

[YALA] Yalla Group Ltd.
Q2 2023 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

Analysts

Xueqing Zhang, CICC
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Kaifang Jia, CITIC
Xiaoyue Hu, Haitong
Lincoln Kong, Goldman Sachs
Edward Wang, Credit Suisse
Rachel Guo, Nomura

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by for Yalla Group Limited's Second Quarter 2023 Earnings Conference Call. (Operator Instructions). After today'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, Kerry Gao, IR Director of the company. Please go ahead.

Kerry Gao: Hello, everyone, and welcome to Yalla's second quarter 2023 earnings conference call. We released our earnings press release earlier today, and the release is now available on our IR website as well as on newswire outlets.

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 annual report 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 a 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 will hear from Mr. Tao Yang, our Chairman and Chief Executive Officer, who will provide an overview of our latest achievements and growth strategies. He will be followed by Mr. Saifi Ismail, the company's President, who will briefly review our recent business developments. Ms. Karen Hu, our Chief Financial Officer, will then provide additional details on the company's financial results and discuss our financial outlook.

Following the management's prepared remarks, we will open up the call to questions.

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, everyone, for joining our second quarter 2023 earnings conference call. We delivered a robust performance this quarter, growing both our top and bottom lines. Despite the impact of the Ramadan holiday, our Q2 revenue reached USD79.2 million, showing Q-o-Q growth of 7.8%. This exceeds the upper end of our guidance by 5.7%, manifesting the popularity of our products.

Our continued efforts to drive quality growth and enhance our operating efficiency are also paying off. In Q2, our non-GAAP net margin reached 42.6%. Our robust quarterly performance showcases our dedication and ability to successfully refine our operations, enhance the gamification of our flagship applications and optimize our user acquisition strategies. All of these holistically elevated the experience for our users, further boosting Yalla and Yalla Ludo's users' willingness to stay and pay on our Apps.

As we discussed on our last call, 2023 has been a year of growth and development. We are witnessing a rapid digital transformation in the Middle East. The momentum we are seeing is arising from the recognition that the region's market opportunity may be strategically significant for global internet giants, as well as robust support from local MENA government, who are determined to build local industries. They are dedicated to fostering collaboration with various nations worldwide, actively participating in local ventures to drive global investments to domestic industries and increasing investments in disruptive projects overseas to create future strategic opportunities.

As the largest MENA-based online social networking and gaming company, Yalla is committed to facilitating this change in the MENA market, and we are glad to see more conversations taking place.

As we discussed last quarter, external collaborations are an important component of our go-forward growth strategy. We are happy to share our experiences and localization capabilities with more industry peers who are interested in exploring the MENA market. Our goal is to secure mutually-beneficial collaborations that expand businesses in our dynamic market where we see great potential in working together.

Next, I'd like to share some important updates on Yalla Game's recent developments. We are happy to report that Merge Kingdoms has been officially launched across MENA, and is now available on both the App Store and Google Play. Merge Kingdoms is a strategy game that takes players on a fun journey through an Arabian-themed landscape. It brings the world of Arabian folklore to life with stunning visuals, rich landscapes and beautiful Middle Eastern music.

The integration of Yalla's unique voice chat engine enhances the game's real-time strategy element. Merge Kingdoms is the first hard-core game to collaborate with Yalla Group on distribution. The game is being promoted on the home pages of both the App Store and Google Play for free, and was ranked as the No. 2 downloaded game in Saudi Arabia on iOS after its launch. We plan to gradually increase our investment in user acquisition in the next couple of months to increase the game's reach.

In terms of Yalla's first self-developed hard-core game Age of Legends, the team has been working on the new game iterations. As a first step, Age of Legends was first launched in Turkey, and at the beginning of August, we successfully launched the Arabic version across Gulf countries. The game was the No. 1 downloaded game in the Role Play Game category on iOS in both UAE and Saudi Arabia. We will continue to monitor Age of Legends' operating and financial performances, and we look forward to sharing more details with you on our next earnings call.

The establishment of Yalla Game is an important strategic move for us. We will keep exploring opportunities in mid-core and hard-core games. For the two hard-core games we just launched, we will continue to work on future iterations to gain regional traction. We will also continue to expand our pipeline of games through both self-development and external distribution collaborations. We look forward to building our mid-core and hard-core game portfolios, and expect these to serve as important growth drivers going forward.

