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NQ - Q1 2011 NetQin Mobile Inc. Earnings Conference Call

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PRESENTATION

Operator

Good morning, and thank you for standing by for NetQin Mobile Incorporated First Quarter 2011 Earnings Conference Call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference is being recorded. If you have any objection, you may disconnect at any time.

I would now like to turn the call over to your host for today's conference Mr. Nicholas Manganaro from Ogilvy Financial. Please proceed, sir.

Nicholas Manganaro - Ogilvy Financial - Analyst

Thank you. Hello, everyone, and welcome to NetQin Mobile Incorporated First Quarter 2011 Earnings Conference Call. The Company's earnings results were released yesterday and are available on the Company's IR website at ir.netqin.com, as well as, on newswire services.

Today, you will hear opening remarks from Dr. Henry Yu Lin, NetQin's Founder, Chairman, and CEO followed by Chief Financial Officer Suhai Ji who will take you to the company's operational and financial results for the first quarter 2011 and give guidance for the second quarter and full year of 2011. After their prepared remarks, Dr. Lin, Mr. Ji, and NetQin's Vice President of Strategy, Will Jiang, will be available to answer your questions.

Before we continue, please note that the discussion today will contain certain forward-looking statements made under the Safe Harbor provisions of the US Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations.

NetQin does not assume any obligation to update any forward-looking statements except as required under applicable law. Also, please note that some of the information to be discussed includes non-GAAP financial measures as defined in Regulation G.



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The most directly comparable US GAAP financial measures and information reconciling these non-GAAP financial measures to NetQin's financial results prepared in accordance with US GAAP are included in NetQin's earnings release, which has been posted on the Company's IR website at ir.netqin.cn. Finally, as a reminder, this conference is being recorded. In addition, a webcast of this conference call will be available on NetQin's Investor Relations website.

I will now turn the call over to NetQin's Founder, Chairman and CEO, Dr. Lin.

Henry Yu Lin - *NetQin Mobile Inc. - Co-founder, Chairman and Chief Executive Officer*

Thank you, Nick, and hello to everyone on the call. I'm very pleased to address you on our first call at the public company following our IPO in May in which we raised over US\$89 million before expenses. We had an outstanding first quarter of strong growth that further validated our innovative framing SaaS business model.

With the rapid growth in smartphone shipments globally, and the growth in mobile Internet applications, mobile security threats are increasing and mobile security is quickly becoming a fundamental key service for every smartphone users. NetQin is well positioned to seize this market opportunity and become a global leading mobile Internet service provider.

We saw strong growth across all our security and productivity offerings during the first quarter as we reached a new high in our numbers of registered users, active users and paying users. We also launched the NQ Space Cloud services platform in the first quarter, and improved the functionality and user experience of our product offering. With our IPO, we have enhanced our market visibility and are now better positioned to grow user base, establish new partners, develop new products and expand our business.

Going forward, we will continue to deliver more free and premium product offerings to our users. Our focus on innovation, user experience and user needs will enable us to extend our market leadership during this exciting time in the mobile Internet industry.

Now, I would like to turn the call to Suhai.

Suhai Ji - *NetQin Mobile Inc. - Chief Financial Officer*

Thank you, Henry, and hello to everyone on the call, and thanks for joining. At the outset, please note that all the financial numbers I will discuss today are in US dollars unless otherwise noted. As Henry had mentioned, indeed we had a outstanding first quarter, which was reflected in both operational and financial numbers. We reached new highs in the three sets of operating metrics we've publicly disclosed.

Our cumulative registered user accounts reached 86 million at the end of first quarter, compared with 43 million at the end of the first quarter in 2010, and 72 million at the end of the previous quarter. Our average monthly active user accounts for the quarter were about 30 million, compared with 15 million for the first quarter in 2010, and 25 million for the previous quarter. Our average monthly paying user accounts for the first quarter in [2010] were 3.7 million compared with 1.4 million for the first quarter in 2010, and 3.3 million for the previous quarter.

The strong year-over-year and sequential growth of -- above user account numbers were driven by a number of factors both external and internal. First, because all of NetQin users are smartphone users, we are able to ride with the global smartphone industry growth, which have been explosive in the past few years and that trend is expected to continue.

