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NQ - Q3 2012 NQ Mobile Inc. Earnings Conference Call and Webcast

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the NQ Mobile Q3 2012 earnings call. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session. (Operator Instructions). I must advise you that this conference is being recorded today, Tuesday, November 13, 2012.

I'd now like to hand the conference over to your first speaker today, Miss Michella Ma. Thank you. Please go ahead.

Michelle Ma *- NQ Mobile Inc - Director of IR & Corporate Development*

Hello, everyone, and welcome to NQ Mobile's third quarter 2012 earnings' conference call. The Company's earnings results were released earlier today, and are available on the Company's IR website at ir.nq.com, as well as on newswire services.

Today, you will hear opening remarks from NQ Mobile's Co-CEOs, Dr. Henry Lin and Omar Khan, followed by our Chief Financial Officer, Suhai Ji, who will take you through the Company's operational and financial results for the third quarter 2012, and give guidance for the fourth quarter 2012, and the full year of 2013.

After their prepared remarks, Dr. Lin, Mr. Khan, Mr. Ji, and our Chief Strategy Officer, Will Jiang, and our Chief Product Officer, Gavin Kim, will be available to answer your questions.

Before we continue, please note that 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. NQ Mobile 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. The most directly comparable US GAAP financial measures and information reconciling those non-GAAP financial measures to NQ Mobile's financial results, prepared in accordance with US GAAP, are included in NQ Mobile's earnings release, which has been posted on the Company's IR website at ir.nq.com.

Finally, as a reminder, this conference is being recorded. In addition, a webcast of this conference call will be available on NQ Mobile's Investor Relations website.

I will now turn the call over to NQ Mobile's founder, Chairman, and Co-CEO, Dr. Lin.

Henry Yu Lin - *NQ Mobile Inc. - Chairman of the Board, Co-CEO, Chief Architect*

Thank you, Michelle, and welcome to everyone on the call. I'm pleased to report that we achieved a strong third quarter with record revenues. Our revenues of $25.8 million again exceeded the high end of previously issued guidance.

We continue to benefit from the rapid increase in global smartphone shipments and consumer awareness and demand for mobile security and privacy solutions. Both our registered and active user base recorded the highest sequential growth for 2012, and reaching 242 million and 85 million, respectively. The strong growth in our user base is also clear validation of our business strategy and execution capabilities.

Additionally, we are starting to see significant revenue contribution from the NationSky acquisition for our enterprise business, which accounted for more than 17% of the total revenue in the third quarter. We are confident about our enterprise business, and expect continuous strong growth in the foreseeable future.

Today, we also announced our intention to acquire 100% of Feiliu, which is a very important strategic step that we undertake to further broaden our mobile Internet service offerings, and to transform NQ Mobile to become a leading mobile Internet service platform company.

With that, I'd like to hand the call over to my partner, and NQ Mobile's co-CEO Omar Khan, who will give you more details on some of the key developments in our business.

Omar Khan - *NQ Mobile Inc. - Co-CEO*

Thank you, Henry, and hello to everyone on the call.

It's been almost a year since I came on board as NQ Mobile's Co-CEO, and I must say, I can't be more pleased with the growth of our Company year to date, currently already at an annualized run rate of $100 million in revenue.

Furthermore, we've continued to globalize our business. We've built the best team in the industry. 54% of our consumer revenues now come from outside of Greater China, up from 51% last quarter.

In the third quarter, we continued our product expansion's drive that I shared with you earlier. We're excited to bring more innovative products to the global market such as NQ Family Guardian. We're going to be launching this in our US channels. It's a comprehensive suite of services targeted at parents and their smartphone-enabled teens and tweens, and even sometimes younger. 58% of teens now own smartphones in the US. It's the fastest-growing segment of the smartphone industry.

Our product allows parents to raise responsible cyber citizens. Parents can monitor, manage and secure their kids, by monitoring their contacts, text messages and photos. Additionally, you can manage their mobile Internet usage on an age-appropriate basis, as well as their mobile application permissions.

Finally, we're able to time-fence their phone usage, meaning when they can be texting, when they can use their phones, etc., when they can be browsing. And finally, you can track their geo-location and put a fence in terms of an area they're safe for them, and you'll be alerted when they're outside of that zone. In fact, I use this product for my 10-year old son, who's a smartpone owner today.

In the latest release for Vaults for IOS and Android, we recently added private messaging with Facebook contacts, so we've continued commitment to expanding our privacy product lines. Together with NQ Mobile Security and NQ Mobile Vault, we have built a trust product suite that's second to none. We'll be sharing more about this strategy later on.

With the enterprise solutions we launched with Enterprise Shield and MMS for mobile managed services through NationSky, we have moved from a single-trusted security provider to a trust services provider, encompassing both consumer and enterprise segments.

To capitalize on the mobile security market opportunity, we also increased our international expansion effort with the formal opening of our international headquarters in Dallas last quarter. We have continued to strengthen our international team as well. Recently, we hired an outstanding lead mobile architect with cross platform expertise across IOS, Android, etc., reporting directly to Gavin Kim, our Chief Product Officer.

