

**Cheetah Mobile, Inc. [CMCM]
First-Quarter 2017 Earnings Conference Call
Monday, May 22, 2017, 8:00 AM Eastern Time**

Company Participants:

*Ms. Helen Zhu; Director, IR
Mr. Fu Sheng; CEO, Director
Mr. Vincent Jiang; CFO*

Analyst Participants:

*Tian Hau; T.H. Capital
David Sun; Morgan Stanley
Joyce Ju; Citigroup Global Markets, Asia, Ltd.
Thomas Chong; Bank of China International
Andrew Orchard; Nomura
Robert Cowell; 86 Research*

Presentation

Operator: Good day and welcome to the Cheetah Mobile first-quarter 2017 earnings conference call. (Operator Instructions)

Please also note that this event is being recorded.

I would now like to turn the conference over to Ms. Helen Zhu, Director of Investor Relations. Please go ahead.

Helen Zhu: Thank you, Operator. Welcome to Cheetah Mobile's first-quarter 2017 earnings conference call. With us today are our CEO, Mr. Fu Sheng, and our CFO, Mr. Vincent Jiang. 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 like to turn the conference call over to our CEO, Mr. Fu Sheng. Please go ahead, Fu Sheng.

Fu Sheng: Thanks, Helen, and hi, everyone.

2017 is a very transformational year for Cheetah Mobile. We will continue to enhance our AI-based technology platform that brings new opportunity to the mobile utility space and drives the

rapid progress of our mobile content products. In addition, AI is the core of our mobile content strategy, enable us to collect over 600 million users with highly personalized content.

Recently our company reached our three-year anniversary as a publicly listed company in the US. In just three years our total revenue grew by almost three times. Our mobile MAU surpassed 600 million. We achieved our goal to transform into a mobile and a global company. In Q1 2017 mobile revenues accounted for almost 85% of our total revenues and overseas revenues accounted for over 78% of our total revenues.

We've made significant progress on our content-driven apps which already contribute to 19% of our total revenues in the quarter.

And we have a very healthy balance sheet.

We understand that there is still a lot of work ahead of us in order to transform into a mobile content platform. With our rich experience in mobile internet industry and our proven track record we are very confident in achieving our new targets. Today I would like to first discuss the progress we have made in the development of content-driven products.

On the revenue side our content-driven products are beginning -- becoming important drivers of our total revenue growth. In Q1 revenues from content-driven products grew by 55% quarter over quarter, which pushed our overseas revenues to an all-time high. Live.me was a key contributor for this growth.

On the other side, we have made strong [demand] for live broadcasting platform in developed markets. Users in Europe and North America love to express themselves. And they see live broadcasting as an efficient channel to help them express their thoughts and lifestyles. That's why the [authentic] live broadcasting (inaudible) is very high in these markets, with a number of our top broadcasting hosts become [fully] performers.

For example, one of our top broadcasting hosts used to be construction worker in the US. He considers Live.me as a social platform and a creative way to earn significant income. He has created interesting live broadcasting content to attract followers. Currently he has more than 220,000 followers. And he has [received virtual gifts] that is worth more than USD170,000. Going forward, we will continue to encourage our users to generate more content and actively interact with other users on our platform through either text or voice messages.

In addition, we are experimenting real-time interpretation service for our top broadcasting hosts, speaking in different language, which have improved user experience and user engagement.

On the content side we have used AI to [improve] the Live.me platform. For example, Live.me is committed to building a [healthy] social platform without [violent or obscene] content, as more than 200,000 hours of live video are broadcasted daily on Live.me. We would have to spend a lot of time and resource to review the content if done manually.

At the same time, it would be hard to reduce human error and issue content quality. Therefore we have applied AI technology for image [recognition] which enables us to review real-time video content more efficiently and [vastly] reduced our [workload].

Live.me platform recently [received] USD60 million from several well known [VC funds] which is (inaudible) of a strong future market potential. We believe outside investments will enable Live.me to execute its growth strategy more efficiently. We look forward to seeing its continued growth.

(Inaudible) content-driven products also made solid progress in the first quarter. After acquiring News Republic in June last year we began to [utilize] AI technology to deliver personalized news content to our users. Since then the DAU in US market has increased by more than 10 times.

AI is transforming the way of news delivery. People no longer receive news just by actually searching key words or being exposed to what is shared on social media. Instead, they can receive highly relevant content automatically [recommended] to them based on their interests and their reading habits.

This is a model that has been proven very successful in China as a pioneer among Chinese internet company winning in the overseas market, Cheetah is again taking their model abroad. We believe that AI will better drive News Republic's growth avenue, improvements and growth in the coming quarters. In addition, News Republic recently has a content portfolio including news from more than 2,500 top global media outlets, which will also help us achieve this goal.

