[CTK] - CooTek (Cayman) Inc.
Third Quarter 2019 Financial Results
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***Presentation***

Operator: Good day, and welcome to the CooTek to announce third quarter 2019 unaudited results on November 18, 2019. [Operator Instructions] Please note that this event is being recorded.

I would now like to turn the conference over to Rene Vanguestaine. Please go ahead, ma'am.

Rene Vanguestaine: Thank you, operator.

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 PR Newswire.

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 both be available to answer your questions during the Q&A session that follows.

Before we begin, I'd like to kindly remind you that this conference contains forward-looking statements within the meaning of Section 21-E 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 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 the company's 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 and 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 the date of the this call, and CooTek does not undertake any obligation to update such information except as required under law.

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

Karl Zhang: Thank you, everyone for joining our third quarter 2019 earnings call.

Our performance this quarter was better than we expected after Google disabled our access to Google Play Store and Google AdMob on July 17, 2019, negatively impacting our second and third quarters' topline and bottom line. Our business started to bounce back during this quarter. We are optimistic about the coming quarter and our long-term growth.

Based on the current state of our business, we have raised our revenue projection by 28% for Q4, from implied $37 million to $48 million. As a sign of our confidence in our long-term growth and the value of our business, we also announced a new share repurchase plan. In this quarter, we have been in continuous communication with Google to clarify the potential misunderstanding behind their action. However, we cannot guarantee that we will prevail or that any such suspended or removed applications will be made available again. Regardless, we're well prepared for either outcome. We have already rolled out effective operational measurements to continue to acquire new users.

In the second quarter, approximately 47% of our portfolio app users were acquired through channels other than Google Play, such as App Store, OEM preloaded store and direct-download advertising platforms. This quarter, we added resources to expand user acquisitions through those channels. Our super app TouchPal Keyboard acquires users mainly through preloading, which was not impacted by Google's action. Additionally, we're also working on alternative plans to make our apps available on Google Play in case we fail to reinstate the apps in the disabled accounts.

In addition, thanks to our fast-growing in-house ad network and other successful initiatives, such as releasing more traffic to other ad exchange networks, we have mitigated the impact on monetization and user growth. Our business started to bounce back during the quarter, as both our daily revenue and the number of daily active users regained growth momentum. This is testament to our strong execution capability, core competency and unique value proposition built on our in-depth user insights.

The average DAU of our content-rich portfolio apps was 23.9 million in September, down from 27.6 million in June. But the MAU increased to 67.5 million in September, as user acquisition recovered and user growth regained momentum. The engagement rate of our portfolio apps was 35.4%, down 7% sequentially. One reason is that we could not use Google push notifications to reach and activate users after our developer accounts were disabled. To mitigate this impact, we have already developed our own shelf-hosted push system. All of our new apps and existing apps distributed through other channels will bundle our shelf-hosted push system in the future.

Nevertheless, our user engagement ratio remains very high, demonstrating the stickiness of our products. Based on current unit economics, key product metrics and overall ROI, we have the confidence to expand our investments on user acquisitions.

Our mission is to empower everyone to enjoy relevant content seamlessly. We believe that the global content app market is still in its early stages. And this gives us massive opportunities in both horizontal and vertical areas. We are investing to firmly establish and continuously evolve our content ecosystems.

Our sophisticated growth platform is built by leveraging our unique in-depth user insights. As we mentioned on our second quarter earnings call, late last year we successfully expanded our product offering to China market. This quarter, we released a multiple new content apps to China markets such as fitness app HiShou (嗨瘦) and Happy Steps (欢乐走), and they are growing pretty fast. We believe our success in China market demonstrates our core competencies and opens up a substantial new opportunity for our long-term growth.

One of our strategic goals is to strengthen our advertising business by reducing external dependency. In this first quarter of this year, we officially launched the CooTek advertising platform, our in-house ad network. This system allows advertisers to create and manage ad campaigns, manage ad budgets and place ads into our app portfolio directly. Furtehrmore, it provides programmatic interface that allows third parties to acquire mobile traffic.

In this quarter, we achieved significant progress, as the CooTek advertising platform started to contribute a significant percentage of our total advertising revenues. It also boosted our monetization efficiency, because the average eCPM for the platform surpasses all the third parties as it changes. The daily ARPU of our content-rich portfolio apps set a new record recently. We will continue to strongly invest in both advertising technologies and our ad ecosystem.

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

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

Now let's start with users. Monthly active users for our portfolio products reached 67.5 million in September, up 100% from a year ago. Average daily active users for our portfolio products in September reached about 24 million, up 1.2x compared to last year.

