

**Yalla Group Ltd. [YALA]
Q3 2023 Results Conference Call
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Executives

Kerry Gao, Investor Relations
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
Lincoln Kong, Goldman Sachs
Rachel Guo, Nomura
Natalie Wu, Haitong International

Presentation

Operator: Good morning and good evening, ladies and gentlemen. Thank you for standing by for Yalla Group Limited's Third Quarter 2023 Earnings Conference Call. (Operator Instructions). After management's prepared remarks, there will be a question-and-answer session. Today's conference is being recorded.

I would like to turn the conference over to your host today, Mr. Kerry Gao, IR management of the company. Please go ahead.

Kerry Gao: Hello, everyone, and welcome to Yalla's Third 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 management's prepared remarks, we will open up the call to questions. Our (inaudible) will also join the Q&A session.

With that said, I'd 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. Thank you, everyone, for joining our third quarter 2023 earnings conference call. We are pleased to report that we achieved strong third quarter results. Our third quarter revenues reached an all-time high of USD85.2 million, surpassing the upper end of our guidance, while year-over-year revenue growth from gaming services exceeded 30% once again.

Our cost efficiency initiatives continued to yield positive outcomes, and as a result, net income increased by 44% year-over-year to USD35.2 million and net margin further improved to 41.4%.

Our robust financial performance reflects excellent execution of our effective, high-quality development strategy. In the third quarter, we continued to refine our operational processes, enhance flagship applications' gamification, improve our gaming mechanics and optimize our user acquisition strategies. These efforts have empowered us to build a more engaged community of users who exhibit high willingness to spend on our content and services.

Supported by our solid business fundamentals and healthy cash position, we remain primed to capture new business opportunities and fulfill MENA users' evolving online social networking and entertainment needs in the era of digitalization.

As we have discussed on our last few calls, the MENA region is actively pursuing new initiatives to drive economic growth, and the digital transformation here continues to advance rapidly. However, our region's exciting economic development is not the only asset drawing businesses and the investors to MENA. Throughout history, the Middle East has been an important hub for cultural and commercial exchanges between East and West. Amid today's changing dynamics across the global landscape, the region is currently gaining increasing strategic importance.

We have observed a mounting number of outstanding businesses considering MENA as their company's next important growth opportunity this year, a testament to the region's unique synergies with both Eastern and Western economies as well as its vast potential and market capacity.

Moreover, MENA's thriving tech ecosystem is fostering entrepreneurship and startups, attracting talent from around the globe. This has created a wealth of opportunities for Yalla to iteration and diverse future business initiatives. As the largest MENA-based online social networking and gaming company, Yalla is well positioned to seize these trends to propel the Company's development as well as progress across local and global economies.

Now, I'd like to share some important updates on Yalla games' recent developments -- first, an overview of our third quarter progress with respect to our two hard-core games, Merge Kingdoms and Age of Legends. Thanks to our consistent game iterations and engagement of our existing Yalla user community, both games have gained traction in the MENA region.

Notably, Merge Kingdoms was ranked in the top 10 strategy games in Gulf countries including Saudi Arabia and Qatar this quarter in terms of revenues on IOS; while Age of Legends also climbed to the top spot on Google Play's Role Playing Games category in terms of revenues in Saudi Arabia, UAE and Oman.

Although compared with our flagship applications, mid-core and hard-core games are still not yet making a substantial contribution to our Group revenues, we see immense room for growth in this sector.

Turning to our strategy for Yalla Games' future growth, through the process of developing our two hard-core games, we have gained a more comprehensive understanding of the local gaming market, as well as operation methods and cooperation strategies. Our experience with these games has strengthened our determination to engage more deeply in mid-core and hard-core games business in MENA.

It is worth noting that users' game genres and design preferences can differ across regions, and are changing rapidly. As such, we will continue to iterate our games based on users' feedback, closely monitor the market and adjust our products and operation strategies accordingly.

Moving forward, we will gradually increase our investment in mid-core and hard-core games, unleashing our growth potential in this flourishing market. We are presently exploring new game categories and already have various games in our pipeline. We expect to accelerate the launch of our new games in the coming year.

We will also continue to actively communicate with excellent gaming studios and production teams across the industry, and look forward to considering potential partnerships.

