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NQ - Q3 2017 NQ Mobile Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the NQ Mobile's 2017 First 9 Months Results Conference Call. (Operator Instructions) I must advise you that this conference is being recorded today, Friday, the 15th of December, 2017.

I will now like to hand the conference over to your first speaker today, Mr. Matt Mathison. Thank you. Please go ahead.

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Hello, everyone. Good evening, and good morning to those in Asia. We welcome you to NQ Mobile's conference call to discuss the financial results for the first 9 months of 2017.

On this call tonight is our Chairman, Dr. Vincent Shi; our CEO, Mr. Zemin Xu; our President, Mr. Justin Chen; and our CFO, Mr. Roland Wu; and I'm Matt Mathison. We thank you for joining us.

Before we begin, here is our safe harbor disclaimer. Please note that the discussion today will contain certain forward-looking statements made under the safe harbor provision of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. NQ Mobile does not assume any obligation to update any forward-looking statements except as required under applicable law.

Also, please note that some of the information to be discussed includes non-GAAP financial measures as defined in Regulation G. The most direct comparable U.S. GAAP financial measures and the information reconciling those non-GAAP financial measures to NQ Mobile's financial results prepared in accordance with U.S. GAAP are included in our earnings release posted earlier today.

Finally, as a reminder, this conference call is being recorded. We are also offering investors a webcast of today's conference call, which can be found on the Investor Relations portion of our website at ir.nq.com.

Now with that, let us begin. We're going to go through the call today as follows: we'll first hear from our Chairman, Dr. Shi. Following his remarks, we will hear from our CEO, Mr. Xu. Justin will then provide the closing commentary on our FL Mobile and Showself divestments. I'll then provide an overview of our future businesses. And our CFO, Mr. Wu, will then review the financials. We will then open up the call for Q&A.

I'm going to turn the call over now to Dr. Shi. Go ahead.



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Wenyong Shi - *NQ Mobile Inc. - Co-Founder, Chairman and COO*

Thank you, Matt. And I wish to thank everyone for joining us today. We are pleased to have completed the FL Mobile and Showself divestments. We have been preparing and planning for future during the long process, and I wish to describe our vision for you today.

We started out by providing mobile security solutions to smartphone users. We expanded our portfolio to including services for consumers and enterprises. We have worked with many industry partners, including handset makers and carriers all over the world and gained a unique position in the whole smartphone ecosystem. We have learned how to work to make a successful business with giant platforms.

As a mobile-first, mobile-only company, we are now changing our focus from smartphones to a Smart ride business using mobility as a service model. We will leverage the expertise and experience as mobile internet pioneer to -- and to start to establish strong partnership in the new smart car industries.

We will work with many industry partners throughout the entire smart car ecosystem and become the mobile experience enabler for car companies. We will also leverage this expertise and bring ridesharing services directly to consumers. Most current players using smartphone to connect passengers and share it to each other. In the future, taking advantage of our Linkmotion carputers, we would like to use car to link the passengers and drivers to each other. This is our future, and we believe this -- there is very compelling growth potential. We will be a leading smart ride business going forward.

I wish to turn over the call to Zemin to discuss more.

Zemin Xu - *NQ Mobile Inc. - CEO and Director*

Thank you, Vincent. Our smart ride business will include both B2B and the B2C solution in the service in the smart car and the ridesharing industries. Let me describe our philosophy around business organization. We will bring in the strategic partners. We will also leverage other important industry and the technology partners. Our organization has a strong talent team -- management team in place focused on the smart car opportunities as part of our Linkmotion team and the ridesharing businesses. As we advance further into next year, we will continue to share more progress and the details. The Linkmotion partnership announced earlier today with Chery is just the beginning.

Now I will turn the call over to Justin.

Yigong Chen - *NQ Mobile Inc. - President, General Counsel and Director*

Thank you, Zemin, and thank you, everyone, for joining us today. Let me just provide you with some concluding remarks about our divestments.

We are pleased to announce today that we have closed this divestment fully. This has been a longer process than anyone planned for, but we're pleased in the outcome.