In terms of monetization, (inaudible) [apps] is popular among [branded] advertisers as they have much higher (inaudible) and fewer (inaudible) ads. This is a key reason why (inaudible) focus on investing in News Republic.

Moving on to our mobile utility products, our utility products and related service continue to generate strong profits, which form a solid foundation for our mobile content transformation. For the first quarter, non-GAAP operating margin from our utility business remained stable at around 22%.

In addition, AI allowed us to further expand our utility product portfolio. For example, we launched Panda Keyboard, our AI-enabled app early this year. This app is able to predict the words or phrase users want to type based on the context and their typing preferences. Recently, Panda Keyboard has been rated as one of the top five personalized apps in the US on Google Play. Panda Keyboard enables us to better [learn] our users' preferences and deliver more personalized content to them.

Another example is the PhotoGrid, leveraging its AI-enabled facial recognition technical. PhotoGrid has added more [interesting], dynamic features which have been well received by our users, who upload millions of photos daily.

Looking ahead, we will continue to invest in our AI technology platform, which recent has been driving the growth of most of our products. We will continue to employ new (inaudible) opportunities that might be derived from our AI technology platform. We will also optimize our cost structure on the utility product side to [manage] profitability.

Okay.

Vincent Jiang: Okay. Thank you, Sheng, and hello, everyone. This is Vincent. I just joined the Company about 1.5 month ago.

For the first quarter of 2017 we reported solid financial results, with total revenue beating the high end of our guidance. Non-GAAP net income increased to RMB150 million. Now let me walk you through the details of our first-quarter financial performance. All financial numbers are in RMB unless otherwise noted.

For the quarter, total revenues increased by 7% year over year to RMB1.19 billion, driven by the fast growth of our content-driven products.

As our various business lines are in different phase of growth, starting this quarter we will report our revenues according to business line in order to help investors better understand our business. We expect to provide more transparency in the performance of this business line in the coming quarters.

Revenues from content-driven products increased by 55% quarter over quarter, which contributed to 19% of total revenues in the first quarter of 2017 as compared to 11% in the fourth quarter of 2016. The growth was primarily driven by Live.me, a popular live video-streaming app serving overseas users, particularly in developed countries.

In the second quarter of 2016 we introduced the virtual gift function, aiming to enhance our user engagement and interaction. This function has been well received by our users, who purchase virtual gifts to show support and appreciation for their favorite broadcasting hosts.

The increase in Live.me in the first quarter was driven by both [paying] user growth and an increase in ARPU. The paying user growth was the result of DAU expansion and the paying ratio increase. And the ARPU growth was driven by an increasing number of live broadcasting events during Valentine's Day.

Revenues from utility products and related services decreased by 13% year over year and 18% quarter over quarter to RMB827 million in the first quarter of 2017. The year-over-year decrease was primarily due to the decline in PC revenues as internet traffic migrated from PC to mobile in

China. In the first quarter of 2017, PC revenues decreased to 15% of total revenues as compared to 26% in the prior-year period and 19% in the prior quarter.

Mobile utility products and related services remained relatively stable year over year in the first quarter of 2017. Specifically, advertising revenues from mobile utility products and related services continued to improve year over year in overseas markets, primarily driven by the increase in total impressions. Other revenues from mobile utility products and related services decreased year over year in China, primarily due to the decline in eCPMs. The sequential decrease was due to seasonality.

Our utility products business has been a stable source of revenues and operating cash flows. It also allows us to invest in content-driven products. In addition, as Mr. Fu Sheng just mentioned earlier, we believe that AI will bring new opportunities to the mobile utility space in the future.

Revenues from mobile games decreased by 16% year over year, but increased by 15% quarter over quarter. The year-over-year decrease was primarily due to a decline in the revenues from Piano Tiles 2, as the user number was at its peak in early 2016. The quarter-over-quarter increase was primarily due to our continuous efforts to introduce more mobile (inaudible) games in the first quarter of 2017, further enriching our mobile game portfolio. Cheetah Mobile was ranked as one of the top four game publishers in the US on Google Play and three of its games were listed in the top 10 most downloaded games in March 2017.

Moving on to our costs and expenses, for utility products and related services, we will continue to optimize our organizational and cost structures to maintain profitability.

For content-driven products, the largest cost and expense components for the content-driven products are, first, the revenue sharing with the live broadcasters and payment channel costs associated with Live.me, which were the primary driver of our year-over-year cost of revenues increase in Q1. R&D personnel costs is the second one, which is associated with the development of AI technologies. Our previous investments in AI translated into our progress in technology platform which has supported our initial success in content-driven products.

And lastly, new user acquisition costs of content-driven products in overseas markets. This investment in content-driven products decreased our operating margin by approximately 14.4 percentage points in the first quarter.

