



Sea Ltd.

Spending to resume

UNITED STATES | INTERNET | 2Q23 RESULTS

17 August 2023

BUY (Maintained)

CLOSING PRICE	USD 40.50
FORECAST DIV	USD 0.00
TARGET PRICE	USD 87.00
TOTAL RETURN	114.8%

COMPANY DATA

Bloomberg CODE:	SE US
O/S SHARES (MN):	567
MARKET CAP (SGD bn / USD bn):	31 / 23
52 - WK HI/LO (USD):	88.84 / 38.01
3M Average Daily T/O (mn):	6.28

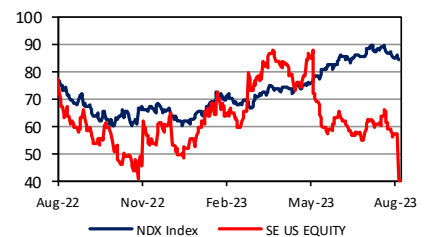
MAJOR SHAREHOLDERS (CLASS A SHARES)

Capital Group Cos Inc/The	8.5%
Gang Ye	5.8%
Baillie Gifford & Co	4.2%

PRICE PERFORMANCE (%)

	1MTH	3MTH	YTD
COMPANY	(35.4)	(44.1)	(22.2)
NASDAQ RETURN	(5.3)	9.5	36.0

PRICE VS. NASDAQ



Source: Bloomberg, PSR

KEY FINANCIALS

Y/E Dec, USD (bn)	FY21	FY22	FY23e	FY24e
Revenue	10.0	12.4	13.3	15.0
EBITDA	-1.3	-1.1	1.0	1.3
Net Profit	-2.0	-1.7	0.4	0.7
P/S (X)	12.5	2.3	1.7	1.6
P/B (X)	16.8	5.1	3.1	2.5
EV/Revenue (X)	12.0	2.2	1.6	1.4
Gearing Ratio	48%	60%	36%	27%

Source: Company, PSR

VALUATION METHOD

Discounted Cash-Flow, WACC 7.6%, g 3.0%

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- 2Q23 revenue missed expectations marginally due to increased shipping subsidies. Earnings were in line. 1H23 revenue/PATMI was at 46%/103% our FY23e forecasts. We expect break-even in 2H23 due to increased incentives and investments.
- Garena looks to have bottomed out, posting an 8% QoQ increase in operating income after 5 quarters, with an 11%/15% sequential uptick in QAU/QPU.
- Increasing shipping subsidies and marketing spend for Shopee GMV growth to impact both top and bottom line, with potential of operating losses in the near-term.
- We cut our FY24e revenue/PATMI by 3%/3% to reflect increasing shipping subsidies and marketing spend, and we raise our outstanding share denominator by 8% due to share dilution. We maintain BUY with a reduced DCF target price of US\$87.00 (prev. US\$100.00), with an unchanged WACC of 7.6%, and a terminal growth rate of 3.0%. We still believe SE is well-positioned to capture e-commerce growth in many emerging markets due to increased digitalisation.

Results at a glance

USD (bn)	2Q23	2Q22	YoY	1Q23	QoQ	Comments YoY%
Revenue	3.1	2.9	5.2%	3.0	1.8%	
- Digital Entertainment	0.5	0.9	-41.2%	0.5	-1.9%	Moderation in user engagement and monetisation
- E-commerce	2.1	1.7	20.7%	2.1	2.1%	Increase in ad uptake and commission rates
- Digital Financial Services	0.4	0.3	53.4%	0.4	3.7%	
Gross Profit	1.5	1.1	33.1%	1.4	2.4%	
OPEX	-1.2	-1.9	-39.4%	-1.3	-9.6%	
- Sales & Marketing	-0.5	-1.0	-49.3%	-0.4	23.4%	
Operating Income	0.3	-0.8	nm	0.1	126.6%	
PATMI	0.3	-0.9	nm	0.1	279.2%	3rd consecutive quarter of profitability
EPS (\$)	0.54	-1.67	nm	0.15	260.0%	

Source: Company, PSR

The Positive

+ Garena likely to have bottomed out. After several quarters of weakness following its Free Fire ban in India last year, Garena finally posted a sequential increase in its segment operating income. 2Q23 operating income grew 8% QoQ to US\$296mn (-41% YoY), driven by an increase in higher margin Free Fire bookings. User metrics QAU and QPU also ticked up 11% QoQ and 14% QoQ, respectively, indicating some improvements in user retention and monetization. Garena operating margins have remained relatively high compared to its peers at 56%. And with the release of its new game, Undawn, we should be able to see sustained improvements in most gaming-related metrics moving forward.