The purchasing group has been sending us portions of the sale price in cash payments steadily since the beginning of November. Today, we received an additional RMB 200 million in cash and also received a senior note for the balance remaining of RMB 1.77 billion. We decided to close this deal now and take the senior note for a couple of reasons: first, the deal is closed and we are able to move forward with our plans; second, the note carries an interest rate of 8% per annum for 12 months. Tongfang has ability to prepay these notes, including principal and any accrued interest at any time.

Now we have received for divesting these assets, in aggregate, about 2/3 of the total cash and the final RMB 1.77 billion in a senior note that will pay us 8% annualized interest and is secured by the assets of the divestments. With the divestment closed completely, we can focusing on moving forward with our future plans.



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With today's closing, we will also move forward with our management investment and direct investment plans previously announced. In addition, we'll begin to buy back shares.

Finally, as Vincent and Zemin highlighted our future business strategies, we are in a strong financial position to build our smart ride businesses and drive future growth. With that, I will turn the call over to Matt. Matt?

Matthew Mathison - NQ Mobile Inc. - VP of Capital Markets

Thanks, Justin. Now I'm going to spend more time reiterating and providing a bit more background on the vision and future of NQ Mobile as just outlined, including what we're labeling our business as specifically, NQ Mobile will strive to become a leading smart ride company. There will be both a business-to-business and business-to-consumer component within this overall strategy. Both sides will help leverage each other. In fact, our vision includes using the car through Linkmotion's carputer to bring passengers and drivers together. In this way, our 2B and 2C businesses will go hand-in-hand.

The B2B business is headlined by our Linkmotion carputer platform. B2C will become a set of ridesharing services for consumers. Let me give some more details.

First, let's discuss the smart car business, namely the Linkmotion carputer opportunity. I think it would be helpful here to provide some additional background. We have been a mobile-focused company from the very beginning, and that will continue. In the previous decade, the technology innovation and advancement within the mobile landscape has been centered on the smartphone device. We believe that the connected automotive and smart car markets will play a more and more important and central role in mobile innovation and technology advancements in the future.

We have been positioning for this change. If the smartphone was the dominating technology device of the past decade for mobile applications, we believe the car is the device of the future decade for mobile application, innovation and opportunity. In fact, we believe through Linkmotion's carputer platform, we will be able to use the car to connect people and services.

Similar to the evolution of the handset and smartphone devices, the initial major disruptions in development came from hardware. However, following a period of hardware revolution, the enabling technology and differentiation came from software. While on a different evolution and revolutionary pace, cars were always defined by engine advancements. However, the major technical revolutions of tomorrow in the automobile space will come from software.

The future is the software-defined car, and Linkmotion's carputer is a secure, connected carputer that combines 5 separate units: the instrument cluster; infotainment; heads-up display; telematics and communications. Cars of today consist of over 200 different electrical control units, ECUs, which all control separate in-car systems. As new functions and features have continued to increase for comfort, convenience and differentiation, the amount of complexity and inefficiency has followed along.

The benefits that proficient software can bring into cars include reducing hardware complexity, security, cost efficiency, added features and a better overall user experience. In addition, the need to deliver these new features and updates through the lifespan of a car has become an integral part of connected devices and solutions. Over-the-air updates for vehicles are critical and drive the need to truly have integrated and connected hardware and software solutions.

Finally, the security of a connected car lies in all the elements of the systems, including the hardware, the software architecture, all applications and connectivity features, including OTA updates. This is why it is impossible to add security as a single feature to an existing system.

Among other reasons, this is why we're so excited and focused on the smart car market going forward because Linkmotion's carputer addresses all of these inefficiencies and weaknesses. The opportunity for mobile software, security and platform systems in connected and smart cars is just beginning. The smart car market is enormous. The market is not just cars either. The existing infrastructure and existing car companies are inflexible. We believe that all new cars will be connected and smart in the not-distant future. In a sense, this is similar to the desktop PC world and the opportunities that were in front of mobile players before smartphones really took off.



