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KONG - Q1 2014 KongZhong Corp Earnings Call

EVENT DATE/TIME: MAY 28, 2014 / 11:30PM GMT



## CORPORATE PARTICIPANTS

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**Wang Leilei** *KongZhong Corp. - Chairman and CEO*

## CONFERENCE CALL PARTICIPANTS

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**Nick Ying** *86 Research - Analyst*

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**Xheo Long Chie** *Credit Suisse - Analyst*

**Rowan Hwang** *Oasis - Analyst*

**Zhuen Zhen** *Rose and Blatt - Analyst*

**Ning Gao** *Finaza Capital - Analyst*

## PRESENTATION

### Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Q1 2000 (inaudible -- technical difficulties). I would now like to hand the conference over to your speaker today, Mr. Jay Chang. Thank you. Mr. Chang, please go ahead.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Thank you, operator. This conference call may contain forward looking statements. Although such statements are based on our own information and information from other sources we believe to be reliable, you should not place undue reliance on them.

For additional discussions of risk and uncertainties relating to forward looking statements and other factors, please see the documents we file from time to time with the Securities and Exchange Commission. We extend no obligation to update any forward looking statements which apply only as of the date of this conference call.

Thank you for your continued interest in KongZhong. I will first review our first quarter results before handing over the call to our CEO, Mr. Wang Leilei.

Total revenues in the quarter were \$49.61 million, an increase of 13% from the fourth quarter of 2013, and 3.5% percent increase from the same period last year, exceeding our guidance range of \$45.5 million and \$46.5 million.

Gross profit was \$23.32 million, an increase of 7.4% from the fourth quarter of last year, and 25.4% increase from the same period last year, also in line with our guidance range. Net income was \$9.95 million, a slight decrease from the fourth quarter of 2013, but an increase of 46% from the same period last year.

(Inaudible) diluted net income [paid out] was 21 cents. Non-GAAP net income was \$10.61 million, an increase of 19.3% from the same period last year, and in line with our guidance range of \$10.5 million to \$11.5 million.

At the end of the first quarter of 2014, the company had \$202 million in cash and cash equivalents, term deposits, held-to-maturity securities, and restricted cash were an equivalent to 4.45 per ADS. The decline in the cash and cash equivalents from the end of the last -- from the end of 2013 was -- reflects the cash outlay for our strategic investment of RMB 100 million in [ROE].



In addition KongZhong today also announced that the company will change their NASDAQ ticker to KZ from KONG to better align our company branding as an online games company. The new ticker, KZ, will be effective as of the start of trading on Monday, June 16th, 2014.

Now, turning to our individual business units, internet game revenues were \$25.01 million in the first quarter, flat compared to the fourth quarter of 2013. For the quarter, mainland Chinese online game operations achieved average MAUs of 1.7 million players, aggregated monthly paying accounts of 280,000, and monthly average revenue per user of RMB 181.

Internet game revenues made up 50.6% of total revenues in the first quarter, while gross profit was \$12.69 million, a 7% decrease from the fourth quarter of 2013. While gross -- internet gaming gross margins were 50.6% compared to 54.4% in the fourth quarter, where the slight decline in internet game growth margins was due to the lower contribution from overseas license fees of our smaller self-developed internet games.

Total mobile game revenues were \$8.11 million, a 65% increase from the fourth quarter of 2013, and 119% increase from the same period last year. The increase in mobile game revenues was mainly due to increased revenues from Kooky Three Kingdoms and Three Kingdom Generals, our new games launched in the first quarter of 2014.

Total mobile game revenues made up 16% of total revenues in the first quarter, while mobile games gross profit was \$4 million, a 16.7% increase from the fourth quarter of 2013. While mobile games gross margin was 49.6 percent, compared to 70% in the fourth quarter, where the decline in both mobile games gross margins was due to the increased contribution of [feature form] revenues, [feature form] game revenues, which have lower gross margins than our smartphone game revenues.

WVAS revenues was \$16.42 million, an 18.78 increase from the fourth quarter, and a 3.6% increase from the same period of last year. WVAS gross profit was \$6.61 million, a 43% increase from the fourth quarter of 2013, while gross margins in WVAS were 40.3% compared to 33.4% in the fourth quarter. However, we expect that WVAS operating environment in the second quarter to see increased mobile operator policies which could lead to a decrease in WVAS revenues and gross profits.

Total opex in the first quarter was \$15.04 million, compared to \$15.7 million in the fourth quarter of 2013.

Now, turning to our second quarter 2014 guidance, the company expects total revenues for the second quarter to be within the range of \$57.5 million to \$58.5 million, with business unit revenue at the midpoint expected to roughly consist of net -- internet game revenues of \$33.5 million, mobile game revenues of \$10.5 million, and WVAS revenues of \$14 million.

Guild Wars 2 CD-Keys purchased and activated during the pre-order sales period will be amortized over roughly a six month period beginning from May 1st, which was the head-start period for Guild Wars 2 in China.

