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NQ - Q2 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 Inc's second quarter 2015 earnings conference call. (Operator Instructions). I would now like to hand the conference over to your speaker for today, Ms. Dahlia Wei. Please go ahead, sir.

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 second quarter 2015. On the call today are our Chairman, Vincent Shi, our CEO, Mr. Zemin Xu, our CFO, Mr. Roland Wu, and our 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 discussions 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 direct comparable US-GAAP financial measures and the information reconciling those non-GAAP financial measures to NQ Mobile's financial results prepared in accordance with US GAAP are included in our earnings release posted earlier today.

Finally, as a reminder, this conference is being recorded. We are also offering investors a webcast of today's conference call which can be found on the Investor Relations section 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. Good morning to everyone in Asia and good evening to the rest of you. We thank you all for joining us today. The call today will go as follows. Our Chief Executive Officer, Mr. Zemin Xu will make some remarks. I will then provide an update on our businesses and operating trends. Mr. Roland Wu, our CFO will then review the financials and our outlook. Finally, our Chairman, Dr. Vincent Shi will make some concluding remarks. We will then open the call up for Q&A. Now before I turn the call over to our CEO, let me also point out and highlight two other press releases that went out today in conjunction with our earnings release.

First, we have entered into a legally binding framework agreement to sell FL Mobile to Beijing Jinxing, a subsidiary of Tsinghua Holdings, for no less than RMB4b or approximately \$626m. As part of this binding agreement, we have agreed to terminate any ongoing discussions regarding any other contemplated transactions involving FL Mobile, including those between Tack Fiori, though we do continue to explore other strategic opportunities with them.

In addition, we also entered into a legally binding agreement to sell NationSky to Mr. Charlie Hou, a founder and senior management member of NationSky for \$80m.

As a result of these announcements, there will certainly be changes in the make-up of our financials and we will provide updated guidance to reflect these changes when these deals close. For the discussions on this conference call and for our financial guidance, we do not account for any such changes yet.

With that said, now Mr. Zemin Xu, please go ahead.

Zemin Xu - *NQ Mobile Inc - CEO*

Thank you Matt. Hello everyone and thank you for joining us.

I would like to thank all of our employees and the management team for their dedication and their commitment to the plans that we laid out at the beginning of the year. Our strict focus on cost controls and the budget is paying off and the benefits are starting to show up in our results. We will continue to focus on delivering results and executing on our business plans. We look forward to continued progress on the monetization of our entertainment applications and the businesses which in turn will help us to drive the overall the customer segment. We made solid progress in the second quarter. We have a long ways to go still, but we are determined to see this through.

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

Thank you Zemin. Now during the last two earnings conference calls, Bryan has described our businesses for you and provided specific business updates on the various segments. I wish to highlight some of the important metrics that demonstrate how our strategic focus and business direction has started to emerge in these second quarter results.

NQ Mobile is a mobile-focused business. Obviously, with the announcement of the NationSky and FL Mobile divestments, there will be some changes to the actual make-up of our business. But we remain a mobile-focused company that is even more focused on our entertainment segment at this current stage.

The second quarter was marked by solid performance across our different businesses. Let me provide an update on our FL Mobile game publishing business. As a reminder, one of the key strengths in our FL Mobile franchise is that our gamers are much more mid to hardcore gamers as opposed to many of our competitors that are focused more on the light and casual gamers. This helps our games have a relatively longer lifecycle than is normal in our industry.

FL Mobile is also very diversified. The pipeline of games is very strong as we have launched several new games in the second quarter. But all of these launches were late in the quarter and therefore did not contribute much. However, this provides the basis for a stronger second half of this year and accelerating growth from here.

Also in the second quarter we launched two co-marketing campaigns with taxi and car rental companies where we provide some of our games in their own game centers like Dragon War Song, God Killer, and Attack Cities and Capture Territories. This, along with the strong pipeline of recently launched and soon to be launched games, has this business positioned for a strong second half.

Our advertising businesses consist of both online and offline channels. At the end of the second quarter, the total reach of our online and offline advertising business was more than 870m unique devices or users up almost 15% quarter over quarter. In the second quarter we grew the number of applications enabled on our platform to over 93,000, up almost 15% quarter over quarter as well. We have begun to act as an advertising agency for large platforms which we will call mega-media platforms that we believe will lead to greater online advertising performance over the course of this year.

