

[YALA] Yalla Group Ltd.
Q3 2021 Earnings Conference Call
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Executives

Kerry Gao, IR Director
Tao Yang, Chairman and Chief Executive Officer
Saifi Ismail, President
Karen Hu, Chief Financial Officer
Jeff Xu, Chief Operating Officer

Analysts

Shiqi Ge, CICC
Kaifang Jia, CITIC
Yulin Zhong, Haitong International
Thomas Shen, Nomura
Yuchen Yang, TF Securities

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by for Yalla Group's Limited Third Quarter 2021 Earnings Conference Call. (Operator Instructions). After management's prepared remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I would now like to turn the call over to Ms. Kerry Gao, Director of IR of the company. Please go ahead.

Kerry Gao: Hello, everyone, and welcome to Yalla's Third Quarter 2021 Earnings Conference Call. We released our earnings earlier today, and the release is now available on our IR website as well as on our 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 these and other risks and uncertainties is included in our earnings 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 will be followed by Mr. Saifi Ismail, the company's President, who will give a brief review of our recent developments. Ms. Karen Hu, our Chief Financial Officer, will then provide additional details on the company's financial results and discuss 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 QA session.

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: Thank you, Kerry, and thank you, everyone, for joining our 2021 third quarter earnings conference call. It has been a year since Yalla's NYSE listing. Before updating you on our business progress during this quarter, I would like to take a moment to elaborate on our mission, vision and strategy.

Yalla was the first UAE technology unicorn to be listed in the U.S. As a company rooted in the Middle East and North Africa, our mission is to provide MENA users with localized online social networking and entertainment services. For 5 years, we have been committed to promoting a healthy and orderly industry environment and providing MENA's people with better access to a digital life. MENA's population is among the youngest in the world, and the region's per-individual average time spent on apps is also considered the highest globally.

Demand for online social networking and entertainment services is high among MENA users, but historically, there have been few digital products reflecting local values or customized for local users' specific needs. When we drafted the prospectus for our IPO, we affirmed that our vision is to build MENA's most popular destination for online social networking and entertainment activities. After a year's time, this vision remains unchanged.

We hope to realize this vision within the next 10 years, and will employ two important strategies to achieve our goals. First, as we continue to develop Yalla's ecosystem, we will diversify our business and revenue streams, and flexibly develop our business and products through investment, collaboration, and other means. Second, Yalla's strong localization capabilities have always been our greatest advantage. We will continue to fortify and refine them with more comprehensive studies on local users' needs and preferences to provide customized, targeted and trendy online services.

Yalla is developing rapidly while also facing challenges in an increasingly complex environment. Under such transformative circumstances, we felt it was critical to help our new colleagues better understand Yalla's DNA and to think and act in Yalla's way. We worked with all of our team members to define and refine Yalla's core principles: Multicultural Understanding, Users First, Simple, and Target. Their initials constitute the memorable acronym M-U-S-T, MUST, which embodies Yalla's culture and ethics. These values will guide Yalla's team as we work to achieve our vision.

Now let's take a closer look at some of our recent accomplishments. Last month, we released the YallaChat 0.2 version. We upgraded the app's foundation and improved stability and response

rate, which elevate the user experience and will allow the product to support a larger user base in the future. We firmly believe that in the digital era, an IM product with features tailored to local users' preferences is a fundamental need, and the MENA region has waited too long for a dedicated product. We feel a strong sense of responsibility to fulfill that critical need for MENA-based users.

Developing a successful IM product is no easy feat, but it is a crucial element of our vision, and we are proud of our brave attempt to fill this technological gap. We will continue to monitor user feedback on YallaChat's new iteration and refine and perfect the details to cater to local users' desires.

As we are all aware, the metaverse will be the next major revolution in social technology. Long before the metaverse concept began trending this year, our team was researching new types of social networking opportunities to provide users with a higher level of freedom and more immersive social experiences. We see strong potential for development and innovation in this area. And we are happy to share that we are working on a cutting-edge social app, which will feature the first-ever social metaverse designed for the MENA region. It may be available to our users as early as the first quarter of 2022.

We are also building and broadening our capabilities in game distribution. We now have a holding subsidiary, Yalla Game, which will focus on the mid-core and hard-core game distribution business in the MENA region. We will identify and collaborate with game studios with high potential and good content, and to help distribute their games within MENA, leveraging our strong localization capabilities. We plan to gradually open our game distribution platform to more quality content, making Yalla Game the ideal MENA-based distribution partner for game developers in the near future.

With respect to our internal initiatives, we officially kicked off our internal ESG program this quarter. We have been communicating intensively with internal and external stakeholders to gather feedback and refine our ESG guidelines. We believe a sustainable growth target is essential for Yalla, our community and our shareholders.

Given the recent policies and initiatives announced by the UAE and Saudi Arabia governments, we understand that building a digital society is becoming a very important topic in this region. Our society is seeking a digital and technological transformation, which aligns with Yalla's vision and mission. As a local company, we support local governments' initiatives and strive to work in a direction consistent with their guidelines and priorities.

