

**CooTek Inc. [CTK]
First Quarter 2019 Earnings Conference Call
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Company Representatives:

Rene Vanguestaine; Christensen & Associates; IR
Karl Zhang; CooTek Inc.; Chairman and Chief Architect
Jean Liqin Zhang; CooTek Inc.; Chief Financial Officer

Analysts:

Hans Chung, KeyBanc Capital Markets
Alicia Yap, Citigroup
Emerson Chan, Bank of America Merrill Lynch
Tina Long at Credit Suisse

Presentation:

Operator: Good day, and welcome to the CooTek First Quarter 2019 Earnings Conference. All participants will be in listen-only mode. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Rene Vanguestaine. Please go ahead.

Rene Vanguestaine: Thank you, Amy. Hello, everyone, and thank you for joining us today. Our earnings release was distributed earlier today and is available on our IR website at ir.cootek.com and on PRNewswire.

On the call today from CooTek are Mr. Karl Zhang, Chairman and Chief Architect, and Ms. Jean Liqin Zhang, Chief Financial Officer. Mr. Zhang will review business operations and Company highlights, followed by Ms. Zhang, who will discuss financials and guidance. They will be available to answer your questions during the Q&A session that will follow.

Before we begin, I'd like to kindly remind everyone that this conference call may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995.

These forward-looking statements can be identified by terminology such as "will," "expects," "anticipates," "future," "intends," "plans," "believes," "estimates," "confident" and similar statements.

CooTek may also make written or oral forward-looking statements in its reports filed with, or

furnished to, the U.S. Securities and Exchange Commission, in its annual report to shareholders, in press releases and other written materials and in oral statements made by its officers, directors or employees to third parties.

Any statements that are not historical facts, including statements about CooTek's beliefs and expectations, are forward-looking statements that involve factors, risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements.

Such factors and risks include, but are not limited to the following: CooTek's mission and strategies; future business development, financial conditions and results of operations; the expected growth of the mobile internet industry and mobile advertising industry; the expected growth of mobile advertising; expectations regarding demand for, and market acceptance of, our products and services; competition in the mobile application and advertising industry; and relevant government policies and regulations relating to the industry.

Further information regarding these and other risks, uncertainties or factors is included in the Company's filings with the U.S. Securities and Exchange Commission. All information provided on this call is current as of today, and CooTek does not undertake any obligation to update such information, except as required under applicable law.

It is now my pleasure to introduce Mr. Karl Zhang. Karl, please go ahead.

Karl Zhang: Thank you. Thank you, everyone, for joining our first quarter 2019 earnings call. We delivered strong growth this past quarter in both user growth and user engagement. User growth, relying on our sophisticated growth platform, went beyond our best expectations. Overall, user acquisition unit cost was kept at low range and stable despite such a large increase in total user numbers.

We achieved significant progress on further improving user engagement by investing in our content ecosystem, optimizing products and enhancing operations. The engagement rate of our content-rich portfolio apps reached nearly 39%. The user retention rate improved as well.

We're excited about the progress on product side because user engagement and retention are two key metrics to evaluate user stickiness. We believe that we are on the right path to bring more and more value to our end users, and increase the stickiness of our user community.

Our mission is to empower everyone to enjoy relevant content seamlessly. We believe that the global content app market is still in its early stage, and this gives us massive opportunities in both horizontal and vertical areas. Hence, our strategy is to release multiple apps to meet different user needs on different content verticals.

We are investing in establishing and evolving our content ecosystem to achieve long-term competitiveness and user stickiness. For example, we redesigned the news feed format for Cherry, our female healthcare and lifestyle community app, in order to evolve our content ecosystem and to increase content consumption. User interaction and time spent improved significantly, and we continue to incubate new content apps to expand our reach across a wide diversity of user interests.

Besides content apps and ecosystem, we are also making good progress on monetization. In Q1, we officially launched the CooTek Advertising Platform, our in-house ad serving platform. This system allows advertisers to create and manage ad campaigns and place ads into our app portfolio directly. Furthermore, it provides programmatic interfaces to allow third parties to acquire mobile traffic directly from our portfolio app.

