Cheetah Mobile Inc.
Third Quarter 2020 Earnings Conference Call
November 24, 2020 at 7:00 AM Eastern Time

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 Third 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'd 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 third quarter 2020 earnings conference call.

With us today are our company's Chairman and CEO, Mr. Fu Sheng, and our company's CFO, Mr. Thomas Ren. Following management's prepared remarks, we will conduct a Q&A section.

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 like to turn the conference call over to our Chairman and CEO, Mr. Fu Sheng. Please go ahead.

Fu Sheng: Thank you, Helen. Hello, everyone. While total revenues exceeded our revenue guidance, we still face challenges in growing our revenues. Total revenues decreased by 60% year over year and 7% quarter over quarter to RMB365 million in the third quarter of 2020, mainly due to the declined overseas business.

We've suffered some setbacks in overseas markets. Facebook and Google, our ex-largest business partners, stopped working with us. As a result, we lost two significant channels to acquire users and monetize traffic overseas. Although we've consistently communicated with Facebook and Google, offered several solutions to them to resume our works, we are still not able to rework with them. Given today's international environment, we don't expect to resume our cooperation in the near future.

To cope with these headwinds, we have taken several measures and have seen some initial results as follows.

First, we have streamlined our operations and cut our costs and expenses. As a result, non-GAAP operating loss narrowed to RMB119 million from RMB222 million in the same period last year, and RMB133 million in the previous quarter. Our operating loss in the quarter also included certain one-off staff restructuring expenses. So we expect to continue reducing our operating losses in the fourth quarter.

Second, our revenues from PC business and mobile utility products in our home market as a whole stabilize. Our PC business has transformed from an advertising model to a membership subscription model. During the quarter, we continued to diversify our premium contents and services, which drove an increase in paying user count and subscription revenues. As a result, daily PC revenues from the membership subscription fees increased 14 times year over year and 42% quarter over quarter in the quarter. Daily membership subscription fees already accounted for about 50% of our daily PC revenues, which demonstrated that our PC business had transformed from an advertising model to a membership subscription model. Besides, our mobile utility products business in our home market resumed quarter-over-quarter growth in Q3. Driven by improved eCPM, revenues from mobile utility products business in our home market grew by 7% quarter over quarter in Q3.

Third, we disposed certain business and assets in the quarter, resulted in a net cash gain of US$21 million in the second half of 2020. Thomas will provide more details about the deal in his part. But I would like to emphasize that we will continue to create and deliver shareholder value in the future. As of today, we have already returned about US$300 million to our shareholders. After the shareholder returns, we still have a strong balance sheet to support our ambitions and investments. Recently, Codemao, a Chinese online education platform which focuses on teaching programming to children, raised a new round of financing. Cheetah Mobile is an angel investor of Codemao. Before this round of financing, Cheetah Mobile held about 10% of equity interests in Codemao.

Fourth, we continue to focus our resources on AI-related robotics business to build our ecosystem and eventually rebuild our long-term growth. Together with our investee company, Beijing OrionStar, we have deployed our AI-related robotics in an increased number of use cases. The recent outbreak of Covid-19 has also helped us expand the usage of our robotics products and solutions. One highlight is our robots deployed in shopping malls. Today, our robots have been deployed in about 1,000 shopping malls across 35 cities in China. As more users use our robots in shopping malls, we have begun to build tentative business models. Meanwhile, we've found that hotels in China have increasingly welcomed delivery and reception robots. So we quickly responded and developed customized robots for hotel customers in the fourth quarter.

Our cooperation with Bejing OrionStar in the AI business builds on our respective strengths. Beijing OrionStar develops and produces AI robots, and Cheetah Mobile builds use cases for the customers. Notably, Beijing OrionStar's robots have been nominated twice in a row in the Service Robot Contest held by Beijing Municipal Science and Technology Commission for

Beijing 2022 Olympic Games. We won four first prizes and one second prize in these contests.

Looking into the fourth quarter of 2020, we currently expect total revenues to be between RMB230 million and RMB280 million. The quarter-over-quarter decreases were due to the disposed assets and business, which Thomas will provide more details at this portion.

Going forward, utility products and services, in particular, in PC business, will be the primary driver of our revenues. Driven by the subscription business, our PC revenues will resume sequential growth in Q4. On the other hand, we will continue to cut our cost and expenses, and narrow our operating losses on both year-over-year and quarter-over-quarter basis.

Before I hand over the call to our CFO, I would like to emphasize that while we don't want to downplay the challenges we face, it is not the first time that Cheetah Mobile encounters unfavorable outside environment. We believe our AI strategy will enable us to build a new future for Cheeteh Mobile.

With that, I will now turn the call to our CFO, Thomas Ren, to go through the details of our third quarter financial results.

Thomas Ren: Thank you, 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.

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 365 million in the quarter, exceeding the high-end of our guidance, representing a year-over-year decrease of 60% and a sequential decline of 7%. Excluding the impact of the deconsolidation of LiveMe, total revenues decreased by 47% year over year in the quarter. This decrease was primarily due to the suspension of our collaborations with Google since February 2020.

By business segment:

Revenues from utility products and related services decreased by 47% year over year and 5% quarter over quarter to 186 million in the quarter, representing 51% of our total revenues in the quarter. PC revenues and mobile utility products revenues in our home market are stabilizing, already contributing to 33% of our total revenues in the quarter.