Looking into the future, Yalla will remain dedicated to the development of UAE's digital economy, and continue to deliver online social networking and entertainment products tailored to the MENA culture.

We are also proud to have bolstered our leadership and governance this quarter. It is my honor to welcome Mr. Saeed AI Hamli to the board as our independent director. He is an accomplished telecommunications executive, with prior roles as CEO of Etisalat Egypt and Etisalat Afghanistan, among other senior positions. I believe that given his excellent leadership skills and extensive industry experience, Mr. Saeed AI Hamli will make great contributions to the company

as we grow our product ecosystem, expand our footprint and our influence. I really look forward to working with him.

In conclusion, I'd like to reiterate that our vision to build the most popular destination for online social networking and entertainment activities in MENA. And we will continue to uphold our core values of prioritizing our users, embracing diversity, and operating with a simple, pragmatic, pioneering and enterprising approach as we work to achieve our goals. Adhering to these principals has been the driver of our past success and will ensure that we keep succeeding.

Looking ahead, we will continue to closely watch MENA's local cultural trends and develop Yalla's ecosystem with various products and services tailored to meet local users' needs.

Now I will turn this call over to our President Mr. Saifi Ismail for a closer look at our recent developments.

Saifi Ismail: Thanks, Tao. Hello, everyone. Thanks for joining us today. In addition to the accomplishments Tao shared, we have made impressive progress with our new products. 101 Okey remained one of the most downloaded app in the board game category in Turkey. We have received very good feedback from users on this product and are seeing an outstanding retention rate. The average daily time spent per active user already exceeds 60 minutes, which also demonstrates the product's increasing stickiness among users.

We are dedicated to providing our users with best-in-class user experiences. For example, in Quarter 3, we released a new version of Yalla Baloot, a card game we designed for Saudi users. We enhanced certain features to help new users learn about the game's flow and become a more integrated part of the community, which notably improved new users' engagement level on the platform.

Along with these new products designed for the MENA market, Yalla Parchis, the South American version of our Ludo app, also performed impressively. By the end of Quarter 3, Parchis contributed 786,000 of Yalla Group's monthly active users. Parchis is showing outstanding user stickiness. And our next step will be to cement our monetization strategy and begin to boost Parchis' monetization capabilities, taking South American cultural differences into consideration.

We are also very excited to share with you that Yalla Group is prominently featured on the official UAE government electronic portal, Invest.ae, as a highlighted local technology company. The UAE government's recognition of our work inspires an even greater commitment to ensuring that our products and services exceed our customers' expectations.

Yalla Group is proud to be one of the top technology companies in the MENA region. We prioritize research and strive to develop innovative features in our existing social and gaming mobile applications, as well as create brand-new apps to give our loyal users more engaging opportunities to express themselves. We believe Yalla Group has received this honor from UAE's government due in large part of these efforts.

We wish to sincerely thank the UAE government for their ongoing trust and belief in Yalla Group. We remain undeterred in our continuing pursuit of excellence and our efforts to maintain our leading position as one of the UAE's most prominent and thriving technology companies.

Additionally, we are delighted to have won a prestigious Middle East Technology Excellence award in the Gaming, Media & Entertainment category. The Middle East Technology Excellence Award recognizes technology companies that have successfully pioneered ground-breaking IT products and solutions in various categories in the Middle East. With recognition from specialized judges representing key players in the international digital industry, such as PwC Middle East and Baker Tilly Middle East, this award further solidifies our position as one of the MENA region's top companies. We now join an illustrious group of past winners including IBM, LinkedIn and Tencent.

We view this distinguished award as yet another testament to Yalla Group's excellent work and our team's accomplishments throughout the past year. We are proud to have created an immersive and social ecosystem filled with a variety of mobile applications that provide our users with memorable and cherished experiences, whether they are talking to friends on Yalla or playing against them on Yalla Ludo.

We would like to sincerely thank the Middle East Technology Excellence Awards Committee for this great honor. We hope to win many more regional and global awards over the next few years.

Furthermore, in September 2021, we hosted an Analyst Day to facilitate communications with our investment community. Our users, team members and industry experts shared their respective experiences with Yalla and the digital economy insights, presenting colorful close-up views of what we do, our market and its tremendous growth prospects. We would like to thank our expert guests for their valuable input. Analyst Day was a great success, and we look forward to future opportunities to organize similar events.

As our CEO mentioned, Yalla's vision has never changed. We aspire to become the #1 online social networking and entertainment platform in the MENA region and we remain focused on that goal.

With that, I will now turn the call over to our CFO, Karen, who will discuss our key financial and operational results.

Karen Hu: Thank you, Saifi. Hello, everyone. Thank you for joining us. We recorded remarkable operating and financial performance in the third quarter of 2021, with a rapidly expanding user base, outstanding operating efficiency and abundant cash reserves, underpinned by our unique market positioning. Our third quarter revenues grew by 110.8% year-over-year to US\$71.3 million, while our non-GAAP net income reached US\$33.2 million with a growth rate of 114.5% year-over-year.