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In the summer of 2015, we invested in and took a controlling stake in Linkmotion. Linkmotion has more than 10 years in automotive software experience, has delivered over 200 projects into these markets and has experience on the global scene. Linkmotion's system was designed to address all of the problem factors mentioned above comprehensively and holistically. The Linkmotion carputer was designed with security throughout. The hardware and software have been designed together, creating layers of defenses to protect vehicles from attack at every layer of risk.

In addition to the all-important security features, we also provide a cost-efficient, robust and secure computer for in-vehicle computation needs. The system is truly a complete platform that is fully customizable by the OEMs and flexible to manage all over-the-air updates and additional feature plug-in needs.

Today, we announced an important partnership agreement with Chery auto, one of China's largest auto manufacturers, and in fact, the largest exporter of China-made cars. The Linkmotion team has been building up a pipeline of partnerships and customers, and we would expect more of these type of announcements forthcoming.

Now the sales cycle into the auto manufacturing industry is long and tedious and consists really of 3 main areas: getting on an approved vendor list; getting designed into prototypes and demos for real road testing; and getting designed into models for consumers.

The first step to getting on an approved vendor list is a monumental and time-consuming effort. The Linkmotion team has been successful at getting us positioned through this important stage generally. We have also had success in getting into some of the prototypes and demo vehicles, including for example, previously in the Lamborghini Huracán model. We will be in other demo and prototype models during the first half of next year as well.

We also will be putting consumer-ready models on the market next year. You should expect more partnerships and platform agreements with others in the future. We recognize the Linkmotion team and their efforts in China and globally for helping us position for the future this way. We will certainly be marketing and educating the investment community about our smart car solutions and positioning next year. We believe in the Linkmotion carputer. We believe that it is a leading, connected, secured carputer. Stay tuned for much more about this side of the business and more recognizable traction.

Now let me just spend a minute on the business-to-consumer part of the future. As I mentioned previously, we have been working on creating a business opportunity around the B2C industry for providing services and solutions to consumers in the ridesharing or car-sharing or even online and connected transportation-as-a-service business model. We have been working on this business quietly over the past year, and we look forward to unveiling more specifics about it next year.

From this point forward, NQ Mobile is striving to become a leading smart ride company. The market size is there. The growth is there. We have enabling technology, existing partnerships and new ones and operational experience to participate in our share of this big future. We look forward to being able to provide more details and information on these businesses as we move forward.

Now on a slightly different but no less important topic, as Justin reiterated, after we have closed the divestments of FL Mobile and Showself, we're committed to following through on our previously stated plans. To reiterate, we're going to use the cash and capital for 2 primary reasons: first, we will buy back stock; second, we will focus our investments and execution priorities on the future of our smart ride business that I just outlined. The chapter of the past is closed, and we are all looking forward to turning the page and beginning this new chapter.

Given that, we will now turn the call over to Roland, who will discuss our financial results for the first 9 months.

Roland Wu - *NQ Mobile Inc. - CFO*

Thanks, Matt. Now let's turn our attention to the financials.



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I wish to walk through some of the highlights and provide you with additional details behind the results. It's important to mention that I will be using figures excluding the FL Mobile and Showself businesses. Some stores have moved to discontinuing operations for the periods reporting and for all the numbers in the comparable period in order to better compare the nature of the business as we have previously done. Now let's start with a discussion of our revenues in the first, second and third quarters of 2017.

We generated USD 12 million, USD 14.7 million and USD 17.5 million in the first, second and third quarters of this year, which the first quarter has decreased 26.3%. The second quarter has increased 15.3%. And the third quarter has increased 23.7% compared with each of the same period in 2016. In summation, the net revenue for the first 3 quarters of 2017 was USD 44.2 million, which was a slight increase, up 2.3% compared with the first 3 quarters of 2016.

In the first 3 quarters, advertising revenues decrease 43.5% year-over-year to USD 7.2 million. Other service revenue decreased 35.7% year-over-year to USD 3.1 million. Enterprise product revenues increased 40.3% year-over-year to USD 33.4 million. The increase in enterprise product revenues was mainly due to stronger hardware sales Trustek.