Future post [OBT] CD-Key revenues will be amortized from the activation of those keys. Further, the company expects total gross profits to be within the range of \$24 million to \$25 million. We expect a U.S. GAAP net loss of \$0.5 million to \$1.5 million. For the non-GAAP -- we expect our non-GAAP net profits to roughly break-even in the second quarter.

Our second quarter guidance reflects roughly an incremental \$10 million in sales and marketing related expenses from the first quarter, for expenses related to the May 15th open beta launch of Guild Wars 2, the open beta launch of Word of War Planes today, and other marketing activities related to the release of the War Saga brands.

As such, we expect total operating expenses in the second quarter to be between \$27 million and \$28 million. However, we expect sales and market expenses to revert to roughly pre-second quarter levels as a percentage of sales in subsequent financial periods for internet games.

Now, I would like to turn the call over to our CEO and Chairman, Mr. Wang Leilei.



**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Thanks, Jay, and thanks for your continuing interest in KongZhong.

As Jay mentioned, we reported our fourth quarter results [in line with] the present. First of all, let's talk about [seems rather] games. I've read this [cost] during our last earnings review. We believe internet games -- the internet game market in China for high-quality [per view] games continues to have significant long-term growth and has a much better potential. Just like people to go to internet radio sites or see TV series, and still to go to movie theaters with friends for [broad butter fumes]. The desire to share a high quality PC games cannot easily be replaced.

In the first quarter for War of Tanks, monthly active users, new registered users, and also the revenue increased year-on-year and quarter-on-quarter. We continue to work closely with War Gaming, the producer of War of Tanks, to develop the new game mode for War of Tanks, including country and historical battle modes. In order to provide the highest quality [major] games in China, War of Tanks, [written delays, under rents] are significant upgrades of its graphics and physics [energy].

In April, we formally announced our new brand strategy to unite all our military games under the War Saga brand. [As it is], if you are interested in learning more information about our [video] games, Guild Wars 2 and War of Tanks, especially Guild Wars 2. After 20 months hard work with our internet, we successfully released Guild Wars 2 to Chinese players on May 15th.

From the pre-sale period, beginning from April 2nd, we adopted the pioneering (inaudible) in-game icon model for China market. At the head-start on May 1st, we achieved 500,000 [PBGs] sold. [Celebrate] retention rates is around 70% on in-game paying rates is over 25%.

Compared to pay-to-play games, which have retention rates well below 50% and the paying rates around 10%, I believe this [magic] on beta are some of the best in the market in China. Our internet, on the KongZhong believes Guild Wars 2 will have a very [long-last] cycle in China. Currently, Guild Wars 2 is around number one on [tour one] and [seen as] most popular game ranking, and is number two on [ten says] ranking.

Based on this, we have committed significant marketing resources to promote Guild Wars 2 in the second quarter. We continue to optimize and enhance our customer service capabilities to ensure a healthy in-game environment, including strict anti-cheating and [voting] system of the games. For [porter] for us to [magic] we will discuss during our second quarter earning call.

For World of Warplanes, we launched the final post-beta test in April, and so [weekly return to risk] is over 50%. The [innovative unified] of Kong's platform allows players to share the same progression, payment, and [reactive] system between War of Tanks and Warplanes. For example, a player only needs to purchase one [reactive] account to get premium rewards in both games.

In addition, based on user feedback, Word of Warplanes is not a niche flying simulation game, only for [high-hand] players. Rather, it's a lower entrance barrier game which can be [written] to Chinese mass markets. We believe that it has the opportunity to be more popular with younger players who -- compared with World of Tanks.

In China, our marketing slogan for World of Warplanes is "One [Mouth], Four Minutes" mobile game. And also we believe that World of Warplanes will be officially launched this afternoon, today.

Because all these three games have strong [deport] and play, we will focus on the promotion and the development of [e-force] events later this year.

Our other PC games, such as Auto Club Revolution, Blitzkrieg 3, and Master of Media Blades, all have plans for continual beta tests, but plans to release these games to market at the end of this year or early next year, when they are ready to achieve similar success and our current [light up].

Now let's talk about KongZhong's mobile game business. Our mobile game segment continued to achieve a high growth rate this quarter. Our self-developed game [is being] exported to Taiwan, Korea, Vietnam, and North America. Kooky Three Kingdoms will be launched on the Korean Kakao platform, and the Japan [lines] platform in the near future. With four self-developed games operating in the fourth quarter, we will have two new games taking beta tests in the second quarter, and plan to commercially release them in the third quarter.

The games are [anawachichi] game called Sky Fantasy, and a [car crashing] game [recalled one parent, Derek]. Because these two games, we have another seven new games under development, covering many [types], including a power defense [animal], [car crashing], [little town] strategy, and also the [ARPG] action [RPG] game.

More recently, to reflect our vision to a high quality mobile game developer, we are co-developing our high-end three-dimension ARPG game called "[God] at War" with a Korean studio. I have plans to release it in the second half of this year. We also have our model game development capabilities by upgrading our Noumena game engine to the second generation, and leveraging unity to produce next generation mobile games.

