

[YALA] - Yalla Group Limited
Q3 2020 Earnings Conference Call
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Executives

Kerry Gao, Senior IR Manager
Yang Tao, Founder, Chairman and Chief Executive Officer
Saifi Ismail, President
Karen Hu, Chief Financial Officer

Analysts

Billy Leung, Haitong International
Alex Poon, Morgan Stanley
Bo Pei, Oppenheimer

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by for Yalla Group Limited's third quarter earnings conference call. At this time, all participants are in a listen-only mode. After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

Now I will turn the call over to your speaker host today, Ms. Kerry Gao, IR Director of the company. Please go ahead, ma'am.

Kerry Gao: Hello, everyone, and welcome to Yalla's Third Quarter 2020 Earnings Conference Call. We have released our earnings results earlier today, and it is now available on our IR website as well as on Newswire services.

Before we continue, please note that the discussion today will contain forward-looking statements made under the safe harbor provision of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, our future results may be materially different from the views expressed today.

Further information regarding this and other risks and uncertainties is included in our earning release and our registration statements filed with the SEC. Yalla does not assume any obligation to update any forward-looking statements, except as required by law.

Please also note that Yalla's earnings press release and this conference call include discussion of unaudited GAAP financial information as well as unaudited non-GAAP financial measures. Yalla's press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures.

Today, you'll hear from Mr. Tao Yang, our Chairman and Chief Executive Officer, who will provide an overview of our recent achievements and growth strategies. He'll be followed by Mr. Saifi Ismail, the company's President, who will give a brief review on the Yalla's IPO ceremony in UAE and the support we received from the local government and media. And he will be followed by Ms. Karen Hu, our Chief Financial Officer, who'll provide additional details on the company's financial results and discuss the financial outlook.

Following management's prepared remarks, we'll open up the call to questions. Our Chief Operating Officer Mr. Jeff Xu will join the call for our Q&A session.

Just want to kindly remind Yalla's 3Q earnings presentation slides are now available on Yalla's IR website for investors to download.

With that said, I would now like to turn the call over to our Chairman and Chief Executive Officer, Mr. Tao Yang. Please go ahead, sir.

Tao Yang: Okay. Thank you, Kerry. Good morning and good evening, ladies and gentlemen. Thank you for joining us today on our third quarter 2020 earnings call. This is our first earnings call as a public company following our IPO in September this year. We appreciate having the opportunity to communicate directly to you all and share our insights on our business operations and financial performance.

We are very pleased to announce that in the third quarter of 2020, we delivered robust group performance, further strengthening our position as the pioneering voice-centric mobile social networking and entertainment platform in MENA. And our revenue and non-GAAP net income reached to US\$33.8 million and US\$15.5 million, increasing 90.4% and 68.3% year-over-year respectively, driven by the strong growth of Yalla and Yalla Ludo and the proliferation of our highly engaged and interactive user community.

Strategically and operationally, during the quarter, we continued to emphasize our core competitive strengths. As the first mover in developing a voice-centric mobile social networking and entertainment platform in MENA, we have achieved a leading position based on our innovative business model, which focuses on users' interactions and social networking experience on our platform, and our deep understanding of the local culture.

As a pure UGC platform, we encourage users to share and participate actively and bring them a sense of belonging as well as a cultural identity, which helps build a healthy and cohesive user community. Going forward, we'll continue to further penetrate into both existing markets and new markets to expand our user base, as well as respond to users' evolving demands and add new features to optimize the user experience and enhance their engagement.

We differentiate from other online social networking and entertainment platforms with our superior social leisure experience for users, as we provide highly localized and customized product offerings. Our platform's interaction and communication features are based on different cultural or backgrounds of users, which underpins the foundation for social interactions in MENA. In addition, none of our products and services currently have any advertising tied to it in order to ensure the highest-quality user experience.