Average daily active users on TouchPal smart input in September were approximately 141 million, up 6% from last year. MAUs were 185 million compared to 180 million last year. Total net revenues were $31.3 million, down 15% from last year. Mobile advertising revenues were $30.5 million, down about 16% from a year ago. With total advertising revenue for the third quarter of 2019, portfolio products contributed approximately 81%; TouchPal Smart Input contributed approximately 2%, and the TouchPal Phonebook contributed approximately 17%.

Turning now to expenses. Our Q3 GAAP cost and expenses were nearly $48 million, a decrease of 8% sequentially and up 40% from the same period last year. Non-GAAP cost and expenses were $47 million, a decrease of 8% sequentially and an increase of 40% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 150%. The operation expenditure increase is mainly driven by sales and marketing expenses.

Sales and marketing expenses increased by 48% from the same period last year and 2% sequentially. The largest component of these expenses is user acquisition costs, and these went down in late July as a result of Google’s action. As we found new ways to reignite growth, we started to spend more in late August and September with tangible results.

R&D expenses decreased by 9% sequentially and increased by 34% year over year, primarily due to the increased cost associated with technology R&D staff. We ended the quarter with 514 full-time employees, up 14% from last year and down 13% from last quarter. R&D employees represented about 63% of total employees, the same as last quarter and the same period last year.

G&A expenses decreased by 56% sequentially and increased by 14% year-over-year. The decrease is mainly due to the accrued provision of bad debt of $4.7 million in last quarter. The increase over last year is due to the organic growth of the company's operations.

Our gross margin was 87.5%, down from 90.7% during the same period last year and slightly down from 89.4% last quarter. The lower gross margin for the third quarter is mainly due to drop in revenue, while the cost of revenue remains stable. With revenue regaining growth momentum, we expect gross margin to recover to previous normal status.

We had a GAAP net loss of $16.2 million, representing 52% of net loss margin.
Excluding the effects of stock compensation, our adjusted net loss was approximately $15.4 million, representing a 49% non-GAAP net loss margin. As of September 30, 2019, cash and cash equivalents and restricted cash was about $56 million compared to $63 million as of June 30, 2019.

Under the share repurchase program announced on November 26, 2018, the company used an aggregate of $12 million to purchase 1.4 million ADS as of September 30, 2019. The company will early terminate the 2018 program on November 20, 2019 and take effect a new share repurchase program on the same day. In the new share repurchase program, the company is authorized to repurchase its class A ordinary shares in the form of ADS with an aggregate value of up to $6 million during the 6-month period starting from November 20, 2019. The company expects to fund the repurchases under this program with its existing cash balance.

Turning now to the revenue outlook. We expect total revenue in the fourth quarter of 2019 to be about $48 million, representing a 2% increase year-over-year. For the fiscal year of 2019, CooTek expects total revenue to be about $157 million, representing a 17% 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: [Operator Instructions] Our first question will come from Alicia Yap of Citigroup.

Alicia Yap: I have a couple questions regarding the reasons behind the fourth quarter guidance raise. So if you could elaborate a little bit, would be better. So which apps that you have seen most of the ads coming from in 3Q, and how should we think about the apps that contribute to the 4Q guidance rate?

And also, when we look at your 4Q guidance, it also suggests that there is an early sign of recovery from the negative impact that you experienced from Google last few months. So are these negative impacts now largely behind us? And how should we think about the next year growth outlook?

Karl Zhang: So I'm going to answer this question.

So yes, our performance this quarter was better than we expected. And our business started to bounce back in this quarter based on the latest operation data. We are very optimistic about the coming quarter and our long-term growth. And that is why we have raised our revenue projection by 28% for Q4 from implied $37 million to $48 million.

Actually, both of our daily revenue and the number of daily active users regained the growth momentum. This is a testament to our strong execution capability, core competency and unique value proposition. And the major driver behind this strong recovery is the Google ad platform. Not any individual app, actually. So CooTek ad platform successfully replaced Google AdMob and raised the overall monetization for all of our portfolio apps.

And I have to admit that we underestimated our potential to build up in-house ad network in Q1 and Q2. We knew that building up in-house ad network is a strategic choice for us to sustain our core business and reduce external dependency. But we underestimated our traffic value, and the possibility in-house ad network could possibly boost our monetization.

So we concentrated our results to focus on developing our own ad ecosystem, we found great potential and opportunities. So as you know that most of our portfolio apps are content-rich apps, purely the traffic from content apps, especially newsfeed apps, have higher conversion for advertisers. So when we sell our traffic directly to ad partners such as AdMob, they don't optimize their ad networks specifically for our traffic. But when we build up our ad network, we can optimize for our traffic. So we have can find specific types of advertisers based on conversion efficiency for our traffic.

For example, we've found that ecommerce advertisers, especially those small and medium advertisers, have higher conversion on our fitness apps. Then we drive our whole sales network to focus on that category and introduce specific advertisers for our fitness apps. This resulted in better eCPM and even better advertiser client satisfaction. There are actually a lot of optimizations we can do to further boost our monetization. And we will continue to strongly invest in both advertising technologies and our ad ecosystem.