Enterprise service revenues decreased [72.8%] year-over-year to USD 0.5 million. The continuous decrease in advertising and other services revenues was mainly due to the lower overall activities within many of the traffic-related business as the company prepare to automate its operations and focus on the smart ride business in the future.

Next, let's spend a few minutes discussing our gross margin and what use some of the key elements within our cost of sales. Our negative gross margin for the first 3 quarters of this year was minus 2.3% compared to minus 5.9% in the same period of 2016. As the primary current source of revenues is coming from product sales within our enterprise business, our gross margins will continue to narrow until the revenues from smart car and smart ride business picked up.

Now let me walk through some of our operating expenses. I also need to highlight the impairment of goodwill and intangible assets, which, according to GAAP, is include as an operating expenses. There was impairment of goodwill and intangible assets of USD 97.9 million in the first 3 quarters. This came from a onetime noncash impairment of goodwill and intangible assets in the remaining portion of the securities and other reporting units.

The total operating expenses in the first quarter of 2017 was USD 93.9 million, an increase 348% year-over-year. This increase was mainly due to the onetime noncash impairment and goodwill and intangible assets recorded in the first and third quarter of 2017. Excluding this change, the total non-GAAP operating expenses for the 9 months was USD 36.5 million, which is about the same as the USD 36.4 million in the year ago.

Total SBC expenses was USD 4.5 million (sic) [USD 5.4 million] for the first 9 months of 2017. The net loss attributable to NQ Mobile was USD 71.4 million in the first quarter, USD 20.9 million in the second quarter and USD 24.4 million in the third quarter of 2017. Those figures in the same period of 2017 was a net loss of USD 7.8 million, a net income of USD 0.5 million and a net loss of USD 9 million, respectively.

In summation, the GAAP net loss attributable to NQ Mobile for this 9 months end September 30, 2017, was USD 116.7 million or \$1.16 per fully diluted ADS.

Non-GAAP net income attributable to NQ Mobile was a net income of USD 15.5 million for the first quarter; a net loss of USD 4.9 million for the second quarter; and a net income of USD 4.3 million for the third quarter, which, in total, the non-GAAP net income attributable to NQ Mobile for the 9 months end September 30, 2016, was USD 15.1 million or USD 0.15 per fully diluted ADS compared to USD 12 million or USD 1 -- USD 0.12 in the year-ago period.

Finally, let me conclude my review of the financial performance for the first 3 quarters of 2017 by highlighting a few other things.

Our balance sheet. We ended the period with USD 248.8 million in cash, cash equivalents, term deposits and restricted cash. If you include the cash received from the divestment since the last quarter, the total is USD 459 million. We have a very strong financial position to move forward with our plan.



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I wish to conclude my remarks by discussing the future for our smart ride business. While currently, it's not a very proper time to provide specified guidance, I wish to give you some key points about Linkmotion and our early efforts in the B2C business as well.

It's important to note that our Linkmotion business has been fully consolidated in our financials. Up to now, it's still a small number of both revenue and COGS, and the total operating expenses for this business so far through the first 9 months of this year has been around USD 6 million, mostly R&D cost, which we see as appropriate. Linkmotion is a technology enabler, providing a carputer to manufacturers, focused on software and solutions. For the rest, we work with OEMs, component players and hardware companies. Accordingly, our Linkmotion team is most of the engineers. We have less than 100 employees, the R&D and maintenance service for this business going forward is reasonable and already part of our existing run rate.

As for the B2C business, as Matt mentioned, we have been building up a team and business service quietly over the past year. We see compelling potential in this area, and we'll unfold more about it next year.

With all of this in mind, we remain focused on our priorities, and we'll be prudent with our balance sheet and cash.

Thank you. I will now turn the call over to Matt.

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Thanks, Roland. This concludes our prepared presentation. Operator, will you go ahead and please open up the lines for Q&A?

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question today comes from the line of Jun Zhang from Rosenblatt Securities.

