Operator: Hello, and welcome to the Cheetah Mobile first-quarter 2018 earnings conference call. (Operator Instructions) Please note this event is being recorded.

I would now like to turn the conference over to Helen Zhu, IR Director. Please go ahead.

Helen Jing Zhu: Thank you, Operator. Welcome to Cheetah Mobile's first-quarter 2018 earnings conference call. With us today are Mr. Fu Sheng, CEO and Chairman, and Mr. Vincent Jiang, CFO. Following management's prepared remarks, we will conduct a Q&A session.

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

At this time, I would now like to turn the conference call over to our Chairman and CEO, Mr. Fu Sheng. Please go ahead.

Fu Sheng: Thanks, Helen. Hello, everyone. (Inaudible) 2018 and (inaudible) note.

Total revenues came in at the high end of our guidance. Profits and margins continued to improve. Today I would like to highlight our progress in both core business and AI-powered business.

First, our mobile game business has been a key growth driving of our company's total revenues. Both its revenue and profits continued to grow in Q1, primarily driving by mobile [casual] games
that we introduced in early 2017. In Q1, the operating margin for our mature games had already reached 15% due to operating leverage. We define mature games as games that are more than one year old.

Cheetah Mobile has already created a powerful matrix of casual games. Our games features carefully selected background music, including popular songs we licensed and original music generated by our users. This music content had allowed our game to enjoy around the 100 million monthly active user players.

Different from many other casual games, our games have longer life cycles. For example, Rolling Sky and Dancing Line achieved record-high MAU in Q1 even though they had been in the market for awhile. These achievements were a result of our efforts to keep adding new game levels to our games. For example, we recently added a new level to both Dancing Line and Piano Tiles 2 based on Alan Walker's popular song, Faded, which attracted a lot of active players and allowed us to convert many of them to paying users.

We are confident in our ability to growth both revenues and profits for our mobile game in 2018. In addition to our innovating titles, we continue to expand the genre of our games and the publishing third-party casual games. In the past month our teams focused on identifying popular and profitable mobile games and made certain adjustments to these games for global launch in later part of Q2. Our games have a long track record in successfully publishing third-party casual games globally. And we have hundreds of millions of users that we can leverage to cross promote our new titles.

Second, our utility products and the related service business continues to earn strong profits and cash flow in the quarter. Non-GAAP operating profits for our utility products and related service increased by 49% (sic -- see press release, 47.8%) year over year to RMB267 million (sic -- see press release, RMB264.7 million) in Q1. This non-GAAP operating margin increased to 36% in Q1, up from 21% in the same period last year. The improvement showed that our previous investment in utility product business have paid off. And we expect this segment will continue to generate a steady return of profits.

Further, we will start to monetize the Cheetah Keyboard. In the past year Cheetah Keyboard's user base and user engagement continued to increase thanks to our efforts in product innovation. [Driven] by organic downloads the DAU of Cheetah Keyboard has recently achieved almost 10 million. Cheetah Keyboards feature AI-powered smart replies and a collection of 3D keyboard themes. Recently we have introduced several music-driving themes which all these apps to make beautiful sounds when users touch the keys. In addition, the DAU of theme launcher already surpassed 10 million in Q1.

Next, I would like to talk about our progress in our AI-powered business. About one year ago we began to focus on the bottom-line growth of our [current] business. We have optimized the costs and expense structure for our utility products business and the [disposed] of News Republic. This strategy has allowed us to generate strong profit and a cash flow to fund our investment in AI-
powered business. In Q1 our AI-powered business made solid progress by (inaudible) introducing some robot products with Beijing OrionStar.

Cheetah Mobile has about 30 equity interest in Beijing OrionStar and has a two-year warrant to gain more equity interest to achieve a controlling position. All the robotics products that we introduced are powered by OrionStar, an open robotics platform developed by Beijing OrionStar. Orion OS allows hardware device to hear, see, understand and navigate to fulfill users' needs, making OrionStar one of handful companies to have a comprehensive sets of technologies to make practical and easy-to-use robots. Recently Beijing OrionStar achieved a record-setting 98.355% recognition rate for its facial recognition technology in the [why not] MegaFace challenge.

In April we started delivering our Cheetah Voicepod, the AI-based smart speaker to customer. We have found that playing music is the most preferred function for our AI speaker users. As a result, we focus on our resource to providing the best experience in playing music. We have integrated OrionStar's OS industry-leading far-field voice recognition and automatic speech recognition technologies into Cheetah Voicepod to allow the product to recommend and stream music, in both Chinese and English, with a superior sound quality. Powered by Beijing OrionStar's test-to-speech technology, Cheetah Voicepod also speaks with a natural and pleasant voice. Initial user feedback has shown its sound and voice had been the top two favorite features of our users.

