Cheetah Mobile, Inc. [CMCM]
Q2 2020 Earnings Conference Call
Tuesday, August 18, 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:
Vicky Wei, Citi

Presentation

Operator: Good day, everyone, and welcome to the Cheetah Mobile Second Quarter 2020 Conference Call. [Operator Instructions] Please also note today's event is being recorded. At this time I'd like to turn the conference call 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 Second Quarter 2020 Earnings 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. Please go ahead, Mr. Fu.

Fu Sheng: Thank you, Helen. Hello, everyone. **We delivered overall better-than-expected results in the second quarter of 2020**. Today -- total revenues came in at RMB 394 million, exceeding the high end of our revenue guidance. Non-GAAP net income grew to RMB 244 million.

However, we're still facing challenges in operating our business. In overseas markets, we are unable to resume our cooperation with Facebook and Google. As a result, we have difficulty in acquiring new users and monetizing our traffic, and our overseas revenues continue to decline. Given today's environment, we are not confident in resuming our cooperation with Facebook and Google. In the domestic market, the online advertising industry has been negatively impacted by the pandemic since the beginning of this year, leading to the decline of eCPM.

To cope with these headwinds, we chose to strategically shift our focus from overseas markets to the domestic market and introduce the user subscription model. Financially, we have reduced cost and expense and focus our AI investments in the shopping malls. In today's call, I would like to highlight the following.

First, we significantly reduced our cost and expense during the quarter. As a result, the non-GAAP operating loss narrowed by RMB 8 million quarter-over-quarter in Q2, despite that our total revenue decreased by RMB 130 million from the previous quarter. The revenue decrease was primarily due to the suspension of our collaboration with Google since February 2020 as well as the outbreak of COVID-19, which continued to impact our online advertising business in China.

During the quarter, we cut back our cost and expense for overseas markets, leading to a 61% year-over-year and 31% quarter-over-quarter decrease in cost and expense for our mobile internet business, namely the utility product and mobile game operations. In the coming quarter, we will continue to improve operational efficiency, reduce cost and expense and significantly narrow our operating loss on the corporate level.

Second, PC revenue increased by 2% quarter-over-quarter to RMB 120 million, driving the growth of user subscription revenue. During the quarter, both paying user count and daily subscription revenue from our Duba anti-virus software reached new highs. This achievement proved the user subscription model within utility apps. Recently, we have copied the user subscription model from PC to mobile by introducing premium service for Clean Master. The initial user adoption has been very encouraging, as we have seen the paying user count and the daily subscription revenue remained growing since inception.

Third, given today's environment, we believe Chinese mobile internet companies will face increasing challenges abroad. As a result, our utility product business will move from overseas markets to the domestic market. This move allows us to reduce cost and expense gradually. During the quarter, we introduced some new utility products in our home market. In the future, we will add more utility products in the domestic market to further enrich our product offering and boost our revenue.

Fourth, the number of AI-related robots in shopping malls grew to about 7,000 by the end of the second quarter. Our robots help customers find the shops and brands they are looking for, improve the customer's shopping experience and create more business opportunity for merchants. The customer's daily inquiry with our robots has been growing. Increased customer usage has attracted many shops and brands to come to us to gain coverage. Recently, we tried to work with several brands, including restaurants, auto companies and accessories, to direct traffic to their local shops. The progress of our robots in shopping malls delayed about six months due to the pandemic. However, we will accelerate the monetization along with the recovery from COVID-19 situation.

Fifth, our long-term equity investments contain several well-known projects. As of June 30, 2020, we had USD 292 million long-term equity investments sitting on our balance sheets. During the quarter, some of our major investees made notable developments. For example, LiveMe achieved profitability. Codemao, a leading Chinese online education platform that teaches programming to children, closed a new round of fundraising.

Looking ahead, we expect to continue facing external headwinds, so that we are unable to grow or sustain our total revenues in the second half of 2020. However, we will continue to reduce cost and expense and narrow our operating loss in the coming quarters. At the same time, we will uphold our commitment to AI, backed with our strong cash reserves. We believe AI will allow us to build a new growth engine for the company in the long term.

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

Thomas Ren: Thank you, Mr. Fu, 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 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. To better present our financial results, we will also provide year-over-year comparisons excluding the impact of the deconsolidation of LiveMe.

Total revenues were 394 million in the quarter, exceeding the high end of our revenue guidance for the second quarter of 2020 and representing a decrease of 59%. Excluding the impact of the deconsolidation of LiveMe, total revenues decreased by 48% in the quarter. This decrease was primarily due to the suspension of our collaborations with Google since February 2020, as well as the outbreak of the COVID-19, which continued to impact our online advertising business in China during the quarter.

