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NQ - Q1 2015 NQ Mobile Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the NQ Mobile's first quarter 2015 earnings conference call. (Operator Instructions). I must advise you that this conference is being recorded today, Wednesday, May 20, 2015. I would now like to hand the conference over to your first speaker today, Dahlia Wei, Investor Relations Director. Thank you. Please go ahead.

Dahlia Wei - *NQ Mobile Inc - Director IR*

Good evening and good morning in Asia. We welcome you to NQ Mobile's conference call to discuss the financial results for the first quarter 2015. On this call tonight is our Chairman, Dr. Vincent Shi, our CEO, Mr. ZeminXu, our Vice President of Strategy and Investor Relations, Bryan Zhou, and Vice President of Capital Markets, Matt Mathison.

We thank you for joining us. Before we begin, here is our Safe Harbor disclaimer. Please note that the discussion today will contain certain forward-looking statements, made under the Safe Harbor provision of the U.S. 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 obligations 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 direct comparable U.S. GAAP financial measures, and the information reconciling those non-GAAP financial measures to NQ Mobile's financial results prepared in accordance with U.S. GAAP, are included in our earnings release, posted earlier today.

Finally, as a reminder, this conference call is being recorded. We're also offering investors a webcast of today's conference call which can be found on the Investor Relations portion of our website, at ir.nq.com.

I will now turn the call over to Matt.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Thank you, Dahlia. We thank you all for joining us today. The call today will go as follows. Our Chairman, Dr. Vincent Shi, will make some remarks, followed by our Chief Executive Officer, Mr. ZeminXu. Bryan Zhou, our VP of Strategy, will then provide an update on our businesses and operating trends. I will then review the financials and outlook. We will then open up the call for Q&A. Dr. Shi, please go ahead.



Vincent Shi - *NQ Mobile Inc - Chairman, COO& Acting CFO*

Thank you Matt and thank you everyone for joining us today. We continue to be focused on executing our business plan. We have the right management team and structure in place to feel confident in our future growth plan. We will remain focused on delivering growth, while remaining strongly-positioned in the vast mobile Internet landscape. I will turn the call over to our CEO, Mr. Xu.

ZeminXu - *NQ Mobile Inc - CEO*

Thank you, Vincent. I am pleased with the performance of the entire team during the first quarter. The various organizations and the business leaders executed according to our plan and positioned us very well going forward into the second quarter to feel very confident about our plan for 2015. I am pleased with their efforts and I wish to thank them all for their diligence. We remain committed to a record revenue year, and we will see our profitability expand, as this year progresses. I will now turn the call over to Bryan Zhou.

Bryan Zhou - *NQ Mobile Inc - VP Strategy & IR*

Thank you, Zemin. On the last conference call, I described who NQ Mobile is by highlighting the three parts of our business. Number one, FL Mobile, which is our game publishing, advertising business. Number two, our B2B business, which is our enterprise mobility segment. And number three, our traffic generating applications which we are beginning to monetize this year. I want to provide an update on these businesses and also discuss for the first time a new branding and structure description for our Company.

In the most simple form, NQ Mobiles products can be broken into two different categories. Number one, entertainment products and, number two, technology products. The entertainment products include those within our FL Mobile game publishing and advertising business and all of other applications we have previously discussed, like NQ Live, Music Radar, and Showself, to name some.

Today we would like to simplify all of these other entertainment products by announcing that we will be re-branding many of them under the Showself name. This is including Showself which we will be called our Showself Live Broadcast business. NQ Live which will rebranding Showself Desktop and Lockscreen. And Music Radar which will be called Showself Music Radar.

Now, let me provide some update on these entertainment businesses for you. As a reminder, FL Mobile consists of our game publishing and advertising business and is a major component of our growth. It is one of the leading mobile game publishers and operators in China.

One of the key strength in our FL Mobile franchise is that our gamers are much more mid to hardcore gamers, as opposed to many of other competitors, that they are focused more on the light and casual gamers. This helps our games have a relatively longer life circle than is normal in our industry. For example Gong Cheng Lue Di and Zhan Di Tank were launched over 12 months ago, and their revenues are still grossing robustly. PaPa Three Kingdom was launched more than 18 months ago and is still growing. Most mobile games' lifecycle is measured in weeks and months, not years.

FL Mobile is also very diversified, with no one single game contributing more than 20% of our game revenues. We view this as important. We do not rely on any one game or on any one game developer.