With the benefit from our in-depth user insights, we offer sophisticated precise user-targeting capabilities to help our advertisers and partners to increase ROI on their -- on our ads platform. This system contributed approximately 14% of our total advertising revenue in March and this percentage is increasing.

We will continue to strongly invest in both advertising technologies and our ecosystem because we believe it will enhance our monetization and bring us substantial long-term value.

With that, I will hand the call to our CFO Jean to walk you through our financial results for the quarter.

Jean Zhang: Thank you, Karl, and thanks, everyone, for joining us on the call today. I'm going to walk you through our first quarter financial results.

Now, let's start with users. We ended March with approximately [242] million people using our global products, up 43% from a year ago. Approximately 169 million people accessed our global products each day on average in March, up 40% from the prior year.

Monthly active users for our portfolio products reached [49.8] million in March, up 3.2 times from a year ago. Average daily active users for our portfolio products in March reached 23.1 million, up 4 times compared to last year.

Average daily active users on TouchPal smart input in March were approximately 146 million, up 26% from last year. This number represented about 76% of 192 million monthly active users. MAUs were up 19% compared to last year.

We delivered strong revenue growth year-over-year. The total revenue was US\$40 million, up 83%, and the ads revenue was US\$39.4 million, up about 89%.

We estimate that of the total advertising revenue for the first quarter of 2019, portfolio products contributed approximately 75%; TouchPal Smart Input contributed approximately 18%; and the TouchPal Phonebook contributed approximately 7%.

Turning now to expenses, our Q1 GAAP cost and expenses were nearly US\$40 million, an increase of 94% from last year, representing 99% of revenue.

Non-GAAP cost and expenses were US\$38.7 million, an increase of about 91% year-over-year, representing approximately 97% of revenue.

We were quite effective in growing our user base with portfolio products DAU growth of more than 4 times -- growth of about 4 times year-over-year, and of 36.7% sequentially with S&M expenses up 1.6 times year-over-year and a decrease of 14% sequentially.

We ended the quarter with 519 full-time employees, up 44% from last year and 4% from last quarter.

R&D employees represented 63.4% of total employees, compared to 58.6% last year.

Our gross margin was 91%, up from 81% during the same period last year and slightly down from 93% last quarter.

We had GAAP net income of US\$0.2 million, representing a 0.4% of net profit margin.

Excluding the effects of stock compensation, our adjusted net income was approximately US\$1.3 million, representing a 3.3% non-GAAP net profit margin.

As of March 31, 2019, cash and cash equivalents and restricted cash was US\$77.3 million compared to US\$84.9 million as of December 31, 2018.

Under the share repurchase program announced on November 26, 2018, the Company used an aggregate of US\$5.7 million to purchase [645,000] ADSs as of -- by the end of last quarter.

Turning now to the revenue outlook, we expect total revenue in the second quarter of 2019 to be between US\$45 million and US\$50 million, representing a 58 % to 76% increase year-over-year.

These estimates reflect the Company's current and preliminary view, which is subject to change.

Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. (Operator Instructions). Hans Chung at KeyBanc Capital Markets.

Hans Chung: I have one question. So I have one question. Just regarding the user engagement, we have seen another improvement in the content portfolio app. Can you explain like what's driving that? And then how should we think about the trend going forward? Should we continue to see the improvement near to mid-term, or it's sort of like the new level that we should be consider?

Karl Zhang: Thank you, Hans. I'm going to answer this question. Yes, we achieved significant progress on further improving user engagement this quarter. The user engagement rate of our portfolio app reached nearly 39% compared to approximately 32% in March last year and approximately 37% in December last year. So we have made very good progress on that. User engagement is actually key metrics we use to evaluate the stickiness of our users. So we are very excited to see such strong improvements on our product capability.

I think the improvement in user engagement is actually as a result of multiple efforts. So firstly, we are investing in establishing and evolving our content ecosystem to achieve long-term competitiveness and user stickiness because we believe content is the key to attract and retain our users. For example, we redesigned the news feed format for Cherry, our female healthcare and lifestyle community app, and our short video app VeeU in order to evolve our key KOL-based content ecosystem, which focuses on professional-generated content, and to increase content consumption at the same time.

