

[YALA] Yalla Group Ltd.
Q2 2021 Earnings Conference Call
August 9, 2021 8:00 PM E.T.

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
Bo Pei, Oppenheimer
Kaifang Jia, CITIC
Yulin Zhong, Haitong International

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by for Yalla Group's Limited Second 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.

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: Thank you. Hello, everyone, and welcome to Yalla's Second 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 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 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 the management's prepared remarks, we'll 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, Kerry, and thank you, everyone, for joining our 2021 second quarter earnings conference call. The second quarter was another solid one for Yalla. Yalla Group's total revenue reached USD66.6 million, representing a year-on-year growth of 110.3%. Despite some impacts from the Ramadan holiday falling in the second quarter this year, we effectively grew our user community and advanced our monetization capabilities and initiatives.

In the second quarter of 2021, we also maintained robust profitability, as demonstrated by our non-GAAP net margin of 48.2%.

With strong execution of our effective marketing campaigns tailored to MENA's local culture, monthly active users for our group increased 17.3% Q-on-Q to 22.1 million. We have also observed diverse impacts from the Ramadan holiday on different types of products. Our social product Yalla's paying users slightly decreased from 1.2 million to 1.1 million, while our casual gaming product Yalla Ludo saw a 14.6% Q-on-Q increase in paying users to 5.3 million, leading to a group paying ratio of 29%.

Our new products have also been performing impressively. We are very happy to announce that we have officially launched 101 Okey Yalla for Turkish users, which is already receiving positive feedback from the market, and has recently reached No.1 in the board game category in terms of downloads in Turkey.

Additionally, Yalla Baloot, a card game we designed for Saudi users, is also in final stage of development. We look forward to sharing more updates about this with you next quarter.

As for YallaChat, since the launch of its beta version in the first quarter, our team has been persistently working to refine and enhance the product based on user feedback. We expect to gradually improve the performance of the product system and roll out new design features and functions through iterations over the next several months. We are committed to perfecting specific features and customizing our products to cater to local users' desires and firmly believe our precise attention to detail will be fruitful.

Besides these 3 new products designed for our main market mentioned above, Yalla Parchis, a South American version of Ludo app, was also officially launched, and have already received very good feedback from our users. Leveraging our experience running Yalla Ludo, we facilitated Yalla Parchis' development much more effectively and efficiently.

We also added the in-game voice chat function we have in Yalla Ludo into Yalla Parchis, a feature that is gaining popularity among our South American users and helps to build our

community. As a result, users' average daily time spent on Yalla Parchis has already reached 80 minutes. And Parchis also reached No. 1 in the board game category in terms of download numbers in 8 countries, including Colombia, Venezuela and Ecuador.

Another important update we would love to share with you is that Yalla initiated its internal ESG guidelines this year, and is also working on summarizing core values that we think will play an important role in steering our team's decision-making. Yalla has experienced exponential growth over the last 5 years, and this period has given us a clear picture of the sort of company Yalla wants to be and a vision for our core values on this journey.

As the first UAE-based technology unicorn to be listed in the U.S., we have always felt a sense of responsibility to contribute to the broader development of the digital economy in MENA, and to build a community with a shared future. Yalla is honored to be participating as a partner in the UAE government's recently-unveiled National Program for Coders. Our President, Saifi, will share more details of this program with you later.

As a UAE-based company, Yalla is deeply committed to respecting local users and local culture. At the same time, we also embrace diversity and proactively add global talents to our team. We have hired employees from more than 15 countries around the world. We learn from each other every day and prioritize fostering an efficient, innovative, friendly and inclusive working environment. We believe our strong management capabilities and seamless collaboration across borders, as well as a deep sense of trust among teams, have led to Yalla's robust growth.

We are so proud of the fact that over the last 5 years, in lock-step with Yalla's development as a company, we have also witnessed more and more young talents become experts equipped with deep knowledge of the MENA Internet industry. We have gradually built a global team with strong expertise, passion, creativity and diversity and deep trust in our company. In 2020, Yalla Group's employee turnover rate was only 14%, an incredible number in the Internet industry.