Our vision is for Yalla to become the largest online social networking and entertainment company in MENA. We have high aspirations in this region, and the whole team has been working tirelessly to achieve this goal. We are exploring many possibilities and identifying how we can better serve MENA users' evolving needs for online services. Our strong cash flow and solid cash position are well-suited to support this journey.

Digital transformation in the Middle East is foreseeable, and the next 3 to 5 years will be a crucial period of this development. We are confident in our ability to capture growth opportunities in this promising and growing market. We will continue to enhance our investments in research and development, and further explore new business opportunities while we work with potential partners from around the world to generate more global participation in MENA's exciting future of digital transformation.

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

Saifi Ismail: Hello, everyone. Thanks for joining us today. Let's take a closer look at our Quarter 2 operations and the performance of our products. We are pleased to deliver robust Quarter 2 results.

Our monthly active users increased by 14.3% year-over-year, reaching 34.2 million. In Quarter 2, we rolled out an array of operation events on both Yalla and Yalla Ludo, refined our product features and systematically improved our customer service management. As a result, Yalla Group's paying users increased by 26.6% year-over-year to 13.4 million in Quarter 2, demonstrating users' increasing willingness to pay on our platform. Our team will continue to refine our user acquisition and operational strategies to further improve operating efficiency.

I am pleased to share with you that during Quarter 2, Yalla Group launched a new product developed to serve Arabic users' traditions in prayer, which plays a significant role in Arabic users' daily lives. Our team launched this user-friendly and ad-free app to provide users in the Arabic community with accurate praying times and a number of other customized functions related to prayer. The introduction of this app aligns with Yalla Group's ESG program, demonstrating our dedication to honoring Arabic culture, which represents a significant portion of today's culturally diverse society.

Next, it is my privilege to announce that as a leading local gaming company, Yalla was invited by the Department of Economy and Tourism of Dubai to participate in the Dubai Esports and Game Festival 2023. Attending the Festival in late June, we showcased our latest hard-core games and discussed the future of mobile games in MENA. Held under the patronage of the ruler of Dubai, the Dubai Esports and Game Festival is a premier esports and gaming event in the MENA region. It introduces the latest developments in the gaming industry through games expos, esports tournaments, influencer challenges and a game industry conference.

This event has also solidified Dubai as a global gaming destination and encouraged a sense of community among gaming enthusiasts. Offering an exceptional gaming experience steeped in Arabic customs, our two new games, Merge Kingdoms and Age of Legends, gained great popularity among players at the festival. This reflects our strong local expertise, and the event also strengthens our brand awareness across the region.

We are also pleased to report that in collaboration with Mohamed bin Zayed University of Artificial Intelligence, MBZUAI, we have launched a trailblazing program to cultivate new AI talent. As the first graduate-level research-based AI university in the world, MBZUAI works to enable the advancement of graduate students, businesses and governments in artificial intelligence in an Arabic environment.

In addition to the internship program that's taking place at Yalla Group's headquarters in Dubai, the two parties will also focus on industrial development, and explore the future application of cutting-edge technology to strengthen the alliance between industry and academia. As the largest online social networking and gaming company in MENA, over the past 7 years, Yalla Group has amassed a great deal of practical experience in natural language processing, computer vision and recommendation systems that fit with Arabic sentiment and Arabic users' customs.

We believe our cooperation with MBZUAI will provide both parties with new ideas, enhance the application of AI innovation in the Arabic environment, and support the acceleration of digital transformation in the region at large.

Last, but not least, we are very proud to announce that for 3 years in a row, Yalla Group was selected by data.ai as one of the top 30 publishers headquartered in Europe, the Middle East and Africa, EMEA, in the 2023 Publisher Awards. In the Middle East region, we were also recognized as being the No. 1 publisher based on consumer spending. Data.ai is a well-known global unified data analysis platform for the mobile application market.

Our No. 1 rating validates our deep local know-how in this increasingly competitive market and the strength of our monetization capabilities. We are honored to receive data.ai's prestigious award, and look forward to continuously providing MENA users with high-quality, customized digital products to meet the fast-growing demands of online users.

In conclusion, I would like to echo the sentiment that Yalla's vision is to become the No. 1 online social networking and entertainment platform in the MENA region. As MENA's digital transformation gathers pivotal momentum over the next 3 to 5 years, we will leverage our extensive operating experience in this region, continue to invest in R&D and roll out new products tailored to local users' habits and preferences.

