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NQ - Q4 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 fourth-quarter and full-year 2015 earnings conference call. (Operator Instructions). I must advise you that this conference is being recorded today. And I would now like to hand the call over to Ms. Dahlia Wei, Director of Investor Relations of NQ Mobile. Thank you. Please go ahead.

Dahlia Wei - *NQ Mobile Inc. - Director of IR*

Good evening and good morning in Asia. We welcome you to NQ Mobile's conference call to discuss the financial results for the fourth quarter and full fiscal year of 2015.

On the call tonight is our Chairman, Dr. Vincent Shi; our CEO, Mr. Zemin Xu; our President, Mr. Justin Chen; our CFO, Mr. Roland Wu; and our Vice President of Capital Markets, Mr. 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 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 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*

Thanks, Dahlia. We thank you all for joining us today. The call is going to go as follows. Our CEO, Mr. Zemin Xu, will make some remarks, followed by our newly appointed President, Mr. Justin Chen. I will then provide an update on our businesses and operating trends. And Mr. Roland Wu will then review the financials and outlook for us. We will then open up the call for a Q&A session.



Now before we proceed forward with the call that I just laid out, I want to take a moment at the very beginning and provide an update on the FL Mobile Divestment since I'm sure some of you on this call are anxious to know.

Now let me reiterate what we have repeated many times before. We are moving forward with this divestment to unlock value for our shareholders. We believe that we have assets and businesses that are not being properly valued in the current state and we can unlock more of the value by selling or divesting some of them.

We were pleased to have closed on the NationSky divestment in December last year and we are progressing forward with our plan to divest FL Mobile. Yes, it is true that the FL Mobile divestiture has taken a long time. The amount of preparation necessary to get FL Mobile in position to be purchased by Beijing Jinxin, a subsidiary of Tsinghua Holdings, and a third party in conjunction with the binding framework agreement has been immense.

Yet we have come a long way. We have taken the necessary steps to see this through. While the initial third party listed company in China, Gansu Huangtai, was unable to proceed with this transaction as we announced a week ago today, the plan and the commitment is unchanged. We have made a lot of progress and we are getting there.

The buyers, the financial advisers and all the parties involved give us the confidence in this plan and eventual outcome. We appreciate your patience throughout and we look forward to sharing the next updates on this FL Mobile divestment very soon.

Now let me turn the call over to our CEO, Mr. Zemin Xu.

Zemin Xu - *NQ Mobile Inc. - CEO*

Thank you, Matt. Hello, everyone, and thank you for joining us. I'm pleased to report that the Company is operating solidly on the day-to-day business and we are seeing strong results in our consumer business. We continue to make gradual progress and we look forward to sharing more progress with you in the coming quarters.

I also wish to introduce to you today for the first time our newest member of the management team, Mr. Justin Chen. We are honored to have him part of our full-time team. I would like for him to say a few words.

Justin, please go ahead.

Justin Chen - *NQ Mobile Inc. - President*

Thank you, Zemin. I'm excited to be a part of the NQ management. As an Independent Director before, I have worked closely with this management team and have a great deal of respect for their hard work and deep passion for NQ and its businesses.

I am honored to have the opportunity to work in this new capacity. I also feel strongly about the future of NQ and will do my part to help us accomplish our goals going forward.

Thank you, everyone.

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

Thanks, Justin. And I also wish to echo Zemin's sentiment. We welcome you to our team and we are grateful to have you part of this organization. Now let's move on with the call.

With the divestment of NationSky completed, it is becoming more relevant and important to clearly entertain -- understand our entertainment and consumer businesses. I will still briefly provide you an update on our other businesses too, but I will particularly highlight the entertainment and consumer businesses.

The fourth quarter was marked by solid performance across our different entertainment and consumer businesses, and we saw a nice jump in our overall mobile value-added services segment, led by both FL Mobile and Showself. In fact, our MVAS segment really had a breakout quarter by showing slightly more than double year-over-year growth to a new record level of over \$51m. The breakout in this segment was the direct result of both the FL mobile game publishing business and the Showself live video platform business, both reaching new record levels and really demonstrating the growth potential that we are focused on.

Let me provide a more specific update on our FL Mobile Game publishing business, which just followed a record third quarter with another consecutive record quarter and achieving its best quarter ever in the fourth quarter.

As we discussed last quarter, the pipeline of games going into the second half of 2015 was robust. Additionally, we had several key launches that helped in addition to a strong set of games that we invested in during the second half. We saw this play out in our results as the game publishing revenues in the fourth quarter reached a new record level.