And secondly, we enhanced the product operation as well to push more relevant content to users based on user profile. It turns out that the click-through rate of our push content improved a lot in the past quarter, helping to keep more users active.

And we also introduced the user recall program for our portfolio apps, just like Facebook and other social media and content app companies if we started to send recall email with relevant content to recall users. So yes, I think the improvement in user engagement is a result of the above multiple efforts. Thank you, Hans.

Operator: Alicia Yap at Citi.

Alicia Yap: I have couple of questions here. Number one is that could you share with us the -- where were the growth and the incremental additions of your MAU and DAU of your portfolio content at this quarter? Where did you see the new users come from, specifically, which apps that you see the most growth in the DAU? And how should we think about the DAU growth in the second quarter? Is there any target for the full year 2019?

My second question is related to the overall global app environment and the sentiment. As we noticed, there were quite a lot of disappointing app outlooks for China market. So I'm just wondering if you have any comments regarding the global market, as we see the second quarter guidance seems to be also showing some weakness or some cautiousness on your side as well.

Karl Zhang: Thank you, Alicia. So I'm going to answer both of your questions. So the first question is about our user growth and the incremental addition of our MAU and DAU. So we delivered very strong growth in the past quarter in both user growth and user engagement. So the total DAU of our content-rich portfolio app reached over 33 million from 16 million last quarter, so an increase of over 200% year-over-year. So we're very excited about that. The results validated that we are on the right path to build up a bigger user community, bring more value to our end users, and make them happy and more actively interact with our products.

In terms of the content-rich portfolio app DAU breakdown, our fitness and lifestyle app series held a bigger proportion of the total DAU and continued to grow. The user engagement and the retention rates have been improving, and the time spend is quite stable. From Q1, we made progress in working with phone manufacturers to distribute our fitness apps with relatively low cost. So we are exploring more opportunity to distribute, at different distribution channels, for our portfolio apps to expand our user base rapidly. And we are also investing to establish and evolving our content ecosystem for long-term competitiveness and user stickiness.

So as I mentioned, that we just redesigned the news feed for our Cherry and in order to evolve our KOL-based content ecosystem, so user interaction and time spend improved dramatically. So

Cherry has reached superior user stickiness, so its [second] month retention rates exceed 55% already, which is pretty high. And we continue to incubate new content apps to expand our reach across a wide diversity of user interest.

For example, we incubate content-rich app, Phone Color Screen, in Q4 last year. It is an app to allow users to enjoy entertaining and other relevant short videos, and choose any of them to replace phone functional screen background. And it also provides relevant news and (inaudible) news feed. The back-end of this app content ecosystem and the content recommendation system is actually connected with our short-video app VeeU. So this app contributed nearly 10% of the total DAU in March. So it is actually one of the key drivers of this quarter's DAU growth.

We don't provide any guidance for our DAU growth target. But here, I want to emphasize that our first priority is still to expand our user base, especially for our content-rich portfolio app rapidly. But the management team will keep a very close eye on the market fluctuation and the market -- and make adjustments based on the ROI of each app dynamically. So we will invest more in apps which have relatively longer lifetimes.

In terms of the user distribution, that's the -- the user geographical distribution, it keeps pretty much the same to Q4 of last year. And we believe that we will -- our user base will continue to grow pretty fast.

And in terms of the second question about the ads, global ads environment, what we sense about the local advertising industry is kind of mixed this year. So we notice that some of our important partners encountered some challenges on mobile ads business as well, and we also noted few trends so far this year. So on one hand, the ad inventory supply is increasing because a lot of companies are faced with the challenge of ad revenue growth are under pressure of monetization. They have been releasing ad inventory to the market.