Now let me discuss our Showself businesses. First, let's begin with Showself which is our live mobile social video platform which has now reached 4.1m monthly active users, which is up just around 10 times from about 400,000 MAUs a year ago and up around 40% sequentially from the first quarter.

Also encouraging, our revenues from the Showself live mobile social video platform business grew to over 30% of our total MVAS revenue segment and continues to grow rapidly each month. This business is already annualizing at more than \$40m rate and is a first tier player in this space. In addition to traditional host shows, we also continue to promote in-show gaming on our various Showself platforms.

Now let me discuss Showself Desktop and Showself Lockscreen. As a reminder, Showself Desktop and Lockscreen is our personalized interactive and programmable mobile desktop application which includes dynamic wallpapers, launchers and lockscreens. At the end of the second quarter, we have shipped this on more than 180m devices, achieved more than 81m MAUs and also have more than 57m DAUs. That is up from 16.7m in the second quarter last year in MAUs or about 450% growth. And up from 6.8m DAUs in the second quarter last year or about 840% growth.

We are now generating revenues from this business as well, primarily from two sources. First, through premium content where users download various themed and branded content and we share with the branded content owners. The second area is that we're monetizing in the form of advertising. On our latest versions of screens and desktops, we are placing ads and we still expect this to be the way we monetize generally across this traffic going forward.

Finally, let me touch on our Showself Music Radar business. This is our audio-based search application business. At the end of the second quarter, our Music Radar application has now exceeded 14.6m monthly active users and we are seeing more than 14m unique search queries a day.

As we turn to the enterprise mobility segment, let me just reiterate what I said before. Given we announced the NationSky divestment today, this segment is going to change. We'll have the opportunity to provide specific details around these changes, once the deal closes. But keep in mind that this segment contains both our NationSky and Trustek businesses now and we announced the agreement to sell the NationSky business which is the majority of this segment.

As for a brief update, we continue to rapidly expand this business with both hardware and software sales. In fact in the second quarter we improved the revenue mix slightly. This software growth continues to be driven by both our customized software R&D for big clients as well as by the channel sales of standardized solutions. We continue to be the leading provider of integrated enterprise security and mobility solutions in China as we gain large clients within the government, banking, retail and airline industries.

To conclude, the second quarter showed some of the first tangible results of the influence of our strategic directives and growth priorities, especially in entertainment.

With that, I will now turn the call over to our CFO, Mr. Roland Wu, who will walk you through our financial performance. Roland.

Roland Wu - NQ Mobile Inc - CFO

Thanks Matt. Now let us turn our attention to the financials. I wish to walk you through some of the highlights and provide you with additional details behind the results. Let's start with the discussion of our revenue in the second quarter of 2015.

We generated \$102m in net revenues for the second quarter of 2015, a 14% growth compared with last quarter.



We achieved continuing growth in our MVAS segment especially at Showself, which maintained strong growth in Q2. We achieved a year-over-year increase in mobile gaming revenues. Our FL Mobile business has a strong pipeline and will continue to experience strong growth going forward. Revenues derived from Showself constitute more than 30% of our total MVAS segment in the second quarter, growing ahead of our expectations, driven by strong momentum in its vast user base. We will continue to see our Showself broadcast business to be a key focus within our MVAS segment going forward.

Meanwhile, as we are working on the diversification of our advertising segment in addition to the existing advertising business model, revenue derived from the advertising segment went down slightly compared to last quarter. This is the result of industry change as well as quarterly fluctuations. However, as Matt mentioned, we are beginning to act as an advertising agency for mega-media and we believe this will lead to greater online advertising performance in the future.

Our enterprise mobility business remained strong and we did see a slight improvement in the software part. In the second quarter our revenue mix for enterprise improved to 88% hardware, 12% software from 90% and 10% last quarter. We do expect this to continue to improve going forward.

For our other traffic and entertainment business, such as our Lockscreen and Desktop applications, Music Radar and so forth, we did begin to see improvement. We continue to drive great traffic and user trend evidenced by our MAU and DAU growth in the second quarter. We will continue to work on monetization as we continue to leverage the strong traffic generation in these applications.