Jun Zhang - *Rosenblatt Securities Inc., Research Division - Head of Asia Research and Senior Research Analyst*

Congratulations on the odd achievement so far. And my first question is about this FL Mobile deal. And so after divestment of this FL Mobile and Showself, what's the remaining business? And what's the addressable market looks like for the smart car system? And could you talk a little bit about what's the advantage and the market position that Linkmotion has today? And how big Linkmotion could grow over the next 3 years?

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Sure. Happy to answer that. Obviously, I think we just detailed what our future is. Our future business after these divestments is going to be the smart ride business. That incorporates both the smart car business, which is headlined by Linkmotion's carputer platform as well as the B2C or business-to-consumer ridesharing business. But let me answer your question about kind of market size or market potential or how big you think Linkmotion can be over the next 3 years. Just to give kind of some statistics, if generally speaking, 50 to 60 million cars, new cars are sold annually, right. That's kind of the baseline for total market position. Currently, a small percentage of those new cars sold annually are actually connected or smart cars. That obviously is ramping and growing quickly. We think over the next 3 years, conservatively between 20% and 30% of all new cars will be smart cars. And so that gives you the baseline for what the total market size is. In terms of Linkmotion's position in that, I think it's safe to use about a \$300 ASP per unit for revenue potential for selling into our carputers into these cars. So I mean, this is -- over the next 3 years, this is a multiple billion dollar business. If you extend it out a little bit more and you believe the adoption of smart cars as a percentage of overall new cars being sold is higher than 30%, which I think most people would argue might be the case, then obviously it's a multiple billion dollar business opportunity.



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Jun Zhang - *Rosenblatt Securities Inc., Research Division - Head of Asia Research and Senior Research Analyst*

Okay, great. And also what kind of spending you need and the CapEx requirement for the Linkmotion business over the -- if you want to grow the business in the 3 years?

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Yes. That's a great question. Roland touched on it in his prepared remarks, but let me just reiterate what he said. I think it's important to remember that we've consolidated Linkmotion's business already, right. We took a controlling stake in it in 2015. So the financials, including the R&D and CapEx and full operational cost of that business are already consolidated into our financials. And so if you look at that, it's already in our current run rate. Year-to-date, as Roland said -- or not year-to-date, sorry, for the first 3 quarters of the year, our total operating expenses on Linkmotion was around \$6 million. And as we roll this forward, a lot of the R&D, a lot of the commercialization, a lot of the production efforts, streamlining production, all of these things have been really baked in and put in place. And so now we will forward, and as we get signed partnerships and actually get cars into the market, we don't really see that CapEx changing as a relative basis. So we like how it's levered, and it's already fully consolidated. Does that help?

Jun Zhang - *Rosenblatt Securities Inc., Research Division - Head of Asia Research and Senior Research Analyst*

Yes, yes, sure. And also, how soon we expect the car to be launched to the market with the Linkmotion system? And also do you expect more -- kind of more partnerships with automotive company like Chery in the future?

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Yes. Yes, let me reiterate what our CEO, Mr. Xu, said. The Chery partnership is just the beginning. We expect -- look, the Linkmotion team has been working on building a pipeline of both partnerships and customers. The sales pipeline is robust. Obviously, it's a long sales cycle, but they've been working at it for a number of years. And so we would expect to see more partnership announcements, more agreements. In terms of when do you expect to see cars on the market, we expect to see that happen in 2018.

Jun Zhang - *Rosenblatt Securities Inc., Research Division - Head of Asia Research and Senior Research Analyst*

Okay. My follow-up question on the deal, which was just announced to be complete, so could you talk a little bit about much cash you have today, including -- or not including the senior notes you received from Tongfang? And maybe talk a little bit more about the part of the payment through the senior notes and what's the security of that and how will you benefit from this type of payment. Yes.