We remain committed to our global expansion efforts, and continue to see strong momentum in international business development, with newly announced agreements with Go Wireless, Wireless, Cat Phones in the United States, Celcom in Malaysia, epay in Australia, and Phones 4u in the United Kingdom. As an example, Phones 4u brings us 600 plus retail locations in the United Kingdom where we'll be launching mobile security. And epay in Australia has access to thousands of locations. We're going to be launching with Harvey Norman, and one additional retailer initially.

As mentioned earlier, revenue from our international markets today already accounts for more than 54% of our consumer business. And we believe that the continued build out and investment in our international business will further drive and sustain our long-term growth. These investments can have had a short-term impact on our margins, but we believe it's necessary and critical for us to undertake in order to position ourselves for our future growth.

We remain confident that 2013 will be another inflection point in the revenue contribution from these markets. In fact, we are starting to see great traction in the retail markets. It's a very important channel for us. For example, with one of our large independent dealers, [A Wireless], we are already seeing attach rates north of 20%, with better performing stores seeing 50%, and even higher attach rates.

Lastly, as Henry mentioned earlier today, we also announced our Feiliu acquisition, our intention to acquire Feiliu, which marks an important strategic step in our effort to move beyond security and establish a mobile Internet service platform. While security and trust services remain the hallmark of our core business with the expectation of continued growth globally, we believe that NQ Mobile has a significant opportunity to combine our proven capabilities in acquiring and engaging consumers, and monetizing mobile services with Feiliu's capabilities that they bring to us.

Feiliu is a leading mobile Internet interested community platform that has 57 million registered users and 12 million monthly active users. They engage users in vertical communities focused on mobile technology, healthcare, automotive and gaming. They're able to convert those users through third-party developers, including gaming, advertizing, and merchants. They are able to monetize those conversions using virtual currency and goods, as well as mobile advertizing and referral fees.

This is an extremely important initiative by NQ Mobile, as we already had an outstanding user acquisition engagement and conversion engine. Feiliu's platform adds unique interest-based community engagement capabilities, and new monetization capabilities such virtual currency and advertisement. As we brought in the services we offer to our consumers and offered jointly to MediaTek consumers through our investment in [baseline] technology through their premium messaging platform, we remain excited about the growth prospect that these investments can bring to our Company.

We're excited that the prospect will continue our evolution as a leading mobile Internet platform and services company, and look forward to sharing more details on our strategy at our Analyst and Investor day that we're hosting tomorrow in New York.

With that, I now turn the call over to our CFO, Suhai Ji, to speak to the third quarter financials and operational results.

Suhai Ji - *NQ Mobile Inc. - CFO*

Thank you, Omar, and hello to everyone on the call. At outset, please note that unless stated otherwise, all the numbers I will discuss today are in US dollars.

So we are happy to report another strong set of results for the third quarter 2012, and this marks the sixth consecutive quarter since IPO that we delivered on and above promise to our shareholders.

In the third quarter, we again saw strong user growth and reached new highs in all three sets of operating metrics that we disclose. Our cumulative registered user accounts reached almost 242 million at the end of the third quarter, up 97% year over year, and 19% sequentially. Overseas users now account for 41% of total registered user accounts, up from 36% at the end of the third quarter of 2011, and 40% at the end of the previous quarter.

Our average monthly active user accounts were about 85 million for the third quarter of this year, up 98% year over year, and 22% sequentially. Active user accounts continue to make up about 35% of the registered user base, and the breakdown between China and overseas are similar to that of registered user accounts. So those ratios have been quite constant for the past two years.

Our average monthly paying user accounts were about 8.2 million for the third quarter this year, up 65% year over year, and 11% sequentially. Overseas paying users now account for 32% of the total paying users compared with 30% for the third quarter last year, and 30% for the previous quarter.

The conversion ratio from active to paying users was 9.7% compared with 10.7% from the previous quarter, as we had yet to turn on the payment option in certain markets while experiencing strong active user growth across all markets. Also in the third quarter, we increased our preload, or pre-installation effort for the China open market channel, with a free version of NQ Mobile product, which resulted in a rapid increase in active users who have not yet been converted to paying users.

As I discussed in the previous earnings call, we will continue to experience fluctuations in both directions as we expand globally and adopt different market strategies.

The overall increase in our user base was driven by both external factors such as the growth in the smartphone industry, the continued proliferation of mobile Internet applications, and the increased awareness of mobile security among consumers worldwide. It also reflects our execution ability to establish effective user acquisition and payment channels, and to continuously improve existing products and launch new products to build user traction.

Now on to the financials. Total net revenues were about $26 million in the third quarter, up about 127% year over year, and 29% sequentially. The increases were mainly due to the strong growth in revenues from premium mobile Internet services, revenues from other services, and also revenue contribution from NationSky, which amounted to $4.5 million in the third quarter.

Net revenues from premium mobile Internet services increased 77% year over year and 14% sequentially to about $18 million in the third quarter of this year. The increases were primarily due to the strong and steady growth in the number of paying user accounts, which reflected growth in the number of registered and active user accounts, as well as increased use of NQ Mobile's premium services, particularly among the overseas paying user accounts, which generally pay a higher subscription fee.

Revenue contribution from overseas users accounted for 54% of total net revenue from premium mobile Internet services in the third quarter this year compared with 50% in the same period a year ago, and 51% in the previous quarter.