Finally, I wish to highlight that our FL Mobile's expansion outside of China is also tracking well. In fact, we are the sole operator of the Forsaken World by Perfect World, which is having tremendous success in Korea local market.

Our advertising business consist of both online and offline channels. At the end of the first quarter the total reach of our online and offline advertising business was more than 750m unique devices and users, up more than 20% quarter over quarter. In the first quarter, we grew the number of applications enabled on our platform to over 81,000. We look forward to continuous strong performance in our advertising business this year.

Now let me discuss our Showself business. I'll start with our Showself Live Broadcast business. Showself is our leading mobile social video platform, which has reached 3m monthly active users, which is up more than 600% from a year ago, and up around 20% quarter over quarter. It has already become one of the leading companies in this area in mobile. Also Showself has now become the 20% of our MVAS revenue segment, showing incredible sequential growth in the first quarter, compared to the fourth quarter.

Now, let me discuss the Showself Desktop and Showself Lockscreen, which were previously known as NQ Live and vLife. Showself Desktop and Lockscreen is our personalized interactive and programmable mobile desktop application, including dynamic wallpaper, launcher, and lock-screen.

At the end of the first quarter of the 2015, we have shipped this on more than 150m devices, achieved more than 65m MAUs and also have more than 35m daily active users. That is more than 42% growth quarter over quarter in MAUs and more than 62% growth quarter over quarter in DAUs. This continues to grow rapidly, and we look forward to more directly monetizing the traffic as the year progresses.

Lastly let me highlight Showself Music Radar, which was formerly known as just Music Radar. This is our audio-based searching application.

We are the world's second largest musical search engine by daily search queries and user, behind only Shazam. At the end of the first quarter of 2015, our Music Radar application has now seen 13.5m unique daily search. We are also seeing now almost 13m MAUs.

Next, let's discuss the technology products. This includes our many productivity applications, like NQ Mobile Security, Vault, and Family Guardian. It also includes our enterprise mobility solution, like MDM, MEAP and the mobile content management, that make up our NQ Sky solution. The third part of our technology products include our mobile healthcare solution.

Let me provide a brief update on our enterprise mobility segment. This segment mainly consists of both our NationSky and Trustek business. We are the leading provider of the integrated enterprise security and mobility solution in China. In a little more than a year, our MDM users grew over tenfold, to over 1.5m, from around 150,000.

Our customers include China Mobile, China Telecom, Agricultural Bank of China and many other large state-owned enterprises, government agencies and some other private companies like Shun Feng Express. Recently we entered into a new agreement with UCar Inc, the leading car rental service provider in China, to build and deploy advanced end-to-end mobile device management platform. In addition, we also had some new wins in development of security software for China Everbright Bank and China Minsheng Bank.

To conclude, NQ Mobile is made up of entertainment products and technology products. This is who we are. With that, I will turn it to Matt.

Matthew Mathison - NQ Mobile Inc - VP, Capital Markets

Thank you, Bryan. I know that understanding the key parts of our business, specifically FL Mobile, which is our game publishing and advertising businesses, our B2B or enterprise mobility offerings, and finally our traffic business, which will be rebranded to encompass our entertainment offerings, is critical in understanding who we are and what our future looks like. Thanks for walking through that again with us.

Now let us turn our attention to the financials. I wish to walk through some of the highlights and provide you with additional details and background, behind some of the results. Let's start with a discussion of our revenues in the first quarter of 2015.

As we mentioned last conference call, the first quarter is the seasonally-slowest quarter for us, especially in our advertising segment, as well as the portion of our enterprise business related to customized software and services. The Apple product cycle offset some of the other normal seasonal trends, which also boosted the hardware portion of our enterprise business beyond normal seasonality.

We generated \$89.2m in net revenues for the first quarter of 2015, exceeding our guidance and expectations.

There were really two drivers of upside in the quarter, relative to our own guidance. As I just discussed, the biggest one was due to strong, continued Apple product demand, as the timing of new product launches and supply availability carried forward from the end of the year.

The other driver of upside, relative to our guidance, came from the monetization of our entertainment products, primarily from our Showself business. We did begin to see revenues from our Showself Music Radar and Showself Desktop and Lockscreen applications, which were previously just called Music Radar and NQ Live or vLife.