The Negatives

- Shopee a slight disappointment due to increased shipping subsidies. Even with orders increasing >10% QoQ, Shopee revenue grew by only 2% QoQ (21% YoY) from ramping up shipping subsidies recorded in its GAAP revenue line. In addition, a sequential US\$100mn rise in marketing spend resulted in a -43% QoQ decline in e-commerce operating income. Shopee's 2Q23 operating margin was 3% (1Q23: 6%).

- Spending more for growth. Throughout its 2Q23 earnings call, management reiterated its stance to ramp-up investments to boost e-commerce growth, citing a stronger base and improved cost efficiencies as reasons for the resumption of investments. SE also said that the ramp-up in investments will negatively impact its bottom line and could see the company move back into the red in the near term. Some of its key areas of focus include live streaming, short-form video, and affiliate partner programs.

GMV: Gross Merchandise Value, QAU: Quarterly Active User, QPU: Quarterly Paying User

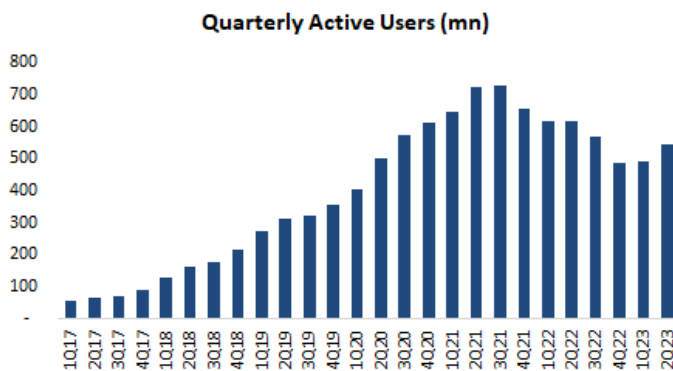
Outlook

Garena: Garena’s revenue decline seems to have bottomed out, with US\$529mn in 2Q23 (-41% YoY vs -52% in 1Q23). QAU and QPU both increased 11% QoQ (-12% YoY) and 14% QoQ (-23% YoY), respectively, as user engagement ticked up (Figure 1). Garena also saw its Quarterly Paying Ratio rise 20bps to 7.9%, but still well below its peak of almost 13% in 3Q21. Operating margins continued to improve over the last 3 quarters at 56% vs 42% in 4Q22. With Garena launching its newest game, Undawn, in Jun23, we should expect user metrics to continue improving in the near term. Undawn reportedly had >10mn pre-registered users before it launched.

Shopee: While core marketplace revenue increased by 38% YoY (increases in advertisement uptake and commission rates), value-added services revenue, mainly consisting of logistics related revenue, increased only 11% YoY, dragged by shipping subsidies (accounted for in its GAAP revenue). Profitability for the segment declined -43% QoQ, with operating income of US\$66mn (Figure 2) hurt by ~US\$100mn increase in marketing spend to boost GMV growth – gross orders rose >10% QoQ as a result. Shopee Brazil continued to see efficiencies of scale as it improved loss per order by 83% YoY to reach -US\$0.24. With SE opting to resume investments to boost e-commerce growth - focusing on live streaming, short-form video, and its affiliate programs - we would expect to see some negative impact on its profitability in the near term.