Cheetah Voicepod features a two-year QQ Music subscription service to customers. In addition, by partnering with several leading third-party online audio and content providers, Cheetah Voicepod offers hundreds of podcasts and audio books that entertain and educate by leveraging Beijing OrionStar voice print technology. Users can also purchase premium online audio content and through WeChat or UnionPay directionally through Cheetah Voicepod.

To distribute Cheetah Voicepod, we have opened online stores on leading e-commerce platforms such as JD.com and Tmall. We have also extended our offline channel by working with China Telecom and several hotel chains. Recently we featured Cheetah Voicepod on some of China's leading radio social platforms such as Miaopai and Douyin as part of our marketing campaign.

We have also made significant progress on Cheetah Voicepod production ramp-up since its launch. We believe that voice recognition technology will be game changing in the mobile internet space. Voice-enabled interaction is most likely to be the next major traffic gateway for user access to the mobile internet in China. By leveraging OrionStar's advanced AI technology and the data in far-field voice, our extensive product experience, talented R&D team, strong cash position and strong connections in China's internet space, we are confident about Cheetah Voicepod's long-term potential.

I would also like to mention Cheetah GreetBot, which is a full-sized reception robot developed by Beijing OrionStar. Cheetah GreetBot can recognize visitors when they arrive, communicate with them, help them find their contacts and then accompany them to meeting rooms. With
Beijing OrionStar's end-to-end knowledge of robot production, they can tailor make Cheetah GreetBot for customers -- such as companies, banks and hospitals -- at a compelling price.

Beijing OrionStar have made significant progress on Cheetah GreetBot production testing since its launch. If they execute according to plans, we expect to start delivering Cheetah GreetBot to customers in Q4 2018. We expect to become the distributor of Cheetah GreetBot, so the sales of their robotics products will contribute to our top line.

Going forward we expect our core business to continue to generate profits and cash flow in the second quarter of 2018 and beyond to support our investment in AI-powered business. At the same time, we will use AI technology to empower smart hardware. To achieve this goal we will leverage Beijing OrionStar AI technologies and our product experience to make practical and easy-to-use robotic products that are focused on the best user experience.

We believe that 2018 will be a transformational year for Cheetah Mobile. While our evolution has had its ups and downs over the years, we have successfully adjusted our operational direction and a strategy to address the rapid changes in the internet and the mobile internet space. With our extremely talented R&D team, massive user base and a strong cash position, we remain confident about our long-term growth prospects and believe that we are on the right track. Thank you for your continued support.

With that, I will now turn the call to our CFO, Vincent Jiang, for a Q1 business and financial update.


The first-quarter results were in line with management expectations. Total revenue for the first quarter of 2018 was RMB1.15 billion, exceeding our previous guidance range of RMB1.1 billion to RMB1.14 billion. Mobile games revenues grew by 25% year over year to RMB175 million in Q1, [already] accounted for 15% of our total revenues in the quarter.

Importantly, we continued to expand our profit margins in the quarter, thanks to our strategy to optimize the cost and expense structure for our utility products and related services business and the disposal of News Republic. Gross profits increased by 3% year over year to RMB754 million in the first quarter of 2018. Gross margin expanded to 65.8% from 6.15% (sic -- see press release, 61.5%) in the same period last year.

Operating profits increased to RMB136 million from RMB26 million in the same period last year. Operating margin expanded to 11.9% from 2.2% in the same period last year. Overall, we continued to drive higher operational efficiency for our core business. At the same time, backing with our strong cash position, we are investing in AI-powered business to [view] the long-term growth for Cheetah Mobile. As of March 31, 2018, our cash, cash equivalents, restricted cash and short-term investments were RMB3.36 billion.
Moving on to each of our reported segments, please note that all financial numbers are in RMB unless otherwise noted. Note that starting on January 1, 2018, Cheetah Mobile adopted ASC 606, the new revenue accounting standards, which took out value-added tax from the revenue and cost-of-revenue line items. To increase comparability with the first quarter of 2018 numbers, 2017 revenue number for today's discussion has been adjusted net of VAT.

For our utility product and related services business, revenue decreased by 8% year over year to RMB745 million in Q1 2018. The year-over-year decrease was mainly due to two factors; first, a decline in revenues from mobile utility products in the overseas markets. As we stated in the past, Facebook and Google have discontinued the placement of ads on mobile-phone lock screens since May 2017 and January 2018, respectively, which reduced our ad inventory. Second, a decline in PC revenues as the internet traffic continued to migrate from PC to mobile. However, the revenue decrease was partially offset by the growth of our mobile utility products business in China, driven by a year-over-year increase in both eCPM and ad impressions in this quarter.

