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NQ - Q3 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 third quarter 2015 earnings conference call. (Operator Instructions). I must advise you that this conference is being recorded today, Tuesday, December 1, 2015. I would now like to hand the call over to Dahlia Wei, Director of Investor Relations of NQ Mobile. 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 third quarter of 2015. On the call tonight are our Chairman, Dr. 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 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 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 call is being recorded. We are 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.

Matt Mathison - NQ Mobile Inc - VP Capital Markets

Thank you, Dahlia. We thank you all for joining us today. The call this evening 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 will then review the financials and outlook. Finally, our Chairman, Dr. Vincent Shi, will make some concluding remarks. We will then open up the call for some Q&A.

Now, before I turn the call over to our CEO, let me first provide you with an update on the progress of our divestitures. I think it is always good to pause and understand why we are doing what we are doing; keep it simple. We are in the process of divesting several of our businesses because we have the opportunity to unlock the actual value that these businesses have to buyers, for cash. We recognize the unique circumstances that exist, and we are determined to unlock value for our shareholders through these divestitures.

In addition, and let me be very clear about this, after the divestitures, we want to simplify who we are and what we are. As stated last quarter, we are focusing on our entertainment business, which will be primarily centered around our Showself business unit, including those other businesses that have been rebranded as such. We will be a mobile-first, mobile-only company that is focused on a growing entertainment and consumer offering, around our Showself platform.

We will have an opportunity to provide some specific updates about our Showself platform later in the call. But let me update you on our divestitures, which is the most important thing, and all of which are progressing forward.

First, we were pleased to announce earlier this month, on November 18, another divestiture, as we have reached a binding agreement to sell Tianya, our mobile healthcare platform, to Tack Fiori for \$40m. As you know, Tack Fiori and NQ worked together on the potential FL Mobile deal. Now both parties are working together, to complete the Tianya transaction, as soon as practicable.

The closing of the transaction is subject to the condition that Tack Fiori obtains the necessary approvals, including shareholder approval, to complete the transaction, as well as additional customary closing conditions, and the satisfaction and compliance of all relevant requirements under the rules governing the listing of securities on the Hong Kong Stock Exchange Limited.

Second, as a reminder, on August 26 we announced the NationSky divestment. As we reported in the earnings press release earlier today, this transaction is moving forward with the same purchase price. However, the payment timeline has been modified. We have received approximately RMB100m, or roughly 20% of the overall purchase price, which marks an important milestone for this transaction. Meanwhile, all parties are working together to complete this transaction as soon as practicable.

Also, just to be clear, since the above-mentioned payment was received in November, it is not reflected in the balance sheet of our third-quarter results.

And finally, and obviously most importantly, as a reminder, on August 26 we announced that we had reached a binding framework agreement to sell FL Mobile to Beijing Jinxing, a subsidiary of Tsinghua Holdings, for no less than RMB4b, or approximately \$626m. We continue to work with the buyers on finalizing this agreement, and both parties are working on completing this as soon as practicable.

This is progressing well and moving closer. In fact, we have made a lot of progress. But due to the confidentiality limitations of Tsinghua Holdings, we cannot disclose more at this time, but we do look forward to providing an update when we can.

As you can see, we are working hard to both execute on our plans to unlock value by selling these businesses through the divestitures for cash, as well as focus our organization on our businesses.

As I said last conference call, also as a result of these divestiture plans, there will continue to certainly be changes to the makeup of our financials, and we will do our best to communicate these changes fluidly.

As we highlighted in our earnings release, we do not believe it is prudent to provide revenue guidance at this time, in part due to the divestitures. But we will do so again when it makes sense and the upcoming changes of these divested companies' performance has been factored in.

Now there should be no question about what we are doing, why we are doing it, and what we will be after the divestitures are completed. With that said now, our CEO, Mr. Zemin Xu, please go ahead with your remarks.

Zemin Xu - *NQ Mobile Inc* - CEO

Thank you, Matt. Hello everyone, and thank you for joining us. I wish to thank you, all of our employees and the management team for their dedication and their commitment. Our strict focus on cost controls and the budget continue to pay off, and the benefits continue to show up in our results.



We are seeing progress on the monetization of our entertainment products and traffic as well, reaching some key milestones in those businesses. On the other hand, the hardware sales within enterprise mobility were below plan.

We will continue to focus on delivering results and executing our business plans, including the successful completion of the major divestitures. Matt.