In conclusion, I would love to reaffirm our mission to build the most popular destination for online social networking and entertainment activities in MENA. As we continue to enrich and enhance the products we offer to better serve local users, we have established and proven our leadership in this field and are confident about the development of the digital economy in this region. Looking ahead, we will continue to closely watch trends in MENA's local culture 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. First all of, I would like to highlight our efforts in product operating. To better encourage user engagement on our platform, we continued to roll out localized operating events that are tailored to the MENA culture. For example, during Ramadan in April and May, we hosted the Ramadan Kareem event on Yalla to encourage users to visit our platform every day and greet their friends with special gifts designed especially for Ramadan. The event attracted more than 600,000 users.

Besides this, we also hosted a series of events online to celebrate Yalla's 5th anniversary in our community. More than 2 million of virtual gifts were sent during these events, demonstrating the impressive engagement level of our participating users.

Additionally, as Tao just mentioned, we are very excited about our participation in an important initiative, the National Program for Coders, announced by the UAE government in July. This program is a testament to the UAE government's dedication to developing talent, expertise and innovation in the digital economy. And we are thrilled that Yalla is the only local Internet company among universities and other global technology giants to be shortlisted as a partner.

The program signals to the UAE government's commitment to attracting more talents from all over the world, further improving the local social infrastructure and supporting innovative new ideas as well as academic development over the next 5 years. Yalla is honored to be part of this great program, and is dedicated to contributing to the development of UAE's digital economy and delivering online social and entertainment products tailored to the MENA culture. We will share more details with our shareholders once the government makes a more detailed announcement regarding the collaboration.

Yalla's close involvement in the program not only demonstrates the company's commitment to facilitating the development of MENA's local digital economy, but also attests to the fact that Yalla is a reliable and trustworthy local partner. This serves to elevate the Yalla brand as we open our doors to more talents to provide best-in-class products and services tailored to MENA users' needs and preferences, and continue to enhance our influence in the local community.

Our mission is to become the number one online social networking and entertainment platform in the MENA region, and we are well on our way to achieving this.

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. Our robust year-on-year growth indicates our sustained strong performance, despite the Ramadan holiday falling during this quarter. This is a testament to the steadfast execution of our growth strategy that prioritizes user experience and community development.

Our second quarter revenues grew by 110.3% year-over-year to USD66.6 million while our non-GAAP net income reached USD32.1 million with a growth rate of 101.4% year-over-year. Our non-GAAP net margin remained elevated at 48.2%, reflecting our unique monetization strategy, market positioning and strong operating efficiency.

Now I would like to walk you through our financial details for the second quarter of 2021. Our revenues were USD66.6 million in the second quarter of 2021, a 110.3% increase from USD31.7 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 enhancement in Yalla Group's monetization capabilities.

Our average MAUs increased by 77% from 12.5 million in the second quarter of 2020 to 22.1 million in the second quarter of 2021. Yalla's MAUs increased by 73.2% to 8.4 million in the

second quarter of 2021 from 4.8 million in the same period of last year; and Yalla Ludo's MAUs increased by 79.5% to 13.7 million in the second quarter of 2021 from 7.6 million in the same period of last year.

Now let's look at our costs and expenses. Our cost of revenues was USD23.8 million in the second quarter of 2021. Excluding share-based compensation expenses, cost of revenues in the second quarter of 2021 was USD22.1 million, a 112.1% increase from USD10.4 million for the same quarter last year. The increase was primarily due to higher commission fees for the third-party payment platforms resulting from our expanding business scale.

Excluding share-based compensation expenses, other components of cost of revenues, as a percentage of our total revenues, remained relatively stable at 33.2% in the second quarter of 2021, compared with 32.9% in the same period in 2020.

