Cheetah Mobile, Inc. [CMCM]
Q4 and Full Year 2019 Earnings Conference Call
Tuesday, March 24, 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 Fourth Quarter and Full Year 2019 Earnings 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.

Helen Zhu: Thank you, Operator. Welcome to Cheetah Mobile's Fourth Quarter 2019 and Full Year 2019 Earnings Conference Call.

With us today are our Chairman and CEO, Mr. Fu Sheng, and our CFO, Mr. Thomas Ren.

Following Management's prepared remarks, we will conduct a Q&A session. A presentation of the Company's earnings release is already on our IR website.

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 call over to our CEO, Mr. Fu Sheng. Please go ahead, Fu Sheng.

Fu Sheng: Thank you, Helen. Hello, everyone.

Our fourth-quarter revenues were in-line with management expectations. However, we incurred a non-GAAP operating loss about RMB200 million in the quarter. Two key factors contributed to this loss: first was our increased investment into our mobile game business, particularly for overseas markets; second was our strategic investments for AI initiatives.

Starting from early January 2020, we've strategically cut down our spending for our overseas mobile games business due to slower than expected progress in launching new games as well as intense competition in the market.

On February 20, 2020, we were made aware of the fact that Google had disabled our accounts for the Google Play Store, Google AdMob, and Google AdManager. As a result, our company's apps have been removed from the Google Play Store, and we were unable to generate revenues from Google, which negatively impacted our overseas business.

According to Google, the decision was made because some of our apps were not in compliance with Google policies, which had resulted in a certain invalid traffic. During the quarter, we engaged in talks with Google to clarify this potential misunderstanding. However, despite making an appeal and providing more information, we were recently notified that Google was unable to reinstate our accounts. While we continue to speak with Google, we cannot guarantee that we will be able to resume these collaborations.

Nevertheless, we have already rolled out some measures to address the current headwinds. Such measures include the following:

First, we have significantly cut costs and expenses while streamlining our operations in overseas markets. As a result, at the corporate level, we expect to reduce our operating losses from the first quarter of 2020 going forward.

Second, we've chosen to refocus our business strategy onto the domestic mobile internet market. As such, we have brought back both our mobile utility product and light casual games businesses. By doing so, we plan to build a robust, medium-term growth engine for the company in the coming quarters.

Our mobile internet business has already made good progress in the domestic market. Notably, since January 2020, our products and game have experienced significant growth in DAUs, user time spent, retention rate, and commercial impressions. These achievements were a result of our proactive efforts to improve our user experience while also reducing some of our ads in our products. The delay in employees returning to work following the spring festival holiday also drove user engagement and user time spent. We believe that our products' recovery of user mindshare will help to pave the way for future monetization in the post-crisis period.

Also in the domestic market, we introduced some premium services for our utility products in the middle part of 2019, which resulted in our number of paying users experiencing significant growth. For example, the paying user count for Duba Anti-virus grew by about 60% between December 2019 and March 2020.

In addition, all of our flagship mobile casual games, including Piano Tiles 2, Rolling Sky, Dancing Line, and Brick n Ball, have already received their gaming licenses for distribution in China.

Third, we will continue to execute our AI strategy to drive long-term growth. The recent coronavirus outbreak has increased customer demand for our robotics products and solutions. Since the outbreak started, we've launched anti-epidemic products for hospitals to relieve some of the pressure caused by a shortage of medical personnel and the threat of cross infections.

As of today, our medical robots have been deployed in many Chinese hospitals, including Peking University Shougang Hospital, Beijing Haidian Hospital, Wuhan Huoshenshan Hospital, and Zhengzhou's Xiaotangshan Hospital. Notably, we have received high praise from local governments in these areas for our initiatives in response to the outbreak.

In early March, four of our robotics products were nominated for use in the 2022 Winter Olympic Games. We are the only company with the most products being nominated. While it may take a while for our robotics products and solutions to generate material revenues, we have already witnessed an increase in consumer awareness and demand for our offerings as a result.