Matt Mathison - *NQ Mobile Inc - VP Capital Markets*

Thank you, Zemin. As we move to divest some of our businesses, it will become more relevant and important to more clearly understand our entertainment business, since that will be our ongoing business. However, I will still briefly provide you an update on our other businesses too.

The third quarter was marked by solid performance across our different entertainment and consumer businesses, with, clearly, some weakness in our hardware sales, within our enterprise mobility segment, as well as our offline channels in advertising.

Let me first provide a specific update on our FL Mobile game-publishing business, which just completed its best quarter ever. As we discussed last quarter, the pipeline of games going into the second half of this year was robust.

Additionally, we had several key game launches, which contributed to the third-quarter revenue growth. We saw this play out in our results, as the game-publishing revenues in the quarter reached a record level. FL Mobile is poised to see continued strong growth, going forward.

Next, let me spend a few moments on our advertising businesses. Our offline channels underperformed, and will likely continue to underperform this year, as weakness in the non-iPhone smartphone shipments persist throughout China.

However, our online channels remain quite robust. At the end of the third quarter, the total reach of our online and offline ad business was more than 899m unique devices, up from around 870m devices last quarter.

In the third quarter, we grew the number of applications enabled on our platform to over 95,000.

Now, much more importantly, because on a going-forward basis, after the divestiture of FL Mobile, the advertising we generate on our own apps, with our own inventory is what will matter, and we have begun to see the makings of promising trends by advertising our own inventory, including our utility and security app inventory. The revenues are still small now, but they are growing. And we were pleasantly surprised by this performance in the quarter and the outlook, going forward.

Let me now take a moment, and elaborate and discuss our Showself desktop business. As a reminder, Showself desktop is our personalized, interactive, and programmable mobile-desktop application.

At the end of the third quarter of 2015, we have shipped this on more than 200m devices, achieved more than 93m monthly active users, and also have more than 62m daily active users. This is up from 32m MAUs in the third quarter last year, or about 300% growth, and up from 13m DAUs in the third quarter last year, or 475% growth, year on year.

We continue to be encouraged at the growth of our user base and traffic within this application set. We will gradually monetize this through premium content and advertising. In fact, again, although the numbers are still small, during the third quarter we actually began to operate this business unit at a rate that is breakeven on a standalone basis, based on our revenue generation.

Our Showself Music Radar business continues to grow its traffic as well. At the end of the third quarter, our Music Radar app, or Doreso applications have more than 15.5m MAUs. And we're seeing now almost 15m unique search queries a day.

Let me discuss now and turn our attention to our Showself Live broadcast business which, together with the other Showself branded applications, will be the focus of our business, following the divestitures.

This is our live mobile social video platform, which has reached now almost 5m monthly active users, up around 240% from year-ago levels and up around 17% sequentially, from what was an incredibly strong growth second quarter.

Our revenues from the Showself Live broadcast business grew to now over 35% of our total MVAS revenue segment. We are continuing to add new features and ways that our hosts can monetize these live shows. We spent more in the third quarter on customer acquisition and promotional activities, as we aimed to further broaden our user base and build scale for this business, as it's growing.

Finally, and before I turn the call over to Roland, to go through the financials, let me briefly touch base on our enterprise mobility segment. This quarter we saw a record amount of software and services revenues within this segment, as we focused more on the higher-margin part of this business.

On the other hand, the sales of hardware from this segment were sequentially down, which created the main factor for our overall revenues falling short of our initial guidance.

Now with all of that said, I now wish to turn the call over to our CFO, Mr. Roland Wu, who will walk you through our financial performance.

Roland Wu - NQ Mobile Inc - CFO

Thanks, Matt. Now let us turn our attention to the financials. I wish to walk through some of the highlights, and provide you with additional details behind the results.

Let's start with a discussion of our revenues in the third quarter of 2015. We generated \$88m in net revenues for the third quarter of 2105, a 14% decrease compared with last quarter. Despite of such a sequential decrease in our overall net revenues, we have actually achieved sustainable business growth in certain key segments, including mobile gaming business, and Showself broadcast business.

As introduced earlier by Matt in his topic covering the [path] part of businesses, as a result of the business expansion, revenues derived from those business segments contributed positively to our total net revenues for this quarter. However, such a positive contribution was dragged behind by the lower performance in hardware sales and mobile security business.

FL Mobile continues to be a very strong business for us, and achieved record high in revenues this quarter, growing 29% quarter over quarter and 40% year over year. The sustainable growth in our mobile gaming business was primarily attributable to the strong pipeline owned by FL Mobile in both domestic and overseas markets. We expect FL Mobile will continue its business expansion going forward.