Our selling and marketing expenses were USD9.8 million in the second quarter of 2021. Excluding share-based compensation expenses, other components of selling and marketing expenses for the second quarter of 2021 were USD6.6 million, a 139.8% increase from USD2.7 million for the same quarter last year. The increase was primarily due to higher advertising and marketing promotional expenses as a result of our continued user acquisition efforts.

As a result of these reasons, other components of selling and marketing expenses, as a percentage of our total revenues, increased from 8.6% in the second quarter of 2020 to 9.8% in the same period in 2021.

Our general and administrative expenses were USD11.1 million in the second quarter of 2021. Excluding share-based compensation expenses, other components of general and administrative expenses for the second quarter of 2021 were USD2.4 million, a 72% increase from USD1.4 million for the same quarter last year, which was primarily due to 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.

Excluding share-based compensation expenses, other components of general and administrative expenses, as a percentage of our total revenues, dropped from 4.4% in the second quarter of 2020 to 3.6% in the second quarter of 2021 due to economies of scale.

Our technology and product development expenses were USD3.2 million in the second quarter of 2021. Excluding share-based compensation expenses, other components of technology and product development expenses for the second quarter of 2021 were USD3.1 million, a 192.7% increase from USD1 million for the same quarter last year. The increase was primarily due to an enhancement in salaries and benefits for our technology and product development staff, which was in turn driven by an expansion of our technology and product development staff arising from higher investment in new products and services.

As a result of these reasons, other components of technology and product development expenses, as a percentage of our total revenues, rose from 3.3% to 4.6% year-over-year.

As such, our operating income was USD18.8 million in the second quarter of 2021, compared with operating income of USD16.1 million in the same period last year. Excluding share-based

compensation, non-GAAP operating income for the second quarter of 2021 was USD32.5 million, a 102.1% improvement from the same quarter last year.

Our income tax expense was USD0.38 million in the second quarter of 2021, in comparison to USD0.23 million in the second quarter of 2020.

Moving to the bottom line, our net income was USD18.4 million in the second quarter of 2021, a 15.2% increase from USD16 million in the same period last year. Excluding share-based compensation expenses, non-GAAP net income for the second quarter of 2021 was USD32.1 million, a 101.4% improvement year-over-year.

Next, I would like to briefly go through our liquidity and capital resources. As of June 30, 2021, we had cash and cash equivalents of USD292.4 million, as compared to cash and cash equivalents of USD261.7 million as of March 31, 2021. This improvement demonstrates our resolve and capability to ameliorate Yalla Group's operations as a consistent basis.

On May 21, 2021, we announced the 2021 Share Repurchase Program. And as an update, we have repurchased 441,931 ADS representing 441,931 Class A ordinary shares from the open market with cash for an aggregate amount of approximately USD8.29 million, as of June 30, 2021.

For the third quarter of 2021, we expect our revenues to be between USD67 million to USD72 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.

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

Questions and Answers

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

Shiki Gee: Congrats on your strong quarter. So I have two questions and I'll ask them one-by-one. My first question is regarding the regulatory risks. Since you have an R&D team in China, do you see any potential influence on your business from recent tighter regulation to Internet companies in China?

Tao Yang: Hi, Shiqi. Thank you for this question. First of all, we highly value the importance of complying with the local policy and law, no matter which countries we operate our business in. In China, there are a lot of experienced talents in the Internet and technology industry. Our R&D team in China has played an important role in Yalla's substantial growth over the past 5 years.

We really appreciate the support from the local government, the open business environment and our team's expertise. And that's also the key reason why we decided to have our R&D center in China.

In addition, I would like to emphasize that Yalla doesn't have a VIE structure. Yalla's headquarter is in Dubai and we don't have revenue from China since our products are not available in China's app stores. As such, there is no impact on our business from China's recent tighter regulation on Internet companies. Our main market is in MENA, and our products are designed based on MENA's culture and MENA users' preferences. We highly appreciate MENA users' trust and UAE government support along our development. Thank you.