In terms of average revenue per user, or ARPU, as measured on a quarterly basis, our blended quarterly ARPU were $2.24 for third quarter of 2012 compared with $2.08 for the same period a year ago, and $2.18 for the previous quarter. ARPU for domestic China users was $1.52 for the third quarter of this year compared with $1.50 for the same period a year ago, and $1.51 for the previous quarter, so it has been quite stable.

ARPU for overseas users was $3.75 for the third quarter of this year, compared with $3.41 for the same period a year ago, and $3.73 for the previous quarter.

Just like the conversion ratios from active to paying for overseas users, overseas ARPU also tend to fluctuate, because it depends on the pricing strategy we set in each country and the timing when we turn on the billing switch. But as the overseas pricing is generally higher than China, and overseas revenue carries more and more weight, we expect the blended ARPU to trend up over time.

Net revenues from other services in the third quarter, which include revenues from NationSky, increased 643% year over year and 91% sequentially to $7.4 million. So excluding the revenues of $4.5 million from NationSky, net revenues from other services were $2.9 million, representing an increase of 197% year over year, and 20% sequentially.

The increases were mainly due to the growth in revenues from secured download and delivery services for mobile applications produced by third parties. The strong growth -- sorry, the revenues from NationSky increased 218% sequentially to $4.5 million in the third quarter due to the strong growth in its enterprise business and the new customer gains. Also, the last quarter revenue for NationSky only included the month of June post the completion of the acquisition.

So excluding revenue from NationSky, net revenues from other services as a percentage of total net revenue was 14% in the third quarter, compared with 9% in the same period a year ago, and 13% in the previous quarter.

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

So 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 expense line items, and we have included a reconciliation table in our earnings release showing the detailed calculation.

Cost of revenues in the third quarter was $8 million, representing an increase of 264% increase year over year, and 70% sequentially. Excluding $3.4 million of NationSky's contribution, cost of revenues increased 110% year over year, and 28% sequentially to $4.6 million. The year-over-year and sequential increases were primarily due to increased customer acquisition costs as a result of more users acquired in the third quarter, and higher revenue sharing with mobile payment service providers consistent with the increase of revenue from them.

Gross profit in the third quarter was $17.8 million, representing an increase of 95% year over year and 17% sequentially. Gross margin, or gross profit as a percentage of net revenues, was about 70% in the third quarter this year compared with 81% for the same period a year ago, and 77% in the previous quarter.

Excluding the impact from NationSky, gross margin was about 79% and 81% in the third and second quarter of 2012 respectively. So given NationSky's lower margin business nature, gross margin is expected to decline further in the fourth quarter of 2012 as NationSky's revenue contribution becomes greater. NationSky's gross margin in the third quarter and second quarter of 2012 were about 25% and 20% on a standalone basis respectively. And the cost of revenues for NationSky primarily consist of the hardware device procurement cost.

Now on to the operating expenses. For the third quarter of 2012, third quarter of 2011, and second quarter of 2012, we recorded total SBC expenses of $7.8 million, $2.7 million, and $5 million, respectively, across the three operating expenses line. The significantly higher SBC in the third quarter this year was primarily due to the SBC impact of newly-hired executives and employees, and acquisition of NationSky, which are also the main reason contributing to the GAAP operating loss we had this quarter.

So to make the quarterly comparison more consistent, I would like to address the following line items on a non-GAAP basis, which excludes SBC expenses.

So non-GAAP spending and the marketing expenses were about $5 million in the third quarter, representing an increase of 252% year over year, and 40% sequentially. The year-over-year and the sequential increases were primarily due to higher marketing and advertising spending and higher staff costs as a result of an increase in salary and headcount.

Non-GAAP general and administrative expenses were $4 million in the third quarter, representing an increase of 92% year over year, and 10% sequentially. The year-over-year increase was primarily due to higher staff costs from salary and headcount increases, higher legal and professional fees, and higher consulting fees resulted from acquisition and investment activities made from the second quarter of 2012; while the 10% sequential increase was primarily due to the higher staff costs, higher traveling, and the entertainment costs partially offset by lower office-related expenses.

So non-GAAP research and development expenses were $2.3 million in the third quarter, representing an increase of 123% year over year and 35% sequentially. The year-over-year and sequential increases were primarily due to higher staff costs from salary and headcount increases.

So as a result, non-GAAP operating income was $6.8 million in the third quarter this year, representing an increase of 44% year over year, and 4% sequentially. Non-GAAP operating margin was 26.4% in the third quarter of this year compared with 41.6% in the third quarter of 2011, and 32.8% in the second quarter of 2012.

So excluding the impact from NationSky, non-GAAP operating margin was 29.8% and 34.5% in the third quarter and second quarter of this year respectively. NationSky's operating margin was about 10.3% and 10.4% on a standalone basis in the third and second quarter of 2012 respectively.

We had a foreign exchange loss of $0.2 million in the third quarter compared with a gain of $1.6 million in the same period a year ago, and a loss of $0.3 million in the previous quarter. The foreign exchange loss was primarily attributable to the depreciation of RMB against US dollars, as the significant portion of IPO proceeds were converted into RMB and placed in bank deposits since the second quarter of 2012 (sic).

