Cheetah Mobile, Inc. [CMCM]
Q1 2020 Earnings Conference Call
Wednesday, June 10, 2020, 8:00 AM ET

Company Participants:
Helen Zhu, Director, Investor Relations
Fu Sheng, Chairman and Chief Executive Officer
Thomas Ren, Chief Financial Officer

Analysts:
Thomas Chong, Jefferies
Vicky Wei, Citi

Presentation

Operator: Good day, and welcome to the Cheetah Mobile First Quarter 2020 Conference Call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. Please note this event is being recorded.

I would now like to turn the conference over to Helen Zhu, Investor Relations Director of Cheetah Mobile. Please go ahead, ma'am.

Helen Zhu: Thank you, operator. Welcome to Cheetah Mobile's first quarter conference call. With us today are our Company's Chairman and CEO, Mr. Fu Sheng, and Mr. Thomas Ren, our Company's CFO. Following management's prepared remarks, we will conduct a Q&A session.

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

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

Fu Sheng: Thank you, Helen. Hello, everyone. Honestly, Cheetah Mobile’s mobile internet business still faced some headwinds in the first quarter of 2020 due to the epidemic, as well as suspensions of our partnerships with Facebook and Google. While we continue to communicate with Google and Facebook, we have not yet resumed our work with them. As a result, we are having difficulties in acquiring new users and monetizing our traffic in overseas markets.

In the first quarter of 2020, revenues from the overseas markets decreased by 56% year over year and 11% quarter over quarter. MAUs in overseas markets declined by 33% year over year and 14% quarter over quarter.

Due to the epidemic, our ecpm in China declined significantly in Q1, resulting in a 75% year-over-year and 42% quarter-over-quarter decrease of our mobile utility product revenue in the domestic market.

Overall, we expect our total revenues to decrease by 49% to 55% year over year in the second quarter of 2020 by excluding the impact of deconsolidating LiveMe.

In the face of these challenges, we have taken measures to sustain our profits, conserve our cash, and build a long-term growth engine. These measures include the following.

First, we have streamlined our operations, focused on the domestic mobile Internet market, and offloaded some non-strategic businesses, such as LiveMe.

Second, we have continued to optimize our cost and expense structure, especially to our mobile Internet business, including the utility product business and mobile game business.

Third, in terms of our investments in AI, we will focus our resources on AI-related robotics business in shopping malls.

Fourth, we have liquidated our equity stakes in other companies, which Thomas will provide some additional color in his part.

Our efforts to implement these 4 measures have started pay off. Non-GAAP operating profit for our mobile internet business unit in the first quarter of 2020 improved substantially from fourth quarter of 2019 despite a decline in revenue. The costs and expenses for our mobile Internet business decreased by 50% year over year and 28% quarter over quarter in the first quarter of 2020.

Excluding the deconsolidation of LiveMe, the costs and expenses for our mobile Internet business decreased by 30% year over year and 28% quarter over quarter in the first quarter. As a reminder, we started to deconsolidate LiveMe's financials since Q4 last year.

As a result, the non-GAAP operating profits of our mobile Internet business improved to RMB8 million from a non-GAAP operating loss of RMB92 million in the fourth quarter of 2019.

At the corporate level, our gross margin expanded on both a year-over-year and quarter-over-quarter basis in the quarter. Non-GAAP operating profits also improved sequentially from the fourth quarter of last year.

Looking ahead, we will continue to implement strict cost saving and expense control measures, while improving operational efficiency.

Meanwhile, our PC revenues stabilized on both a year-over-year and quarter-over-quarter basis at around RMB120 million in the first quarter of 2020. Importantly, the composition of our PC revenues is changing. In addition to advertising revenues and gaming revenues, we generated an increased amount of PC revenues from paying users who subscribe to the premium services of our Duba antivirus software.

Both the paying user count and daily subscription revenue reached record highs during the pandemic. While these metrics declined slightly after Chinese users had returned to work and schools, they have recently started to grow again.