Revenues from our mobile games business were 158 million in the quarter, representing 43% of our total revenues in the quarter. As of September 30, 2020, the Company had disposed certain business and assets related to the gaming business in overseas markets. In the third quarter of 2020, the disposed business and assets as a whole contributed approximately 27% of our total revenues and generated operating losses.

As a result, for the fourth quarter of 2020, we expect revenues from the mobile games business to shrink significantly. However, we expect revenues from PC and mobile utility products in our home market to remain stable and account for the vast majority of our total revenues.

And for our fourth quarter revenue guidance, we currently expect total revenues to be between RMB230 million and RMB280 million. Please note, this forecast reflects our current and preliminary views and is subject to change.

Turning to our third quarter of 2020 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 earnings release.

In the past several quarters, we continued to streamline our operations and cut our costs and expenses. In the third quarter of 2020, total costs and expenses decreased by 58% year over year and 9% quarter over quarter to 481 million. Excluding the impact of LiveMe, our total costs and expenses decreased by 38% year over year.

As a result, the gross margin expanded to 69% in the third quarter of 2020, from 60% in the same period last year. Operating loss reduced to 119 million in the quarter, from 222 million in the same period last year and 133 million in the previous quarter.

During the quarter, we disposed some of our businesses and assets related to the gaming business in overseas markets. This disposal boosted our earnings and helped us to create shareholder value. In the third quarter of 2020, our net income attributable to Cheetah Mobile shareholders grew to 266 million from 244 million in the previous quarter.

Importantly, our balance sheet remains strong. As of September 30, 2020, we had cash and cash equivalents, restricted cash, and short-term investments of US$235 million and long-term equity investments of US$332 million. Our strong balance sheet gives us the confidence to continue to invest in the AI-related business for our future.

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

Questions and Answers

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

Thomas Chong: (Speaking foreign language). My question is about the 2021 outlook. Can management share about your view about the business trends across different segments as well as the competitive landscape?

Fu Sheng: (Speaking foreign language).

Thomas Ren: Okay. Let me translate the first part of Fu Sheng's answer.

(Translated). So indeed, this year, the year 2020, for us, Cheetah Mobile is a difficult year especially after our product was removed from Google. And as you know most of our utilities revenues coming from overseas market, but after we performed such adjustments, as we mentioned just now, after we were removed from Google, Google Play Store, now we're focusing our efforts to domestic market. And in domestic market, PC side that we already completed the pivoting from advertising model to the subscription model that we rely on, on utilities products we rely on advertisement a lot previously, but on the advertising industry view, we're influenced by our partners significantly. So we think now we have improved significantly, as I just talked, and now PC as a vertical market, it will not disappear along with the widely use of our mobile phones. And now we can see the user base is still stabilizing on our PC front and with a slight increase. So we think next year for our utility business, we can regain some increases.

Okay. For the AI business, especially our shopping mall robotics, it depends on the offline. So due to the Covid-19, it was affected a little bit, but now, I think we're recovering from the Covid-19 situation and also the whole offline traffic in the shopping mall. So I think there is still a great chance in our shopping mall business model.

Yes, for the greater economic view, I'm not a professional, but from my point of view, we think for sure in China next year, the growth should be in leading part globally. And now our strategy is focusing on the China market to focusing on our utility and AI business to do a great job in our home market.

Yes, hope that answers your question, Thomas.

Thomas Chong: Thank you.

Operator: The next question comes from Vicky Wei with Citi.

Vicky Wei: (Speaking foreign language). My question is about the AI investment, the AI business investment. So given the company does not anticipate significant revenue from the AI business in the foreseeable future, what does management think of the investment needed for the AI business? And what does it imply for the company's cash balances in the mid-term?

Fu Sheng: (Speaking foreign language).

(Translated). Yes, let me highlight a few points from AI front. So first, previously we are combined both our 2C and 2B AI business revenue in the AI revenue. So for the 2C products, we used to have a product named Cheetah Translator, which is AI-based interpretation device. But due to the situation of Covid-19, people don't travel abroad. So this product, we almost suspended it for now. And also for the Covid-19 in Q2 for our 2B sales, we cannot meet our customers due to some travel restrictions. So it impacted us a little bit in Q2, but now, I think we have seen some rebounds of our AI business in this quarter.

After the recovery of the Covid-19 situation, I think the market is having a greater acceptance for the no-touch service like robotic services. So the acceptance for the industry is growing as we speak.

Yes, and our investment in AI, it mostly consists of R&D expenses. So after some functions were developed, such investment may not be a continued investment.

So as we mentioned just now in Q3, there is some one-time staff restructuring expenses in Q3. So in Q4, we expected our operating loss level could be improved a lot and as per our own estimation. So as for such a trend, our balance sheet can support our investment in the mid-term, and also when we explore the monetization model or shopping more in the hotels, as we mentioned, I think we may expect some more growth on AI front next year.

I think we don't need to worry too much about our AI investment. On one hand, as we mentioned, the market is recovering quickly, including both the hotel and also the shopping mall industry and also we are exploring our business model. And also on the other hand, along with our cost and expenses cutting, you may see greater improvement on our bottom line. And also we have sufficient cash and investments. So I think our vision is to make the business of service robotics great to be our new growth engine. Thank you.

Vicky Wei: Thank you.

Operator: As there are no further questions at this time, I'd like to hand the conference back to our 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 so much. Bye.

Operator: This conference has now concluded. Thank you for attending today's presentation.