And we continue to record interest income in the third quarter resulting from our strong cash and deposit position. Interest income was $0.8 million in the third quarter of this year compared with $0.5 million in the same period a year ago, and $0.8 million in the previous quarter. So the significant year-over-year increase was primarily due to the higher term deposit position.

Income tax expenses were $0.3 million compared with $0.08 million in the same period a year ago and $0.12 million in the previous quarter. So the sequential and the year-over-year increase are mainly due to the more taxable profit generator. And we expect our effective income tax rate to remain relatively low for the remainder of 2012.

Net income attributable to NQ Mobile was $0.3 million in the third quarter compared with $4.3 million in the same period a year ago, and $2.1 million in the previous quarter. Again, the decline in net income is mostly due to the higher SBC expenses in the third quarter.

Non-GAAP net income attributable to NQ Mobile was $8.1 million in the third quarter compared with $7 million in the same period a year ago, and $7.1 million in the previous quarter. On an EPS basis, our third quarter GAAP earnings per ADS is about 1p on a diluted basis, and the non-GAAP earnings per ADS is about [$0.16].

In the third quarter of 2012, we continued to generate strong cash flows. Our net cash flow generated from operations for the third quarter was $6.9 million compared with $2.6 million for the same period a year ago, and $1.9 million for the previous quarter. As of September 30, 2012, the Company had a total cash position of about $126 million, about $35 million in cash and cash equivalents, and $91 million in term deposits and a deferred revenue of $10.9 million.

So looking forward to the fourth quarter of 2012 and beyond, we expect net revenues to be in the range of $28.5 million and $29.5 million for the fourth quarter of 2012, thereby raising our net revenue guidance for the full year 2012 from the previous issued range of $86 million to $89 million to the new range of $90 million to $91 million. And the Company also initiates its revenue guidance for 2013 to be in the range of $150 million and $155 million.

So please note the above guidance for 2013 does not include the impact from the just-announced Feiliu acquisition.

So this concludes my remarks. And lastly, as a reminder, I'll encourage all of you to attend in person or watch through the webcast of our analyst Investor Day tomorrow, starting at 1pm New York time.

So I will now hand the call over to the operator and open the line for questions.

Operator?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Mark Murphy, Piper Jaffray.

Mark Murphy - *Piper Jaffray - Analyst*

Congratulations on a strong quarter. I wanted to begin by asking you about the conversion rates at TCC and A Wireless. You had mentioned a number of 20%. I wanted to -- and I think you said in some cases 50% conversion rates. That is just a lot higher than I would have expected. I think we were seeking 10% to 20% maybe.

I want to make sure that we heard you correctly, and what is --? Is the 20% number a blended average of the stores that are online thus far? And maybe how do those conversion rates compare to what you had hoped when you entered into those arrangements?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

So I'm going to start. Hi, Mark. Thanks for the question, and I'm going to start and then I'm going to let Gavin also provide some additional insight.

Yes, so what I shared on the call itself from a components perspective, was absolutely was from it was from A Wireless; it's a blended average of the stores that they've launched. And when I said the statement that I did, which is higher-performing stores are at 50% or above, it all has to do with the performance of individual stores where we have -- where the training has taken hold, where the store manager is personally engaged and is even using the product. It all has to do with training.

And so what we're trying to do is to get as many of the stores replicated at the higher-performing rates as possible, and that has to do with the engagement with the store manager, with the amount of point-of-sale material that we put out there as well as the training that we provide the store managers and their sales force.

And so that's partly what you and I -- we chatted about on the last conference call is we were making a pretty large investment throughout the quarter, as well at the end of Q2, to make sure that training was proper for the stores. And I'd promised that during the Q3 conference call we'd share some insights or some data around what we're seeing.

So absolutely the blended average is above 20% already our internal, estimates, and that's just for A Wireless for now. We'll share additional data over time. But as you just mentioned, we've -- internally, we had a range of forecasts. We're very pleased with the way the numbers are coming in right now and we continue to think there's opportunity to continue to improve that attach rate as well.

So, Gavin, any --?

Gavin Kim - *NQ Mobile Inc. - Chief Product Officer*

Yes, not to labor the point, but, yes, the deals that we have already launched in market, obviously is A Wireless. We're in with the TCC Moorehead relationship as well.

Yes, those channels are -- they're performing well. We, like Omar had mentioned, we're seeing attach rates north of 20%. We think there's clearly a lot more headroom in the business. A lot of it for us is -- frankly we're still learning how to execute within that channel. Omar mentioned a lot of the key success factors for us. A lot of it goes back to training. A lot of it does go back to just understanding how to work through the sales process.

This is still in the US market, we're calling it assisted sale. And so that process of working through the retail channel to educate the retail sales professionals on how to actually position security is something that we're learning, our channels are learning, and we're taking clearly some best practices and trying to roll them across the channels that we have in market today.

Omar Khan - *NQ Mobile Inc. - Co-CEO*

And then one additional point, Mark, is that, again, that's just mobile security. We see the opportunity as we're heading forward to launch -- we're going to be launching NQ Family Guardian in that same channel as well. So our team right now, Conrad Edwards and his team, our Chief Experience Officer is actually, he's going to be sharing some more details tomorrow at the Investor and Analyst Day, but we're developing point-of-sale material to make sure that as a parent is walking into a store that there's point-of-sale material that's engaging the parent at the store that says if you are here to buy your kid a smartphone, don't walk out of here without buying NQ Family Guardian. And we are making sure that we're putting the right investments in place to convert other products that retail as well.

