an increasingly important pillar of our core businesses. It is contributing meaningfully towards both our top line and bottom line. It has enjoyed a healthy and improving risk profile and strong ecosystem synergies. Under SeaMoney, we continue to strive to develop more comprehensive products and services to meet the financial needs of users across our markets.

With that, I will invite Tony to discuss our financials.

Tony:

Thank you, Yanjun, 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 3.3 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 35 million dollars, compared to an adjusted EBITDA loss of 358 million dollars in the third quarter of 2022.

On e-commerce, our third quarter GAAP revenue of 2.2 billion dollars included GAAP marketplace revenue of 1.9 billion dollars, up 18% year-on-year, and GAAP product revenue of 0.3 billion dollars. Within GAAP marketplace revenue, core marketplace revenue, mainly consisting of transaction-based fees and advertising revenues, was 1.3 billion dollars, up 32% year-on-year 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, down 4% year-on-year.

E-commerce adjusted EBITDA loss was 346 million dollars in the third quarter of 2023, compared to an adjusted EBITDA loss of 496 million dollars in the third quarter of 2022.

For our Asia markets, we had an adjusted EBITDA loss of 306 million dollars during the quarter, compared to an adjusted EBITDA loss of 217 million dollars in the third quarter of 2022. In our other markets, the adjusted EBITDA loss was 40 million dollars, narrowing meaningfully from last year, when losses were 279 million dollars. Contribution margin loss per order in Brazil improved by 91% year-on-year to reach 10 cents, reflecting better monetization and higher efficiency in our ecosystem.

Digital entertainment bookings were 448 million dollars and GAAP revenue was 592 million dollars. Adjusted EBITDA was 234 million dollars, compared to 239 million dollars in the second quarter of 2023.

Digital financial services GAAP revenue was up by 37% year-on-year to 446 million dollars. Adjusted EBITDA was 166 million dollars in the third quarter of 2023, compared to an adjusted EBITDA loss of 68 million dollars in the third quarter of 2022.

We recognized a net non-operating income of 46 million dollars in the third quarter of 2023, compared to a net non-operating loss of 9 million dollars in the third quarter of 2022. The year-on-year improvement was mainly due to higher interest income in the third quarter of 2023.

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

As a result, net loss was 144 million dollars in the third quarter of 2023, as compared to net loss of 569 million dollars in the third quarter of 2022.

With that, let me turn the call to Minju.

Minju:

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