At the same time, we expand our cooperation with three major Chinese mobile operators, by continuously introducing our own products onto their mobile game platform. We are currently ranked number six in terms of revenue with China Mobile. We expect to publish more games and greatly increase our mobile game revenue level in the second half of this year.

Although I believe KongZhong will continue the development of quality play in the future, as a leading and a [second shady] online game company. So that's all for the summary of the whole quarter.

Operator, I'd like to open the call to questions.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. Ladies and gentlemen, we will now begin the question and answer session. (Operator instructions.)

Your first question comes from the line of [Mai Yoo], of ICBC. Please ask your question.

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### Mai Yoo - ICBC - Analyst

Good morning Mr. Wang, Jay, and Leilei. And congratulations on your solid results. Thank you for taking my call, sir. I have three questions [if you don't] for [critical lack].

And first, the multi [sepradic], how many is that incremental increase or for [paying user] U.S. dollar sales in the marketing sense, in the second quarter. What should we expect as a trend for sales and marketing expense for the second half of 2014, as well as the company's expectation for the gross margin trend for the following quarters? Thank you.

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### Jay Chang - KongZhong Corp. - Chief Financial Officer

Yeah. Thanks for your question. So, during the second quarter we had some exceptional marketing events. One was after the culmination of, you know, over a year and a half of hard work, getting Guild Wars 2 ready for the China markets.

We spent a significant amount of resources to build awareness in that game, and we were off to a good start, a great start, as well as promoting the War Saga brand and concept, which is the unification of all the war gaming games together onto a unified account platform, as well as the launch of World of Warplanes today, actually.

So a lot of those events are all occurring in the second quarter with the revenues and the performance of those games, really, in the second half of the year. So we do expect sales and marketing to revert back to roughly a pre-2Q level as a percentage of internet game sales. However, we still will be promoting other games in the PC, but it's more [important] that it's [martial] games.



So we do expect other marketing to come down quite a bit in the second half. But specifically we haven't provided that, you know, second half guidance yet, but we do expect it to normalize in the second half.

Regarding gross margins, we do expect internet game gross margins to be roughly around the 1Q to 2Q levels in the second half. Smartphone games are really dependent on our partnership with the mobile operator channels, relative to working with the Apple stores and the Android stores in China. So right now I don't have a specific mix that we have, which really depends on how the testing of those games goes, and now our discussions, repeated discussions with the different channel partners go.

For WVAS, we expect those margins to terminate weak as we guided. We received a slight decline in 2Q revenues and we -- and our gross margins -- our gross profits guidance reflects primarily lower gross margins and gross profits from WVAS.

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**Mai Yoo - ICBC - Analyst**

Thank you. And my second question is regarding to your newly launched [making] Guild Wars 2. (Inaudible) is that an early performance for this game is (inaudible). Could you share with us more, kind of, on this game about it operating metrics? Also what kind of expectation on this game through [random] contribution for 2014? Thank you.

And also, just to double check, for the second quarter [gathers] how [late counted] is the Guild of Wars of 2, the [brand new] contribution? Yeah. Thank you.

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**Jay Chang - KongZhong Corp. - Chief Financial Officer**

Yeah, so, thank you. [The CG] does reflect some contributions from Guild Wars 2. However, you the large percent of the revenue is from CD-Keys, which are going to be amortized over a roughly six month period, so some of those will be, you know, pushed out to the second half.

In terms of specific metrics beyond what Leilei mentioned in his call in terms of retention and [paying user] ratio which we believe are actually some of the best in the industry, which reflect the quality of the game, you know, we did announce 500,000 CD-Key sales around the May 1st head-start date, but any future CD-Key sales [and outputs] or any other key metrics, you know, will be coordinated with our internet around global release figures and important China milestones as they occur.

So, until those times, you know -- and our -- more specifically, our second quarter earnings results, you know, we've -- you know, we've kept up as much as we're able to provide right now. But over all we believe the game is off to a really great start. The retention is great. I think our goal going forward is to take this great game, build the momentum and word of mouth, and continue to build this game over a long period of time. I believe (inaudible) Guild Wars 2 will be very long in China.

And in addition, as you may have seen, they've recently announced the start of the Living World Season 2, which will begin in North America around July 1st, and China will be very, very shortly after, so in the next month or so we'll have quite a number -- another round of amazing content to deliver to Chinese players for Guild Wars 2. So we're excited about that.

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**Mai Yoo - ICBC - Analyst**

Thank you. My third question regarding to the mobile games. [Notice -- combination between the three digital vehicles from the focusing]. Could you show that regards about your [patterns] for this year? And also [some -- leave us some] information that you will focus on sales developed for mobile games. And you will also launch your -- the [multiple share mobile game] on Kakao, online. Would like to know what the company's expectations are on this game.



**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Well, I think the best thing is to talk about, kind of, the near game pipeline and games which we have started testing next week or the next few weeks and, you know, plan to launch in 3Q. Two games, one is -- it's the English, now, I believe, is Sky Fantasy. It's actually a skill-based action RPG game, which has a pretty advanced tech system and -- but the graphics are actually quite unique to the China market. It's a little bit more Korean, Japanese, ARPG-type of game. And I think that we've been developing this game for well over a year now, through our [tension teams]. And that game hopefully will come to market some time in the third quarter.