However, our Showself Broadcast business is growing well ahead of our expectations and was already around 20% of our total MVAS segment in the first quarter. Our own data suggests that Showself is one of the leading mobile-only offerings of its kind. One of the things that will lead our Showself Broadcast business to even greater growth is that, in addition to the traditional host shows, we have started to introduce in-show gaming, where we are seeing some traction. This will be an important component of our monetization ramp within our Showself Broadcast business going forward.

The other revenue trends in the first quarter, included seasonality in advertising during the Chinese New year period, continued softness in premium consumer security revenues, and a seasonally weaker services performance with our enterprise mobility segment, which was all within our expected ranges.

I will point out that although our services revenues within our enterprise mobility segment declined from the fourth quarter, it is trending significantly higher on a year-over-year basis. And in fact we are off to a very strong start with our services component trending nearly 150% higher year over year. This trend will carry forward and we do expect software and services to grow sequentially throughout the year each quarter, which is an important element to our profitability expanding as this year progresses.

Next, I'd like to spend a few minutes discussing our gross margins and walk through some of the key elements within our cost of sales. As we expected, given the seasonality in the first quarter, especially in our advertising segment and services portion of our enterprise mobility group, we saw our gross margins in the quarter decline from the fourth quarter levels.

Obviously, the biggest impact to our gross margin performance is the revenue mix. In fact around 90% of the total increase in cost of sales in the first quarter of 2015 compared to the fourth quarter of 2014 is the result of products sold within our enterprise mobility segment. And combining that revenue mix with the seasonal drop in advertising, the mix of enterprise to consumer revenues grew to more than 50% of total revenues coming from our enterprise segment during the first quarter. When you exclude the impact from our enterprise mobility segment on our cost of sales, gross margins were around 39%.

However, excluding the impact from enterprise mobility revenue mix, there is one other important impact that we shared with you last conference call, but we wish to reiterate again to help you understand the gross profitability of our businesses excluding enterprise. The other meaningful increase in our cost of revenues, excluding the enterprise revenue mix, is in the revenue-sharing cost associated with app stores and other partners within our gaming business; and now that our Showself business is contributing more materially to our revenues, also the revenue-sharing component within this business.

This accounted for approximately the remaining 10% of the total increase in our cost of revenues in the first quarter, compared to the fourth quarter. This also now includes the cost of revenue sharing within our Showself live mobile social video platform business, where we have to account for the revenue-sharing with hosts and their agents as a cost of sales.

Let's now walk through our operating expenses. In the first quarter our operating expenses were down significantly from the fourth quarter. Total operating expenses in the first quarter was \$35.6m, down almost \$11m from last quarter.

The biggest portion of this improvement came from a significant drop in G&A expenses, mostly coming from significantly reduced share-based compensation expense. In fact our total SBC expense was \$12.5m in the first quarter, which I might add was the lowest total since I joined the Company in the middle of 2013. As we said on our last conference call, we expect share-based compensation expenses to trend down over time; while still fluctuating quarter-to-quarter given various performance conditions on our previous acquisitions, the trend will be down.

The other big improvement in G&A came from a significant decrease on legal and other professional fees.



The improvement in our overall operating expenses resulted in a lower net loss for the quarter, even as gross profits were also reduced. For the first quarter, total net loss attributable to NQ Mobile was \$17m, compared with the loss of \$21.2m the quarter before.

We also achieved non-GAAP income attributable to NQ Mobile of \$446,000 for the quarter or roughly \$0.0 per ADS.

Finally, let me conclude my review of the financial performance for the first quarter of 2015 by highlighting a few other key things.

First our balance sheet. We ended the first quarter with \$270.5m of cash, cash equivalents and restricted cash. We generated over \$9m in cash flow from operations during the first quarter as well.

I will now turn to our outlook for the second quarter and our updated view on 2015. We expect net revenues for the second quarter to be between \$102m and \$103m. And we are also updating our full year 2015 guidance to be between \$455m and \$460m, which is up from the \$450m to \$455m we gave last quarter. This is signaling tremendous and continued growth.

The sequential strength in revenues for the second quarter and the ramp in the second half of the year is going to come from, primarily, three things. Number one, more growth and monetization in our entertainment segment, especially at Showself.

Number two, continued strength with our FL Mobile game publishing business, as the pipeline of new games drives even higher growth beginning in the current second quarter.

Number three, a seasonal recovery in our advertising business. We will certainly continue to see the strong environment within our B2B businesses. And our services portion will also seasonally recover and sequentially continue to improve and trend higher from these levels each quarter throughout this year.