So I think we've talked about the strategy. We've put retail in place, and one of the benefits of it is the low incremental or marginal cost of adding new products into that channel. And that's something that we are going to fully take advantage of with the launch of our additional products.

Mark Murphy - *Piper Jaffray - Analyst*

Okay, great. And, Omar, just want to see if I'm digesting this correctly. From our side of the fence here, can we extrapolate that 20% out across all these stores, say the ones that haven't rolled out yet, and as we think through, there's A Wireless, you have a whole slew of new agreements I think in the UK and Australia. Are you throwing this number out so that we can start thinking about that as a broader global average across these types of retail stores? Or would you -- you think we should maybe remain more conservative than that until we learn more about some of these other stores and geographies?

Gavin Kim - *NQ Mobile Inc. - Chief Product Officer*

So our experience, I think what we're relaying to you has really been our experience in the US market. Clearly, the channels that are now under full execution are very specific to A Wireless and TCC.

As you know, we've announced a number of additional relationships, including Wireless and Go Wireless, epay in Australia, Phones4U in the UK. A lot of these other channels, a lot of these other markets, are sterling markets, so we've got to go through that same learning process. I think if you would ask the people here in the room that question, I think we'd say we're all very optimistic those channels are going to execute really well for us, especially as we move overseas, specifically in the UK and into Australia, we're going to have to experiment, we're going to have to figure out what the right model is, what the right experience is at retail in order to [convert].

But to put it into perspective, in the United States, the 20% number that we have shared, that has been a number that has grown over time. If you asked us that question a month ago, it would have been a different number. So we're continuing to see a lot of headroom in the channel. We want to keep growing it, keep building it out.

Omar Khan - *NQ Mobile Inc. - Co-CEO*

So, Mark, as we launch, obviously it starts at a lower number and has [ramped] to this perspective. So as you think about bringing additional stores on line, they come on line, so there are two factors. One is stores coming on line themselves and then working up to this type of attach rate and then beyond it as well.

So there's obviously a phasing from -- purely a deployment perspective, and there's also a phasing in terms of growth rate around attach rates that you have to model.

Mark Murphy - *Piper Jaffray - Analyst*

Okay, great. Got it. Thank you, Gavin and Omar. I appreciate that. I wanted to ask you as well about the longer term. I guess I call it the strategic role of some of the more traditional security products to your business model. What I mean by that is products like the [Core Antivirus]. You're rolling out some of these very exciting new products like Vault and Family Guardian, which are -- I guess you could argue they're security oriented types of applications, I suppose, but they have a very innovative, modern and different feel to them, and flavor to them.

And so I want to try and understand how you're looking at this. And do you think that a few years down the road that the traditional security products are going to be more of a minority role in the business?

Gavin Kim - *NQ Mobile Inc. - Chief Product Officer*

If you think about mobile security by itself, we share a business still being very regionalized, meaning the industry is [to sell] to people that we compete with. They are very regional competitions, and I think we've continued to win business, or we're widening the gap on the merits of really our core technology platform. The ability of our own model basically to engage and convert customers; and then clearly, just a proven capability and credibility of the business that we've earned over time.

You're right. I think we recognize that there is just an explosive opportunity and need to try to drive broader security capabilities, and I think the way that we think about it is not security as a kind of endpoint security pure play, but it's really more about this migration to a trust services opportunity, and hence the reason why we've [tucked] in products like Vault and Family Guardian.

We've seen a lot of strong interest from our partners. They are looking for companies who can deliver end-to-end solutions to them. And it's not purely just only about security, it is really about this idea about a trust service platform, or a trust service suite. and really on that basis -- and frankly, the reason why, if you look at some of the retail relationships that we have announced, even with Go Wireless and Wireless, they are going to roll out all three of them, as an example, in the US market, and that's just obviously an example only.

But I guess for us, we see the opportunity for us to see these other products as really engagement points. The more people engage with our product, the more opportunity that we then have to drive through the conversion opportunity. And that happens either in the form of cross-sell, but also product bundling. Product bundling is an example I mentioned before where at retail, somebody might choose to buy a whole trust package which would include Vault and Family Guardian as well as security. But also just experiencing the app itself, we are already doing things like cross-selling of Vault through the application itself.

So for us, it is about using security as the foundational layer in the Company, but then driving additional increment trust services on top of that.

Mark Murphy - *Piper Jaffray - Analyst*

Okay. Great, fantastic. Appreciate that very much. I wanted to move on, and another one, if I may. Just in terms of the competitive dynamics, say, within China versus globally, as you are expanding here, and quickly becoming more of a global footprint, what do you see in terms of just the presence and the effectiveness of the various competitors in the different markets, and maybe also the willingness to pay on the part of the consumers?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

So from a competitive dynamics perspective, if you look at the traditional core security business that we've built our business on top of, the dynamics remain quite stable in terms of what we have seen. The competitive set that we've talked about over the past few quarters are the same ones we're running into both in China and outside of China.