The uniqueness of our business model and the premium user experience we offer on our platform have contributed to strong monetization capabilities for us. In the third quarter and the first 9 months of 2020, our adjusted net margin was 45.8% and 47% respectively. Through the sale of virtual items and upgraded services such as VIP rights or premium memberships on our platform, we will further capitalize on the immense market opportunities in MENA, where stable economic development and well-established mobile Internet infrastructure have created a positive environment for the online social networking and entertainment market.

Now let's take a closer look at the third quarter performance of our core products Yalla and Yalla Ludo. Yalla primarily features Yalla rooms, which can be viewed as the online version of majlis or cafés, where people spend their leisure time in casual chats. For Yalla, we maintained a sharp focus on building a tight-knit and high-quality user community.

In the third quarter, Yalla's average MAUs and paying users both more than doubled year-over-year, exceeding 5.5 million and 1 million, respectively. We will continue to enrich Yalla with new localized features and new mobile social leisure activities tailored to users in MENA, in an effort to improve user engagement.

Let's turn to our second flagship mobile application, Yalla Ludo, for which we have been growing the user base and strengthen our monetization capability significantly. Yalla Ludo resembles a family living room where family members and friends play simple board games that are highly popular in MENA, such as Ludo and Domino. While playing games, users can voice-chat and bond with other players, as well as engage in social networking through chat rooms. We also organize various types of tournaments to enrich users' gaming experiences on our platform.

Since its introduction in the third quarter of 2018, Yalla Ludo has rapidly gained popularity, and has become a significant driver of our user community expansion and now also an important contributor of our revenue growth.

In the third quarter of 2020, the average MAUs of Yalla Ludo increased by more than 20 times to 8.8 million. The rapidly growing popularity of Yalla Ludo, which was recommended by numerous app stores, including Apple Store and Google Store on their home pages, is a testament to its superior foundation of social features tied to the cultural norms of the region, with users able to enjoy real-time voice interaction while playing board games.

Looking ahead, we are confident that we can continue to capitalize on the significant growth potential in MENA's underserved online social networking and entertainment market. With our continuous product innovation and our committed vision to cultivating an online voice-centric social community, we are optimistic we can continue to strengthen and broaden our monetization capabilities.

And now I will turn this call over to our President, Mr. Saifi Ismail, to give you a closer look of Yalla's IPO ceremony in UAE and the supports we received from local government and media.

Saifi Ismail: Thanks, Tao. We are proud to be the first UAE-based technology unicorn to go public at the NYSE. Our successful September 30 listing on the New York Stock Exchange this year has attracted immense attention from many UAE leaders and royal family members. The Vice President and Prime Minister of the UAE, His Highness Sheikh Mohammed Bin Rashid,

and the Minister of the Digital Economy, congratulated us on our IPO and highlighted Yalla as the first UAE-based technology unicorn to be listed on the New York Stock Exchange in front of the public.

We were also honored to have members of the royal family attend our listing ceremony in Dubai. In addition, more than 100 members of the Dubai media reported on our listing, many of whom had stories that lead their front-page headlines, providing further exposure for Yalla. Getting listed in the United States is an important strategic move for Yalla, and we look forward to seeing more local partnership and branding opportunities across the MENA region in the future.

Now I will turn this call over to our CFO, Ms. Karen Hu, for a closer review of our financial performance in the third quarter.

Karen Hu: Thank you, Saifi. Hello, everyone. Thank you for joining us. We are very pleased to report our operating and financial performance for the first time as a public company, where our strong monetization capabilities led to healthy top and bottom line performance in the third quarter.

Our revenues reached US\$33.8 million in the third quarter while our non-GAAP net income was US\$15.5 million. We were also able to maintain a high non-GAAP net margin of 45.8%. We are confident in our positioning and ability to capture further significant growth in MENA's underserved online social networking and entertainment market.

Now I would like to walk through our financial details for the third quarter of 2020. Our revenues were US\$33.8 million in the third quarter of 2020, a 90.4% increase from US\$17.8 million in the same period last year. The increase was primarily driven by the widening of both Yalla's and Yalla Ludo's user base and the robust enhancement in Yalla Ludo's monetization capability.