The year is off to a solid start. We look forward to continued progress on the monetization of our entertainment applications and businesses which will, in turn, help to drive the overall consumer portion of our business forward, even as our enterprise mobility demand remain strong. This will lead to an improvement in margins and profitability as this year progresses.

With that, that concludes our prepared remarks. Now, before I turn the call over to the operator for questions, let me address one important topic that we know you all are eagerly awaiting, the FL Mobile transaction. I want to reiterate that we disclosed a memorandum of understanding with Tack Fiori International on December 18 of last year. At this time, we are still in the process of finalizing the negotiations related to that proposed transaction.

We will provide an update for you as soon as that is finalized and we have reached a definitive agreement. It is important to note that on April 30, Tack Fiori International issued a press release stating that they had appointed a sponsor in connection with the proposed submission of a new listing application, as well as engaged other professional service providers which is customary. Until a definitive agreement is reached, there will be no other comment about this proposed transaction that we can make.

Thank you all for joining the call. Tara, would you please open up the call for Q&A.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jun Zhang, Rosenblatt Securities



Jun Zhang - *RosenblattSecurities - Analyst*

Thanks for taking my question. I have a couple of questions. The first question, I want to get more color on the revenue breakdown for the mobile game, Showself, as well the current mobile security business. Thanks.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Yes. Hi Jun, thanks for your question. Within the mobile value added services component, again, what we disclosed was that Showself was about 20% of the MVAS segment. The remaining portion, the majority of that was made up from our mobile gaming segment. And our security portion was also about a little bit more than 20%. And then there was other immaterial amounts of revenue from the other entertainment products, including Showself launcher, desktop, as well as Music Radar.

Jun Zhang - *RosenblattSecurities - Analyst*

Okay. So should we expect that part of the business -- because the mobile security business basically is very small right now, so should we expect that business will continue ramping quarter to quarter?

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Yes, absolutely. If you look at the drivers in the MVAS segment, again, the three components, the major declines in the security business have largely been felt. Mobile gaming we expect to continue to grow strongly. And obviously we are just beginning the ramp up of the entertainment group, including Showself, so that will continue to drive forward. So as we move forward, the MVAS segment should start to grow again sequentially and should start to become a more meaningful part of the revenue mix going forward.

Jun Zhang - *RosenblattSecurities - Analyst*

Okay. And my second question is about enterprise mobile security business. So you mentioned -- I think [Vincent] mentioned a couple of contract win from different Chinese companies. And could you give us more color on the -- on what percentage revenue now coming from the software and what's your expectations going forward for the enterprise mobile security business? Thanks.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Yes, absolutely. Thanks for your question.

In the first quarter of 2015 the revenue split between hardware and software and services was roughly 90%/10%. If you go back and you look at the revenue split in Q4, it was closer to 80%/20%. And as we've said, Q1 is the seasonally slowest quarter for some of the customized software and services solution, which we expected. We will see the software and services component within our enterprise grow sequentially throughout the year.

If you look at 2014 as an example, Q1 was the low point and grew rapidly and sequentially each quarter thereafter and we expect that to continue again. I provided a piece of information that said that year over year, our software and services business grew about 150%, from Q1 of this year compared to Q1 of last year. So we're seeing pretty strong software and services growth year over year and that's going to continue to grow sequentially from here as well.



Jun Zhang - *RosenblattSecurities - Analyst*

Okay. And, yes, my third question is about your share based compensation. So I do see in Q1 you had share based compensation coming down year over year. So could you give us more details about what's the trend going to be for the rest of the year? Thanks.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Sure. Obviously there will continue to be quarter-to-quarter fluctuations. Remember during any one quarter there may be performance conditions related to previous acquisitions of that hit that could show some fluctuations quarter-to-quarter. But our share based compensation expense for the year will be lower on a year-over-year basis and we continue to see that trending down over time.

Jun Zhang - *RosenblattSecurities - Analyst*

Okay, thanks. And so my next question is about the -- because right now a lot of the Chinese companies listed here, in the US market, they are looking for different, alternative choice. Some company looking for privatization, for example the CMGE which is a mobile game company, and some company are selling some of the key assets to the [China], Asia-listed company for example Airmidia. So I think you have lot of good assets in different parts. So, in addition to the FL Mobile, do you have any plan or thoughts over -- to monetize some of the early investments or [MA]? That's my -- the fourth question. Thanks.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Jun, I would like our Chairman, Dr. Shi to answer that question.