Our non-GAAP net margin remained exceptionally high at 46.6%, reflecting our strong monetization capabilities and disciplined SG&A spending.

Now I would like to walk you through our financial details during the third quarter of 2021. Our revenues were US\$71.3 million in the third quarter of 2021, a 110.8% increase from US\$33.8

million in the same period last year. The increase was primarily driven by the broadening of Yalla Group's user base and enhancements to Yalla Group's monetization capabilities.

Our average MAUs increased by 81.9% from 14.3 million in the third quarter of 2020 to 25.9 million in the third quarter of this year. Yalla's MAUs increased by 72.2% to 9.5 million in the third quarter of 2021 from 5.5 million in the same quarter last year. And Yalla Ludo's MAUs increased by 79% to 15.7 million in the third quarter of 2021 from 8.8 million in the same period of last year. And Yalla Parchis's MAU also reached 786,000 in the third quarter of 2021.

Now let's look at our costs and expenses. Our cost of revenues was US\$23.4 million in the third quarter of 2021, compared with US\$25.6 million in the third quarter of 2020. The decrease was mainly driven by lower share-based compensation expenses of US\$1.3 million recognized during the third quarter of 2021, a 91% decrease from US\$14.1 million in the third quarter of 2020, and partially offset by an increase in commission fees for the third-party payment platforms resulting from our expanding business scale.

Excluding share-based compensation expenses, cost of revenues as a percentage of our total revenues decreased from 34.1% in the third quarter of 2020 to 31.1% in the same period of 2021 due to continued optimization of our revenue mix, which resulted in less increase in commission fees for third-party payment platforms.

Our selling and marketing expenses were US\$11 million in the third quarter of 2021, compared with US\$8.5 million in the same period last year. The increase was mainly driven by higher advertising and marketing promotion expenses, led by our continued user acquisition efforts and expanding product portfolio; and partially offset by decreased share-based compensation expenses of US\$1.8 million during the third quarter of 2021, compared with US\$4.5 million in the third quarter of 2020.

Excluding share-based compensation expenses, selling and marketing expenses as a percentage of our total revenues remained relatively stable at 12.9% in the third quarter of 2021.

Our general and administrative expenses were US\$7.3 million in the third quarter of 2021, compared with US\$28.9 million in the same period last year. The decrease was mainly driven by lower share-based compensation expenses of US\$4.6 million recognized during the third quarter of 2021, a 82.9% decrease from US\$27.1 million in the third quarter of 2020, and partially offset by an increase in salaries and other benefits for our general and administrative staff. This in turn was driven by an expansion of our general and administrative staff.

Excluding share-based compensation expenses, general and administrative expenses as a percentage of our total revenues decreased from 5.3% in the third quarter of 2020 to 3.8% in the third quarter of 2021 due to economies of scale.

Our technology and product development expenses were US\$3.9 million in the third quarter of 2021, compared with US\$1.7 million in the same period last year. The increase was mainly driven by an increase in salaries and benefits for our technology and product development staff, and partially offset by decreased share-based compensation expenses of US\$0.2 million during the third quarter of 2021, which compared with US\$0.8 million in the third quarter of 2020.

Excluding share-based compensation expenses, technology and product development expenses as a percentage of our total revenues also increased from 2.6% in the third quarter of 2020 to 5.1% in the same period of 2021.

As such, our operating income was US\$25.7 million in the third quarter of 2021, compared with operating loss of US\$30.9 million in the same period last year. Excluding share-based compensation, non-GAAP operating income in the third quarter of 2021 was US\$33.6 million, a 116.2% improvement from the same quarter last year.

Our income tax expense was US\$0.42 million in the third quarter of 2021, compared with US\$0.11 million in the third quarter of 2020.

Moving to the bottom line, our net income was US\$25.3 million in the third quarter of 2021, compared with net loss of US\$31 million in the same period last year. Excluding share-based compensation expenses, non-GAAP net income for the third quarter of 2021 was US\$33.2 million, a 114.5% improvement year-over-year.

Now next, I would like to briefly go through our liquidity and capital resources. As of September 30, 2021, we had cash and cash equivalents of US\$326.3 million, as compared to cash and cash equivalents of US\$292.4 million as of June 30, 2021. This improvement demonstrates our commitment to continuously streamlining and refining Yalla Group's operations.

On May 21, 2021, we announced the 2021 Share Repurchase Program. As an update, in the third quarter, we repurchased 1,042,985 American depositary shares, representing 1,042,985 Class A ordinary shares from the open market with cash for an aggregate amount of approximately US\$14 million.

In the fourth quarter of 2021, we expect our revenues to be between US\$67 million and US\$72 million.

The above outlook is based on the 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.

One more update before I hand the call over to the operator. Starting in the fourth quarter of 2021, as we continue to expand our product portfolio, we will report our MAUs and paying users at the Company level instead of by product, to better reflect our increasingly integrated product ecosystem.

This concludes our prepared remarks for today.