Another game we're working out of Shanghai is actually a very unique card-based game, card-based [font] on vampires and Japanese anime. The core card-game play is a little bit more in depth than many of the card games out there in the market today. It's actually a little bit more closer to a card-based game than anything -- if you're familiar with a game called Hero Academy. That game hopefully we should be testing in the June period also. That game has been under development for well over a year as well.

Those are the two, kind of, primary games which we believe will contribute in the third quarter. Specifically, in terms of our expectations, you know, we'll have to see how the testing goes but we believe those games have opportunity for us to see continued growth in our smartphone game business.

Further out, we mentioned we're working on a number of other types of games including, you know, with the IP of [Quay Box], a movie which will come out in roughly the fourth quarter of this year. We have two projects around that [Quay Buy] IP which should hopefully be starting in the beta test in the third quarter period.

And then we have a number of other co-developments as well as second-generation ARPG games we're developing both internally on unity, as well as upgrading our internal mobile game engine, as well as a co-development with a new mobile game company in Korea, but with a management which has experience developing some of the top games in the Korean market, on [to top].

And then, as Leilei mentioned, we do have -- we expect in the next few months to launch Kooky Three Kingdoms on Kakao and [lines] which will contribute to future revenues in the [parts on make up].

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**Mai Yoo** - ICBC - Analyst

Thank you. And if I may, I have another question. It's a much broader question regarding to your position on your [momentum] strategy about the [specific] games. Exactly for the World of [constant war] ones, we're going to have to know which comes is [longer] company strategy for the PC games.

Where is -- where, for example, on the PC games, are we seeing [mercy sides] the [things] for a [very longer term of the castle]. [What counts] they have all paid for the first of the year, what this means for a longer term if they have received [Arianna] on the circle, where we actually [stable gross] for the [seams, are we roasting a] the new games develop take over the older games. So, that's what I would like to know your observation for those games. Thank you.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

All right -- hang in there. I was a little bit -- your question was a little bit muddled. If you could just ask that question really quickly in Chinese, to Leilei, I think he can answer that in English to you.

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**Mai Yoo** - ICBC - Analyst

Okay, sure.



(Speaking in Foreign Language)

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

I think for World Tanks now is [about] the three years operations period, after the World of Tanks launch. And also we see the PCU and the user activities, also continued growth, and we believe it's still -- the life cycle for World of Tanks 2 still have three to five years. And also we just launched War Saga brands, just to build up -- unite our -- all military games into one platform. And today we will open base our official of World of Warplanes in China.

Also we have a strong portfolio named World of Warships. So that means KongZhong is the largest military games platform in China and we have almost 14 million military game players as a base in our platform. So this is one part of our [RMPG] game. Also we just launched a Guild Wars 2. Response, and we believe this game, and the [RMPG] type game have a long life cycle, just like World of Tanks.

And we believe we have a strong pipeline for other big titles, especially for Blitzkrieg 3, the military type, real [charger] game, and we will launch for the fourth month of next year. And we believe our [risk-penalty] games have a very strong [PCP] features, that contain a long time life cycles. So we believe all of [surgical] PC games and our game type is very stable growth in the future, for three or five years.

Hello?

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**Mai Yoo** - ICBC - Analyst

Thank you. That's all my questions. Thank you.

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**Operator**

Thank you. The next question comes from the line of [Nick Ying] of 86 Research. Please ask your question.

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**Nick Ying** - 86 Research - Analyst

Hi. Thanks for taking my question.

So, my first question is on Guild Wars 2. How do we see the CD-Key sales trend in our announcements of 500,000 pre-sales units, and maintaining senior level of [core press a week]. And are we confident to which our CD-Key sales targets be somewhere between 1 million to 6 million by end of this year?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Hi, Nick. CD sales continues to remain robust for Guild Wars 2. But, as I mentioned on the call, you know, any more specific CD-Key numbers will coordinate with the internet for global release and any important milestones for China. And then we would obviously talk -- like to talk about those in our second quarter call.

So we have a lot of activity arranged in the month of June, and in 3Q, especially around or Living World Season 2. I think we need to drive awareness, word of mouth, for Guild Wars 2.

At the same time, we believe there's actually a strong [east port] component of Guild Wars 2 which, you know, from when they launched the game to the things that they've improved in [PDP], that that's coming only now in the China market. We believe there's a lot of [east port] potential as well, for Guild Wars 2. So we're excited about that.



And you'll see a lot of [east port PDP] tournaments from us in the next few months and quarters. Guild Wars 2 including, I believe, in June 5th and 6th, there's a starting of our, kind of, weekly or more of a regular cadence of PDP tournaments for Guild Wars 2, already started next week.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Last week, we just do a tournament for Guild Wars [PDP], and the radio, live radio audience, is about three times bigger than World of Tanks. But, you know, World of Tanks, where we just do the [PDP] tournament, almost for three years, and we believe [PDP] features more popular than the other games, also than the World of Tanks in our platform.