In Q1, the decrease in our mobile utility product revenue in the domestic market was due to the epidemic, and our initiatives to proactively reduce some advertising slots in China to enhance our user experience. Now, we still have close to 100 million MAU on both PC and mobile in China.

We believe our utility product business in China has been stabilizing. Going forward, we expect both our PC revenues and mobile utility product revenue in the domestic market to remain resilient. At the same time, we will replicate our user subscription model from PC to mobile.

To rebuild our long-term growth engine, we continue to focus our resources on selected AI-related robotics business, such as the AI new retail. Since last year, we have deployed our robots in more than 800 shopping malls throughout China's tier-1 and tier-2 cities. Our offerings help customers to find the shops and brands they are looking for, improve the customers' shopping experience, and create more business opportunities for merchants.

Before the outbreak, the customers' daily inquiries with our robots had been growing since inception. While the engagement level decreased during the outbreak, it is back to the -- in recovery mode now. On the other hand, the accuracy rate of our speech interaction service has already surpassed 90%, which is reaching the level of smart home speakers.

Increased customer usage has attracted many shops and brands to come to us to gain coverage. Our team has developed an online system, which has helped users register, adjust, and update their information on a real-time basis. Recently, we have tentatively directed more traffic to certain users to monetize our user traffic. In the coming quarters, we will focus on the monetization of our user traffic in shopping malls.

Additionally, we have deployed our robots throughout many hospitals in China during the recent outbreak of COVID-19, further increasing brand awareness for our products and solutions.

With that, I will hand the phone over to our CFO, Thomas.

Thomas Ren: Thank you, Fu Sheng, and good day, everyone. Thank you all for joining us today. Now, I will walk you through our financial results. Please note that unless stated otherwise, all money amounts are in RMB terms and all growth comparisons are made on a year-over-year basis.

As we stated in previous quarters, LiveMe amended its share incentive plan on September 30, 2019. As a result, we no longer hold the majority voting power in LiveMe, and have started to deconsolidate LiveMe's financial results since the fourth quarter of 2019.

During the first quarter of 2020, total revenues decreased by 51% to 528 million. Excluding the impact of the deconsolidation of LiveMe's revenues, total revenues decreased by 36% in the quarter.

Let's now look into our results for each business line, starting with utility products and related services. Revenues from utility products and related services decreased by 58% to 211 million in the quarter. Moreover, during the quarter, about 71% of our revenues from utility products were generated from advertising. This decrease was primarily due to the following: First, the decline in our mobile utility product business in overseas markets. Mobile utility product revenue in overseas markets decreased by 63% to 54 million in the quarter, which was mainly due to the suspension of our collaborations with Google on the advertising front since February 2020.

Second, the decline in our mobile utility product business in the domestic market. Mobile utility product revenue in the domestic market decreased by 75% to 62 million in the quarter, which was the result of headwinds in China's online advertising market.

Third, the decline in PC-related revenues. PC-related revenues decreased by 6% to 95 million in the quarter, as internet traffic in China continued to migrate from PC to mobile devices.

Revenues from our mobile games business decreased by 5% to 285 million in the quarter, mainly due to the suspension of our collaborations with Google on the advertising front since February 2020. In addition, during the quarter, about 70% of revenues from our mobile games business were generated from advertising, while the remaining portion of revenues were generated from in-game purchases.

Turning to our costs and expenses, the following discussion of results will be on a non-GAAP basis, which excludes stock-based compensation expenses and goodwill impairment. The use of non-GAAP measures in this context will help us to better present the results of our operating performance without the effect of non-cash items. For financial information presented in accordance with U.S. GAAP, please refer to our press release which is available on Cheetah Mobile's website at ir.cmcm.com.

In the first quarter of 2020, we implemented strict cost saving and expense control measures to our mobile Internet business, especially for our utility product business, and the mobile game business.