We do see an opportunity to -- now as -- just to piggy-back on what Gavin said, outside of China, for instance, as we broaden the set of services that we offer to drive trust in the mobile ecosystem in terms of different constituencies, constituencies looking for, let's say, an encryption solution, or constituencies looking to protect their kids from a smartphone perspective, or the enterprise constituency looking for a BYOD solution, we see a broadening of maybe the competitor set that we may have otherwise gone up against.

So there's point -- so we have [N10] solutions that individually there's point competitors in regions that we run up against, but from an end-to-end perspective, there is much fewer competitors that offer the entire suite, everything from consumer endpoint security to consumer privacy and encryption solutions as well as for family services, family protection services as well.

So as we engage with channels our customers are looking for more of an N10 solution, that competitive set around the world continuously diminishes. But we do have competitors, as I mentioned earlier, that are in the point solution. ?So we have competitors that are providing family solutions, as an example. There's competitors in the enterprise business; competitors in the consumer endpoint security [base], and those dynamics haven't changed. I think what's changed for us is that we are able to engage our customers more broadly in an N10 solution where we give them an opportunity with one engagement, with one support structure, with one marketing support engine, with one point-of-sale system in terms of channel marketing, etc., to be able to sell a broad set of solutions. So it's not just about having to partner with three different partners or two different partners, it's all [product] solutions so the offering itself I think gives us a competitive advantage.

Inside of China, it's a traditional competitor set that we talked about. We continue to see tremendous growth in our China business from user acquisition perspective as well as from monetization perspective. It's the same [folks]. Although I will say that if you look at the strategy that we've started to unveil, both with the investment and [new time] technologies in terms of joint venture with MediaTek, as well as the investment and acquisition that we announced today related to Feiliu.

We see an opportunity, Mark, that we've got an engaged customer set in the China market, as an example. We believe that there's an opportunity to broaden the set of applications and services we can provide to them and monetize in a broader variety of ways. It's an element we've talked about in the past, but now we're giving obviously a broader lens to it.

So as we think about, for example, the investment in Hesine Technologies is an investment that brings to us the ability to develop, co-develop and integrate the trust services suite into a product platform that's a premium messaging or premium messaging platform, and that's a daily act of engagement user product. That's somebody engaging with a product or service through messaging, email, IM, SMS, on a multiple times a day basis.

So we believe we can -- we believe we have the opportunity to complement that service with security, as well as open the door for other services, whether it's through the Feiliu acquisition or other third party developers, and then be able to monetize not just the premium service offering through carrier billing or subscription services, but also start to monetize that traffic through other means, whether it's referral fees, whether it's advertising and beyond.

So I think that gives you an understanding of -- hopefully, it gives you an understanding. And you can definitely ask a follow-up question that within the China market, we are broadening beyond -- even though the secured business is growing stronger, we see an opportunity to leverage the platform that we built, complement it with pieces from the Feiliu acquisition as well as from the Hesine Technologies investment, and have a broader offering with a broader monetization opportunity.

Mark Murphy - *Piper Jaffray - Analyst*

Okay, great. I think I got all that. And, Omar, finally from me, I think, my phone connection wasn't perfect, and forgive me if I completely misheard this comment in your prepared remarks, but I thought you said something about adding private messaging with Facebook content. I'm not sure if I got that right, but any clarification there would be appreciated, because I don't think I've heard you articulate anything that way before.

Omar Khan - *NQ Mobile Inc. - Co-CEO*

Yes. So it was in the Vault product. Actually, I'm going to let Gavin talk about that.

Gavin Kim - *NQ Mobile Inc. - Chief Product Officer*

Yes. Sorry, Mark. It's really within Vault, and this is our current release that's available on both IOS as well as on Android. We've basically enabled you to encrypt and secure messages between Facebook contacts, and that's part -- again, that is already commercially available on both IOS as well as Android.

Mark Murphy - *Piper Jaffray - Analyst*

Okay. So, that's something you already -- you're already monetizing that; that's already reflected in some of the Vault business that you're doing?

Gavin Kim - *NQ Mobile Inc. - Chief Product Officer*

We've already released it. It's actually a free feature.

Mark Murphy - *Piper Jaffray - Analyst*

A free feature. Got it. Okay, thank you very much.

Operator

Mike Walkley, Canaccord-Genuity.

Unidentified speaker

This is (inaudible) for Mike Walkley, actually. Mike's on a delayed flight to your Analyst Day. Congratulations on the great quarter, and I have a couple of questions, if I may. The first one is for Suhai. Given the acquisition that you've announced today, for modeling purposes, what kind of a weighted average diluted share account should we be thinking about in the fourth quarter and 2013 perhaps?

Suhai Ji - *NQ Mobile Inc. - CFO*

Yes. From the earnings call we just released, our weighted average share account increased from $50.1 million in the last quarter to about $51.2 million this quarter. We think we will see a gradual slight increase in this share account because there are options exercised by the employees; and also, there are certain options or shares that we invested from the certain small-scale acquisition investment that we made -- acquisitions basically in shares that we made that we'll be investing. But I do not have an accurate estimate in terms of what number that will be, but we think it will be more gradual in terms of share account increase.