For example, YouTube is increasing ad inventory. Facebook is adding more ads to Instagram and WhatsApp. And a lot of small and medium-size apps have started to focus on monetization this year. This result is that the supply side of the ad industry this year has a surplus supply that sometimes become expensive. On the other side, ad demand does not look that strong for different reasons, such as uncertain economic growth. We noticed some big advertisers are controlling ad budgets this year to save costs.

The ad industry is actually a balancing act between the demand side and supply side. So in supply side, it's adequate with expectations that it will increase, but demand is inadequate. The price, which is the (inaudible) and the fill rate goes up. This is the fact, and the challenges we are faced with this year in terms of the monetization. But we believe this industry volatility is short term, and the mobile advertising industry still has great potential to grow. Thank you, Alicia.

Alicia Yap: Thank you.

Operator: Emerson Chan at Bank of America Merrill Lynch.

Emerson Chan: Regarding our own ad platform launch in Q1, could you please elaborate how we can benefit from it? And how does it impact our financial performance in this year and in long run?

Karl Zhang: Thank you. So I'm going to answer this question. So as I mentioned at the very beginning, our user base is growing very fast and the user engagement improved dramatically. So this means we are releasing more and more ad inventory. At this moment, we are relying on our ad exchange and other ad business partners to monetize our increasing inventory. So that if the industry volatility and its impact on our business partners will impact others; we do not have direct control over our business partners at resource allocation strategy.

So we realized, under current environment, that relying on third-party business partners to effectively fill our fast-growing ad inventory is a challenge. Both the fill rate and the average [impression] price has been [flat to 18] this year. On the other hand, we have two powerful weapons, fast-growing diverse ad inventories and this impact user insight that we obtained from our user app TouchPal Keyboard; and now our portfolio app, which is a unique and a valuable asset to optimize ad performance and ROI.

So it makes us confident that we have great potential in the global mobile advertising industry. Therefore, we have been developing our own in-house advertising platform since the middle of last year. We officially launched the CooTek advertising platform, our in-house ad serving platform early in Q1. This system allows advertisers to create and manage ad campaigns, manage ad budgets and place ads in our ad portfolio directly. Furthermore, it provides programmatic interface to allow third-parties to acquire mobile traffic from us directly.

We believe this is a very strategic investment. With benefits from our [best] user insight, we offer sophisticated precise users' targeting capability to help our advertisers and partners to achieve better ROI on our ad platform. This makes us believe that advertisers and the -- this makes us believe that we have great potential to grow in the global advertising industry.

We're excited to see that as we benefit from our unique and [best] user insights, the monetization efficiency of our in-house ad platform has surpassed most of our ad business partners. It is winning revenue share from them actually. So this system contributed approximately 14% of our total advertising revenue already in [March], and this percentage is still increasing.

Our goal is to make CooTek advertising platform one of the top-tier global ad platforms in terms of advertisers through ROI. Although it takes time to ramp up, in short term, we believe our in-house ad platform will boost our revenue and profit in long term. Thank you.

Operator: (Operator Instructions). Tina Long at Credit Suisse.

Tina Long: Just a quick follow-up on the previous in-house ad platform. Can you just explain a little bit of the financial impact of this in-house ad platform on your financials?

Karl Zhang: Thank you, Tina. I'm going to answer this question. So by attracting advertisers to spend their budgets directly on our advertising platform, and serving them better, we will make our monetization much more independent and reduce the impact of market volatility, and eventually, realize the big value of our [best] user insight to boost our revenue and profit.

At this moment, the cost to build up our own ad ecosystem is mainly on engineering side, as we expanded our team and hired experienced engineers. On the sales side, we will establish a global direct sale agency network to sell our ad inventory. We will provide rebates to our global

partners as incentive, which will be excluded when recognizing the net revenue. So basically this is the impact. So mainly, at this moment, the impact is mainly on the R&D cost. Thank you.

Tina Long: Okay. Thank you.

Operator: (Operator Instructions). Seeing no further questions. I'd like to turn the conference back over to Rene Vanguestaine.

Rene Vanguestaine: Thank you, Amy. Thank you all for joining our call and for your continued interest in CooTek. Please do not hesitate to call us if you have any questions or want to visit. Thank you, and good night.

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