Our average MAUs increased by 358.9% from 3.1 million in the third quarter of 2019 to 14.3 million in the third quarter of 2020. Besides, another primary contributor to our solid revenue growth was the significant increase in the number of paying users, which grew from 510,000 in the third quarter of 2019 to 5.1 million in the third quarter of 2020.

Our revenues generated from group chatting services were US\$30.3 million in the third quarter of 2020. And our revenues generated from gaming services were US\$3.5 million in the third quarter of 2020.

Now let's look at our costs and expenses. Our cost of revenues was US\$25.6 million in the third quarter of 2020, compared with US\$5.4 million in the same period last year. Excluding share-based compensation expenses, other components of cost of revenues were US\$11.5 million for the third quarter of 2020, a 112.6% increase from US\$5.4 million for the same quarter last year, which was in line with our revenue growth and primarily due to our expanding business scale.

Excluding share-based compensation expenses, cost of revenues as a percentage of our total revenues increased from 30.6% in the third quarter of 2019 to 34.1% in the same period in 2020, primarily due to an increase in commission rate for third-party payment platforms.

Our selling and marketing expenses were US\$8.5 million in the third quarter of 2020, compared with US\$1.7 million in the same period last year. Excluding share-based compensation expenses, other components of selling and marketing expenses were US\$4 million for the third quarter of 2020, a 131.4% increase from US\$1.7 million for the same quarter last year, which was primarily due to higher advertising and marketing promotion expenses as a result of our continued user acquisition efforts.

Excluding share-based compensation expenses, selling and marketing expenses, as a percentage of our total revenues, increased from 9.9% in the third quarter of 2019 to 12% in the same period in 2020, primarily due to higher spending in marketing activities related to Yalla Ludo, which experienced substantial growth in the year 2020.

Our general and administrative expenses were US\$28.9 million in the third quarter of 2020, compared with US\$1 million in the same period last year.

Excluding share-based compensation expenses, other components of general and administrative expenses were US\$1.8 million for the third quarter of 2020, a 78.4% increase from US\$1 million for the same quarter last year, which was primarily due to, one, an increase in salaries and other benefits for our general and administrative staff, which was in turn driven by an expansion of our general and administrative staff; and two, an increase in professional service fees.

Excluding share-based compensation expenses, general and administrative expenses, as a percentage of our total revenues, remained at a very stable level of 5.3% in the third quarter of 2020.

Our technology and product development expenses were US\$1.7 million in the third quarter of 2020, compared with US\$0.4 million in the same period last year. Excluding share-based compensation expenses, other components of technology and product development expenses were US\$0.9 million for the third quarter of 2020, a 105.6% increase from US\$0.4 million for the same quarter last year, which was primarily due to an increase in salaries and benefits for our technology and product development staff.

Excluding share-based compensation expenses, technology and product development expenses, as a percentage of our total revenues, slightly increased from 2.4% in the third quarter of 2019 to 2.6% in the same period of 2020. As such, our operating loss was US\$30.9 million in the third quarter of 2020, compared with operating income of US\$9.1 million in the same period last year.

Excluding share-based compensation expenses, non-GAAP operating income for the third quarter of 2020 was US\$15.6 million, a 70% increase from the same quarter last year.

Our income tax expense was US\$0.11 million in the same quarter of 2020.

As a result of the foregoing, our net loss was US\$31 million in the third quarter of 2020, a 436.9% decrease from US\$9.2 million in the same period last year. Excluding share-based compensation expenses, non-GAAP net income for the third quarter of 2020 was US\$15.5 million, a 68.3% increase from US\$9.2 million for the same quarter last year.

Next, I would like to briefly look at our cash and cash equivalents. As of September 30, 2020, we had cash and cash equivalents of US\$75.7 million, as compared to cash and cash equivalents of US\$58.5 million as of June 30, 2020.

For the fourth quarter of 2020, we expect our revenues to be between US\$35 million and US\$36 million.

The above outlook is based on current market conditions, and reflects the Company management's current and preliminary estimates of market and operating conditions and customer demand, which are all subject to change.

This concludes our prepared remarks for today. Operator, we are now ready to take questions.