Second, with the proliferation of mobile applications, mobile security is becoming a fundamental need for smartphone users, as more and more people become aware of the mobile security threats. And the mobile productivity services have also emerged as a new user need.

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Third as the Company focused on mobile security and productivity from the very beginning, we have continuously improved existing and launched a new product and service offerings to deliver a better user experience and gain user traction.

We have also established diversified and effective user acquisition channels, and have leveraged our premium SaaS business model to build a large user base, which has reached a critical mass for us to monetize upon. These operational data also give clear evidence on the management capability to successfully execute our business strategy.

Now, turning to the financials, our total net revenues in the first quarter were US\$7.6 million, an increase of almost 217% year-over-year and 21% sequentially. Such significant growth was due to primarily to the increasing revenues from premium mobile Internet services and to a lesser extent, the increasing revenues from other services.

Net revenues from, premium, mobile Internet services in the first quarter were US\$6.6 million, an increase of 214% year-over-year and 23% sequentially. The increases were primarily due to the strong growth in the number of our paying user accounts, which in turn reflected the growth of the number of our registered and active user accounts and their increased use of our premium services. In particular, we saw a greater increase in the number of our overseas paying user accounts, which generally are charged a higher subscription fee for our premium services.

Our revenue from overseas already accounted for about 45% of total net revenues from premium mobile Internet services in the first quarter. Net revenues from other services in the first quarter were US\$1.1 million, an increase of about 267% year-over-year and 22% sequentially. Such increase was primarily due to the growth in revenues from secured download and delivery service for mobile applications produced by third party.

Before moving on to the cost of revenues and operating expenses, I want to remind you to read and understand our disclosure on non-GAAP financial measures that was included in our official press release. The only difference between our GAAP and non-GAAP numbers are the share-based compensation, or SBC expenses.

SBC expenses are included across cost of revenues and operating expenses on a GAAP basis, but are excluded to derive our non-GAAP numbers. Most of the SBC expenses are incurred in operating expenses line items, and we have included a reconciliation table in earnings release showing the detailed calculation.

So, cost of revenues in the first quarter was US\$1.5 million, compared with US\$0.8 million in the same period in 2010 and US\$2 million in the previous quarter, representing an increase of 88% and a decrease of 25% respectively. The year-on-year increase was primarily due to the increased user acquisition costs, increased fees charged by mobile payment service providers and increased staff costs.

The sequential decrease from the previous quarter was primarily due to decreased user acquisition costs as a result of viral marketing effect associated with a larger user base. The SBC expenses included in a cost of revenues are very small, so there is little difference between the GAAP and non-GAAP numbers.

Gross margin of net revenue was about 80% in the first quarter, compared with 66% in the same period in 2010 and 68% in the previous quarter. The increase was primarily due to two facts. First, we collected a larger portion of our net revenues through prepaid cards distributors in the first quarter. As we recognized net proceeds from prepaid card distributors as net of revenues, the cost of revenues associated with such revenues is much lower, thus increasing gross margin.

And second, a larger portion of our revenues in the first quarter, which is 45% versus 39% in the same quarter year ago and 40% in the previous quarter was generated from overseas users who generally pay a higher subscription fee and a higher portion of the prepaid cards.



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So the gross margin for our business has a lot to do with our revenue recognition policy and how we collect revenues from China and overseas users, thus from analytical point of view, the management places less emphasis on gross margin than on our operating margin especially the non-GAAP operating margin.

So, now on to the operating expenses, for the first quarter of 2011 and first quarter of 2010 and fourth quarter of 2010, we recorded a total SBC expenses of US\$1.4 million, US\$0.4 million, and US\$11.2 million respectively across these three operating expenses line item.

The large SBC expenses in the previous quarter were due to the options granted during that quarter, a significant portion of which was immediately vested upon grant. For this reason, and to make the quarterly comparison more consistent, I would like to address the following line items on a non-GAAP basis, which exclude the SBC expenses.

Our non-GAAP sales and marketing expenses were US\$1.4 million in the first quarter, compared with US\$0.9 million in the same period in 2010 and US\$1.5 million in the previous quarter. The year-over-year increase was primarily due to higher staff costs from headcount increase and higher marketing advertising spending.