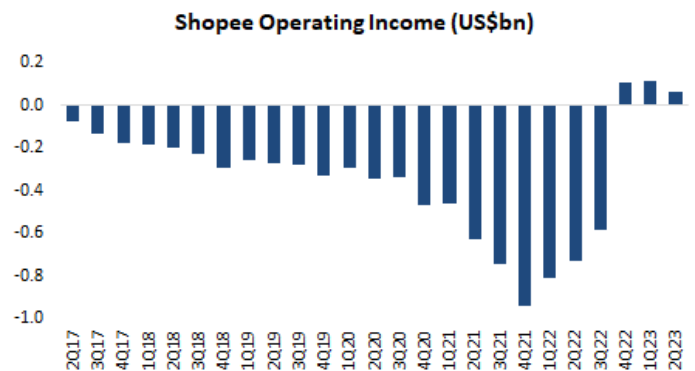
SeaMoney: Revenue grew 53% YoY to US\$428mn, with operating income improving by US\$244mn YoY (43% QoQ), segment operating margin improved 780bps to 28%. SeaMoney also continued to expand its product offerings, allowing users to purchase digital products more seamlessly through its bank app, and also introducing a direct debit feature to allow Shopee buyers to make payments on Shopee directly from their bank account. SE’s loan book stood at US\$2.0bn at the end of 2Q23, with NPL >90 days remaining healthy. We are positive on SeaMoney’s growth, and expect it to continue delivering synergies with Shopee for more frictionless transactions.

Figure 1: Garena’s user metrics starting to show some stabilisation, with QAU ticking up for a 2nd consecutive quarter.



Source: Company, PSR

Figure 2: Shopee operating income could see some near-term pressures due to shipping subsidies and marketing spend



Source: Company, PSR

RULE OF 40

The “Rule of 40” was first introduced as a benchmark to measure the balance between growth and profitability of SaaS companies, taking into account both revenue growth, as well as profitability (Revenue Growth + EBITDA Margins), with the addition of both metrics needing to exceed the 40% threshold. We have modified this slightly by averaging revenue growth over a 3-year period compared with just a single period growth rate. Adding together SE’s 3-year average revenue growth of 49% and its EBITDA margin of 5%, the total of 54% is more than our required threshold of 40% (Figure 3).

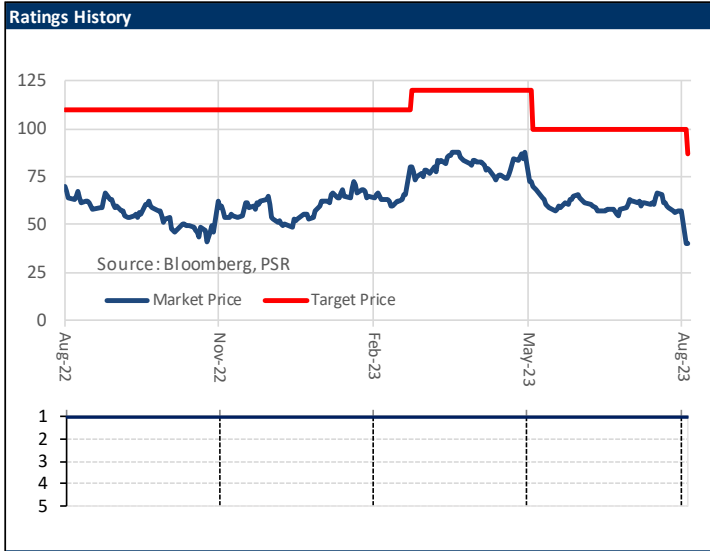
Maintain BUY with a reduced target price of US\$87.00

We cut our FY24e revenue/PATMI by 3%/3% to reflect increasing shipping subsidies and marketing spend, and we raise our outstanding share denominator by 8% due to share dilution. We maintain BUY with a reduced DCF target price of US\$87.00 (prev. US\$100.00), with an unchanged WACC of 7.6%, and a terminal growth rate of 3.0%. We still believe SE is well-positioned to capture e-commerce growth in many emerging markets due to increased digitalisation.