Also our (inaudible) in the [two can of security]. One is five [war top five PDP.] The other is World of War, is a thriller compete [PDP] model.

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**Nick Ying** - 86 Research - Analyst

Okay. That's very helpful. And also for Guild Wars 2, how much do we expect of revenue will come from [PDP] sales, and how much will come from in-game item sales down the road? Any rough leads that would be helpful.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Yeah, we don't have a split right now. But I think the way to think about it is, obviously, when [inspects], you know, around the launch and then new content upgrades, [PDP] sales usually are -- begin robust. But it's over the long-term we believe that end-game sale is part of the fun of the game will be in the future as the majority have referenced.

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**Nick Ying** - 86 Research - Analyst

All right. Okay. And also [emergency is some] in earlier quarter, alleging there's some hyper issue. I'm not sure if that's really causing some trouble at all, or -- and comments on that?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Any popular game in China will always have some type of interest from, obviously, third party forces wanting to get into a game which has a big gold economy. We actually are very, very focused and partnered, you know, very closely with the [internet] to ensure we have the healthiest and the most stable kind of in-game environment for players, especially as, you know, they paid for [PDP].

And we believe right now with Guild Wars 2, the in-game environment is actually one of the healthiest in China. And we have seen other games who have experienced similar activities at their launch, and they were not able to respond to those effectively, so we believe we've done that very effectively, and continue to use the monitors very closely and, you know, we will not tolerate any type of cheating box whatsoever in the game. And, you know, we are actively banning those types of accounts.

But they -- as a percentage of overall accounts, they're actually -- the percentage is very, very, very small, well under 1%.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

I think our accuracy for cheating and [voting] is very strict this time. For example, if the people respond, they use some kind of voting or cheating software which just blocks their account permanently. So we want to give healthy player a healthy environment in those games. So this time we feel very, very strict to compete with [voting] and cheating.



**Jay Chang** - KongZhong Corp. - Chief Financial Officer

And if we think this is actually a competitive advantage for us, with the CD-Key model, you know, our strategy hasn't been to have a massive, huge, you know, spike in [PCUs] and then have it come down a lot, you know, over the following quarter. Our goal is to grow this game and this business, and it's creating very well over time.

And part of that strategy includes having a very healthy game environment such that causes word of mouth, and we believe we've achieved that. But we continue to work hard, though, to make -- to ensure that's the case.

And we -- that's very different than many games in the marketplace which are -- a lot of them are pay-to-win. A lot of them have a lot of hacking. A lot of them don't have the same kind of game system that Guild Wars 2 has, which are very innovative and revolutionary to the market, so that's overall part of our strategy. And we believe so far we've been very successful doing that.

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**Nick Ying** - 86 Research - Analyst

Thank you. Then we look at it as to what a [workman] team. How big can this game become if we compare it to what World of Warplanes?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

I'm sorry?

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**Nick Ying** - 86 Research - Analyst

Hi. Can you hear me?

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

OK. So, we believe that World of Warplanes, the potential growth is similar like World of Tanks. For example, so, three years ago we launched World of Tanks. The first year as a PCU and it's around 750,000. Now -- 75,000. But now, we received a [retro apply] for 220,000 base models. So we believe this PDP taps in is stable growth yearly, and we have confidence. We know the template and user-experience more similar like World of Tanks.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

So to put that in some context, Nick, we expect, hopefully this weekend, that World of Warplanes would have similar types of [DAUs, PCUs] when we launched World of Tanks three years ago.

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**Nick Ying** - 86 Research - Analyst

Okay. That's very helpful. Then, so, World of Tanks. What's the trend right now? Do we still see a good number of [unique] players coming into this game?

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

It's a bit of an increase for the [areas they] new users. New users.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Yeah, we're seeing at the same stable growth in both user -- sorry, MAUs as well as revenues. In the second quarter, you know, we still kind of see that type of thing, the same type of performance.

In the second half, we're introducing a new game play mode called Fortification.

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**Nick Ying** - 86 Research - Analyst

Oh.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Okay?

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**Nick Ying** - 86 Research - Analyst

Oh, oh, yeah. Then if you look at your military games as a whole, how should we think about the military PC game market? How big this segment can be? How big is the military gamer base size, and their relative playing capabilities versus what the industry average. So, any estimates of the military game market share in the (inaudible) kind of being market [buy] which was about RMB 80 billion last year. Thank you.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Well, I think the military game is a big potential market in China, especially where we have the first [papesher], which is a very successful launch military game, World of Tanks, an online game. So we see the market [running papershers] or producers, they would follow us to [lost] many of the local military games.

We believe, just like [castle] games markets, military-type games have much big portion of the total game package. In the future we believe the military games portion bigger than before. And you see the [clock] there is roughly in military-type games, and also [tensen] will launch their warplane-type, war [sender] is a military-type game. So we believe in the future, the military-type game is most -- more popular in China.

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**Nick Ying** - 86 Research - Analyst

Thank you. And in my [Portuguese feet we all grow up learning some alert]. How should we think about our [second] revenue mix between PC and mobile at this point in time? Thank you.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Well, some -- so we believe the mobile game for this year is roughly 15% to 20% of the total revenues. And our PC game is about [65% to 70%] total revenue. Other games that [we've come in from the public media].