Unidentified speaker

Okay, great. And perhaps, Omar, staying on the retail channels, obviously, significant deal momentum this quarter. I just wanted to talk about what kind of strategies are you using for in-store promotion and product placement and pricing in these retail channels; and how easy is it to replicate this at, say, another retailer, or, say, in the international markets?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

So, yes, we spent a lot of time, Sid, on getting it right the first -- with these first couple of launches. We put a lot of attention and energy, and we still are, by the way, and we don't believe -- as Gavin mentioned, we don't believe that we fully -- despite the fact that we're seeing good results, please don't believe there's opportunity to improve our capability at the point of sale.

So Conrad and his team, who runs basically Marketing and Consumer Experience for us, we've got a handful of engagement techniques that we're using, and we're going to share a little bit more -- actually, a lot more detail tomorrow at our Analyst Investor Day, which I know Mike will be attending, everything from point-of-sale materials that are physical materials, whether it's brochures, floor-standing displays, window-cleaning. And then, from a pricing strategy perspective, Mobile Guard is an example of a price today at $19.99 at retail for consumers, and there will be pricing strategies revealed shortly thereafter for additional products.

So it's a very good offer that we go to retail with. We create a margin opportunity for the channel selling it which allows us to engage and get -- and the incentive structure is aligned so that the channel is well intended to sell the product as well. So from a scalability perspective, the amount of time we've spent, Sid, in terms of making sure that we are able to do this right, it is scalable.

So as we launch, when we go from 300 stores to 500 stores to 1,000 stores to 1,500 stores to 2,000 stores specifically in the US market, we believe the strategy scales very, very well. It's not that we -- we don't have to start from scratch or zero to be able to engage these channels, and we're also -- when a channel runs out of material, we've created a process by which they can reorder those materials for each of those individual stores. And we're continuously improving that process as well and we've also brought on customer care capabilities here in the US as well.

Internationally, I think Gavin alluded to this earlier, we are initially going to follow the best practices that we've learned here in the US, but we will not necessarily -- we're not going to have our blinders on. We do not believe that the US model is a one size fits all. So we're going to be very careful in understanding the feedback from the channels, both Australia and the UK, as we launch Harvey Norman and Phones 4u, to make sure that we understand how we will be able to engage through those channels, what the user feedback is, what the difference is in terms of consumer engagement and selling techniques.

Obviously, the best resource we have, Sid, is the fact that we're engaged with retailers who actually know how to sell to their customers, and that's the best feedback that we can have is listen to them how they sell devices and cell phone services today, and then give them the materials that they need rather than imposing necessarily our strategy upon them. We have a very collaborative process with the retailer because it's not necessarily -- internationally it may not be a one size fits all strategy. It's working well to date, and our hope is that we continue to work very closely with the channel to help launch it and scale it.

Unidentified speaker

Great. And just one last from me. In terms of the customer acquisition costs, now that you have retail channels and there's -- you're having in-store promotions and other customer acquisition costs associated with it, how should we view this customer acquisition cost trending essentially? Perhaps you can talk about this anecdotally. Is it higher or lower in certain geographies or certain product categories or in certain user acquisition channels perhaps?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

I think Suhai and I can tag-team this. Obviously, every channel has a different structure in terms of acquisition costs. The digital channels or [asteroid] channels, user acquisition costs come primarily from advertising or other types of fees associated with acquiring users in other channels.

When we talk about acquiring users through retail channels, it's -- there's channel marketing costs that we have in the sales and marketing line that go to supporting those channels, but there's no specific user acquisition costs other than the channel margins that we have to absorb, but those are already netted out when it comes to a net revenue basis.

So there is no cost of sales associated with user acquisition. The net margin already reflects channel margins -- sorry, the net revenue already reflects channel margins that we would have to pay to the retailer for their cut, and they're intended to be able to market and sell that product at resale as well. We do have channel market costs in terms of point-of-sale material, etc., that go into our sales marketing line, but I'll let Suhai add a little bit more color on that.

Suhai Ji - *NQ Mobile Inc. - CFO*

Yes. I think if you only talk about user acquisition costs mostly we pay, it's really for the online user acquisition, and also for the pre-installation. Those are on a CPA basis, which is cost per action. We pay for the [registered] user that's generated through those different channels, and those vary in terms of pricing greatly from one market to another. For example, China usually is much cheaper than in overseas market.

And those user acquisition costs are part of our cost of sales, and as we increase our effort on both online acquisition and [pre-installation], that cost will go up, just like in this quarter, [and so] the gross margin for the NQ Mobile, excluding NationSky business dropped about 2%, and that's mostly due to the user acquisition efforts that we put up.

On a blended basis, our average user acquisition costs are between $0.02 to $0.07 per additional, per new registered user. So that's where our cost is.

Then for the other marketing, all the channel marketing, all the advertising that we do, not on a CPA basis, those fall under the sales and marketing expenses.

Unidentified Participant

Great, thanks. I'll pass along.

Operator

Andy Yeung, Oppenheimer.

Andy Yeung - *Oppenheimer & Co. - Analyst*

My first question is about your Feiliu acquisition. Can you [give us a sense] then how Feiliu fits into your product offering? And also, what kind of synergies do you expect from Feiliu? And also, what's the current revenue run rate for Feiliu and margins?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

I will take a shot at answering that question.

We're going to talk about this in detail actually tomorrow during our Analyst and Investor meeting. I know we've given a bunch of plugs for that, but we definitely want to leave some of that information for tomorrow, because I think it makes a lot more sense in pictures and on charts when we show it to you.

