



YY Inc.
2Q16 Earnings Conference Call Script
August 2016

Operator:

Good day everyone and welcome to YY's second quarter 2016 earnings conference call.

At this time all participants are in listen-only mode. With us today is Mr. David Xueling Li, Chairman of YY, Mr. Zhou Chen, CEO of YY, and Mr. Eric He, CFO of YY. Following management's prepared remarks, we will conduct the Q&A session.

Before we begin, I refer you to the Safe Harbor Statement in our earnings release, which also applies to our conference call today as we will make forward-looking statements.

I will now turn the call over to Chairman Li.

Mr.Xueling Li – Overview and Management transition

Thank you, operator. Hello, everyone. Welcome to our earnings call.

We have many things to cover, so let me begin with what is at the top of everyone's mind, the withdrawal of our privatization. As you know, I, along with Lei Jun, our former Chairman, had aimed to take our company private up until recently. Given the uncertainty surrounding China's capital market's policy, we believe that the U.S capital market offers a more suitable and stable market for YY's growth over the long term, especially as we determine our international strategy. For now, we need to **get back to basics**, and focus on our respective growth frontiers and driving our businesses forward more aggressively.

That being said, **the first step** was the withdrawal of our privatization. **The second step** we take today with the resignation of Lei Jun as our Chairman and as a member of YY's Board of Directors, which will enable him to focus more on Xiaomi. As we mentioned in the press release, Mr. Lei will remain a major investor, strategic partner and advisor of YY going forward. Additionally, I will take the position as the Chairman of the Company's Board of Directors and have resigned my CEO role. This move will enable me to focus more on our broader corporate strategy and the development of new and emerging applications and products based upon YY's core technology platform for live streaming applications.

The third step of our revamping includes the promotion of Mr. Zhou Chen to CEO. He has been the key executive who has run our online music and entertainment business, our largest business segment, for the past six years. Chen Zhou joined YY in 2007 and has built our online music and entertainment business from scratch. Under his leadership, YY online music and entertainment has grown organically by more than 60 times in terms of revenue over the past five years. This significant growth demonstrates Mr. Chen's strong strategic thinking and execution capabilities, as well as his ability to quickly adapt to the ever-evolving market. Mr. Chen is known to the Board as a respected and down-to-earth leader, who has been years ahead of our competition in identifying and executing many of the entertainment businesses on the YY platform. We firmly believe he has all the qualities necessary to lead YY through our next stage of growth.

Lastly, as a part of strengthening our senior management team for this next phase of growth, we are promoting Mr. Rongjie Dong to be the new CEO of Huya Broadcasting, an independent online game broadcasting subsidiary of YY. Mr. Dong has served as the Executive Vice President of YY since he joined YY in 2006, and over the past ten years, he earned much respect from our employees and the Board for his strategic leadership and deep

understanding of the market. Mr. Dong will bring over 15 years of experience to his new role, and we have no doubt that this appointment will further deepen and broaden our management capabilities across YY's executive team.

Thank you for your support and interest in YY and we look forward to helping grow our shareholder value with you together going forward. With that, I'll turn over to our new CEO, Chen Zhou.

Mr. Zhou Chen – Strategic Highlights of 2Q16

Thank you, David. And hello, everyone.

It is a great honor for me to take the position as YY's CEO. I have some big shoes to fill, having seen how David's vision and leadership has built YY into a leading live streaming platform in China, and the opportunities that lie ahead of YY are significant. Going forward, I aim to continue leveraging my knowledge and experience in order to accelerate the innovation of our content and service offerings as well as fully execute our expansion strategy to enhance YY's platform and stay ahead of our competitors.

To begin with, we are glad to report another strong quarter with both top- and bottom-line growth across the board. Our growth and diversification continues unabated and the recent popularity of live mobile broadcasting has helped further popularize our platform and growth momentum. This is exemplified by the fact that during the second quarter, our revenues increased by 46% year over year to 2 billion RMB. The growth momentum was primarily driven by solid year-over-year user adoption of over 54.5% to 4.2 million paying users and robust 48.7% year-over-year growth in IVAS revenue. More importantly, we continued to see steady growth in our large MAU base on the YY platform to over 141.9 million users, a 16% year-over-year increase.

In June 2016, we revamped our online music and entertainment branding to *YY Live*. This rebranding effort is a key part of the company's transition to a broader live-broadcasting entertainment platform and strategic focus on our core live-broadcasting capabilities. With the new brand, we aim to further leverage the established YY brand and build an even deeper content ecosystem.

First, we will focus on the development of PUGC, the professionally-curated user generated content. We view it as YY's most important content generation model, since it combines the advantages of PGC and UGC and hence is able to balance the content's quality, quantity and cost of production.

Secondly, on PGC side, *YY Live* will dive into more diversified market segments, such as sports, movie, anime, etc., through cooperation with leading partners. We believe that with the joint efforts of our partners, YY will be able to further enhance the live broadcasting interactivity with high-quality and innovative content offerings.

Overall, with our revamped management structure, new branding and comprehensive content ecosystem, we firmly believe YY is making solid progress in the transition to a broader entertainment platform while focusing on our core live-broadcasting capabilities. We are confident in our ability to stay ahead of our competitors and further fortify our competitive moat as China's leading interactive, live streaming platform.

Now, I would like to turn the call over to our CFO, Mr. Eric He.

Mr. Eric He – Financial Results

Thank you Chen Zhou and good morning, everyone.

As previously mentioned, we saw both top- and bottom-line growth across the board in the second quarter of 2016, primarily driven by the robust growth of our paying users and IVAS revenues, which leads me to discuss the performance of our business segments.