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Sure. Let me answer that. And if Justin wants to add in on the note, he's welcome to. But specifically on the cash, again, you can see in the financial statement, as of September 30, the total cash, cash equivalents, term deposits and restricted cash was just under \$250 million, \$248 million. If you include the cash received since September 30 for the divestments, that total is \$459 million. Obviously, we'll report our Q4 results later in the year and give a full detail of cash and cash flows and all of that. But if you include just the cash received since September 30 for the divestments, that total is \$459 million. That does not include the note. In terms of the note, again, as Justin said, this is a senior note with Tongfang, and it's secured by the assets of the divestments. And we get paid -- we're getting paid an 8% interest on it. So we've been receiving steadily money and cash from the purchasing group since the beginning of November, as you know. And this was an opportunity to close this deal right now, take a note that's secured by the assets of the divestments, collect interest of 8%, and Tongfang obviously has the right to prepay that in full plus accrued interest at any time. So we did it. It's the right thing for us. With the divestments now closed, we can fully move forward with our business plans and get going.



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Jun Zhang - *Rosenblatt Securities Inc., Research Division - Head of Asia Research and Senior Research Analyst*

Okay, great. And my last question's about the buyback. And previously, you announced the MBO program. So could you give a little bit color that the time line for the buyback and MBO program you previously announced?

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Yes. Very simply and direct, Jun, we remain committed to buying back stock. And as Justin said, now that the divestments are closed, both the management purchase or the management investment, direct investment and stock buyback are things that we will now do.

Operator

Our next question today comes from the line of [Xu Xiang Dai] from China Reinsurance.

Unidentified Analyst

(foreign language)

Wenyong Shi - *NQ Mobile Inc. - Co-Founder, Chairman and COO*

(foreign language)

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

And I'm going to -- just for the English speakers on the call, I'm going to let Justin just quickly summarize what the question and what Vincent's answer was in English.

Yigong Chen - *NQ Mobile Inc. - President, General Counsel and Director*

Okay. He said -- asked 2 questions. The first one just for me just to summarize because we just heard, was to ask we had a Chery collaboration partnership. Were there are more of those types expected by the company? The answer was by Vincent in summary was the team had been building pipelines. Chery is one of those, and we are working with other partners. We expect that more will come. We'll share with the market when those are ready to be announced. The second question relates to the expected revenue or income after we made the major decision to transit from the previous business to the new smart car business, specifically 2B and the 2C, how we expect the business to grow.

The answer given by Vincent, in summary again, was the major focus of the company has indeed been transited from the previous to the new smart car sector. It includes both 2B and 2C businesses. It will become the major income or revenue for this company. We expect that we have more to share with the market in the future. And as we work out on this new future and have more information relating to our financial performances. That's a quick summary of that question and answer.

Operator

Our next question today comes from the line of [Michael Debold] from BTIG.



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Unidentified Analyst

Just want to know what you thought the -- or what you expect the business split to be for the consumer and enterprise segments, probably like 3 years out, where you see it then?

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Yes. I mean, look, obviously 3 years out, it's hard to say. I would say though, just as a business model, if you look at the market size for the carputer business, which I already outlined, right, it's a -- there's a billion -- multiple billion-dollar business for the carputer business.

If you also look at the -- again, ridesharing business, that also is a multiple billion dollar business, right. I mean, for the carputer business, if it's a \$300 ASP per unit, people can quickly do some math on kind of what percentage of the overall number of new smart cars sold into the market we need to get to generate certain revenue levels. For the ridesharing business or the B2C part of the business, you could similarly break it down based on our early learnings in this business over the past year. Again, it depends on the exact type of business model. There's a business model where you are effectively a broker. You don't own the car or the driver, and you just take a share, like a Didi or Uber business model. And then there's also other business models where you actually are bringing the car to a driver or passenger. Again, slight differences in those business models, but again, per unit, per car or per driver, those can generate between \$10,000 and \$20,000 per year, again, depending on the business model. So again, if you look at that, again, that's another multiple billion dollar business. So look, too early to say what the revenue split's going to be 3 years out for us, but we see both working hand in hand and working together in our smart ride future.

Operator

(Operator Instructions) Since we have no further questions on the line...

Matthew Mathison - *NQ Mobile Inc. - VP of Capital Markets*

Great. Operator, I think that'll conclude this conference call. Again, we'd like to thank all those that participated today, and we will talk to you soon.

Operator

Thank you. Ladies and gentlemen, that does conclude our call for today. We thank you all for your participation. You may now disconnect.

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