The FL Mobile team is excited about the current pipeline of games, including a big launch recently with Perfect World, where we are co-publishing a very popular title called the Legend of Condor Heroes 3D.

2016 is off to a good start and FL Mobile is poised for continued strong growth and performance given our recently launched title lineup as well as the pipeline and the backlog.

The team was also honored recently by winning this year the Golden Plum award for the most influential mobile game publisher in China. We are certainly proud of our FL Mobile team and their accomplishments.

As for the advertising segments within the FL Mobile business, the fourth quarter saw a seasonal snap back from the third-quarter levels in both online and offline channels. At the end of the third quarter the total reach of our online and offline advertising business was more than 958m devices, up from around 899m last quarter. In the fourth quarter, we grew the number of applications enabled on our platform to over 97,000. As a reminder, there is seasonality within the advertising segment and we would expect to see some seasonal headwinds during the first quarter.

Now let me discuss more details about our Showself live mobile video platform business, which, together with our other Showself-branded applications, will be the focus of our entertainment-led business following the completion of our divestitures. This is our live mobile social video platform, which has reached more than 6.7m MAUs, up around 176% from a year ago and up 38% sequentially from what was already a very strong third quarter.

As I mentioned at the beginning of this call, we are very pleased with the revenue growth of our live video platform business, which, incidentally, surpassed what the game publishing business that FL Mobile generated last quarter. Showself live video platform revenues accounted for approximately or actually slightly more than one-third of the total MVAS segment, and that represents more than 5X or more than 500% year-over-year growth and almost 60% sequential revenue growth quarter over quarter. We are also adding new platforms and new applications using this technology, and that is helping to generate new users and new interest with a more dedicated focus.

We are continuing to add new features and ways that our host can monetize these live shows. This is an enormous market and it is growing rapidly. We are one of the first movers here and one of the biggest mobile-only platforms. And we will work hard to capture and benefit from the opportunities of this market going forward.

Now let me elaborate and discuss our Showself desktop and Showself lock screen business. As a reminder, Showself desktop and lock screen is a collective group of applications that are personalized, interactive and programmable mobile desktop applications, including dynamic wallpapers, launchers and lock screens.

At the end of the fourth quarter we have shipped these on 250m devices, achieved more than 98m MAUs and also have more than 66m DAUs. That is up from 45m in the fourth quarter last year in MAUs and a little more than 21m DAUs in the fourth quarter last year.

Now the monetization of this traffic is still a work in progress and we continue to explore the optimal path toward revenue generation. We are gradually monetizing this through premium content and advertising. And as we stated last quarter, even though the monetization numbers are still small, we are operating this business at a rate that is breakeven on a standalone basis based on the revenue generation.

Our Showself Music Radar business continues to grow its traffic as well. At the end of the fourth quarter our Music Radar app or Doreso applications have more than 16m MAUs. And we're seeing more than 15m unique search queries a day.

Our partnerships are vast across the mobile ecosystems for audio and music search. As the music industry evolves in China, we believe that we will be able to capture our share of the market opportunistically given these vast industry partnerships and licensed traffic.

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. We did complete the divestment of NationSky at the end of December last year. And therefore going forward and beginning this year, this segment will consist mostly of Trustek. For your reference, Trustek represented approximately one-third of our enterprise mobility segment last year.

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

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 the discussion of our revenues in the fourth quarter and fiscal year 2015.

We generated \$127.5m in net revenues for the fourth quarter, a 45% increase compared with last quarter. And compared to last fiscal year, net revenues increased 22% to \$406.7m for the fiscal year 2015.

The key drivers to revenue growth came from our FL Mobile game publishing business, our Showself live mobile video publishing business, and our enterprise mobility business. Both FL Mobile and Showself reached new record levels in the fourth quarter and full year.

Our advertising revenues increased 38% sequentially due to strong seasonality but was slightly down year over year due to slower smartphone sales and shipments which impact our offline network, particularly for the full year.

Revenues derived from our enterprise mobility business increased 33% in the fourth quarter sequentially when compared with last quarter, and 28% for the fiscal year when compared to last year. Beginning from this year, Trustek will be the most significant part of the enterprise mobility segment, which historically has been about one-third of the total enterprise segment performance, mostly with hardware sales.