The profit and margins of our utility product and related services continued to improve, thanks to our strategy to optimize the cost and expense structures for this business. In the first quarter of 2018, non-GAAP operating profits for our utility product and related services increased by 48% year over year to RMB265 million. The non-GAAP operating margin for our utility product and related services expanded to 36%, up from 22% in the same period last year. The year-over-year increase in profits and margins were due to two factors. First, we continued to optimize our product offerings and we improved our operating efficiency, which led to a decrease in the bandwidth and IDC costs and a reduction in R&D headcount for the segment. Second, we adjusted promotional activities for our utility products in overseas markets.

For our mobile entertainment business, revenues increased by 8% year over year to RMB392 million in the first quarter of 2018. The year-over-year increase was driven by our mobile game business, which grew by 25% year over year to RMB175 million in the quarter.

The growth was primarily driven by the mobile casual games that we introduced in early 2017. As Mr. Fu Sheng mentioned, our casual games have longer life cycles than many other casual games. For example, Rolling Sky was launched in mid-2016, but it continued to drive our revenue growth in the quarter. Over the past years, we kept adding interesting game levels, features and in-game purchase items to Rolling Sky. Our efforts have been well received by the Rolling Sky gamers. Another example is Dancing Line, one of the most popular titles we launched in early 2017. The game was recently selected by Google Play as one of the best Android apps in games for 1Q 2018.

Further, we have also brought some of our favorite mobile games in the overseas markets to our home markets. For example, the DAU of Piano Tiles 2, Rolling Sky and Dancing Line hit record highs in China during the Chinese New Year.

Revenues from our content-driven products decreased by 3% year over year to RMB280 million in the first quarter of 2018. The decrease was a result of a year-over-year growth in revenues
from Live.me, which were offset by a decline in revenues from the News Republic application as we disposed of this business in the first quarter of 2017.

The increase in Live.me revenue was driven by growth in both the number of paying users and ARPU. We have seen that overseas live streaming users are more willing to buy virtual gifts to give to their favorite broadcasting hosts and they're more generous. However, we are still in the early stage of building live broadcasting and virtual gift model in overseas markets, so we will continue to focus on improving our product features, enrich our content offerings and explore innovative ways to operate the platforms.

Our non-GAAP operating losses for the mobile entertainment business shrank to RMB75 million in the quarter from RMB128 million in the same period last year. The reduced losses were primarily attributable to, first, a 25% year-over-year increase in the mobile game revenues, which also drove the profit improvement of our mobile game operation; second, the reduced costs and expenses from the News Republic business. We disposed of News Republic in Q4 2017. The reduced losses were partially offset by our increased investments in the Live.me operation.

Now I would like to provide revenue guidance. For the second quarter of 2018, we expect total revenues to be between RMB1.02 billion and RMB1.08 billion. The Q2 guidance is a bit softer than we previously expected. Let me explain the reasons.

First, Facebook and Google Play discontinued lock screen ads in May 2017 and January 2018, respectively. This reduced the ad inventory for our utility products in overseas markets. The impact to our revenues started in Q1 and now has fully reflected in the Q2 financials. With that said, we expect that our utility product and related services business in overseas market will remain healthy and continue to generate strong profits and cash flow.

Second, we noticed that some Chinese advertisers in the news, live streaming and short video categories scaled back their online promotional activities in Q2 due to the government's tightened control toward online contents. We believe this is a temporary issue and has limited impact on our long-term business prospects, given that we have always been very selective on ad placements within our products to provide the best user experience. We expect many of those advertisers will resume their marketing campaign in the second half of the year as they seek business growth. We are also introducing new categories of advertisers on our platform and further expand our partnership with third-party mobile advertising platforms in China.

Importantly, our mobile MAU in China achieved a record high of 170 million in first quarter of 2018, up 33% year over year and representing a 34 million net addition from the previous quarter.

Third, the growth of our mobile games also had a temporary setback in Q2. We have been focusing on improving our advertising and in-game purchase platform in Q1 to improve monetization efficiency. As a result, we postponed the marketing campaign for some of our new
games. However, we expect that revenues from our mobile game business will continue its growth trajectory in the second half of 2018.

Finally, the depreciation of US dollar against RMB in 2017 will continue to add some pressure on the yearly comparison for our overseas revenues as the majority of our overseas revenues, which accounted for 61% of our total revenues in Q1 2018, are recognized in US dollar, but reported in RMB.