Question and Answer Session

Operator: We will now begin the question-and-answer session. (Operator Instructions).

[Billy Leung with Haitong] International.

Billy Leung: Thank for taking my question Yangzong, Saifi and Karen. Congratulations on a good set of results since your listing. I have a few questions. The first question is just to do with our outlook. We've got very strong growth in Q3 and we're also expecting strong growth in Q4. So my first question is do we have any revenue target for 2021, or maybe user target for 2021? That's my first question.

In terms of the second question, I am wondering if management can share any details on the time spent for Yalla and Yallo Ludo during Q3.

And my final question, my third question, is whether we can share any color on maybe new apps or functions or features for 2021 over the next 12 months. Thank you, that's all my questions.

Karen Hu: Thanks, Mr. Leung. The first question is based on the company's current estimates. Our revenue for the year 2021 will exceed US\$200 million. And for the next question, I will transfer to Yang to give you answer.

Yang Tao: For the update on the time spent, the average daily time spent for Yalla was 4.5 hours in Q2, and we have this number [increased] in Q3. However, we hope investors understand that Yalla's daily average time spent is already very high compared with the peer average. And we hope we can be more rational when we look at the growth of this metric. And for Yalla Ludo, the average daily time spent reached to 105 minutes, and we think there are still ample room to grow. This is the update for the time spent.

And for the pipeline of the new apps, we have our Yalla Baloot for the Gulf countries launched recently, and we are still under optimization. And hopefully, we will start our campaign from

early of next year for Yalla Baloot. And we have another casual game for Turkish people; it's called 101 Okey. It's still under development. I think we will launch it in Apple and Google in December this year.

And for the pipeline in next year, we do have our plans, but we prefer not to disclose at this moment. Hope you can understand. Thank you, Billy.

Billy Leung: Thank you. Thank you. That was very helpful and congratulations again. I'll get back into queue.

Tao Yang: Thank you very much Billy, thank you.

Operator: Our next question comes from Alex Poon with Morgan Stanley , please go ahead.

Alex Poon: Hi management, Congratulations on the very strong results. I have a question on the use of cash. Can you tell us what's your plan for the use of cash, especially IPO proceeds in the remaining of the year and also next year, the type of cash?

And my second question is regarding if I look at the sequential growth, is there anything to do with the normalization of Covid-19 because there was more severe lockdown during the second quarter period. How does it affect the user engagement in third quarter compared to second quarter? Thank you.

Karen Hu: Thanks Alex. For the first question in use of proceeds, to (inaudible) with our Group's strategy, we will use our proceeds to continue to expand our user base and new product development. As a result, we see ourselves investing more into technology and marketing, and then develop our chances on partnership. We believe that we will spend around 30% to 40% on marketing, and 20% to 30% on R&D. And we will be very cautious at spending the remaining 30% on M&A or strategic collaborations of some projects.

At the moment, I would think that organic (inaudible) rate for the company to grow and MENA will continue to be our key focus in terms of regions to capturing the users. For the Covid-19 influence, we both think that Covid-19 is inference us as a positive effect. But now, Yalla and Yalla Ludo still keep the pace for the growth always under our control. So we can -- we think that in the next quarter, we will still -- can beat our expectations, and we will see. Thank you.

Alex Poon: Thank you very much.

Operator: Bo Pei with Oppenheimer. Please go ahead.

Bo Pei: Hi good morning management, thanks for taking my question. Congrats on the solid results and the recent IPO. So I have two questions if I may. So the first is about our two products, very successful in MENA. So I'm just wondering what are the most of our products in MENA? Is that use of scale, or is there something else?

And then the second question is, you talked about a little bit the new product launch plan. And then I'm just wondering, the rationale and the strategies behind this product launch, how do we

decide what kind of products to develop? How do we determine the market opportunities, and then related to that.

Yang Tao: Thank you. Thank you. Mr. Pei. I'll answer the two questions. For the first question, I think first of all, we have already built a highly interactive and engaged user community. And our unique business model differs from the traditional live broadcast with interaction, it's mostly one way. There is no host in any of our chat rooms and all contents are user-generated. This allows all users in Yalla and Yalla Ludo to participate actively, further stimulate their activities that strengthen our user loyalty to our platform.