Next, let's spend a few minutes 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 to 18% from 24% last quarter. Gross margin for the fiscal year 2015 was 21.5%. Besides revenue mix and the impact from hardware sales, the main reason for the decline in the gross profit and gross margin was due to the decision to invest more on user acquisition promotional activities. There will continue to be quarter-to-quarter fluctuations because of the factors such as revenue mix and so on.

Let me now walk you through our operating expenses. In the fourth quarter our total operating expenses was \$41.2m and for fiscal year was \$121.2m.

We significantly reduced our operating expenses for the year, down 35% from \$186.6m last year. This was one of our objectives of the year and we will continue to stay focused on this going forward.



Total share-based compensation expenses was \$4.4m in the fourth quarter and \$16.6m for the full year. This was significantly below last year's total SBC expenses of \$83.8m.

As a management team, we are very focused on controlling our costs and adhering to our budget. I am pleased with our progress on this front. We have completed a Company-wide and sustainable budget and cost structure which we believe are most properly aligned with the revenue potential in each Group.

Our net income attributable to NQ Mobile for this quarter was \$19.9m or \$0.21 per ADS compared with a net loss of \$2.5m last quarter. We record a gain of \$56.2m from the disposal of NationSky. For the fiscal year 2015 our net loss was \$1.3m or \$0.01 per ADS compared with a net loss of \$66.7m in 2014.

We also achieved non-GAAP net income attributable to NQ Mobile of \$43m for the quarter or \$0.46 per ADS and \$51.3m for the full year or \$0.55 per ADS.

Finally, let me conclude my review of the financial performance for the fourth quarter and the full year of 2015 by highlighting a few other things. First, our balance sheet. We ended this quarter with \$254.3m of cash and cash equivalents, term deposits and restricted cash.

I wish to point out that the currency rate for translating our RMB figures to US dollars impacts our balance sheet by a little more than \$7m from the third-quarter results.

We generated \$8.6m in cash flow from operations in the fourth quarter. For the full year the total amount of net cash used in operating activities was \$12m.

Also I want to note a couple of things about the convertible notes. As a reminder, we raised \$172m in proceeds in October 2013 and 4% coupon convertible notes become due in October 2018. The holders of these notes have the right to put them to the Company at par in October of this year. But we don't know what each holder will ultimately do. In October of this year we are planning on preparing to pay the balance back entirely, assuming all of the outstanding notes are put this year. We are preparing and planning for this. And we'll be ready to pay the notes back according to the terms of [the falling].

Also you will notice that we have moved the total outstanding amount of debt related to the CB from the long-term liabilities to the short term on the balance sheet due to the options to put this to the Company this year.

And now, secondly, let me provide some preliminary guidance for 2016 for you. We won't provide you with some guidance about our annual revenue target in light of the closing of the NationSky divestment.

For 2016 we currently expect our total revenues to be between \$355m to \$360m. This is our preliminary outlook without the NationSky business. To put this into perspective for you, this assumes approximately 25% year-over-year growth if you compare it with 2015, ex NationSky.

This concludes my prepared remarks. And I will turn it back over to Matt.

Matt Mathison - NQ Mobile Inc. - VP Capital Markets

Great. Thank you, Roland. Kevin, this concludes our prepared presentation. Will you please open up the lines for Q&A? Thank you.



QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Jun Zhang, Rosenblatt Securities.

Jun Zhang - Rosenblatt Securities - Analyst

Thanks for taking my question. So my -- I have a couple of questions. So first question is could you give us more detail about the FL Mobile and Showself business and what's the growth rate right now for the December quarter? And for the Showself business, is that profitable in Q4 for the standalone business? And could you also give us some updates on FL Mobile deal? What's the next step the management team going to do to achieve firstly the goal for the deal? Thanks.

Matt Mathison - NQ Mobile Inc. - VP Capital Markets

Sure. Thanks, Jun. I will address your questions. Let's start with your first one, talking about -- why don't I talk about FL Mobile and Showself separately when you talk about growth? Clearly -- and I'll start with FL Mobile.

Clearly the mobile game business in China is a fast-growing sector and industry and it's growing very rapidly. We have a very strong position at FL Mobile within this segment. We're performing very well. Obviously the fourth quarter was a breakout quarter for the mobile game publishing business, with really rapid growth.

And as I highlighted in my prepared remarks, given our backlog and our title lineup that we have coming out, including just the recently launched Perfect World game that we're co-publishing with them, we are poised to continue this strong growth that we saw in Q4. So 2016 should be a really strong year and we'd expect similar growth rates for FL Mobile.