The sequential decrease was mainly due to the higher marketing advertising spending in the previous quarter, as we launched our application on Google Android market and incurred initial product launching costs during that quarter.

Non-GAAP general and administrative expenses were US\$0.9 million for the first quarter, compared with US\$0.3 million in the same period in 2010 and US\$1.2 million in the previous quarter. The year-over-year increase was primarily due to the higher staff costs from headcount increase including the hiring of senior executives, and the sequential decrease was mainly due to the higher professional and consulting expenses incurred in the previous quarter, which is related to the Series C-1 financing.

Non-GAAP R&D expenses were US\$0.9 million in the first quarter, compared with US\$0.6 million in the same period in 2010 and US\$0.8 million in the previous quarter. The year-over-year and sequential increase were mostly due to the increased staff cost. As a result, our non-GAAP total operating expenses in the first quarter were US\$3.1 million, compared with US\$1.8 million in the same period in 2010 and US\$3.6 million in the previous quarter.

Non-GAAP total operating expenses as a percentage of net revenues was roughly 41% in the first quarter, compared with 75% in the same period in 2010 and 57% in the previous quarter. Our non-GAAP operating income, which excludes share-based compensation expenses in the first quarter was US\$3 million, compared with operating loss of US\$0.2 million in the same period in 2010 and operating income of US\$0.7 million in the previous quarter.

Non-GAAP operating margin was about 39% in the first quarter of 2011, compared with negative 8% in the same period in 2010 and 11% in the previous quarter. The significant year-over-year and quarter-over-quarter improvement in non-GAAP operating margin was primarily due to the robust revenue growth and the strong operating leverage we enjoyed, as our user base continues to grow and scale up.

Non-GAAP net income attributable to NetQin was US\$3.1 million, compared with US\$0.02 million in the same period in 2010 and US\$0.6 million in the previous quarter. As a mobile internet company, our business is highly scalable and we enjoy significant operating leverage as seen from the above financial results.

And to ensure maximum financial transparency, the Company has decided to disclose the full set of three financial statements, including the cash flow statement. Our operating cash flow for the first quarter was a net inflow of approximately US\$2 million. And at the end of the March 31, 2011, we had cash and cash equivalents of US\$24.5 million and deferred revenue of US\$3.4 million.



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Given the recent IPO, our balance sheet is getting even stronger with a cash position of over \$100 million and zero debt. So the cash value for ADS is now over US\$2, and we believe our current stock price is significantly undervalued, given our growth profile and strong business fundamentals.

So looking forward to the second quarter and beyond, we expect net revenues to be in the range of US\$8.6 million and US\$8.8 million for the second quarter of 2011, representing a year-over-year growth of 139% to 144% and quarter-over-quarter growth of 13% to 16%.

And for the full year of 2011, we expect net revenues to be in a range of US\$37.5 million and US\$38.5 million, an increase of 112% to 118% compared to fiscal year 2010. Again, the Company's business fundamentals remain as strong as ever, and we will continue to execute to deliver solid financial results.

Now, I will turn the call back over to Henry for closing remarks.

Henry Yu Lin - *NetQin Mobile Inc. - Co-founder, Chairman and Chief Executive Officer*

Thank you, Suhai. As you have seen from our press release and in light of recent market environment surrounding the current (inaudible) of financial statements on Chinese company, we have taken the opportunity to demonstrate our commitment to financial transparency and integrity by providing investors with additional financial disclosure such as cash flow statement for the first quarter, as well as the key operating metrics.

With [fresh] capital (inaudible) from recent IPO, investors can have confidence in the strength of our balance sheet and our ability to take advantage of the tremendous growth opportunities in our industry. It is our intention to provide cash flow statement as part of future quarterly financial as we position NetQin as a leader in financial transparency and some corporate governance.

Again, we're very pleased with our first quarter results, and our company's IPO last month was another great milestone for us. But we're even more excited about our future. We'll look forward to executing our strategy in the incoming quarters, and we thank you all for your continuous support on NetQin.

If you have any additional questions after this call, please feel free to reach out us and we will be happy to address them through a meeting or call. The management team is committed to make ourselves as accessible as we can to our investors.