Revenues derived from Showself constituted more than 35% of our total MVAS segment in the third quarter, which was primarily driven by the continuing growth 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.

Our advertising revenues remained flat, when compared with last quarter. The offline advertising channel has been negatively impacted by slower smartphone shipments throughout China, which is the biggest threat to the performance of the overall segment. However, we are encouraged by the earlier progress of monetization through advertising on our own inventory and within our own apps.

Revenues derived from our enterprise mobility businesses decreased over 20%, when compared with last quarter, which was primarily attributable to the lower performance in hardware sales. However, in the third quarter we did see improvements in our revenue mix for enterprise mobility businesses, which was improved to 77% hardware and 23% software from last quarter's 88% versus 12%. And we do expect this to continue to improve going forward.

For our other traffic and entertainment businesses, such as our desktop applications, mobile medical applications and so forth, we are encouraged to see improvements on the continuing growth of these businesses, as evidenced by our MAU and DAU to drive greater traffic and user trends.



We are also pleased with the progress of our Showself platform and are encouraged by the early performance of the desktop monetization.

Next let's spend a few minute discussing our gross margin and walk you through some of the key elements within our cost of sales. Our gross margin in this quarter decreased slightly to 23.6% from 24.8% last quarter, which was a reflection of the performance of our different business segments.

For example, the gross margin of our Showself's broadcast business went down this quarter, as we spent more in our user acquisition and promotion channels. However, on the other hand, we are pleased to see an improvement in the revenue mix within our enterprise mobility businesses, which contributes positively to the overall gross margin. All of these factors are jointly resulted in the slight fluctuation in our gross margin for this quarter.

Let me now walk you through our operating expenses. In the third quarter our operating expenses were sequentially down from the second quarter of 2015. Total operating expenses in this quarter was \$21m, down by 14% from last quarter. The biggest portion of this improvement came from a significant drop in general and administration expenses, mostly coming from significantly reduced share-based compensation expenses, and effective budget controls of costs and expenses of all our business segments, which we did see continuing progress.

As for our SBC expenses, we are pleased with the improvement achieved in controlling the expenses, which were sequentially down since the first quarter of this year. For the third quarter our total SBC expenses was a negative \$1.5m, which was primarily due to adjustment on performance-based share options relating to employees. We expect SBC expenses to be maintained at a relatively low level, which may still fluctuate quarter to quarter.

And also, 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 done Company-wide and each subsidiary's cost structures, which are properly aligned with revenues, including recent changes we have made at our NQ US subsidiary.

Another improvement in operating expenses came from a decrease in marketing and advertising expenditures, under the sales and marketing expenses, as a result of less expenditures on consumer mobile security businesses, as well as a decrease in spending on the promotional channels for mobile games.

Our net loss for this quarter was \$2.5m, compared with a loss of \$1.6m last quarter. There was a slight increase in our net loss which was mainly due to the lower performance in our net revenues, as we mentioned earlier, while it was primarily offset by our effective control over costs and expenses.

We also achieved non-GAAP net income attributable to NQ Mobile of \$0.9m for the quarter, or \$0.01 per ADS.

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

First, our balance sheet. We ended this quarter with \$203m of cash and cash equivalents, term deposits and restricted cash. Our cash flow used in operations was \$15m, which was primarily was purchase of hardware and payments for revenue-sharing costs. Cash flow used in investments was approximately \$16m in total this quarter, with a main focus on game development.

And now, secondly, as to our business outlook, we believe it is prudent to temporarily suspend the practice of providing revenue guidance, in part due to the previously-announced ongoing divestitures of certain business segments. We will resume providing revenue guidance when it is more appropriate.

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 & Co-Founder

Thank you, Roland. I wish to highlight three things, as we close the conference call.



First, our divestitures are on track and closing these deals is a priority we will deliver.

Second, our organization remains focused on executing and delivering results, especially our cost control and budget.

Finally, with the closing of our divestitures, we will have significant cash. And we will properly balance both shareholder returns with investing for the future, as we focus on ensure our early success in our entertainment business continues well in the future. Thank you, everyone.

Matt Mathison - *NQ Mobile Inc - VP Capital Markets*

Operator, that concludes our prepared remarks. Would you please open up the call for Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jun Zhang, Rosenblatt Securities.