On a related note, according to Newzoo's research, MENA's gaming market currently brings in USD7.2 billion in annual ad revenue with a growth rate of 6.9% year-over-year, among the fastest-growing markets worldwide.

Meanwhile, given the considerable size of the mature gaming markets in China, the U.S. and Europe, those regions may also offer opportunities for suitably-themed games. We will remain dedicated to the MENA market while examining the possibilities, and may modify and distribute our games in additional regions as we see fit.

Before I conclude, I'd like to mention that in addition to mid-core and hard-core games, we are exploring new products and businesses that could bring traditionally offline services online for MENA users as a complement to Yalla's portfolio. These initiatives show great promise in advancing MENA's digital transformation, as well as the potential to serve millions of MENA residents. We will share more details with you when there is meaningful progress.

In summary, we remain confident in the growth opportunities presented by MENA's increasingly pivotal role on the global stage and the region's rapid digital transformation. As the largest MENA-based online social networking and gaming company, we are dedicated to building relationships locally and globally to broaden our business horizons and drive MENA's economic development. We will continue to assess new growth prospects as we develop compelling digital products tailored to the needs of local users, creating sustainable value for all of our stakeholders.

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, and thanks for joining us today. Let's take a closer look at our third quarter operations and our products' performance. We delivered another robust quarter results as our efforts to improve the gamification of our products continued to bear fruit. As Tao mentioned, our enhancement level have led to increased user engagement across our platform, with average monthly active users rising by 13.6% year-over-year to 35.1 million.

Our high-value users exhibited great willingness to spend on those enhanced gamification features, driving ARPPU up to USD7.35 in the third quarter from USD6.89 in the same period of last year.

On a related note, one of our third quarter adjustments to our game mechanism was aimed at boosting overall user engagement and delivering better user experiences. This resulted in lowered frequency of certain low-spend consumption on the platform, which in turn, led to a slight decrease of 2.6% in our total number of paying users. We are still fine-tuning these adjustments as we seek the right balance, and as such we expect the fluctuation in paying users will be temporary. We are closely monitoring the impact of this adjustment and will adapt accordingly.

For our flagship application, Yalla, we continued to improve gaming features, and rolled out a series of operational activities, including an Islamic New Year event and National Day events across several countries in MENA in conjunction with local festivals, to enhance user engagement. Activities like these demonstrate Yalla's commitment to user satisfaction and strengthen the sense of community on our platform.

With respect to Yalla Ludo, we launched a number of operational events, including an Islamic New Year event and a Mystery Store Opening event. We also continued to improve the gamification of the app, which drove a significant increase in consumption compared with that of the previous quarter.

Now I'd like to share two additional third quarter highlights. At Yalla Group, sustainability has always been integral to our corporate values. In August, Yalla established a Sustainable Account for Cash Management with Standard Chartered, one of the world's leading international banks. Deposits in Sustainable Accounts are referenced against Standard Chartered's sustainable projects, addressing some of the world's gravest long-term sustainability threats.

As the MENA continues to develop rapidly, we will leverage our strong cash position and local insights to incorporate sustainable practices company-wide. Ensuring that our cash management procedures contribute to enhancing sustainability throughout the local and international

economies, reflects Yalla's overall direction as well as our profound commitment to the MENA region.

Furthermore, we were recently invited to speak at GITEX GLOBAL's Expand North Star 2023, the world's largest technology and startup event, held in Dubai in October. Inspired by GITEX GLOBAL, the world's most established and iconic large-scale tech exhibition, Expand North Star unites founders, venture capitalists, and tech leaders to facilitate connections among the startup ecosystem. Its unparalleled content program featured lively discussions among over 70 unicorn founders, including Yalla, on 2023's biggest tech stories.

Events like GITEX GLOBAL showcase our region's open and communicative business ecosystem on a global stage. We were honored to recount Yalla's development story, business experience and industry insights at this preeminent event, and proud to highlight the unique advantages that the MENA region offers for tech companies and startups. As the first UAE-based tech unicorn to list on the NYSE, Yalla is deeply committed to driving progress across the tech startup community, while propelling digital development throughout the MENA.

Yalla is excited to witness and participate in MENA's digital transformation. Riding this wave of economic development, we will continue to push the boundaries of innovation to offer premium products and services tailored to local users' habits and preferences. As always, we remain dedicated to becoming the No. 1 online social networking and entertainment platform in the MENA region.