Please note that this forecast reflects our current and preliminary views and is subject to change.

This concludes our prepared remarks. Operator, we are now ready to take questions. Thank you.

Questions & Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions) Thomas Chong; Credit Suisse.

Thomas Chong: (Speaks in Chinese, repeats in English)

I will translate my question into English. Hi. Good evening Fu Sheng, Vincent and Helen. I have two questions.

My first question is about the margin trend for Q2 and 2018, due to our investment in the robotics business. And my second question is about our competitive strengths and our differentiations in the robotics business versus our peers. Thank you.

Vincent Jiang: Hello, Thomas. Let me take on the first question.

First of all, for the OrionStar, Beijing OrionStar, this is a -- we are not controlling the company right now. We only have a warrant to acquire controlling portion. So at this moment -- it was a [cost method] but of course right now we're [calling it a] alternative measurement. So we're not recognize the cost and expenses of Beijing OrionStar yet. So they're just on our books [as a] cost. The expenses and costs will not impact the bottom line of Cheetah Mobile.

In terms of the margin, we expect that the gross margin will probably be slightly lower because the top line will be reduced. The other, the [related] costs such as IDCs and bandwidth, they will be proportionally reduced. And for the marketing expenses and all the other expenses, we expect that we will maintain probably similar levels. So overall, our profit margin will probably be narrower than the previous quarter. For the full year, yes, probably will be similar trends.

Fu Sheng: (Speaks in Chinese)
Okay. So first of all, since we have the comprehensive technology set for our robotic products which includes voice, image recognition and navigations, so we can [customize] our product based on a particular application and scenario.

Okay. So, we're not just launch the product by ourself. Actually, we have our business partners. We also have companies that we invested. We'll jointly roll out all the products. And that's why we launched five robotic products in March.

Okay. So in terms of the technology itself, actually at this stage of development it's the data itself that makes more difference. So we have launched our voice product, Xiaoya smart speaker, with Himalaya. And we have been using all those user datas since the beginning because the entire voice interactive system was developed by Beijing OrionStar. Also, we are one of the supply Xiaomi smart speaker and we have its -- we provide voice recognition and text-to-speech technologies, so we have a lot of data from Xiaomi as well.

So also for our Cheetah Voicepod, we launched that in April and we are gradually increasing that production capacity. So we are gaining more datas now.

So also for the image recognition technologies, we have been ranked number one on one of the challengers, which they are MegaFace challengers, which means that we are also having a pretty good image recognition technology as well,

So in terms of the gap between us and those giants, we actually don't think there's a huge difference here right now.

So in summary, we have been developing other products by ourself and we have been focusing to improve the user experience. So we think that we do have competitive strengths in the markets.

Operator: Wendy Huang; Macquarie.

Wendy Huang: Thank you, Management. I have two questions. (Speaks in Chinese)

I will translate the question myself. So first, can you provide some volume or value data from five robotics products that you launched in March? And secondly, just want to clarify with you about your prepared remark comments about the OrionStar's profitability. You mentioned that the OrionStar will actually turn profitable and there is [some] positive cash flow from second quarter onward.

And lastly, on your second-quarter revenue guidance, I think it implies both year-over-year and as well as a sequential decline which touches on several factors that may contribute to your second-quarter revenue guidance. Just wanted to quantify the impact from those factors. And also, given the single-digit revenue decline in the first half, shall we still expect on the full-year basis that you can achieve flat or maybe even slight growth? Thank you. That's all my questions.
Vincent Jiang: Okay. So, Wendy, let me take on this question. So first of all, right now I think it's premature to discuss the number of sales for the robotics business products, so -- because we expect to have production -- we expect the product to go to in production probably later this year. So this is slightly too early to discuss that.

For the second part, probably there's some misunderstanding here. We don't -- Beijing OrionStar has not -- actually, we didn't discuss that Beijing OrionStar -- is it profitable right now actually.

So for the third part, in terms of the Q2 guidance, where we do mention a few factors, let me go through those factors one by one now. So --

Wendy Huang: So on the guidance --

Vincent Jiang: -- (inaudible) --

Wendy Huang: -- (inaudible) -- yes, can you break down the -- because the guidance -- yes, the guidance implied the single-digit revenue decline. So I just wondered if you can quantify the impact from each factors that you mentioned in the prepared remarks.

Vincent Jiang: Okay. The easy part is the depreciation of US dollars. Because in Q1 the overseas revenue account for 61% of our total revenues. And we know that in Q2, if we compare the exchange rate in Q2 last year and this year, it's about 6% of increase in terms -- or increase in terms of RMBs. So (inaudible), say, 6 times -- (inaudible) is about roughly close to 4% of the total impact.