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**Nick Ying** - 86 Research - Analyst

Okay. That's very helpful. Thank you, Leilei and Jay. Yes.

**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Thank you.

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**Nick Ying** - 86 Research - Analyst

Thank you.

(Speaking in Foreign Language)

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Any additional questions, Operator?

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**Operator**

Thank you. Our next question comes from the line of [Zhuen Zhen] of [Rose and Blatt]. Please ask your question.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Hi, Operator. We can't hear the question and to answer. Is there any other additional questions?

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**Operator**

Yes. There's another question from the line of [Brian Roberts] of China Stock Research. Please ask your question.

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**Brian Roberts** - China Stock Research - Analyst

Good morning, and thanks for taking my question. I've got a quick, kind of, follow up on Guild Wars 2. You mentioned earlier that you had a ten-year retention rate upcoming for the past two game [chains] of about 25%. I just kind of wondered how that compared to what you were expecting. [You won last year.]

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

We were expecting similar rates but, you know, as we've seen at the scale that we've achieved with the Guild of Wars 2, we're very, very satisfied and happy with those rates. And I would say even -- if some instances it's higher than our expectations.

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**Brian Roberts** - China Stock Research - Analyst

All right. And in spite of [actually -- from a] -- on the World of Tanks and World of Warplanes, if you remember, you know, there's a War Saga [mist] the platform of players who are playing two different games. [Is there any rent call] and more [vation] between the two types of games?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

We actually haven't seen it -- we've seen it, actually, as strong additives to the overall base. One thing we learned, actually, you know, we haven't even really launched World of Warplanes yet, but what we learned from markets like Russia is that some of the highest [R2] players who play World of Tanks become also the highest [R2] players of World of Warplanes, but they actually spend more on both games once they are playing both games, since they have more to do, and more [clan] members and so on and so forth. So we think overall it's an additive.

In addition to that, taking some data points from the Russian market, only, you know, a small percentage of active World of Warplane users actually are also World of Tank users. So it actually just, you know, covers a lot of your base of military fans. So we expect the same thing in the China market.

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**Brian Roberts** - China Stock Research - Analyst

Thank you.

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**Operator**

Thank you. Our next question comes from the line of [Xheo Long Chie] of Credit Suisse. Please ask your question.

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**Xheo Long Chie** - Credit Suisse - Analyst

Hi. Good morning, Leilei and Jay, and the [media]. Thanks for taking my question. I have a quick follow up on Guild Wars 2. I just wonder if [management ensures] and colors on -- in a -- in [top down] via hacking activities around the performance of Guild Wars 2.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

So, I think Guild Wars 2 is very popular in China for the players, potential players. And also it's very popular for the hackers in China. So, for -- well, they mask many -- attacking every day. Before the official launch of [Invader] in the middle of May, [for one day] no attacking World -- of about 17 million attacks from the internet hackers.

And [we normally] have the anti-hacker security system for the player. And that includes some -- the second time [verify] system when you long in, in the game. And we just let people to bundle their mobile phones on their [ID], and they can download from a random real-time synchronization with [service] password, with [ATP] from an iPhone or [NG] from Android.

So, before the open beta in middle of May, the user complaints which seemed little bit -- a little bit larger, but after we enhance our security system, after the official launch of the -- in the middle of May, the account hacking user complaint is less than before.

Hello?

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**Xheo Long Chie** - Credit Suisse - Analyst

Thank you very much. Yeah, thank you very much for the color. I have another question. It's a more detailed question that is for Leilei.

I understand you have been in this kind of internet industry for many years. I actually just wonder what's your long-term vision for KongZhong, what kind of company you might want to grow KongZhong to, what you might want to grow KongZhong to in the future, maybe three years down the road?

**Wang Leilei** - KongZhong Corp. - Chairman and CEO

I think, we focus on the games business in the next five to ten years. We only focus on the gaming business.

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**Xheo Long Chie** - Credit Suisse - Analyst

Only focus on the gaming business. So will you see more focus on the game publishing, or you will sort of, you know, develop your in-house -- like the effects on your in-house IT and development business.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Yeah, we always have a more [survive to fight] balance strategy. Even now, our major revenues, our mobile revenues coming in from licensing games. And KongZhong is the [papersher]. But also we just achieved a large [in-call] development [pin] to develop our [RPG] games.

Also you'll see our mobile games revenue is nearly 100% coming in from our in-house development team. Maybe in the future, we have opportunities to license some mobile games from Korea and Japan. So that means we always have the right strategy or, for us, somehow from coming all our sales development, some coming from our overseas partners.

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**Xheo Long Chie** - Credit Suisse - Analyst

Thank you for the color. I'm getting back to the queue.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Thank you.

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**Operator**

Thank you. Your next question comes from the line of [Rowan Hwang] of [Oasis]. Please ask your question.

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**Rowan Hwang** - Oasis - Analyst

Hi, Leilei. Hi, Jay. Thank you for taking my question.