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. We delivered strong results for the third quarter of 2023, highlighted by our all-time high revenues and impressive net margin expansion. Our relentless efforts to streamline costs, as well as our enhanced ROI-based marketing strategy continued to yield positive outcomes, enabling us to elevate our overall efficiency.

In addition, we continued to strategically leverage high interest rates to achieve higher returns. As a result, our net margin rose to 41.4% and non-GAAP net margin rose to 44.9%.

As we head into the fourth quarter, we will continue to execute our high-quality growth strategy with focus on efficiency and profitability enhancement. We believe our solid fundamentals and strong cash position will support us in capturing future opportunities. As always, we remain dedicated to creating sustainable value for our shareholders in the long run.

Now let's move on to our detailed financials for the third quarter of 2023. Our revenues were USD85.2 million in the third quarter of 2023, a 6.4% increase from USD80.1 million in the third quarter of last year. The increase was primarily driven by our broadening of our user base and our enhanced monetization capability.

Our solid revenue growth was also partially attributable to the significant increase in ARPPU, which grew from USD6.89 in the third quarter of 2022 to USD7.35 in the third quarter of 2023.

Now let's take a look at our costs and expenses. Our total costs and expenses were USD52.8 million in the third quarter of 2023, a 5% decrease from USD55.6 million in the same period of last year.

Our cost of revenues decreased by 6.1% to USD27.8 million in the third quarter of 2023, down from USD29.6 million in the same period of last year.

Cost of revenues as a percentage of our total revenues decreased to 32.6% in the third quarter of 2023, compared with 36.9% in the same period of last year.

Our selling and marketing expenses were USD11.3 million in the third quarter of 2023, a 5.5% decrease from USD12 million in the same period of last year, primarily driven by lower share-based compensation expenses recognized in the third quarter of this year. Selling and marketing expenses as a percentage of our total revenues decreased from 14.9% in the third quarter of 2022 to 13.3% in the third quarter of 2023.

Our general and administrative expenses were USD7.3 million in the third quarter of 2023, a 14.5% decrease from USD8.6 million in the same period of last year, primarily driven by our lower share-based compensation expenses recognized in the third quarter of 2023. General and administrative expenses as a percentage of our total revenues decreased from 10.7% in the third quarter of 2022 to 8.6% in the third quarter of 2023.

Our technology and product development expenses were USD6.4 million in the third quarter of 2023, a 16.6% increase from USD5.5 million in the same period of last year, primarily due to an increase in salaries and benefits for our technology and product development staff to support our development of new businesses and expansion of our product portfolio. Technology and product development expenses as a percentage of our total revenues increased from 6.9% in the third quarter of 2022 to 7.5% in the third quarter of 2023.

As such, our operating income was USD32.4 million in the third quarter of 2023, a 32.3% increase from USD24.5 million in the same period of last year. Excluding share-based compensation expenses, our non-GAAP operating income in the third quarter of 2023 was USD35.4 million, up 20.4% year-over-year.

Our interest income was USD5.6 million in the third quarter of 2023, compared with USD0.8 million in the same period of 2022, primarily due to a significant increase in interest rates applicable to the Company's bank deposits and a continued increase in the Company's cash position.

Our income tax expense was USD710,000 in the third quarter of 2023, a 10.2% decrease from USD790,000 in the same period of last year.

Moving to our bottom line, our net income increased by 44.3% to USD35.2 million in the third quarter of 2023, compared with USD24.4 million in the same period of last year.

Next, I would like to briefly go through our liquidity and capital resources. Our cash position remains solid. As of September 30, 2023, we had cash and cash equivalents, restricted cash, term

deposits and short-term investments of USD545 million, compared with USD453 million as of December 31, 2022.

Under our USD150 million Share Repurchase Program that began May 21, 2021, and has since been extended by our Board through May 21, 2024, we have repurchased 1,670,735 ADSs or Class A ordinary shares, in open market cash repurchases, totaling approximately USD8.5 million in the third quarter of 2023. Cumulatively, we have repurchased 3,972,876 ADSs or Class A ordinary shares, in open market cash repurchases, totaling approximately USD35.5 million as of September 30, 2023.

Moving to our outlook, for the fourth 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.