Vincent Shi - *NQ Mobile Inc - Chairman, COO& Acting CFO*

Thanks, Jun. Yes, we totally agree the Asia market is very hot now. There are many potential opportunities for us to increase the shareholder value and we will update you when we have something in the future. Thank you.

Jun Zhang - *RosenblattSecurities - Analyst*

Okay. Thanks. And also I have the last question about -- because Omar left the Company, so what's your sense right now for the US and some of the South American markets with this?

Vincent Shi - *NQ Mobile Inc - Chairman, COO& Acting CFO*

Yes. We're still working on US market and business plan. And I think we maybe need a little bit more time to set up and approve the new business plan for US team.

Jun Zhang - *RosenblattSecurities - Analyst*

Okay, thanks. Great. That's all my questions; thanks a lot.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Great. Tara, let's go to the next question.



Operator

Solomon Chuen, Citigroup.

Solomon Chuen - Citigroup - Analyst

Thank you for taking my questions. Here is Solomon from Citigroup. And I ask the following question on behalf of my colleague, Ravi Sarathy who is travelling so he can't dial-in the call himself.

Okay. We have two question. The first one regarding to the gross margin, management share your view or give us more color on the gross-margin outlook when the business normalizes? This is first one.

And the second question is could management give us more color on the strategic growth plan on the non-gaming business in the three-years time? Thank you.

Matthew Mathison - NQ Mobile Inc - VP, Capital Markets

Solomon, thanks for calling in.

Let me address the first question and I may have you repeat the second question. But on the gross margin trends, again gross margins are --they primarily are based on our revenue mix. We know that if you look at the enterprise business obviously gross margin -- that's the lowest gross margin business. And especially during quarters when the software and services component is only 10% of the overall, that's going to be the lowest gross-margin quarter for us, which you saw in Q1.

The drivers to our gross margin is improving going forward are exactly what I reiterated on our guidance and our outlook for Q2 and going forward, namely we're going to see increased monetization with our entertainment products and services, specifically from Showself. We're going to see continued improvement and probably a reacceleration on the FL Mobile gaming side, given a great line-up of key games starting this quarter. And our Advertising segment will recover, based off of the seasonally slow Q1 period during the Chinese New Year.

Those three things are going to lead to increased consumer-based revenues which obviously have a higher gross margin than our enterprise business and those are the make-up; which is why we feel confident that our profitability, including gross margin and operating margin, will expand and improve from these levels and as this year progresses. So really those are the drivers for gross margin. Did that answer your question?

Solomon Chuen - Citigroup - Analyst

Yes, very clear. And what is your plan for the non-gaming part in this year and/or in three-years time frame, because I know that probably it will take some time to get a rebound in that. If it does, then it would help the gross margin I think, so what is your view on that part?

Matthew Mathison - NQ Mobile Inc - VP, Capital Markets

Yes. I'm sorry can you restate that question; I missed the first part of it so I just want to make sure I [get that].

Solomon Chuen - Citigroup - Analyst

Okay. The second question we have is what is your plan to grow the non-gaming part this year and going forward?



Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Yes. So to grow the non-gaming revenue part, that's what you're asking?

Solomon Chuen - *Citigroup - Analyst*

Yes, non-gaming, yes, yes.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Got it. I'm sorry; I just wanted to be clear. Yes, very specifically, within -- on the consumer-based business to grow the non-gaming revenue part, there is really two parts of it. There is the products that make up the entertainment products which we've laid out, including Showself Live Broadcast Showself Desktop and Launcher which is our NQ Live and vLife businesses, as well as Showself Music Radar. Those are driving traffic, right, that we can monetize in a bunch of different ways, including the advertising, premium services, in-game purchasing or in app purchasing in our Showself Broadcast business etc.

The second component of the non-gaming business that's going to drive revenue is really monetizing this traffic via advertising. And we have tremendous online and offline mobile advertising assets that we feel good about.

Solomon Chuen - *Citigroup - Analyst*

Okay. Thank you very much.

Matthew Mathison - *NQ Mobile Inc - VP, Capital Markets*

Great, thank you. Tara, if there's no other questions we'll go ahead and conclude the call.

Operator

Thank you very much. Ladies and gentlemen, that does conclude the conference for today. Thank you so much for your attendance. You may all disconnect.

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