Shiqi Ge: Thank you. That's very helpful. And my second question is about the short selling report that came out a few months ago. Although neither of them was written by big influential institutions, could you please provide more details on their questions about your MAU and the business model? Maybe help clarify whether there are robots in your chat room, and whether you hire KOLs to run the chat rooms. And also why does the company have a bank account in Singapore?

Tao Yang: First of all, I would like to reiterate that those two short reports are of poor quality and contained numerous errors. They weren't even able to provide any solid evidence to prove many of their claims. Here I would like to provide some additional details to our investors. Firstly, regarding our MAU, Yalla clearly states in the press release that it has never placed a robot in any of its chat rooms. Yalla is a world-centric social platform on which users need to talk and interact with each other to make sense. People who understand this business can easily tell robots won't even work on our platform.

It is true that in some rooms, there are accounts with similar names. Users create these alternative accounts to collect actual virtual coins or gifts from the platform. Similar cases exist on many other online platforms and Yalla has taken many measures to restrict such user behavior. For example, we set various rules to examine and block accounts with suspicious user behavior. However, the replicated accounts are like a game of hide-and-seek. It's very difficult to radically remove them at once.

But what we can confirm is that alternative accounts are only a minority on Yalla, as evidenced by the strong growth in our revenues every quarter. If the majority of users were only alternative accounts, which have limited spending power, we won't have been able to deliver such strong revenue growth.

Secondly, regarding our business model, we can resolutely affirm that we have never paid money or shared revenue with any KOLs, or any professional content creators on Yalla or Yalla Ludo. These two products are both designed to be pure UGC platforms. This is our strategy for those two products and we may remain unchanged in the foreseeable future. Accompanying our pure UGC platform is a no-cash-out feature, which is an important reason why Yalla is able to achieve high net margin every quarter.

Thirdly, in contrary to the claims of those short sellers who try to mislead their audience, we didn't have any unprofessional audit partner. Instead, Yalla's auditor is KPMG, one of the Big

Four. And we have been working with KPMG since 2018, long before Yalla went public. Integrity is one of our top priority. We have very high standards in our financial reporting and, we highly value the importance of compiling with SEC's requirements on disclosure.

And lastly, regarding cash, Yalla's cash balance has always been consistent with our reported revenues, and cash is always the most difficult to lie about in any business. We disclosed in our 20-F that we have bank accounts in 3 countries including Dubai of UAE, Singapore and Hong Kong, China. Dubai is where our headquarters basing, and both Singapore and Hong Kong are global financial centers.

A company needs to consider a lot of factors when allocating its cash; for example, whether it's convenient for our daily operations and whether we have instant access to it, etc. Yalla has a solid business in the MENA region. We are very confident in our business model and our business and potential to grow is also solid. Hope this answers your questions. Thank you.

Shiqi Ge: Thank you, very clear. Thank you.

Operator: Bo Pei with Oppenheimer.

Bo Pei: Thanks for taking my questions. So I have three if I may. The first one is about the repurchase plan. So I think during May 21 and the end of last quarter, we bought back around USD8.7 million shares. So is this the sort of pace we should be expecting for the future quarters? Do we consider increase that buyback amount, given our cash balance has been growing pretty nicely?

And then my second question is about the progress of new apps. We talked about some user metrics, time spent, engagement. But can you talk about when should we expect to see some meaningful monetization from these new apps? Should it be later this year or maybe next year?

And then the last question is about the margin. So we have been achieving very healthy margins since the IPO. So can you talk about with these new apps and potentially some advertising activities, should we still expect this kind of healthy margin going forward?

Karen Hu: Thanks, Bo. This is Karen. I will take the number one and the number three questions. By means of our rehab on May 21, 2021, we announced a share buyback program authorized by our Board of Directors, whereby we repurchased up to USD150 million of our ADS from time to time over the following 12 months. And by the end of Q2, we have already repurchased 441,931 ADS from the open market with cash for an aggregate amount of around USD8 million. For the remainder of our authorized period, we will continue to repurchase shares in this program depending on market conditions, and always with the commitment to work for the best long-term interest of our shareholders.