Nicholas Manganaro - *Ogilvy Financial - Analyst*

We will now hand the call over to the operator, and open the line for questions. Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Your first question today comes from the line of Mark Murphy with Piper Jaffray. Please proceed.



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Mark Murphy - Piper Jaffray - Analyst

Yes, thank you very much, and congratulations on the strong Q1 results. I wanted to ask you about your future products roadmap. And what I was wondering if you could comment on adoption of NQ Space?

Thus far, we do understand that it was launched recently. And maybe discuss just at a high level what types of new products we might expect to see in the next 12 months, and perhaps a comment on the expected mix of your security products versus your productivity and other products over time here.

Henry Yu Lin - NetQin Mobile Inc. - Co-founder, Chairman and Chief Executive Officer

Okay. Thanks, Mark. NQ Space helps NetQin users to manage all (inaudible) installed product and service from the [call side]. You also have users to manage all their backup data and security data from a web browser, in addition to remote lock, delete, alert, and locate when users lost their mobile phone. We have seen an active usage from the user base, for example, so far we already have almost 10 million users who are backing up contact lists on NQ Space.

Going to the future, we will upgrade existing service capabilities and introduce additional functionality by releasing new version of mobile anti-virus and mobile manager, and currently the flagship products of ours. In addition, we will support more platforms by offering full suite offerings to iPhone, BlackBerry, and tablet platform. Currently, productivity applications represents about 15% of revenue mix, and [it will] increase as we introduce more services in the productivity area.

Mark Murphy - Piper Jaffray - Analyst

Okay, good, thank you. And as a follow-up on the topic of Nokia and the Symbian platform, could you discuss your -- just what your current attachment is of the Symbian platform as Nokia attempts to transition some of its smartphones to the Windows platform?

I'm wondering at what rate you think your Symbian revenue can grow in the next couple of years. And then also, what do you need to do if you're going to position NetQin to participate in the growth of any Nokia smartphones in the future that will be Windows based?

Will Jiang - NetQin Mobile Inc. - Vice President of Strategy

Good morning, Mark, this is Will, and I'll take this question. Our observation matches the general market intelligence data that's been provided by the likes of IDC and Gartner. This transition will take several years to complete from Symbian to Windows form of platforms.

Symbian right now still shipped a stable volume. It expects to ship more volume within the next couple of years. And it will still compete hard for the medium-to-low smartphone market share, as being demonstrated by (inaudible) in the most recent interview. Hence, we still do see growth on this platform, and since we're also a mobile internet service provider and we should expect a much longer lifecycle from our service.

We're working closely with Nokia and because of our experience as 14 to 15 Windows mobile platform without OEM handset makers such as HTC, NetQin service will further proliferate on Nokia devices for both Windows and Symbian. Certainly on an industry perspective, we do believe Android gross momentum is very strong globally and NetQin is also well positioned to capture this market shift, as it is also the greatest volume platform in our user growth momentum.



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Mark Murphy - Piper Jaffray - Analyst

Okay, good. So, the other question that I wanted to ask you about is on the Android platform and maybe the international opportunity that -- from what we've seen you appear to have strong momentum on this Google Android platform.

And wondering what's stage are you in, in this process of -- where you can either be [seeding] the marketplace, or you can reach a point where you're starting to more seriously monetize it. And I think, particularly in overseas markets, maybe what milestone should we be looking for in the next year or two just to be able to verify that you're capitalizing on this Android opportunity?

Will Jiang - NetQin Mobile Inc. - Vice President of Strategy

Well, Mark, as I just mentioned Android right now represents the fastest growing platform in our user base. So based on the small scale pilots in the newly entered developed market, we're very pleased to share with you that the preliminary results of the Android platform, which is direct to the convergence rates and consumer willingness to pay is very high.

We do believe Android presents us the huge potential going to the future. Our top goal right now is to acquire a dominant market share globally as quickly as possible. This will present an excellent foundation for our user stickiness, as well as the future potential conversion.

NetQin, right now, is working aggressively to sign on our additional OEM partnerships for pre-installation, additional payment channels, and also overseas carrier relationships. We will continue to be announcing these strategic partnerships publicly as they materialize in the future.