In addition, we reported approximately RMB68 million of other income, net, as a result of gains from a disposal of certain investment assets in the first quarter. We have significant long-term minority investments in a portfolio of companies. Most of these assets were booked with the cost method and are remaining with (inaudible) equity method. The total book value of these investments were approximately RMB955 million as of March 31, 2017. We intend to gradually dispose of these investment assets to focus more on our core businesses.

Turning to our balance sheet items, as for March 31, 2017, we had net cash and cash equivalents, restricted cash and short-term investments of approximately RMB1.47 billion. Our strong cash position enables us to fund our mobile content transformation.

Looking into our revenue guidance, for the second quarter of 2017 we expect total revenues to be between RMB1.19 billion and RMB1.24 billion, representing a 14% to 18% year-over-year increase, and 0 to 4% quarter-over-quarter increase.

Looking ahead at the rest of 2017, we expect revenues from content-driven products to continue to grow. In addition, we will continue to refine Live.me products, expand its user base and experiment with monetization and operational models that have been proved effective in China.

We expect our revenues for utility products and related services to decrease year over year as certain ad formats have been recently discontinued by some of our overseas third-party advertising partners. And the resulting ad inventory may not be fully filled up by our other advertising partners for some periods. Please note that we are still working with these advertising partners on other ad formats.

In addition, we are exploring new initiatives in our mobile utility products. For example, as just mentioned by Mr. Fu Sheng, we have been successfully applying AI technologies to new products such as Panda Keyboard and to existing products such as PhotoGrid. Going forward, we expect these new initiatives to drive the recovery of our mobile utility app revenues. For (inaudible), we expect more titles to be released in the second half of 2017.

Please note that this forecast reflects the Company's current and preliminary view and is subject to change.

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

Questions & Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions) Tian Hau; T. H. Capital.

Tian Hau: (Speaks in Chinese)

So congratulations on the good Q1 results. My question is related to user applications for Live.me going forward. So what's the plans to acquire more users for Live.me? And also, the traffic on Live.me, what's the synergy between Live.me and user public and utility apps? That's my question. Thank you.

Fu Sheng: (Speaks in Chinese)

As translated by Vincent Jiang: Okay, I'll translate. Although Live.me has finished external investments and -- but it's still the majority-owned subsidiary of Cheetah Mobile and we still operate as the same company. So although it has certain independence in its operation, but it will still be operated as the same company. In that sense, Cheetah Mobile will find a way to [effectively] convert its current users into Live.me users.

Although we have seen many successful models [at Cheetah Mobile] and they have attracted significant user traffic using [the live] broadcasting model, but we also [have] other approaches. And we will, using the same approaches such as social platform and shorter video stream and shorter video content, to attract more user traffic to the platform.

Cheetah Mobile is using -- is developing its AI technologies, and we believe that when we achieve certain level of the [coming] technology excellency, we will be able to using AI technologies to bring (inaudible) traffic. So we'll be able to using AI technology to find out the current users' preference and interests and then we will recommend the appropriate user traffic to the Live.me platform.

Tian Hau: Okay. Thank you very much.

Operator: David Sun; Morgan Stanley.

David Sun: (Speaks in Chinese)

So I will translate the question by myself. So the first question is regarding the reclassification of the revenue reporting lines. So we have reclassified revenue into utility apps, content products, and mobile games. So just want to get a sense what do the margin profile look like for these three key segments and also the revenue outlook for this year.

So the second question is that we see the Company currently has three key business [options] -- core utility apps, such as Clean Master and Battery Doctor. Second one is content apps such as Live.me and News Republic. And the last one is AI, or robotic-related initiative. So just want to know how do Management view the short-term and mid- to long-term opportunities of this different businesses, and how do Company allocate resources accordingly. Thanks.

Fu Sheng: (Speaks in Chinese)

As translated by Vincent Jiang: Okay. Well, you can consider those products in this way. The utility tool is Cheetah's today. And the content product is for tomorrow. And the robotics products is for the apps more in the future.

In the past three years Cheetah Mobile has turned its two utility apps into global products. And it has refined its business model. And although it has reached a relatively mature phase of its life cycle, it will continue to be a -- it will continue to maintain its profitability.

So today, the two apps is still the best approach to acquire users and the quickest approach to acquire users. It also helps us create a significant amount of user data. It also generates a lot of user traffic that can support our products under the AI technologies.

The content product can help our more than 600 million users to spend more time with our products to increase their user engagement and user stickiness, and also helps our monetization model.

Using the content we have acquired, it helps to refine our AI technologies. And that will be a foundation for our next phase, which is the robotics business. So that's the second question.