Now, in the remaining part, we kind of -- the Facebook and Google Play, that has a more significant impact, actually. We will probably -- we never disclose the exact amount, actually, for this kind of impact. We would say it's a lower single digit. And then the remaining are from the advertisers in PRC markets and the setback in mobile] games.

Wendy Huang: Regarding the impact from the le, so you also mentioned in the prepared remarks that the second quarter fully reflects that impact, although it started in the first quarter. So does that mean we shouldn't expect the further impact from the Google in Q3? And also, given that it's truly reflected in the second quarter, so by the end of the second quarter what is actually the revenue -- what will be the revenue contribution from Google? Because last time I think when the policy [trend was just to continue] you kind of mentioned that, okay, 40% of the -- Google's related [revenue] got affected. I just wonder if you actually imply that less than 60% will be completely wiped out in the second quarter. Or that's not really the case? Yes, if you can provide any color on that, that would be helpful.

Vincent Jiang: Actually, in either way to -- just to compare the overseas revenues in terms of utility products, you can see we actually disclosed the numbers for the mobile utility products in the overseas market. So you just compare the number from Q2 last year and Q2 this year, you
can see the difference here. In terms of -- by the end of Q2 and in terms of Q3 and Q4, we explained that in Q3 we will see sequential growth for the overseas revenues.

Wendy Huang: Okay. Thanks, Vincent.

Operator: Thank you. (Operator Instructions) Robert Cowell; 86 Research.

Robert Cowell: Management, thanks for taking my question. I wanted to ask about the MAU number. You showed some strong growth in MAU, so I'm wondering what products in particular is that growth coming from. And then it also seems that the domestic MAU is outperforming even stronger based on your comment that there is 170 million domestic MAU now. So what products are driving that? And specifically in the domestic market, are there any products that are performing particularly strong? Thanks.

Vincent Jiang: Hi, Robert. This is Vincent. So actually there are two products. First one is the Clean Master. Its MAU has increased significantly in China. And the second one is the Cheetah Keyboard. We have seen significant increase in overseas markets. And also we have some increase in the games as the games is pretty significant in China right now.

Robert Cowell: If I could ask maybe one more follow-up -- you mentioned that monetization of Cheetah Keyboard is in the cards for the coming quarters. How should we be thinking about how that monetization is going to impact your performance?

Vincent Jiang: Well, initially it will be relatively insignificant. We're still in the early stage of experimenting different monetization approach.

Robert Cowell: Okay. Thank you.

Operator: Liping Zhao; CICC.

Liping Zhao: (Speaks in Chinese).

Okay. I have two questions for the management. The first one is related to our games business because we have a very strong growth, revenue growth, in our games sector. So how many games in our portfolio right now? And what's the MAUs for our games sector? And what will be the pipeline for next quarters in this year?

My second question is related to our cash. I noticed that in our balance sheet we have around RMB3.3 billion right now. And what's Management plans for this kind of cash? Thank you.

Fu Sheng: (Speaks in Chinese)

(As translated) We have been launched, also operated probably a dozen or so casual games. And we do have quite a few in the pipeline and because we are not only -- some of those are
developed by ourself, but we also license from third parties. For the increase in Q1, it's mainly because the Chinese national holiday in Q1, the Spring Festivals. And because the user numbers and the in-game purchase have both generally quite significant growth in this period, that's why our Q1 revenues are -- have a very good increase.

And in terms of the number of game users, we have around 100 million game users. And this number fluctuates but we expect that number will increase because we do have more games in the pipeline. And also, we're kind of -- [may be] adopting a new approach because we are going to release and launch new games more frequently than previous. And we also have quite a few even smaller casual games in pipeline because we have been talking to quite a few third-party publishers, and we are hoping that those new games can bring more users to us.

For the cash, we do have quite a significant amount of cash on our balance sheet. We plan to use this cash to invest in AI-powered business, which is actually our key strategy right now.

So our overall strategy is to continue to generate strong cash from our existing business, including utility products, casual games and Live.me. And we are going to invest heavily in AI-powered technologies because, as we said previously, this is our transitional trends in [new] years. The current utility products and games will continue to be a cash cow business and we expect that, in the longer run, our AI business will become a more significant and probably even the major part of our business. Thank you.

Operator: (Operator Instructions) All right. As there are no more questions at the present time, I would like to return the call to Management for any closing comments.

Helen Jing Zhu: Thank you all for joining us today. If you have any further questions, please do not hesitate to contact us. Thank you. Bye.

Operator: Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.