Besides, we have a very strong local team. The management has a deep understanding to the MENA market. MENA is a market with high barrier. Without local knowhow, it's very difficult to succeed here. A team with years of experience and living in this area and expertise in the TMT industry is also very important. I think that's the most for our product in MENA.

And for the second question, just now I already replied Mr. Alex about our product pipeline, which are Yalla Baloot and 101 Okey for Turkish people, and that we are not restricted to the two. We have other plans, but we prefer not to disclose it at this moment. But for the -- I can tell you what -- how we decide what kind of products we plan to develop, what's our decision chain in our company. We have a very strong local team, and the management has deep understanding to the MENA market, as mentioned just now.

We will make our decision based on the management local knowhow combined with insights we gained from user survey we conducted. Now we have already over 15 million MAUs with both Yalla and Yalla Ludo so we have our user survey, and what they like, what they'd like to have, in the future, we know that. At this stage, we already identified popular social networking and entertainment activities offline, and replicated them online to fulfill the MENA local people's daily needs that have existed for a long time. Thank you. That is our answer.

Bo Pei: Thank you. That's very helpful. Thank you.

Operator: (Operator Instructions). -Billy Leung with Haitong International.

Billy Leung: Hi management, it's Billy from Haitong again. Just wanted to follow up with one question and it's to do with competition. Can management maybe share their view or maybe the outlook of what you see in terms of voice social networking, or maybe just in terms of social networking competition in MENA region, just to share with us in terms of the competitive environment?

Saifi Ismail: I would like to answer that question. So there are well-established online social network and entertainment companies that are trying to get into MENA like YY, who have developed apps like Bigo, Hago and Hello Yo. If you look at the MAU numbers of Bigo or Hago, they have around 10 to 12 million monthly active users in MENA in the Q2 of 2020 at most. They have been in the market since 2018 and they are still just of the same or, if not smaller, than our company.

Therefore, we would like to emphasize that it's not that we have not faced any competition; the competition do exist in MENA and we are able to compete effectively due to couple of reasons:

number one is our ability of understanding what the MENA user really need as we mentioned before. Second is the design of our product, not just duplicating a product from the West or East to MENA. We have very effective marketing and user acquisition strategy, which is reflected in our sales and marketing expenses.

For the third reason, more importantly, the community we have established is a strong barrier to entry. User is very sticky to our platform, more than 5 hours they spend on the daily average. So in that case, I think MENA is a very highly underserved market. Even if there are more apps coming into the market, why can't we co-exist just like China and U.S.? We said the different needs of online users and the other competitors like Bigo live streaming, and we do voice-chat and casual games, also shares short videos, we will all have our own position in MENA.

Billy Leung: Thank you, Saifi, that was very, very helpful. And just to follow up on that, is it possible to share maybe some engagement data for Q3 against Q2? Are we seeing better engagement in the last quarter?

Saifi Ismail: In terms of engagement, it's the same users' behavior. We have seen the users engaging on our Yalla platforms. They are socializing, talking, singing, running music, sharing moments of a lot of photos with each other; the gifting nature is very strong as we go on. And the Yalla Ludo experience also the same behavior after we integrated the online Majlis, but the users are still enjoying and entertaining and playing the game of Ludo and Domino. So the users are still having the same level of engagement, if not more, and this is proven by the incremental of the time spent on our platform.

Billy Leung: Thank you. That was helpful. I'll get back into queue.

Operator: As there are no other questions, now I'd like to turn the call back over to management for closing remarks.

Kerry Gao: Thank you once again for joining us today. We look forward to speaking with you in the next quarter. If you have further questions, please feel free to contact Yalla's investor relations through the contact information provided on our website or The Piacente Group Investor Relations.

Yang Tao: Okay. Thank you. Thank you all. Ladies and gentlemen.

Operator: This concludes the conference call. You may now disconnect your lines. Thank you.