Mark Murphy - Piper Jaffray - Analyst

Okay. And then -- thank you for that, Will. Just one last one for me. Just can you comment on a high level at -- on mobile security threats? What did you see during Q1, or even so far in Q2? It is -- we are largely through Q2 here, but what is the rate of mobile malware and spyware and infections on smartphones recently?

Will Jiang - NetQin Mobile Inc. - Vice President of Strategy

Certainly, Mark. NetQin actually released a white paper last month on the overall malware situation in Q1. One key set of data we'd like to share with you; our research team has discovered more than 2,000 malware in Q1 alone on the Android platform, while the previous cumulative total has been around 100.

This data proved that Android adoption has hit a critical mass around the end of last year and people with ill intent are actively trying to profit off this trend. For example, one recent virus is called BaseBridge, that is repackaged and embedded in legitimate apps. This malware can actually dial out calls and send text messages without notifying the user, and incurs fees for usage as well.

We expect to see the number of malware to grow at a greater rate into the future. Our global leading security knowledge repositories are updated continuously to help NetQin as we're fending off these attacks. Privacy theft, privacy intrusion and financial thefts are just some of the top security threats out there. With the expected proliferation of mobile commerce, mobile payments, mobile banking and mobile brokerage, the concern will be even more great.

And also since smartphones are associated with user's real identity, including names, phone numbers, contact lists, call logs, text messages, photos and location data and many others, privacy disruption is also expected to become a much more serious than PC attacks.

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Mark Murphy - *Piper Jaffray - Analyst*

Okay. Thank you very much. That's all I had.

Will Jiang - *NetQin Mobile Inc. - Vice President of Strategy*

Thank you.

Unidentified Company Representative

Thank you.

Unidentified Company Representative

Thank you, Mark.

Operator

Your next question comes from the line of Andy Yeung with Oppenheimer. Please proceed.

Andy Yeung - *Oppenheimer - Analyst*

Hi. Good evening, Henry, Suhai, and Will. Thank you for taking my questions. My first question is regarding the controversy with respect to your partnership with Feiliu prior to the IPO? You have put out a press release this morning addressing the issues.

So, can you guys elaborate a little bit more on the topic? And particularly regarding, one, any potential government investigations? Two, any changes in user acquisitions and user behavior during this period? And three, your relationship with wireless carriers and handset OEMs?

Will Jiang - *NetQin Mobile Inc. - Vice President of Strategy*

Yes, Andy, we've finally passed our IPO blackout period and as you just mentioned, we have (inaudible) official PR regarding the matter. As it clearly stated, the government has cleared NetQin and Feiliu of any wrongdoing, and NetQin stands behind the quality, integrity and credibility of our products, services and our employees.

With regards to the user acquisition, we did notice a slight drop in terms of newly acquired users in the two days after the March 15th event, which is when the original allegation came out. Within a week of March 15th, the user growth momentum has gone back to the pre-March 15th level. We did not see any other user behavior change since March 15th.

This controversy didn't really impact any relationships with the carrier or the handset OEM, and all the existing contracts are still ongoing. And with the IPO, we're in an even better position to forge a relationship with more partners globally.



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Andy Yeung - *Oppenheimer - Analyst*

That's great. So my next question is about your user acquisition. You mentioned earlier that the shift to -- or in your press release, to viral marketing has possibly impacted your user [acquisition calls]. What are the key user acquisition channels and how did the mix shift over time and any long-term target for that mix?

Suhai Ji - *NetQin Mobile Inc. - Chief Financial Officer*

Yes, Andy, Suhai here. Yes, for our user acquisition channels, that can be summarized into three different categories. Basically they consist of word of mouth, viral marketing, handset pre-installation and online downloads, via app stores or portals.

So in the first quarter, the viral marketing contributed to about 30% of the user acquisitions, and the handset pre-installation represented about 25% and the remaining 45% came from online download.

So as our user base grows, and we sign more contracts with the handset OEMs, we expect both viral and handset channels to further increase. But certainly online downloading channel remains to be an effective method to acquire users globally, and hence we will also develop more online channels in the future as well.

Andy Yeung - *Oppenheimer - Analyst*

Okay. Great. And just one -- let me try to follow-up on the question regarding handset operating systems. Can you give us some insights into the distribution of the user base by smartphone operating systems? And both on an accumulated basis and on a new user base in first q? And what's your overall view on that mix shifting in the -- in this year and next year?