Next let's spend a few minutes discussing our gross margin and review some of the key elements within our cost of sales. Obviously the biggest impact on our gross margin performance is the revenue mix. However, as we expected, with improvement in the service portion of our enterprise mobility group, we saw our gross margin in this quarter increase to 24.8% from 21% last quarter.

For this quarter around 75% of the total increase in the cost of sales compared to the first quarter 2015 is the result of products sold within our enterprise mobility segment. When you exclude the impact from hardware sales in our enterprise mobility segment on our cost of sales, gross margin was around 45%.

Excluding the above impact from the enterprise mobility mix, the other major cost component was revenue sharing costs that I have to mention to you, which increased in line with business expansion at Showself where we have to account for the revenue sharing with the host and their agents as a cost of sales. The FL Mobile gaming business. For this quarter, it constituted 31% of the increase in total costs of sales on a quarter-over-quarter basis.

Let me now walk you through our operating expenses. In the second quarter, our operating expenses were sequentially down from the first quarter of 2015. Total operating expenses in this quarter was \$24m, down almost \$12m 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 expenses and effective budget control of cost and expenses of our business segments, which we did start to see in progress.

In fact our total SBC expenses were \$1.1m this quarter, which was the lowest total ever for our Company. This was primarily due to a one-off reversal of the unvested share options related to a former executive as a result of his departure from this Company this quarter. Also less share-based acquisitions and also fewer performance-based share options.

And as a management team, we are very focused on controlling our costs and strictly adhering to our budget. I am pleased with our progress on this front. We have gone Company-wide and each subsidiary's cost structure are properly aligned with revenues, including most recently the changes we have made at our US subsidiary where we have just completed cost alignment program recently.

The other big improvement in operating expenses came from a significant decrease in marketing and advertising expenses and the S&M expenses. As a result of decreased spending on the promotional channels for mobile games, due to the later launch of new games in this quarter as well as less expenditure on consumer mobile security business. The improvement in our overall operating expenses resulted in a lower net loss for this quarter, which was our best quarterly performance since the third quarter of 2013.



For our second quarter total net loss attributable to NQ Mobile was \$1.6m compared with a loss of \$17m in the quarter before. We also achieved non-GAAP income attributable to NQ Mobile of \$7m for the quarter or \$0.08 per ADS.

Finally, let me conclude my view of the financial performance for the second quarter by highlighting a few other things.

First, our balance sheet. We ended this quarter with \$239m of cash and cash equivalents, term deposits and restricted cash. Our cash flow used in operations was \$14.7m, partially because the continuing expansion of our enterprise mobility business resulted in longer turnover days and some additional cash outflow for example, the timing of payments for CB interest semi-annually which negatively impact our second and fourth quarter.

And now secondly, I will turn to our outlook for the third quarter and updated view on 2015. We expect net revenues for the third quarter to be between \$110m and \$112m and our full-year 2015 guidance to remain unchanged at \$455m to \$460m. This outlook includes net revenue expectations for FL Mobile and NationSky and is subject to change based on the timing of the closing of the announced FL and NationSky divestments.

With that, that concludes our prepared remarks and I will turn the call back to our Chairman, Dr. Shi.

Vincent Shi - *NQ Mobile Inc - Chairman and COO*

Thank you Roland. There are two things I wish to say today. First, NQ Mobile continues to be a mobile-only, mobile-first company that is focusing more on entertainment sector in our present state. Second, we will continue to innovate and invest for the future. Thank you for your time.

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

Thank you. If you can now open up the call for Q&A please.

QUESTIONS AND ANSWERS

Operator

Jun Zhang.

Jun Zhang - *Rosenblatt Securities - Analyst*

Hi. Thanks for taking my questions. So I have a couple of questions. First of all, congrats on the solid deal -- solid quarter and deal on FL Mobile and NationSky. So my first question is after you spin off FL Mobile and NationSky, I think the core business becomes Showself. So could you give us some updates on the Showself business? What's the outlook on that business and what's the market, the current market position and how the margin looks like on that business? Thanks.

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

Hi Jun. Thanks. I'll take your first question. Specifically to Showself, let me just reiterate a couple of highlights. We achieved over 100% sequential revenue growth in the second quarter from the first quarter and this particular entertainment segment accounted for more than 30% of our total MVAS revenues in the second quarter. Largely, this was driven by strong momentum in our vast user base. Also, as I mentioned before, MAUs increased by 40% sequentially to 4.1m and again that was up a little bit more than 10X what it was a year ago.