I wanted to ask a follow up on the [stats] on marketing, the item from incremental \$10 million. Can you tell us the aggregate marketing budget for Guild Wars 2, and also World of Warplanes? Thank you.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

It's about -- almost [80%] for Guild Wars 2, and [20%] coming -- already here for World of Warplanes in the second quarter.

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**Rowan Hwang** - Oasis - Analyst

Oh. Okay, it's ahead. That was not -- I wanted to know about the aggregate marketing budget, right now, for Guild Wars 2, the absolute amount.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

I think it's very difficult to tell you the -- accurately the number of the market budget for Guild Wars 2. And we believe in the next earnings release meeting we can say more about our marketing activities in the second quarter, for Guild Wars 2.

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**Rowan Hwang** - Oasis - Analyst

Okay. Okay. Thank you.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

Thank you.

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**Operator**

Thank you. Your next question comes from the line of [Zhuen Zhen] of [Rose and Blatt]. Please ask your question.

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**Zhuen Zhen** - Rose and Blatt - Analyst

Hi, Jay, Leilei. Thanks for taking my question. Congrats on the [products] of Q1.

My first question is about your Q2 guidance. You have a very strong guidance for the internet games revenue ramp in Q2, about [fully packed], sequential growth. Could you give us a little bit a sense about what this sequential growth, if we look at, you know, coming from the World of Tanks, or how much growth coming from the Guild Wars 2 in Q2? Thanks.

And also, [three] model the similar sequential growth for the internet games in Q3 and Q4, [about three] percent, and the (inaudible) -- could you also comment about gross margins? Thanks.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

So, our Q2 guidance for internet games reflects both the launch of Guild Wars 2 as well as contribution from World of Warplanes, but the bulk of the [e-contra] -- increases from Guild Wars 2 with very stable performance on World of Tanks.

We expect the gross margin in internet games to remain roughly around the [3%] level. But we haven't provided guidance yet for 3Q or 4Q.

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**Zhuen Zhen** - Rose and Blatt - Analyst

Okay. And also could you talk a little bit about, right now, the ongoing (inaudible) for internet games, that -- do you think it's going to affect the internet game structures? Thanks.

(Speaking in Foreign Language)

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

(Speaking in Foreign Language)

**Zhuen Zhen** - *Rose and Blatt - Analyst*

Okay. Okay.

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**Wang Leilei** - *KongZhong Corp. - Chairman and CEO*

Okay.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

We don't believe those [flood Cassidy owings] the internet game business.

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**Zhuen Zhen** - *Rose and Blatt - Analyst*

Okay. And the last question is about the W1, [she has] revenues. The guides are a little bit sliding down for Q2. Is that due to the normal [Cincinnati]? And do you expect the WVAS business will be fairly stable in the next couple quarters? Thanks.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Well, it doesn't look like anything specific to, kind of, the -- the [anti-graft circus sights and August] campaign, but because the overall environment is more strict, you know, the challenges are more strict, the partners are more strict, you know, we believe that there will be a slight decline in WVAS revenues, as well as less profits from WVAS.

For the rest of the year, though, we still, you know, at kind of Q2 levels, we see things hopefully more stable, but, you know, we'll look forward on that, you know, as we get going, as we get, obviously, through the second half of the year.

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**Zhuen Zhen** - *Rose and Blatt - Analyst*

Okay. Thanks a lot. That's all my questions.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Okay. Thank you.

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**Operator**

Thank you. (Operator instructions.)

Your next question is from the line of [Ning Gao] at [Finaza] Capital. Please ask your question.

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**Ning Gao** - *Finaza Capital - Analyst*

Hi. Good morning, Leilei and Jay. Thanks for taking my questions. So I have several questions. First is about your Q2 guidance. So, we can see that you gave us a Q2 guidance which is 20% gross of quarter-over-quarter, but actually the gross profit is kind of flat which translates into a lower gross margin in Q2 compared to Q1. So I just wanted to know what's the reason for that? Thank you.



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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

So, that primarily is gross profit contribution from WWAS. The gross -- we expect gross profit margins for WWAS to be lower in 2Q compared to 1Q.

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**Ning Gao** - Finaza Capital - Analyst

So, which means that the internet game business, like Guild Wars 2, [gross mountain agreement] (inaudible) were the [games]?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Yeah, we -- well, in our internet games business, our Q2 guidance, with the contribution of Guild Wars 2 and World of Warplanes, we expect internet gross margins to be roughly the same as 1Q levels. Yeah.

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**Ning Gao** - Finaza Capital - Analyst

Okay. Thank you. My second question is about your mobile phone games. Can you give us a breakdown of your mobile game revenue of [Q 7s], like how much is the feature phone, and how much is smartphone games?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

So, one thing is, you know, going forward, we're going to look forward to single mobile game line item. Our belief in there is, we're actually more and more -- our feature phone games, or what has been historically called feature phones, are actually IOS and Android distributions through the operator channels.

So we're actually promoting and pushing and publishing smartphone games through the operator channels, but previously they've been considered as feature phones. It's just, they just pick [carry a roller coast margin], because of the operator revenue shift.