Will Jiang - *NetQin Mobile Inc. - Vice President of Strategy*

Sure, Andy. This is Will. So first of all, next gen security and productivity services are actually a platform and device agnostic. So as a mobile Internet service provider, we welcome users from every platform.

Cumulatively speaking, the majority of our users are using Symbian platforms. This is also actually a good reflection of the current smartphone user base globally, as Symbian takes up a large percentage of the market, especially in Asia and China.

With regard to the newly acquired users, Android growth momentum is the strongest within our user base, which is expected. Since in terms of newly shipped devices, Android has already taken over the number one spot from Symbian globally. So, Android is definitely a focus and priority for us.

We also released NetQin Mobile security products for the BlackBerry OS in Q1, and are seeing very good momentum. With regard to the iPhone platform, we released a new productivity service called Smart Calendar in Q1 as well, and we plan to introduce the mobile security product within the next six months.

Over the next couple of years, we do expect the Android platform to represent the majority, while the rest of the platforms will be quite evenly split between iOS, Symbian and BlackBerry.

Andy Yeung - *Oppenheimer - Analyst*

Got it. All right. Thank you for answering my questions, and congratulations on a very strong quarter.

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Unidentified Company Representative

Thank you.

Unidentified Company Representative

Thank you.

Operator

Your next question comes from the line of Mike Walkley with Canaccord Genuity. Please proceed.

Mike Walkley - Canaccord Genuity - Analyst

Great. Thank you very much, and congratulations on the strong quarter. Just building on some of the previous questions, with the ramping Android sales in China and globally, likely more competitors targeting your mobile security and productivity markets, can you update the overall competition, how you're positioned?

Clearly there's some very positive industry growth trends with smartphones and the need for mobile security and productivity, but there seems to be increasing solutions getting onto the Android ecosystem and just wondering how you guys are faring versus the competition.

Unidentified Company Representative

Definitely. The competition landscape actually remained quite the same for the last quarter. Most of our competitors are still either the traditional PC security players or the new startups. We believe NetQin currently has the best mobile security technology in the world and we expect to keep this leadership by continuously investing in R&D.

And the other advantage lies within our business model, in which actually our premium business model, which is a package of free services and premium services bundled in one package, helps us to continuously gain large user base while enhancing user stickiness.

So, for example, right now, actually, we already have over 20 services available -- free services available and the number of premium services that stands at nine. So basically going to the future, we do expect our leadership in technology and the continuous execution in our premium business model will keep us as a definite leader in the mobile security and productivity market.

Mike Walkley - Canaccord Genuity - Analyst

That's great. Thank you. And, Suhai, just given your strong guidance for the June and for full year 2011, can you walk us through some of your assumptions? Is this strong sales growth driven by increasing ARPU to your installed base or increasing ARPU to the fast-growing international market helping the mix? Or, is it just a strong growth of the customer base or all of these trends? Just trying to get a thought behind what gives you the confidence for your full year guidance?

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Suhai Ji - NetQin Mobile Inc. - Chief Financial Officer

Yes, I think it's really a combination of the fact -- the factors that you just mentioned. We are seeing strong growth, both within China and the overseas markets. From the macro perspective, the smartphone shipments have seen explosive growth and mobile threats are also becoming bigger concerns and they're driving more awareness for the mobile security.

So NetQin is really very well positioned to capture this growth, as we are already the dominant leader in this market. And we are seeing continuous strong momentum in registered, active and paying user base. And in addition, as we further expand our footprint in overseas markets and the higher ASP in those markets, we do expect ARPU, which is average revenue per user, to trend up in the long run as well.

And also because we are a B2C company, it's direct to consumer and we have our subscription business model and also -- which is on the recurring basis. That also gives us a better visibility into the future revenues.

So all those factors mentioned above give us a comfort level in terms of giving our next quarter and also the full year's revenue guidance.

Mike Walkley - Canaccord Genuity - Analyst

Okay. Great. That's very helpful. And, Suhai, you talked about the strong operating leverage in your model. Do you have any intermediate term, like June quarter, operating margin targets and the longer-term targets for your operating margins?