So we're seeing strong growth in users as well as revenues and, as Dr. Shi said, we are a mobile-first, mobile-only company that continues to be focused on this. But especially at this stage, we're focusing much more on our entertainment business and Showself is obviously a key part of that.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. So what does the market look like right now compared with your current gross margins and the profit margin?

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

Sure, I can handle that question. I think we said last quarter, we gave some color on the last quarter's conference call, where we give a breakdown of the host and the agent payments, and then we basically said look, on a revenue basis we split 70%/30% roughly. And so our gross margin in that business is generally 30%-ish. And again after we complete the divestment of FL Mobile and NationSky, we'll be able to provide specific color on what the profitability of the business is going forward at that point. But I think we'll wait till we do those divestments before we give specific guidance on that.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. And my second question is could you give us a little bit of color on the deal on the FL Mobile and with the reputable buyer, Tsinghua Group? When do you expect that deal to be closed and how are you going to use the cash, continue buyback or any other thoughts on that? Thanks.

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

So I'm going to let Roland answer the question on the cash. But specifically to timing of closing, again we'll provide updates as that happens; make no specific guidance right now on that. Go ahead, Roland.

Roland Wu - *NQ Mobile Inc - CFO*

Thank you for your question, Jun. The management team and the Board of directors will continue to consider both the long-term strategic growth initiatives of the Company along with the market-driven opportunities to deliver shareholder returns through the use of our cash and balance sheet I think. We will be in a very strong position to balance both the investment needs of the business with shareholder-friendly actions, including buybacks.

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

Jun, was there one other question?

Jun Zhang - *Rosenblatt Securities - Analyst*

Yes. So my last question is the because you have a lot of other assets, like the Music Radar and some other assets, is there also potential to spin off those assets in exchange for cash or any other increased return to investors in the future. Thanks.

Roland Wu - *NQ Mobile Inc - CFO*

Yes, actually we have mentioned before we are a mobile-first and mobile-only company and we will balance the asset management and the business operations in the future and we will try to get the best benefit for our shareholders.



Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Great. Thanks. That's all my questions. Congrats again.

Vincent Shi - *NQ Mobile Inc - Chairman and COO*

Thanks Jun.

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

Thank you.

Operator

Fred Ziegel.

Fred Ziegel - *Topeka - Analyst*

Good evening or good morning. Just a follow-on question. So do I think about NQ as a mobile company or do I think of it more as an incubator of mobile businesses, a la FL Mobile, NationSky and obviously you've got a lot of other things in the pipeline? So for the FL Mobile and NationSky, you've owned it for a couple of years, it's obviously in the process of being sold -- is that the template going forward for the Company?

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

Hi Fred. Thanks for your question. I'm going to let our Chairman answer that for you.

Vincent Shi - *NQ Mobile Inc - Chairman and COO*

Yes, I just say NQ will continue to be a mobile-first and mobile-only company that's focusing on entertainment at this stage. And our Showself business and the mobile entertainment applications will make up the core of our focus now and we will continue to innovate and invest in the business going forward. Thank you.

Fred Ziegel - *Topeka - Analyst*

With the acquisitions you've made in the past, they've been reasonably small in size dollar wise. Assuming both of these FL Mobile and NationSky deal closes, you're going to be approaching \$1b in cash. Should we think that you're likely to be making larger size investments or acquisitions going forward?

Roland Wu - *NQ Mobile Inc - CFO*

Thank you for your question, Fred. We always think cash is the king, so, yes, I'm glad that both of the deals will improve our cash position and improve our financial situation. I can say we will balance our investment needs of the business and we also will consider shareholder friendly actions in fact. We also will consider in the future, if we have good opportunities we will not reject any chance to invest in the industry. I think we will do our best effort to increase the shareholder value. Thank you.



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

Fred, any other questions?

Okay. Again, thanks everyone for joining us on our second-quarter earnings conference call. We look forward to speaking with you again soon. And everyone have a good day in Asia and have a great night in the rest of the world. Thank you.

Vincent Shi - *NQ Mobile Inc - Chairman and COO*

Thank you.

Roland Wu - *NQ Mobile Inc - CFO*

Thanks everyone.

Operator

Ladies and gentlemen, this does conclude our conference for today. Thank you for participating. You may now all disconnect.

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