Total costs and expenses decreased by 38% year over year to 675 million in the first quarter of 2020. This year-over-year decrease was mainly due to the deconsolidation of LiveMe and our efforts to reduce costs and expenses for our mobile Internet businesses. Excluding the impact of LiveMe, our total costs and expenses decreased by 16% year over year in the quarter. In addition, on a sequential basis, total costs and expenses decreased by 18% in the first quarter of 2020.

Turning to each line items of our costs and expenses, cost of revenues decreased by 60% year over year and 19% quarter over quarter to 148 million in the quarter. The year-over-year decrease was mainly due to the deconsolidation of LiveMe. The quarter-over-quarter decrease was mainly due to the reductions in IDC and CDN costs relating to the Company's utility product business.

Gross profit decreased by 47% year over year and 12% quarter over quarter to 380 million in the quarter. Gross margin grew to 72% in the quarter from 66% in the same period last year and from 70% in the previous quarter.

R&D expenses decreased by 25% year over year and 1% quarter over quarter to 136 million in the quarter, mainly due to a reduction in the personnel for the Company's utility products and related services business in overseas markets.

Selling and marketing expenses decreased by 30% year over year and 11% quarter over quarter to 304 million in the quarter. The year-over-year decrease was mainly due to the reduction in promotional activities for the Company's utility products and related services business in the domestic market, as well as the deconsolidation of LiveMe. The quarter-over-quarter decrease was mainly due to the reduction in promotional activities for the Company's mobile game business in the overseas market.

G&A expenses decreased by 12% year over year and 46% quarter over quarter to 87 million in the quarter. The year-over-year decrease was mainly due to decreased professional fees. The quarter-over-quarter decrease was mainly due to lower salaries and employment benefits related to our G&A staff.

Operating loss was 141 million in the quarter, compared to an operating profit of 9 million in the same period of last year. However, our operating loss reduced by 31% on a sequential basis, thanks to our efforts to implement cost saving and expense control measures.

Moving onto each reporting segment, operating profit for our utility products and related services was RMB44 million in the quarter, decreasing from RMB123 million in the same period of last year. Despite this year-over-year decrease, which was mainly due to the decline in revenues, operating profit for our utility products and related services increased on a sequential basis from RMB29 million in the last quarter thanks to our cost saving and expense control measures.

Operating loss for our mobile entertainment business was 36 million in the quarter, decreasing from 44 million in the same period of last year. This year-over-year decrease was mainly due to the deconsolidation of LiveMe. Sequentially, operating loss for our mobile entertainment business narrowed from RMB120 million to RMB36 million this quarter, which was mainly due to our cost saving and expense control measures for our mobile game business.

Operating loss for AI and other business was 149 million in the quarter, compared to 70 million in the same period of last year, mainly due to the increased investments in our AI-related business.

Moving onto our balance sheet, as of March 31, 2020, we had cash and cash equivalents, restricted cash, and short-term investments of US$331 million and long-term equity investments of US$361 million.

We continued to review our investment portfolio and selectively liquidate some of our investments. Recently, we disposed our remaining equity ownership in Bytedance Ltd., which will result in a gain on investment of approximately US$66 million and a cash inflow of approximately US$130 million in the second quarter of 2020.

We also continued to return cash to our shareholders. Recently, our Board approved a special cash dividend of US$1.44 per ADS. The aggregate amount of the cash dividends was approximately US$200 million. Importantly, Cheetah Mobile's cash position remains strong, even after paying out this special cash dividend.

Now let me provide you with our second quarter revenue guidance. We currently expect total revenues for the second quarter to be between RMB340 million and RMB390 million. Excluding the impact of deconsolidating LiveMe, this guidance implies a year-over-year decline in total revenues between 49% and 55% in the period.

Please note, 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 and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Thomas Chong from Jefferies.

Thomas Chong: (Speaking Foreign Language). My first question is about the Q2 revenue guidance. Can management comment about the business trend for each segment on a monthly basis, and how we should expect the outlook in the second half?