Suhai Ji - NetQin Mobile Inc. - Chief Financial Officer

Yes, I think for our operating margin, as you can see, our non-GAAP operating expenses, as a percentage of net revenues, was already at 41% in the first quarter. And we believe there is still room to improve. And as a result, our operating margin for the first quarter is actually at 30 -- already at 39%. And our longer-term target operating margin is probably between 45% to 50%. But we also want to have the flexibility to balance that with our business strategy in different markets.

For example, in certain markets, we may want to spend more to grab market share as expenses are slightly lower operating margins. But we believe our current quarter's operating margin's 39%. Going forward, in the future quarters, we will do better than we currently have.

Mike Walkley - Canaccord Genuity - Analyst

Okay. Great. Thank you. And just one last question, Suhai. From just tax rate, for modeling purposes, can you help us, it's still low in Q1. What should we be thinking about tax rate for 2011 and 2012?

Suhai Ji - NetQin Mobile Inc. - Chief Financial Officer

Yes, I think as you saw in the Q1 number, we actually had a tax benefit instead of expenses, mainly from those deferred tax benefits carried from previous periods. And for modeling purposes, for 2011 and 2012, very conservatively I think we will not have a tax rate any higher than 7.5%.

And we are also planning to -- we are also doing certain tax planning to minimize the tax impact for this and next year. So I think to be safe, it's no more than 7.5% for sure.

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Mike Walkley - *Canaccord Genuity - Analyst*

That's great. Thank you. Okay.

Suhai Ji - *NetQin Mobile Inc. - Chief Financial Officer*

Thanks.

Mike Walkley - *Canaccord Genuity - Analyst*

Good luck with this quarter, and I look forward to staying in touch.

Suhai Ji - *NetQin Mobile Inc. - Chief Financial Officer*

Yes. Absolutely. Thanks, Mike.

Unidentified Company Representative

Thank you.

Operator

(Operator Instructions)

Your next question comes from the line of Jin Yoon with Nomura. Please proceed.

Unidentified Audience Member

Hi. This is George calling on behalf of Jin and good evening, everyone. Good evening, Henry, Suhai and Will. Congratulations, on a strong quarter. And actually, I have three questions.

The first one is regarding that breakdown of your revenues because you guys just shared the breakdown of revenue by product mix and also by regions. And I wondered, can you guys share the product -- the breakdown of revenue by distribution channels, meaning how much is from mobile operators, and how much is from third-party online payments, something like that? Thanks.

Unidentified Company Representative

Okay. The first question, actually, we break down our revenue between the geographic regions. And also we give a rough idea on the -- among the different products.

However, you cannot break down our revenue based on the distribution channels. Those payment channels serve, basically, as a means for us to collect revenue. And at that, almost half of the -- our revenue collection is done through mobile operators or the mobile payment service providers. And the other half that's collected is through the prepaid card distribution -- prepaid card distributors.

However, we do not acquire users through those channels. The pre-installation and also online downloading channels, those are the cost items. Those are the money we spend to acquire users. Those are our user acquisition channels. So, those two are

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quite different. And we don't assign our revenue based on those acquisition channels because they have more to do with our costs rather than revenue.

Unidentified Audience Member

Okay. Got it. Thanks. And my second question is regarding your operating margins. And as we see -- you guys have this very good operating leverage and so going forward, in the next couple of quarters, do you guys have any like promotional activities, R&D and expenses, that will increase? Or are you -- as you mentioned the margins will be stable or trending a little bit up in the coming quarters?

Unidentified Company Representative

Yes, we believe our current margins is already at 39%. And in the coming quarters, we don't -- we see further increase of this margin as our users -- user base further increases and the scale -- excuse me, and they scale up.

So, as I mentioned earlier, so the longer-term operating margin is kind of between 45% to 50%. And even -- because we have user base across almost 200 different countries, so we don't -- if we have certain marketing initiatives.

For example, in the last quarter we launched our applications on the Android market in the US. So we would incur some one-time launching costs in one particular market. But we do not see that impact to have a big impact on our overall operating margin, as that's sort of leveraged across different countries, across different platforms.

Unidentified Audience Member

Okay. Got it. So is it safe to say that, for example, for any incremental top-line growth, like at least like 45% to 50% of the top-line incremental revenue, will fall on the bottom line?