Figure 3: Rule of 40 calculation

Rule of 40		
3 Year Average Revenue Growth	+ EBITDA Margin	= Total
49%	5%	54%

Source: Company, PSR



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

Financials
Income Statement

Y/E Dec, USD mn	FY20	FY21	FY22	FY23e	FY24e
Revenue	4,376	9,955	12,450	13,332	15,015
Gross Profit	1,349	3,896	5,185	5,599	6,457
Other Income	(190)	(288)	(279)	(299)	(337)
EBITDA	(1,179)	(1,333)	(1,114)	971	1,337
Depreciation & Amortization	(181)	(279)	(456)	(489)	(550)
EBIT	(1,360)	(1,612)	(1,571)	482	787
Profit before tax	(1,483)	(1,715)	(1,501)	617	980
Taxation	(142)	(333)	(168)	(216)	(294)
PATMI	(1,618)	(2,047)	(1,651)	402	687

Per share data (USD)

Y/E Dec	FY20	FY21	FY22	FY23e	FY24e
Diluted EPS	(3.16)	(3.67)	(2.92)	0.70	1.19
BVPS	6.68	13.31	10.29	13.03	16.49

Cash Flow

Y/E Dec, USD mn	FY20	FY21	FY22	FY23e	FY24e
CFO					
Profit after tax	(1,618)	(2,047)	(1,651)	402	687
Cash Flow from Operations	556	209	(1,056)	1,665	1,498
CFI					
CAPEX, net	(336)	(772)	(924)	(933)	(931)
Cash Flow from Investing	(887)	(3,767)	(2,429)	(2,154)	(2,152)
CFE					
Cash Flow from Financing	3,733	7,402	400	1,114	1,114
Net Change in Cash	3,483	3,785	(3,228)	626	460
CCE, end	6,167	9,248	6,030	5,066	5,525

Source: Company, Phillip Securities Research (Singapore) Estimates

Balance Sheet

Y/E Dec, USD mn	FY20	FY21	FY22	FY23e	FY24e
ASSETS					
Cash & Cash Equivalents	6,167	9,248	6,030	5,066	5,525
Prepaid Expenses	1,054	1,402	1,799	2,326	2,853
Receivables	363	388	269	402	552
Others	1,069	2,597	2,537	2,590	2,614
Total current assets	8,939	15,135	12,688	13,437	15,598
PPE & IA	426	1,082	1,453	2,036	2,438
Long-term Investments	190	1,053	1,254	1,334	1,414
Goodwill	216	540	230	230	230
Others	684	946	1,378	1,447	1,493
Total non-current assets	1,517	3,621	4,315	5,047	5,575
Total Assets	10,456	18,756	17,003	18,484	21,173

LIABILITIES

Accruals	2,033	3,531	4,575	4,575	4,575
Deferred Revenue	2,150	2,644	1,535	1,935	2,386
Others	452	1,001	825	926	1,163
Total current liabilities	4,636	7,176	6,936	7,437	8,123
Convertible notes	1,840	3,476	3,339	2,678	2,590
Others	559	679	918	918	918
Total non-current liabilities	2,399	4,155	4,256	3,595	3,507
Total liabilities	7,035	11,332	11,192	11,032	11,630

Equity

Share Capital & APIC	8,527	14,623	14,560	15,808	16,659
Shareholder Equity	3,420	7,424	5,811	7,452	9,542

Valuation Ratios

Y/E Dec	FY20	FY21	FY22	FY23e	FY24e
P/S (X)	23.3	12.5	2.3	1.7	1.6
P/B (X)	29.8	16.8	5.1	3.1	2.5
EV/EBITDA (X)	nm	nm	nm	21.4	15.4

Growth & Margins

Growth					
Revenue	101.2%	127.5%	25.1%	7.1%	12.6%
EBITDA	-4.4%	13.1%	-16.4%	nm	37.7%
EBIT	0.4%	18.6%	-2.6%	nm	63.2%
Net profit, adj.	10.6%	26.5%	-19.3%	nm	71.0%
Margins					
Gross margin	30.8%	39.1%	41.6%	42.0%	43.0%
EBITDA margin	nm	nm	nm	7.3%	8.9%
EBIT margin	nm	nm	nm	3.6%	5.2%
Net profit margin	nm	nm	nm	3.0%	4.6%
Key Ratios					
ROE	nm	nm	nm	5.4%	7.2%
ROA	nm	nm	nm	2.2%	3.2%
Net Gearing	nm	nm	nm	nm	nm
Net Debt/EBITDA (X)	nm	nm	nm	nm	nm

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