We will also work to expand our partnerships with local channels and look forward for collaboration opportunities with industry peers around the globe who are eager to explore the MENA market. Keeping our Group vision in mind, we will remain faithful to 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.

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 today. In the second quarter, we achieved solid top-and bottom-line growth as we continued to pursue the high-quality development of our business. We remain committed to executing our disciplined cost management and ROI-faced marketing strategy, further elevating our overall operational efficiency.

We have also strategically leveraged the high-interest rates to achieve higher return to support our strong cash position. As a result, we maintained a healthy level of profitability with a net margin of 35.7% and a non-GAAP net margin of 42.6%.

As we move into the second half-year of 2023, we will continue to leverage our high-quality growth strategy and further enhance our efficiency. We believe our ample cash position and strong execution capabilities will equip us to seize future opportunities that can foster sustainable growth and generate value for all of our stakeholders.

Now I would like to walk you through our detailed financials for the second quarter of 2023. Our revenues were USD79.2 million in the second quarter of 2023, a 4.1% increase from USD76.1 million in the second quarter of last year. The increase was primarily driven by the broadening of our user base and our enhanced monetization capabilities.

Now let's take a look at our costs and expenses. Our total costs and expenses remained relatively stable at USD55.3 million in the second quarter of 2023, compared with USD55.2 million in the same period of last year.

Our cost of revenues decreased by 3.2% to USD28.3 million in the second quarter of 2023, down from USD29.3 million in the same period last year. The decrease was primarily due to lower commission fees paid to third-party payment platforms, as we diversified our payment channels, as well as lower technical service fees as a result of our more disciplined cost management.

Cost of revenues, as a percentage of our total revenues, decreased from 35.8% in the second quarter of 2023, compared with 38.5% in the same period last year.

Our selling and marketing expenses were USD12.4 million in the second quarter of 2023, a 10.4% increase from USD11.2 million in the same period last year. The increase was primarily due to higher advertising and marketing promotion expenses related to increased user acquisition efforts and promotions associated with our expanding product portfolio.

Selling and marketing expenses, as a percentage of total revenues, remained relatively stable at 15.6%, compared with 14.7% in the same period of last year.

Our general and administrative expenses were USD8 million in the second quarter of 2023, a 15.4% increase from USD6.9 million in the same period last year, primarily due to an increase in incentive compensation and an increase in professional service fees. General and administrative expenses, as a percentage of total revenues, remained relatively stable at 10.1%, compared with 9.1% in the same period last year.

Our technology and product development expenses were USD6.6 million in the second quarter of 2023, a 14.8% decrease from USD7.7 million in the same period last year, primarily due to the appreciation of the U.S. dollar, which resulted in a decrease in the reporting currency amount of salaries and benefits for our technology and product development team, showing one of the benefits of our globalized talent acquisition strategy.

Technology and product development expenses, as a percentage of our total revenues, decreased from 10.2% in the second quarter of 2022 to 8.3% in the second quarter of 2023. As such, our operating income increased to USD23.9 million in the second quarter of 2023, compared with USD20.9 million in the same period last year. Excluding share-based compensation, our non-GAAP operating income in the second quarter of 2023 was USD29.4 million.

Our interest income was USD4.6 million in the second quarter of 2023, compared with USD176,000 in the same period of 2022, primarily due to a significant increase in interest rates applicable to our bank deposits and a continued increase in the company's cash position.

Our income tax expense was USD821,000 in the second quarter of 2023, compared with USD780,000 in the same period last year.

Moving to our bottom line, our net income increased by 39% to USD28.3 million in the second quarter of 2023, compared with USD20.4 million in the same period last year. Excluding share-

based compensation expenses, non-GAAP net income for the second quarter of 2023 increased by 18% year-over-year to USD33.8 million.

Next, I would like to briefly go through our liquidity and capital resources. Our cash position remains solid. And as of June 30, 2023, we had cash and cash equivalents, term deposits and short-term investments of USD510.5 million, compared with USD453 million as of December 31, 2022.

Under our Share Repurchase Program that began May 21, 2021, and has since been extended by our Board through May 21, 2024, we have repurchased 2,302,141 ADSs or Class A ordinary shares, in open market cash repurchases, totaling approximately USD27 million as of June 30, 2023.

Moving to our outlook. For the third quarter of 2023, we expect our revenues to be between USD73 million and USD80 million.

The above outlook is based on the current market conditions and reflects the company management's current and preliminary estimates of the 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.