But I think Gavin and I both talked about how Feiliu fits in from a product platform strategy perspective. So if you think about the fact that we've got a set of services that we then can augment in terms of customer engagement through the vertical communities and increase the engagement with our services using that strategy, that's one aspect of it from the services perspective.

From a components perspective, they have a lot of different components, everything from user profiling to intra-space profiling. And in terms of how they pick those users and how they engage those users, and how to identify what products and services to sell through to those users, that's very valuable information that we can use to then complement the monetization opportunity.

So if you think about the monetization capability, Andy, that we've had to date, that we've done really well, we've done digital sales very well, where we've built through carrier bill and premium, other premium, capabilities such as subscription services.

In addition, our retail activation and retail sales, what Feiliu brings us is it augments your billing capability, virtual goods, virtual currency, advertising monetization. So you can see that it completes the picture when it comes to -- we call it billing or monetization.

So every stage of the value chain of our business we believe that the Feiliu acquisition is complementary in terms of how we look at it, in terms of how it fits into our business model.

From a revenue perspective, obviously, we've talked about the fact that we see Feiliu as earnings accretive in 2013. It's a high-growth business. We're going to share additional details with you and with our investors as the acquisition closes. But currently, from a revenue outlook perspective for 2013, our expectation range is about $20 million to $25 million is what we're forecasting for the Feiliu business.

Andy Yeung - *Oppenheimer & Co. - Analyst*

Great, thanks for that. I look forward to more details tomorrow.

My next question is about growth opportunities. You have recently launched a host of new products and expanded geographically. So in terms of your top monetization opportunities, in terms of geography of products, can you give us the top one or two that you think have the most incremental opportunities for monetization next year?

Omar Khan - *NQ Mobile Inc. - Co-CEO*

So I think the way I think about it is our core security business continues to provide significant opportunities for growth globally. And what I mean by that is the fact that it's a continued -- it's still a very early market when it comes to mobile security. In markets like North America, Latin America and Western Europe, we see continued upside in terms of penetration opportunities for mobile security in these markets. And we still see continued growth in the emerging markets, whether it's China, Middle East, South East Asia, India, etc.

So that still remains a very, very important growth factor for our business for us, and enterprise continues to be a big opportunity as well. So we've seen success with our mobile managed services product line that we've commercialized or that NationSky has commercialized. Security sits very, very nicely within that portfolio.

So when you think about mobile application management, mobile content management, mobile device management, security is a very core component of what you need to offer a holistic solution or a complete solution to an enterprise. And so the enterprise opportunity that we see, both in China and abroad, is still significant.

And then when we think about the rest of the trust services offerings, whether it's privacy products or family-oriented products that drive trust within the mobile ecosystem among these other constituencies, those are, again, layered components of growth that we see globally.

As an example, Family Guardian, you're touching a segment that is fairly -- to a certain degree, it's fairly price insensitive. Parents will spend to a certain degree what they need to spend to protect their kids in that environment. And we've seen tremendous feedback on this product, both from tech reviewers, from media, as well as from parents themselves on what this product does and how important is for them to have it.

So we're targeting a very enthusiastic segment that has -- obviously, we're going to price it correctly, but there is a high degree of conversion opportunity for that segment. So we see growth opportunities coming from Family Guardian as well.

And then I think tomorrow, we'll talk a little bit more detailed about what monetization opportunities are created by Feiliu and the business integration when it comes to how that plugs into our platform, because I could spend probably 10 or 15 minutes talking about it, but I think we'll go into it in more detail. It's really exciting.

Andy Yeung - *Oppenheimer & Co. - Analyst*

Right. And one more question about your M&A strategy. Obviously, you still have a very strong balance sheet with more than $120 million in net cash, and you've made some new acquisitions and investments this year, NationSky, Feiliu and Hesine. So can you give us some color in terms of your overall M&A strategy? What other areas are you looking into, and what criteria do you use when you're making an investment?

Will Jiang - *NQ Mobile Inc. - Chief Strategy Officer*

So for companies that have really good revenue and profit track records and are earnings accretive, and really have clear synergistic products and business models, such as Feiliu and NationSky, we would consider acquiring a majority stake or 100% of the company to maximize the synergy and collaboration potential.

Another possibility would be we would also consider consolidating competitive offerings to increase our market share globally. And also, we would like to share more insights on our Investor Day in the strategy session. We would like to share with you some of the detailed strategy going forward in terms of making [early] investment to complement our core offering and platform offering in a detailed manner more.

Andy Yeung - *Oppenheimer & Co. - Analyst*

Great. I look forward to the Analysts' Day tomorrow, and congratulations again on a very solid quarter.

Operator

There are no further questions at this time. Please continue.

Michelle Ma - *NQ Mobile Inc - Director of IR & Corporate Development*

Thank you, operator. If there's no further questions at present, we'd like to conclude by thanking everyone for joining us on the call.

We welcome you to reach out to us directly by emailing investors@nq.com should you have any questions or requests for additional information; and would encourage you to visit our investor relation website at ir.nq.com, where you can find numerous resources and materials, including the recording of the previous earnings webcast.

This concludes NQ Mobile's earning call.

Operator

Ladies and gentlemen, that does conclude the conference for today. Thank you for participating. You may all disconnect.