Over the past several years, we have built a great team, developed a strong balance sheet, and executed a number of successful business transitions. With that in mind, we remain confident in our ability to weather these short-term challenges and rejuvenate our growth in the coming quarters.

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

Thomas Ren: Thank you, Sheng, and good day, everyone. Thank you all for joining us today. I'm very excited to have joined the Cheetah Mobile team and look forward to meeting with everyone in the coming months.

Now let's turn our attention to our financial results in the fourth quarter of 2019. 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.

Total revenues decreased by 56% to 612 million in the fourth quarter of 2019. Excluding the impact of the deconsolidation of LiveMe's revenues, total revenues decreased by 47% year over year in the quarter.

As we stated in the previous quarter, 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.

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 62% to 299 million in the quarter. Moreover, during the quarter, about 80% of our revenues from utility products were generated from advertising. The decrease was primarily due to the following:

- First, a decline in our mobile utility product business in overseas markets. Mobile utility product revenue in overseas markets decreased by 69% to 93 million in the quarter, which was mainly due to the suspension of our collaborations with Facebook on the advertising front since December 2018, and a decline in MAUs.

- Second, a decline in our mobile utility product business in the domestic market. Mobile utility product revenue in the domestic market decreased by 70% to 107 million in the quarter, which was the result of headwinds in China's online advertising market.

- Third, a decline in PC-related revenues. PC-related revenues decreased by 26% to 99 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 13% to 285 million in the quarter, mainly due to a lack of new hit games and the market saturation of our existing hyper-casual games. In addition, during the quarter, about 77% of revenues from our mobile games business were generated from advertising while the remaining portion of revenues was 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.

During the quarter, we continued to implement strict cost and expense controls. As a result, total non-GAAP costs and expenses decreased by 36% to 815 million in the quarter, mainly due to our efforts to reduce cost and expenses for our utility product business and the deconsolidation of LiveMe.

Cost of revenues decreased by 56% to 182 million in the quarter. **Gross profit** decreased by 56% to 430 million in the quarter.

- R&D expenses decreased by 22% to 138 million in the quarter.
- Selling and marketing expenses decreased by 41% to 343 million in the quarter.
- G&A expenses increased by 40% to 161 million in the quarter, mainly due to one-time asset impairment charges.

Operating loss was 204 million in the quarter, compared to an operating profit of 110 million in the same period of last year.

Moving onto each reporting segment.

Operating profit for our utility products and related services was 29 million in the quarter, decreasing from 224 million in the same period of last year, mainly due to the decrease in revenues.

Operating loss for our mobile games business was 120 million in the quarter, compared to an operating loss of 11 million in the same period of last year, which was caused by the increased amount of investment made into our mobile games business as we continued to launch new game titles.

Moving onto our balance sheet

We have amassed a strong balance sheet. As of December 31, 2019, we had cash and cash equivalents, restricted cash, and short-term investments of US$338 million and long-term equity investments of US$362 million. Our portfolio of long-term equity investments include Bytedance, WIFI Master, Codemao, and other well-known assets, all of which we made early-round investments into.

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

We currently expect total revenues for the first quarter to be between RMB490 million and RMB540 million. Please note, 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. Thank you.

Helen Zhu: Operator, we are now ready to take questions, please. Operator?

Questions and Answers

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

Unidentified Analyst: (Speaking Foreign Language). I have a few questions. First question is about the update about advertising trend in domestic and overseas market as a result of COVID-19. And what are the new games in the pipeline in the entertainment segment, and how is the performance of existing games?

And the increase in time spent at home helped the performance of games? And thirdly, about the investment strategy on AI initiatives and when should we expect it to achieve breakeven?

Fu Sheng: (Speaking Foreign Language).

Thomas Ren: Okay. So let me answer your first question about the coronavirus effect to our overseas and domestic advertising business. I think first, for the overseas advertising business, I think for this year, as we mentioned, because we received the notification from Google that our collaboration with Google was terminated since late February, I think this will be the biggest impact for our overseas advertising business.