And my second question is about the momentum in terms of the recovery in domestic and overseas market. Given the coronavirus in terms of the timing, and the recovery is different in China and overseas, how we should think about the impact to our business line going forward?

Thomas Ren: Okay. I will answer your first question and Fu Sheng will answer your second question. So the first part of your question is about the -- to provide more color on Q2 guidance. So normally, we don't provide breakdown for revenue guidance, and also we don't provide monthly revenue guidance as well. But you can see our Q2 revenue guidance is between RMB340 million to RMB390 million compared to RMB530 million (The Company edited: revenue guidance for 1Q20 is between RMB490 million and RMB540 million.) last quarter. So the decrease will mainly come from the utility business and gaming business being affected by Google's termination of collaboration since late February.

And for the Q2 AI revenue, we expect it to be stable compared to Q1. Although the impact by COVID-19 to supply chain and sales is recovering step by step, we do need some more time to pick up the AI revenue.

For the second half outlook, I would say that because of the impact by Google's termination of collaboration for our utility and gaming business, i.e., our mobile Internet business, for short term, we may expect some downturns on revenue side mainly coming from overseas markets, while the domestic utility revenue has been stabilized. But we do think while we reconstructing our revenue composition, and we are experimenting a monetization model for AI new retail, mentioned in our prepared remarks, AI and other revenue will contribute a more sizable part if the experiment is successful during the second half of this year. Hope this answers your question.

Thomas Chong: Thank you.

Fu Sheng: (Speaking Foreign Language).

Thomas Ren: Yes, let me translate the first part about the overseas market.

(Translated). So although we are still trying to communicate with Google and Facebook, we still have no clear answer from both companies, how we -- or what we can do to resume our collaborations. So this causes us that we cannot upgrade our products to further serve our huge user base. So now for the overseas market, we are actively looking for some opportunities for asset sales. And we are also focusing our business on domestic market.

Fu Sheng: (Speaking Foreign Language).

Thomas Ren: Okay. Let me translate about the domestic market.

(Translated). So on the PC side, we are changing our model from a free-plus-advertisement model to free-plus-premium subscription model, which we believe is more acceptable by all the PC users. Now while our revenue on the domestic mobile side is declining, our PC revenue is stabilizing currently. And we are also -- as we mentioned, we also are trying to replicate our model, user subscription model, from PC to mobile.

Thomas Chong: Got it. Thank you.

Operator: (Operator Instructions). Vicky Wei from Citi.

Vicky Wei: (Speaking Foreign Language). I have two small questions. So would management provide some color on the progress of the strategic focus on mobile Internet market in China?

And my second question is about margin trend. Would management provide on the gross margin trend after the deconsolidation of LiveMe? In the future, will there be any room to improve?

Thomas Ren: So I will answer your question. So for the first part in your question, I believe we have mentioned for our domestic utility business, as we mentioned in the prepared remarks, although the revenue is decreasing due to the epidemic and our sales adjustment on advertising slots for user experience, our revenue has been stabilized, and we have also changed the revenue composition by adding premium member subscription model. So based the paying user comment, daily subscription revenue has reached a record high. And also, as we mentioned just now, we will also replicate the same subscription model from PC to mobile.

Now, for the domestic gaming business, we will be focusing key titles to ensure our profitability, while we also selectively and carefully choose new title, if there is any available. So I hope this answers your first question.

So for your second question about gross profit ratio, actually, our gross margin trend, it really depends on our revenue composition. So normally, we have higher gross margin for mobile Internet business, ie. utility and gaming business. And we believe for mobile Internet business, the gross profit ratio will be stabilized after deconsolidating LiveMe.

Well, for AI business, because it includes robotic sales or consumer product sales, the margin will be lower than the traditional Internet business. So if we are increasing a portion of AI revenue later, the gross margin might be lower than the current level because of the different revenue compensation. Yes, hope that answers your question.

Vicky Wei: Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to management for closing remarks.

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

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