Unidentified Company Representative

You can say that. I cannot give you the exactly quantitative number. But absolutely. For the same selling increase in revenue, it's a smaller marginal increase in the operating expenses to support that growth. So, a larger portion will filter through to the bottom line.

Unidentified Audience Member

Okay. Great. And maybe my last question is a little bit on the strategic level. And it's about your competition strategy. Because I understand that you guys have this premium and SaaS model, which is great and also the technology and it's also [a four bore].

But I understand that some of your competitors are being very aggressive and they use a very -- totally free model and if you look at that -- look back at a few years back, at the PC security software base in China, some of the competitors, they don't have the best technology, but they just offer their products for free. And that actually worked out.

So, in terms of that, what's your plan or what's your strategy to compete with that kind of competitors? Thanks.

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Will Jiang - NetQin Mobile Inc. - Vice President of Strategy

So, George, this is Will. So, basically, because we operate leveraging a premium business model, which means that the combination of free services and premium services, so while we are competing with the players who use the free services, in fact we're only competing using the free portion working against them.

So, basically, what we're saying is that, for example, we already have over 20 services available, free services. While our competitors offer, on average, less than five free services.

So, basically, we have a huge advantage in terms of offering free services to our user. So this definitely gives us the edge to acquire a larger market share as illustrated by our dominant market share in China, where we actually own a 67% market share by the end of last quarter -- by the end of, actually last quarter. Sorry, the last quarter in 2010.

So, really, we believe we're competing with our competitors from different fronts. Number one, it's technology. And because our engine is optimized for mobile from day one, we do definitely have an edge in technology as we continuously invest into R&D, this leadership will only grow.

Secondly is, our premium business model, like I mentioned, and because of our free services, we're able to gain more users and have better traction among our user base. Thirdly is, really regarding the user base and stickiness. And because of the user base, we also gained additional ecosystem partnerships, such as likes of Sony Ericsson, Samsung, HTC, Nokia and many other handset OEMs.

So, along with all these advantages, we're building a very high entry barrier for any competitor to come in. So, this is why we are continuing to expect our market share will maintain, if not increase -- further increase, in mobile security market in China.

In addition, we also believe because the models for the PC security guys -- the models they use, and the advertising model. However, this doesn't necessarily apply to mobile because in order to do a proper mobile advertising, you need to have -- you need to extract data from, first, people's smartphones. And because the real identity associated with your smartphone and you're actually taking away people's privacy. So we believe this model is actually fundamentally contradictory to what mobile security is supposed to be doing in the first place.

So definitely another point I would like to mention. And because we have strategic investments from the likes of Qualcomm, HTC and Mediatek, we can further enhance our advantage in the ecosystem, hence building a higher entry barrier.

Unidentified Audience Member

Okay. Got it. That's very helpful. But is it possible that maybe some of your competitors just offer some -- like your premium model, a premium service for free, just to grab market share?

Will Jiang - NetQin Mobile Inc. - Vice President of Strategy

Well, actually, premium services has much higher technology requirements and entry barrier as well. So basically what we're seeing is that for the premium services, really we have a much better technology leadership in the span of actually several years. So really by continuously innovating our premium services, as well as our free services, we'll definitely maintain this advantage.

In the future, we're not even discounting the possibility by making premium services free, to further enhance our user base. However, by doing so, we must continuously innovate on releasing more premium services as well, going into the future.

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Unidentified Audience Member

Okay. Great. Thanks. Thank you very much, everyone. Thanks.

Will Jiang - *NetQin Mobile Inc. - Vice President of Strategy*

Thank you.

Unidentified Company Representative

Thank you.

Unidentified Company Representative

Thank you.

Operator

Ladies and gentlemen, this does conclude our question-and-answer portion of the call. I would now like to turn it back over to Nicholas Manganaro for closing remarks.

Nicholas Manganaro - *Ogilvy Financial - Analyst*

Thank you, Operator. I would just like to thank everyone for joining us today and remind them, if they have any further questions, please do not hesitate to contact us. Thank you.

Operator

Ladies and gentlemen, that concludes today's conference. Thank you for your participation. You may now disconnect. Have a great day.

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