Vincent Jiang: Now I'll answer the first question about the segments and margins. Starting -- well, in this quarter we still view the Company as a single segment. But we start to divide the revenues into three parts, which are the three business lines. For the second quarter, we plan to present the Company's financial into three segments, which will not only have revenues for each business line, you also will have operating costs and expenses. So with that, we'll have better visibilities for the three segments.

In terms of profit margins, we expect that the margin for the utility products will decrease year over year next quarter. And the margin for the content products were (inaudible) the loss, but the relative amount of loss will narrow in the next quarter as we are starting to see economy of scales for our content products. For the games, we expect we will -- that the profit margin probably we will not see a significant change to this in the next quarter.

Have we answered your questions?

David Sun: (Speaks in Chinese)

Vincent Jiang: Thank you.

Operator: Joyce Ju; Citi.

Joyce Ju: (Speaks in Chinese)

I will translate my questions. We have seen this quarter and the costs actually reduced year over year and quarter on quarter. So my question is, because we saw in the press release that is due to the personnel reduction. So I'm wondering how many R&D personnel now have in the R&D department and in the future how this number will change. Will we add more R&D investment to continue to grow our AI technology or content products? Thank you.

Fu Sheng: (Speaks in Chinese)

As translated by Vincent Jiang: So right now for the R&D personnel we have more than half of them are still in the utility apps segment. In the past two years we have seen that -- we still see

some room that we can help the R&D people to increase their productivity. So I think we still have some room for the improvements.

So in the past year we have already invested heavily in the AI technology and we have significant high in the last year. So right now the workforce for the AI technologies, while even though we will [not] be able to compare to those super large companies, but more comparable to many other so-called AI companies. So we do not expect we will have a larger headcount increase in the next year. Instead, we will be focused on to improve productivity and have more product to go to the markets.

So there will be some teams, such as Live.me, they may still increase their R&D strengths and the skill sets, so they might have other headcounts. But overall for the Company we will probably not see a large R&D fee increase. We'll be more focused on the productivity again.

Joyce Ju: (Speaks in Chinese)

Fu Sheng: Thank you.

Operator: Thomas Chong; BOCI.

Thomas Chong: Hi, good evening. Thanks for taking my question. I have two questions. The first question is about Live.me. When should we expect the business to be profitable? Should we expect it to happen in the fourth quarter?

And my second question is about the second-quarter guidance on the utility apps revenue, about our relationship with advertisers. Can Management talk a little bit more about the app format and why we have [to see this] year-on-year decline? Should we expect it to happen in the third and the fourth quarter?

(Speaks in Chinese)

Vincent Jiang: Okay. Hello, Thomas. Let me answer your first question. For the Live.me business, although it's approaching a breakeven point right now, but the [seeking] profitability is not the focus of this business right now. So we'll be more focused on increase the user base at this stage.

Hold a second.

So, I'll come back. For the second question, which is about the certain app format, so this is what happens. There are a lot of utility app companies. They have various type of app formats. And certain formats may not be considered to be user friendly by some advertisement platform. So some other third-party advertising platforms, they decide to discontinue to deliver apps to those kind of formats. So that will impact us as well.

And we will see some added inventory which now may not be filled up immediately by our other advertising platform partners. So that's what happening right now.

So, Thomas, does that answer your question or do you have some follow-up?

Thomas Chong: Yes, thanks for the color. Yes, I will go back to the queue.

Operator: Andrew Orchard; Nomura.

Andrew Orchard: (Speaks in Chinese)

So just a quick question on the investment structure of the robotics business -- can you give us some updates or some color on how this investment is going to be structured? Thanks.

Vincent Jiang: Hello, Andrew. I'll answer that question. Right now the robotics business, it is still -- it has not been -- well, let me put it this way, it's still in the progress. It hasn't been signed or closed yet. So we expect to have a public release pretty soon. But today we probably -- we will not be able to talk too much about it.

Andrew Orchard: Okay. Thank you.

Operator: Robert Cowell; 86 Research.

Robert Cowell: (Speaks in Chinese)

So my question is also about some of the investment items. In the first quarter it looks like they're a RMB67 million gain from other income. I'd like to know what investment this gain is coming from. Thank you.

Fu Sheng: (Speaks in Chinese)

As translated by Vincent Jiang: Okay, let me translate. Well, we had two exits in this quarter. One is for a company that has been listed in Asia markets, in China. And the other one is a [normal] VC investment exit. Cheetah Mobile has invested in a portfolio of about more than 40 companies right now. And from time to time we may make exits, because the portfolio is actually performing pretty well.

So when we decided that the investee, the investor company, is not strategically significant to our business, we may want to make an exit when the timing is appropriate. So this time the two companies we exit, one is a gaming company. Another one is advertising platform. And actually we had a pretty good return on this. Thank you.

Okay. Next question, please.

Operator: (Operator Instructions) There are no further questions at this time. I would like to turn the conference back over to Management for any closing remarks.

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

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