First, in Huya, our online game broadcasting business, we are quite excited and proud of the success we have achieved from the strong lineup of hugely successful hosts, Huya's innovative and diversified content offerings, as well as the improved monetization strategies we've implemented on mobile devices- all of which have resulted in significant growth. To exemplify this, during the second quarter, we saw revenue increase by 67.7% year over year to 143.1 million RMB, which was primarily fueled by a significant 111.6% year-over-year growth in the number of paying users to 1.1 million.

Moving on to our online music and entertainment business, As David mentioned, we have revamped our online music and entertainment branding to *YY Live*. In the second quarter of 2016, we maintained strong revenue growth of 50.3% year over year to 1.1 billion RMB, and the number of paying users further grew by 51.4% year over year to 2.8 million. Meanwhile, our music and entertainment business on mobile devices continued its robust growth with 96.7% year-over-year increase in revenue, and 88.3% year-over-year increase in the number of paying users. According to our internal analysis, our YY Live App was the most downloaded live broadcasting App in Android arena. Going forward, with the new brand, we will expand into a broader entertainment platform and strategically focus on our core live broadcasting capabilities. We will continue to strengthen and invest into our content offerings, especially PUGC, to further expand our user community and user stickiness on our platform.

For our online dating business, in the second quarter of 2016, revenue continued to grow by 72.3% year over year to 271.1 million RMB, mainly driven by a 35.6% year-over-year increase in the number of paying users to 316,000.

Going forward, we will continue to invest in and leverage our comprehensive content ecosystem and resources of our hosts, celebrities and industry partners to further expand our innovative content and service offerings across our business lines. This strategy is one of our key differentiators as we strive to meet the evolving demands of our massive user base in China's dynamic internet market. Overall, we remain confident in our market opportunity, especially with our new branding strategy and aim to fortify our position as the leading interactive, live streaming platform in China.

Now I will turn to our quarterly financial details. Before I get started, I would like to clarify that all the financial numbers we are presenting today are in Renminbi amounts and percentage changes are year-over-year comparisons, unless otherwise noted.

Net revenues for the second quarter of 2016 increased by 45.9% to 1.98 billion. This increase was primarily driven by the increase in IVAS revenues.

IVAS revenues increased by 48.7% to 1.93 billion, which was mainly driven by the 54.5% year-over-year growth in number of paying users. Now let's look at each of our IVAS business lines.

- **Revenue from online music and entertainment** increased by 50.3% to 1.10 billion in the second quarter of 2016. This increase was driven by a year-over-year increase of 51.4% in the number of paying users to 2.8 million. In addition, the number of mobile paying users grew by 88.3% year over year to 1.8 million in the second quarter.
- **Revenue from online dating** increased by 72.3% to 271.1 million RMB. This increase reflected a 35.6% year-over-year increase in the number of paying users to 316,000 and 27.1% year-over-year increase in ARPU to 858 RMB in the second quarter.
- **Revenue from online games** were 188.3 million RMB, as compared to 199.4 million RMB in the corresponding period of 2015. This decline was primarily caused by a 29.2% year-over-year decrease in the number of paying users, which reflects the continued softness in China's web game market, but was partially offset by a 33.3% year-over-year increase in ARPU of online games.

- **Other IVAS revenues** increased by 76.6% to 375.3 million RMB in the second quarter of 2016. This mainly includes revenues from Huya Broadcasting which increased by 67.7% to 143.1 million, and revenues from PK Show which significantly increased in the second quarter of 2016.

Other revenues, mainly including revenues from our online education platform, Huanqiu Education Online, and online advertising revenues from Duowan.com, were 47.8 million RMB in the second quarter of 2016, compared with 57.2 million in the corresponding period of 2015.

Cost of revenues increased by 45.0% to 1.2 billion, which was primarily attributable to an increase in revenue-sharing fees and content costs to 893.3 million in the second quarter of 2016. The increase in revenue-sharing fees and content costs paid to performers, channel owners and content providers was in line with the increase in revenues and was primarily due to higher level of user engagement and spending driven by promotional activities, as well as the Company's investments in expanding the amount of new and innovative content it provides to users. In addition, bandwidth costs increased to 150.7 million in the second quarter of 2016, primarily reflecting the continued user base expansion and the video quality improvements, but partially offset by our improved efficiency and pricing terms.

Gross profit increased by 47.4% to 772.4 million in the second quarter of 2016. Gross margin increased to 39.0% from 38.6% in the prior year period.

Our non-GAAP operating income increased by 52% to 485.4 million in the second quarter of 2016. The Non-GAAP operating margin increased to 24.5% from 23.5% in the prior year period.

GAAP net income attributable to YY increased by 18.1% to 343.3 million RMB in the second quarter. Net margin in the second quarter of 2016 was 17.3%, compared to 21.4% in the corresponding period of 2015. Excluding a one-time non-operating expense of RMB23.5 million for the disposal of a subsidiary company of YY, net income attributable to YY Inc. was RMB366.8 million, representing an increase of 26.2% year over year.

Non-GAAP net income attributable to YY Inc. increased by 27.3% to 384.8 million from 302.3 million in the prior year period. Non-GAAP net margin was 19.4% in the second quarter of 2016, compared to 22.3% in the prior year period.

Diluted net income per ADS in the second quarter of 2016 increased by 17.1% to 5.97 RMB from 5.10 RMB in the prior year period. Non-GAAP diluted net income per ADS increased by 25.7% to 6.65 RMB from 5.29 RMB in the prior year period.

Finally, looking at our business outlook, for the third quarter of 2016, the Company expects its net revenues to be between RMB2.00 billion and RMB2.10 billion, representing a year-over-year growth of approximately 34% to 41%. These forecasts reflect the Company's current and preliminary view on the market and operational conditions, which are subject to change.

This concludes our prepared remarks. Thank you for joining our call today, and we would like to conclude the call now.