On the Showself, again, this live mobile video industry in China is exploding. And the business, the sector is young. It's fairly -- it's young and it's in infancy, but it's growing really rapidly. And there's lots of players and lots of competitors. The nice thing about Showself is we're a first mover and an early mover here.

We started as a mobile-only platform, so we're not going from a desktop heritage and trying to convert into mobile. We go mobile-only. And again, given the immense growth that we're seeing in that industry, we're very excited about what 2016 and the future holds for that. And so again, the growth rates are obviously really large in Showself but obviously coming off very small bases. And so those will normalize some, but the growth rates will remain very rapid in this year.

I think you asked about profitability or whether Showself was profitable on a standalone basis. The answer's yes. It's obviously a lower gross-margin business because of the revenue share that we have with our hosts and our agents. But even though it's a lower gross-margin business, it's profitable, and so yes.

And I can't remember, what was the last question you asked?

Jun Zhang - Rosenblatt Securities - Analyst

The last question is updates on the FL Mobile deal and what's the next step the management team is going to do achieve the previous goal to divest FL Mobile? Thanks.



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

Yes. Again, obviously I have to be careful about what I say here, obviously because we have an ongoing divestment and deal process going on. But what I can say and reiterate is the buyers and all the parties involved remain committed to that binding framework agreement that was put in place last summer. And we are marching forward and getting closer to the completion of that. So we'll obviously provide updates as they come.

But again, I just point you back to my prepared remarks. We've made a lot of progress. There was a tremendous amount of preparation that had to happen in order to position FL Mobile to actually be sold to a third party, and obviously one listed in China via the binding framework agreement with Tsinghua. And that work has been done and so we're moving closer. And we'll provide an update very soon on that.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. So Tsinghua still, the binding -- you still have the binding agreement with Tsinghua Holdings, right?

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

Yes. No change to that. No change at all to that.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. And my follow-up question, could you give us some details about -- you have about \$12m investment impairments and also I saw you only collect about \$53m payment for the NationSky deal. So could you give us some details on that investment impairment and what's the progress about NationSky payment collection? Thanks.

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

Sure, yes. Actually, just to correct you, we received the full amount for the NationSky divestment. And that -- we received that full amount during the fourth quarter. I think that the \$56m that you're referring to, that was the gain on the disposal of that investment that was recorded as a gain. But we received in cash the full amount in the fourth quarter. So that's that.

In terms of the impairment question, yes, as you know, through regular process we follow all required accounting and auditing and regulatory procedures around the fair value treatment of goodwill and our assets. And the \$12m impairment was related to this fair value treatment associated with our -- mostly from our investment in Hissage, which was one of our investments we made several years ago.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. And also my follow-up, another follow-up question, as Roland talked about, the Company is planning to pay back the convertible balance this year. So could you give us some color on that? After paying back the capital bond, what cash level you have remaining on the balance sheet? Thanks.

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

Yes. Obviously at the end of the year, Jun, our cash and cash equivalents and term deposits balance was a little more than \$254m. So we have a very robust and strong balance sheet. We generated cash flow from operations in Q4. Even for the full year, given all of the changes and the extreme one-offs, the total amount of cash used in operations for the full year was only \$12m.



So we're going to continue to grow cash. Obviously there'll be some quarter-to-quarter fluctuations. But we have a strong balance sheet. And I think Roland's point is he's just reiterating that, providing the information on the convertible bond. There is this put option. And as an organization and as a management team, we're just fully expecting and planning on doing that in October. Whether or not all the holders put or not, that will be their decision. But we're planning for it and making the necessary preparations and feel very comfortable with our balance sheet and our liquidity.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay. Thanks. Congrats on a solid quarter. Thanks. That's all my questions.

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

Thank you. Kevin, are there any other questions?

Operator

There are no further questions at this time. I'd like to hand the call over back to you. Thank you.

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

Great. Thanks. Just as a reminder, obviously these calls are reserved for Q&As from analysts, but to the extent that other investors and others have other questions, we obviously will make ourselves available. You can reach us at investors-at-nq.com and we'll find time to answer any remaining questions that you may have from these results.

So we appreciate your time tonight in the US and obviously this morning in Asia. And we wish you all a good day and we'll talk to you soon.

Operator

Thank you, ladies and gentlemen. That does conclude our conference today. Thank you for participating. You may all disconnect.

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