By business segment, revenues from utility products and related services were 195 million in the quarter, representing 50% of our total revenues in the quarter. Revenues from our mobile games business were 179 million in the quarter, representing 46% of our total revenues in the quarter. **By region**, revenues from China accounted for 41% of our total revenues in the quarter, while revenues from overseas markets accounted for 59% of our total revenues in the quarter. **By platform**, PC revenues improved slightly quarter over quarter to 118 million and represented 30% of our total revenues in the quarter, while mobile revenues accounted for 70% of our total revenues in the quarter.

<u>Turning to our costs and expenses.</u>

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 noncash items. For financial information presented in accordance with U.S. GAAP, please refer to our earnings release.

During the second quarter of 2020, we chose to strategically shift our focus from overseas markets to the domestic market and thus continued to reduce our expenditures on our mobile internet business in overseas markets in turn. At the same time, we remained focused on our AI-related investments for shopping malls.

As a result, **total costs and expenses** decreased by 47% year over year and 22% quarter over quarter to 528 million in the quarter. Excluding the impact of LiveMe, our total costs and expenses decreased by 30% year over year and 22% quarter over quarter.

In particular, cost of revenues decreased by 65% year over year and 23% quarter over quarter to 113 million in the quarter. R&D expenses decreased by 43% year over year and 17% quarter over quarter to 113 million in the quarter. Selling and marketing expenses decreased by 46% year over year and 33% quarter over quarter to 205 million in the quarter.

Moving onto our profits and margins.

Gross profit was 281 million in the quarter. Gross margin was 71% in the quarter, compared to 66% in the same period last year and 72% in the previous quarter.

Operating loss narrowed to 133 million in the quarter from 141 million in the previous quarter. The decrease in operating loss during the second quarter was a result of our strict cost-saving measures and represented the third straight quarter in a row of reducing operating losses since third quarter of 2019.

During the quarter, we disposed our remaining stake in ByteDance, which resulted in an investment gain of about USD 66 million.

As a result, we reported a non-GAAP net income attributable to Cheetah Mobile shareholders of 244 million in the quarter, compared to 82 million in the same period last year and a non-GAAP net loss attributable to Cheetah Mobile shareholders of 98 million in the previous quarter.

In addition, we reported a non-GAAP diluted earnings per ADS of USD 0.25 in the quarter, which grew from USD 0.08 in the same period last year and a non-GAAP diluted loss per ADS of USD 0.10 in the previous quarter.

Moving onto our balance sheet.

As of June 30, 2020, we had cash and cash equivalents, restricted cash, and short-term investments of USD 453 million and long-term equity investments of USD 292 million.

On July 9, 2020, we used cash from our balance sheet to pay a special cash dividend of USD 1.44 per ADS to our shareholders. The aggregate amount of the cash dividends was about USD 200 million.

Now let me provide you with our third quarter revenue guidance.

We currently expect total revenues for the third quarter to be between RMB 310 million and RMB 360 million. Excluding the impact of deconsolidating LiveMe, this guidance implies a year-over-year decline in total revenues between 47% 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: [Operator Instructions] And our first question today comes from Vicky Wei from Citi.

Vicky Wei: [Foreign Language] I have two small questions. The first is about the advertising market update. So will management provide some color about the category performance of the advertising market in the second quarter and the third quarter?

And my second question is about the U.S.-China tension. So lots of Chinese ADRs are coming back to China to dual list, or they privatize. So what does management think of this and what is the plan of the company? Thank you.

Fu Sheng: [Foreign Language]

Thomas Ren: [Foreign Language] Okay, so I will answer your two questions. So first one is about the industry with good performance for our advertising business. So I think our situation is similar with other players in the advertisement industry, as most of our advertising revenue is coming from major domestic platforms. We can see greater contributions from e-commerce and online education with the increased investment for their June 18th promotional campaigns or for summer holiday courses. And in the categories such as automobile and consumer electronics, they marketed more aggressively as consumption recovered. Hope this answers your first question.

For your second question, it's about the -- what's the management view about the delisting from U.S. market or dual listing in Hong Kong capital markets. So yes, we did know that recently many Chinese companies, they have either chosen to delist from the U.S. stock markets or completed dual listing in the Hong Kong stock market. Meanwhile, we also noticed that many Chinese companies have completed their successful U.S. IPOs in the past couple of months.

So I believe that the different capital markets provide a variety of options for different companies at different growth stages. So for us, as Cheetah Mobile's management, our top priority is definitely the company's business development and growth. At the same time, we will also pay attention to various options available in different capital markets. So yes, for sure, if we have any plan, we will disclose to the public as soon as possible.

Operator: [Operator Instructions] And ladies and gentlemen, at this time and showing no additional questions, I'd like to turn the conference call back over to management for any 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 so much. Bye.

Operator: Ladies and gentlemen, with that, we'll conclude today's conference call. We do thank you for attending. You may now disconnect your lines.