For the domestic advertising business, we do see some increase from the user login numbers and users' time spent. But I think there was some impact by the coronavirus that some advertisers reduced their advertising budget, at least for the first couple of quarters of this year. So it may have some negative impact for our domestic advertising revenues.

So your second question is about our gaming pipelines, right?

Unidentified Analyst: (Speaking Foreign Language). Yes.

Thomas Ren: And also the performance of our current games?

Unidentified Analyst: Yes.

Thomas Ren: I will say that, as mentioned in our prepared remarks, the Google event did have some impact also on our gaming business. So for this year, we will be pivoting some of our games from overseas market to domestic market for the gaming business as well. So we do have some -- a large amount of gaming pipeline. But while we are transitioning from overseas to domestic, we may need some time to figure out what's the right channels, what's the right strategy for the gaming in the domestic market.

And for the current games, the hot games we used to have, like Piano Tiles, Rolling Sky, Dancing Line, B 'N B, I think most of them, we can see the causal games' user life is reaching to a saturation or maturity. So we may see some slight decrease for those existing games.

Yes. The third is question about the AI and the breakeven point, right?

Unidentified Analyst: Yes, yes.

Thomas Ren: For the AI business that we mentioned in the prepared remarks, we do see some significant customer demands, especially during the coronavirus outbreak here in China. And we also do want to do something to relieve the pressure by the medical staff. But also because of the -- that people can not return to work, there was some impact on both the supply and also the sales side. So I think we may need 1 or 2 quarter to pick up all the orders. If the coronavirus situation can recover in the near future, we believe we can see some sizable revenue from the AI business.

Along with the increase, the forecasted increase, on revenue, we may see some reducing loss for the AI business. But I think for now, it’s a little bit too early to tell when is the time to breakeven, but I think, as we mentioned, the whole Company’s loss, operating loss, on corporate level will be reducing quarter-by-quarter compared to the Q4 results.

So we remain confident that maybe in another a couple of quarters, we can see more clear when we can break even. Hope that answers your question.

Unidentified Analyst: Thank you.

Operator: Vicky Wei, Citi.

Vicky Wei: Wish everyone good health under the epidemic. I have two questions. The first one is about the Google collaboration. So does Company have any plan B if the Google collaboration cannot resume within short time?

And my second question is about the AI investment. So would management please provide some color on the 2020 AI investment strategy and the margin profile?

Fu Sheng: (Speaking Foreign Language).

Helen Zhu: (Speaking Foreign Language).

Fu Sheng: (Speaking Foreign Language).

Thomas Ren: Okay. So I will translate Fu's answer for your two questions.

(Translated). First question is regarding the business plan after Google’s termination of collaboration. So we think on the mobile internet front, our focus will be domestic market in the future, and China already has a large enough market to accommodate all kinds of players.

And on the Google front, we will keep communicating with them, but we cannot guarantee or cannot predict it when -- or whether we can be restored to Google, Google Store. And also we realize that for the Android system, utilities apps is no longer a must-to-have. From our own revenues, we can see that we already have gaming revenues very larger than utility revenues. So yes, for the gaming, we will also focus on the domestic market.

So for the AI investment initiative, so during the coronavirus outbreak, our business, AI business, is being kind of delayed because people cannot travel. But while we can see people are returning to the office, and the situation is being recovered as we speak right now, so we do see a great growth potential on the AI front.

And also during the outbreak of the coronavirus, we also realized that the scenario that AI can be applied is actually larger than we originally think. So our original scenarios for AI application was like library, shopping mall and government.

But now, we realize that robotic product can do more than that. With the robot, we can do the remote infrared temperature management. The doctors can do remote consultation with patients without facing the risk of the infection. So we do see a lot of increasing demand for the AI business. So we will continue to invest to our AI business and to discover more thoughtful selling opportunities.

Vicky Wei: Thank you.

Thomas Ren: Hope that answers your question.

Vicky Wei: Thank you.

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

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

Thomas Ren: Thank you.

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