And for the margin question, I think that we were able to maintain our net margin at a relatively stable level over the past several quarters at around 45%. Although we have been launching some new products in the second quarter, but we think that we will still able to maintain our net margin at this level. And at this point, we don't expect to see significant changes to the net margin in the third quarter. Thank you.

Tao Yang: And for the progress on the new apps and the monetization, I will answer you. As we just discussed during our prepared remarks, we have officially launched two new products that are receiving good feedback from the market. At the current stage, I think we will still focus more on expanding our initial user base and developing our community. Usually, monetization will come after that and the past that Yalla Ludo went through can be a good reference. We hope next quarter, we will have good operating numbers of our new apps to share with you and our investors. Thank you, Bo.

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

Operator: Our next question will come from Kaifang Jia with CITIC.

Kaifang Jia: You mentioned that you released your new apps. So could you please provide more details on your strategy in building Yalla's ecosystem?

Tao Yang: Okay. I will answer this question. We have built two flagship applications, Yalla and Yalla Ludo; through years of development, we're gradually building our Yalla community. Going forward, when our next generations of social products are ready, we plan to drive traffic from Yalla to these new social apps. We will also leverage Ludo's user base to promote our new casual game product, as well as upcoming mid-to-heavy games. As most of Ludo users are game lovers, the trial we conducted earlier have shown very good conversion rate from Ludo.

In this way, we expect to introduce more of our products and services to our users, continue improve our efficiency in user acquisition and further develop the Yalla ecosystem. Thank you.

Kaifang Jia: Okay. Thank you, very clear.

Operator: (Operator Instructions). Natalie Wu with Haitong International.

Yulin Zhong: This is Yulin on behalf of Natalie Wu at Haitong International. Thanks, management, for taking my question and congratulations on the very strong quarter. My question is regarding your user metrics. Could the management share with us more colors on the trend of your latest user matrix for Yalla and Yalla Ludo, such as user demographics, retention rates, and acquisition costs? Thank you.

Jeff Xu: Thanks Yulin; this is Jeff and with respect to user profile, Yalla's users are usually between 18 to 35, and the male-to-female ratio is about 7:3. For Yalla Ludo, since it's a popular traditional casual game, age range of users is between 12 to 40 and the male-to-female ratio is around 6:4. But since we highly value our users' privacy, we don't require users to verify their IDs to join Yalla and we don't have LBS leader. So the demographic data is just for your reference.

In terms of user acquisition cost, since our business covers the whole MENA region, costs can vary a lot among different countries. For example the cost in GCC countries is usually higher than that of the other countries. Yalla's products are designed for Arabic users, as well as users from some other countries with similar culture backgrounds. As you can see, we have a large market and our current user base only accounts for a small portion of the total population in the region. So we still see a lot of untapped potential in this market.

Because of Yalla and Yalla Ludo's unique business model, their development doesn't require massive spending in sales and marketing, which has been demonstrated by our stable sales and marketing expenses over the past years. As such, we think the user acquisition cost will be relatively stable for us, at least in the near-term. And we believe we still have ample room to grow in this region.

Yulin Zhong: Thanks. That's very clear. I have follow-up questions regarding your outlook. I was wondering if you could share with us your expectations on your MAU growth going into the third quarter and the fourth quarter. And last one here, I just want to confirm if the third quarter revenue guidance has included the revenue contribution from the new APP or not? Thanks.

Karen Hu: Our guidance of Q3 didn't include in the new app.

Yulin Zhong: Okay. Thank you. And could you share with us your expectation for the user growth going into the third quarter and the fourth quarter? Thank you.

Karen Hu: For the users' growth, as we told the investors always, we can beat the Q-on-Q around 13% to 15% for the user growth, both Yalla's and Yalla Ludo's. And for the new product user growth, we don't conclude it in the expectation.

Yulin Zhong: Okay. Thank you. That's very helpful.

Operator: There are no further 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 next quarter. Thank you.

Operator: This concludes this conference call. You may now disconnect your line. Thank you.