Jun Zhang - *Rosenblatt Securities - Analyst*

Thanks for taking my question. So my first question is that you gave us a couple of updates on the asset-sales process. So could you give us more color on the rationale behind that -- those buyers; why those buyers want to buy assets from NQ? Thanks.

Roland Wu - *NQ Mobile Inc - CFO*

Thanks, Jun. Yes, it's an open question I think. I'm glad to give you some color about it. In fact, it's a little hard to comment on what was going on of our buyer thinking. I think, as we have introducing our business before, the mobile business is still the most and effective by the economic, and it's a sustainable growth progress -- with high growth. So I think that's why they are interested in our assets.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks for your comment.

Matt Mathison - *NQ Mobile Inc - VP Capital Markets*

Yes, Jun, let me just add in there -- Jun, let me just add in. Obviously with three divestitures announced, each one has a different buyer and a different set of expectations and each of the businesses are very different. And so the reasons why the buyers are buying these businesses vary, obviously. But I think it's obvious that these are good assets that these buyers believe they can get good returns on.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. And also you announced that you already received RMB100m deposit or down payment for NationSky. Does that mean the deal is -- the buyer is already committed to that deal? Could you give us more color on that? Thanks.



Roland Wu - *NQ Mobile Inc - CFO*

Okay. Yes. I'm pleased to see the buyer -- we have got around 20% of the price we had set before. And I think it shows all parties are really serious about the business. Yes. Although the time -- the schedule of the payment may be modified a little, I think that, during our working together, all parties have shown their efforts and their confidence about this transaction. So, yes, I think we hope we will do our best as practical, as possible to close this deal, close this transaction. Thank you.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. My second question is about the cash flow, because it seems that the cash decreased a little bit due to, partially, operating cost, and also partially due to the investments in the mobile game developer. And what do you expect after you spin off NationSky? How do you expect on the cash flow going forward? Thanks.

Roland Wu - *NQ Mobile Inc - CFO*

Yes. Thanks, Jun. I would like to answer this question. Yes, I'm quite confident about our cash flow from the investment cash flow side. And we hope [after the deal] -- [we hope], through our transaction, we will have the cash flow in and will keep have cash flow coming in. As it progress, so it will keep going maybe some quarters continuing.

And from an operating cash flow side, I also feel confident about it. First, we are conducting our cost control throughout our organization and through cash control. And we will -- as you know, some management -- some cash control still need time to really reflect in our cash flow. It will gradually show its effect.

Second, as you know, we are in the progress of divesting some of our businesses. Then I think the cash flow will improve, when the divestitures really close.

And thirdly, our cash-generating business are growing rapidly and it will keep to improve our operating cash flow.

So I think I'm quite confident about, no matter from the operating cash flow or investment cash flow, it will improve gradually in the future.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. So my last question is about the margin. So you talked about temporarily there was some impact from the business shift, from NationSky and more user-acquisition cost on the Showself platform. So, going forward, when do you expect the temporary impact will be gone and gross margin will normalize?

And also could you give us more color on how do you control the costs in order to improve the operating margin? Thanks.

Roland Wu - *NQ Mobile Inc - CFO*

Yes. Thank you. I think this quarter our margin decreased slightly, about 1.2% this quarter. I expect our margin will be also quite stable, as we have a diversified asset profile.

And for the cost control --

Jun Zhang - *Rosenblatt Securities - Analyst*

My second question is about the operating margin.

Roland Wu - *NQ Mobile Inc - CFO*

Yes, yes. For the operating margin, I think it's much more stable. And you can see our operating profit is -- with under non-GAAP rules, is still positive. And we think -- we hope this trend will be continued.

And for the cost control, yes, you know we have -- we will launch our SAP system soon, maybe this quarter or next quarter, so it will help a lot for our budget control.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks.

Roland Wu - *NQ Mobile Inc - CFO*

Okay.

Jun Zhang - *Rosenblatt Securities - Analyst*

That's all my questions.

Roland Wu - *NQ Mobile Inc - CFO*

Thank you, Jun.

Operator

Ladies and gentlemen, that concludes the question and answer session for today. I would now like to hand the conference back to Mr. Mathison for closing remarks.

Matt Mathison - *NQ Mobile Inc - VP Capital Markets*

Great. Thank you all for joining us. We look forward to providing you further updates as they come, and we will be speaking with you again soon. Thank you.

Operator

Ladies and gentlemen --

Vincent Shi - *NQ Mobile Inc - Chairman & Co-Founder*

Thank you everyone.

Operator

That does conclude our conference for today. We thank you all for your participation. You may now disconnect.

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