So the growth that we're seeing if we had historically talked about breaking out feature phone and smartphone is coming from feature phones. But those are actually smartphone games. They just have a little gross margin [spent] in, markup.

But going into the future, you know, we're going to talk about mobile games as overall, because as you probably realize, and as the whole market realizes, any [Java] game is basically going to zero, and everything else is becoming Android and IOS regardless. It's just the channel is different.

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**Ning Gao** - Finaza Capital - Analyst

OK. Thank you. And my [fifth] question is about your [agile comprehensive] income of this quarter is the [inactive] 2.8 million . . .

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Exchange. What exchange -- exchange rate differences. Exchange rate differences. The bulk of our . . .

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**Ning Gao** - Finaza Capital - Analyst

Oh. Okay.



**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

... our balance sheet is in RMB, so.

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**Ning Gao** - *Finaza Capital - Analyst*

Okay, great. That's [unpretentious]. Thank you.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Okay. Thank you.

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**Operator**

Thank you. Your last question on the line comes from [Rowan Hwang] of [Oasis]. Please ask your question.

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**Rowan Hwang** - *Oasis - Analyst*

Hi, Jay. Just wanted to follow up on one of the question that was just asked. You said that the feature phone and smartphone, they're both smartphones but it's due to channel difference. Could you explain that again? I [bet] didn't get it.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Yeah. So if we would promote an IOS or an Android -- well, primarily Android smart phone games through China Mobile, given the revenue shares. You know, the revenue share is well under [60%], so they take [60%] off the top, plus there's a value-added tax, plus there's some other expenses related there.

So the margin for smartphone game on the operator channel which we have previously categorized as feature phone or -- that's becoming -- and we still see some growth there. Those are, you know, why they have lower margins, compared to having a game on Apple which is only 30%, right? So.

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**Rowan Hwang** - *Oasis - Analyst*

I see. So I guess for the first quarter, in our mobile gaming, you said that, you know, the declining gross margins was due to increased contribution from feature phones. What you really meant is the decrease in gross margins was due to the increased contribution from games sold by China Mobile channels.

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**Jay Chang** - *KongZhong Corp. - Chief Financial Officer*

Correct. Correct. Yeah.

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**Rowan Hwang** - *Oasis - Analyst*

Thank you.

**Jay Chang** - KongZhong Corp. - Chief Financial Officer

We kept -- we kept the feature phone monitored in our earnings release, because that's what we'd used in the past. And that's been changing over the past six to nine months, in terms of what type of games are through that, kind of, type of channel, or that line item. But in the future, because really everything is smart phones, games, or on Androids, from now, we've decided to combine them.

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**Rowan Hwang** - Oasis - Analyst

Okay. No, that makes sense.

And then my last question is -- is more qualitative. I know that, expect for Guild Wars 2, you have also 2CD-Key, or the two main CD-Key products. One is RMB 198. The other one's 88.

Quant -- like, I guess, quantitatively, what are you seeing between the people who are buying [solo] -- you know, buying the different -- does this in any way indicate -- have any indication of [R2] going forward? How should we think about the two [SKUs] that you're offering? I think we actually offer three, but I picked two to ask because those are the main ones.

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**Wang Leilei** - KongZhong Corp. - Chairman and CEO

It's a good question. Before we start pre-fill for CD-Keys from April, we believe it's only 5% coming from other expensive CD-Keys, which is something that is worth about 100 -- nearly RMB 200 for CD-Keys, which is [costing] some virtual items. But it's amazing that the real number is bigger than this portion, and we believe this is due to our marketing promotion and brand awareness for the players in China.

So it's about 10 to 12 percent, the total, from . . .

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**Rowan Hwang** - Oasis - Analyst

So, which one's which? Which one are you selling 20 -- which one are you selling more?

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

No, the head-starts -- at the head-starts [theory], because the 198 version included a head-start access privilege.

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**Rowan Hwang** - Oasis - Analyst

Yeah.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

That sold much higher than we expected. We had, you know, previously only expected maybe 5% of sales to be from that 198 version, but it actually was closer to 20%.

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**Rowan Hwang** - Oasis - Analyst

Wow.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Way higher than we had thought. But in the future, because the only benefit of that SKU now, for that CD-Key is the Hall of the Dragon, [hologram venues], and a [wolf skill], that that (inaudible) is less now, obviously. But it's still relatively healthy and well over 5%.

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**Rowan Hwang** - Oasis - Analyst

Right.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Yeah. The Dragon ones, you actually sell on the auction house.

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**Rowan Hwang** - Oasis - Analyst

Okay. Cool. Thank you.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Okay.

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**Operator**

Thank you. There are no other questions on the line.

I would now like to hand the conference back to today's presenters. Please continue.

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**Jay Chang** - KongZhong Corp. - Chief Financial Officer

Thank you for your interest in KongZhong, and we look forward to speaking to you in the near future. Take care. Bye.

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**Operator**

Ladies and gentlemen, this does conclude our conference for today. Thank you for participating.

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