In terms of next year, since we have regained the growth momentum -- and what's more, our monetization is even more stable now -- we believe we will be on the fast lane next year, not only on revenue side, but also on product side. And we are confident to invest more on user acquisitions to drive our user growth.

I think I will be able to provide more color when we finish the fourth quarter.

Operator: Our next question will come from Tina Long of Credit Suisse.

So this is Ivy Liu on behalf of Tina. I have two questions here.

First one is, we understand that CooTek's in-house ad system is growing really fast. And that mitigates some of the impact from the Google incident. So can management give some color in terms of the key metrics for this ad system, such as ROI and the eCPM; and how the revenue growth trend will be like for next year for in-house ads?

And second question is, does management have some guidance on the user growth front for 2020 in terms of MAU and DAU?

Karl Zhang: One of our strategic goals is to strengthen our advertising business by reducing external dependencies. In the first quarter of this year, we officially launched the CooTek Ad Platform. And this year, this quarter, we achieved significant progress as the CooTek Ad Platform started to contribute a significant percentage of our total advertising revenues. So yes, it offsets the impact from Google's action and boosts our monetization efficiency. Because the average eCPM is higher than other average changes.

I think I can provide some detailed numbers here. So the average ARPU DAU of our portfolio apps in October is approximately 40% higher than Q1 average of ARPU DAU. At that time, we were not impacted by Google yet. We expect that the revenue generated from our in-house ad network will take more revenue percentage in the future. And we believe it will help to sustain our ARPU growth.

And in terms of the DAU and MAU outlook. We don't provide guidance for DAU and MAU growth, but I can give you some color about it. So our sophisticated growth platform is built by leveraging our unique in-depth user impact. So we are very confident on our growth capability. So the DAU of our content-rich portfolio apps started to bounce back, and MAU continued its growing pace even in Q3. So we are looking forward to strong user growth in the next year.

Operator: Our next question will come from Hans Chung of KeyBanc Capital Markets.

Hans Chung: So I guess I just have one question. So in the third quarter, we have the engagement ratio, which is DAU divided by MAU, came down to 35%-ish. And that's compared to the last quarter, we have over 40%. So can you explain a little bit more why we have lower engagement ratio? And also, what should we think about the trend going forward?

Karl Zhang: So the engagement rate of our portfolio apps was 35.4% in third quarter, down 7% sequentially. There are two major reasons. First, we could not use Google push notification service to reach and activate our users after our developer accounts were disabled, so push notifications, email push and the retargeting advertising on major channels connected to our personalized recommendation systems to recall and activate our users. To mitigate this impact, we have already developed our on-shelf hosted push system. All of our apps will bundle our shelf hosted push system.

And another reason for the decline is that some of our apps have higher long-term retention rates and good ROI but have naturally lower average engagement rates. The MAU percentage of such apps are increasing. For example, Cherry, which is a female lifestyle community app -- its engagement rate is around 25% to 30%, a little bit below average. But its long-term retention is very good, so it's MAU percentage is increasing. Another case is HiShou, which we released to China market. Its engagement ratio is a little bit lower than average. Its ARPU DAU is 2x above average. So we don't think it's a problem, because the overall ROI of those apps are actually above average. We cannot choose just to focus on engagement in the future, but product lifetime value, ROI, long-term retention rate and the value it brings to our users.

Operator: [Operator Instructions] Our next question will come from Alicia Yap of Citigroup.

Alicia Yap: So Karl, I have follow-up questions on the sales and marketing spend you mentioned. Seems like you're increasing the budget in 3Q, which helps to drive the DAU and MAU growth. And then, the sales and marketing percentage is actually higher than the revenue for the third quarter. So was this also one of the reasons that contribute to the faster fourth quarter revenue growth? So will sales and marketing need to remain high to support the stronger revenue growth into the 2020?

Karl Zhang: Yes. So we are investing more to acquire users, because we are pretty confident on our user growth. And the overall ROI and unit economics is pretty good, even without Google Play. So that's why we are confident to put more money to drive the user growth. And yes, because the ROI -- the total assets at the entire ROI of our system is very good. So the budget we spend to acquire users and the part of the budgets were just change according to the revenue. So part of the revenue is coming from this quarter's investment to user acquisitions. And we expect that the percentage of our sales and marketing costs will just decrease. But still, we will continue our investment on user acquisitions in the fourth quarter and next year.

Operator: [Operator Instructions]

This concludes our question-and-answer session. I would like to turn the conference back over to Rene Vanguestaine for any closing remarks. Please go ahead.

Rene Vanguestaine: Thank you, operator.

This concludes our call for today. Thank you, everyone, for joining the call tonight.  If you have any questions or comments, please don't hesitate to reach out to any of us.  Good night.

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