[CTK] - CooTek (Cayman) Inc.
Fourth Quarter and Fiscal Year 2019 Financial Results
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Company Representatives:
Tip Fleming, Christensen
Karl Zhang, CooTek Inc., Chairman and Chief Architect
Jean Liqin Zhang, CooTek Inc., Chief Financial Officer

Company Participants:
Unidentified Analyst, KeyBanc Capital Markets
Nelson Chung, Citigroup
Ivy Liu, Credit Suisse

Presentation

Operator: Good day, and welcome to the CooTek's fourth quarter and fiscal year 2019 unaudited financial results conference call. [Operator Instructions]. Please note this event is being recorded.

I would now like to turn the conference over to Tip Fleming at Christensen. Please go ahead.

Tip Fleming: 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. SEC, 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 the 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. SEC. 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. Thank you, everyone, for joining our fourth quarter 2019 earnings call. Our performance during the fourth quarter far exceeded our expectations, as our business bounced back strongly to regain its growth momentum.

Total net revenue for the quarter was US$69 million, beating our adjusted guidance US$53 million by 30%. Our ability to derive sophisticated user insights and drive growth remains one of our key core competencies.

We also made promising progress on delivering competitive content apps and building a distinctive content ecosystem.

Our in-house ads network, CooTek Ads Platform, grew rapidly during the quarter, which fueled our monetization efficiency and mitigated the risk of third-party dependency. All of these positive momentums made us optimistic on our long-term growth.

Based on the current state of our business, we project our first quarter 2020 revenue will exceed US$85 million, representing a 23% growth rate sequentially, despite the industry seasonality and the impact of the global coronavirus outbreak.

Our focus remains on developing and growing our portfolio of content-rich apps to meet the evolving needs of users. The average DAU of our content-rich portfolio apps was 24.7 million in December, up from 23.9 million in September. The MAU increased to 74.6 million in December, up from 67.5 million in September.

Our content-rich portfolio apps contributed approximately 95% of our total revenue during the quarter. This is a testament to our mission of empowering everyone to enjoy relevant content seamlessly.

During the quarter, we were in communication with Google to clarify the potential misunderstandings behind the removal of our apps from Google Play in July. However, as of today, those apps have not been reinstated yet. We cannot guarantee that we will prevail in our effort, or that any such removed applications will be made available again.

Regardless, we have already rolled out effective operational measures to release new content-rich apps, diversify our user growth channels such as AppStore, and strengthen our internal compliance efforts. With all these initiatives, our business regained strong growth momentum, and we believe that the impact of Google's action in July is behind us. We are moving on and focusing on growing our new portfolio apps.

While the engagement rate of our portfolio apps was down 2% sequentially at 33.1%, we are not overly concerned. One reason for this drop is that we cannot use Google Push Notification to reach and activate our users after our developer accounts were disabled.

We fully expected DAU to drop for those apps removed by Google's action. Thanks to the strong DAU growth of the new content-rich portfolio apps, total DAU regained growth momentum.

While some of our new portfolio apps have naturally lower-than-average engagement rate, they have much higher ARPU and overall ROI compared to the removed apps. We are satisfied with the growth momentum of these high ARPU, but naturally with lower-engagement, apps. Again, we are moving on and focusing on growing our new portfolio apps.

Going forward, we tend not to just focus on engagement, but also on product lifetime value, ROI, and the value that we bring to our users.

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.

At this stage, we have focused our content app strategy on 3 special categories: scenario-based vertical content apps, such as fitness and healthcare apps; long reading-content apps, such as global online novels; and casual games, which is typical entertainment content. We believe that these 3 markets are massive globally, and that our sophisticated user-insight driven growth platform will help us deliver a unique value proposition in these categories.

Here I want to emphasize that our first priorities at this stage are to grow the user base of our content-rich portfolio apps aggressively and to cultivate our content ecosystem. We will continue to follow this strategy and make decisions with long-term growth in mind. With the current ROI level and the business opportunities, we are confident to invest aggressively to grow our use base, and at the same time, make great efforts to improve our app key metrics, such as user retention rate continuously.

In this quarter, we released some new casual games to the global market on both Android and iPhone, such as Idle Land King Tycoon, Crazy Painting and Farm Hero.

With our casual game business in its very early stage, we still have plenty of room to improve in terms of the game quality and localization and user retention. By leveraging our user-insight driven growth platform, these casual games delivered better-than-expected ROI and started to contribute meaningful revenue. This gives us the confidence to invest more in this entertainment content segment.

One of our strategic goals is to strengthen our advertising business by reducing external dependencies. In the first quarter of 2019, we officially launched the CooTek Advertising Platform, our in-house ads network. This system allows advertisers to create and manage ad campaigns, manage ad budgets and place ads in our app portfolio directly. In the past couple of quarters, we have worked hard to improve our ads network by leveraging AI technologies, optimize end-to-end ads conversions and cultivate our advertiser ecosystem.

CooTek Ads Platform boosted our monetization efficiency because the average eCPM for the platform surpassed that of all the third-party ad exchanges, and it started to contribute a significant percentage of our total advertising revenue. During March 2020, we are generating approximately 60% of our revenue from our ads network. 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. Thank you.

Jean Zhang: Thank you, Karl, and thanks, everyone, for joining us on the call today. I'm going to walk you through our fourth quarter financial results and a few key results from full year 2019. All comparisons are on a year-over-year basis unless otherwise noted.

Let's start with users. Monthly active users for our portfolio products reached 74.6 million in December, up 62% from a year ago. Average daily active users for our portfolio products in December reached about 24.7 million, up 46% compared with last year.

Average daily active users on TouchPal smart input in December were about 137.6 million, down 2% from last year. MAUs were 182.8 million, down 4% from last year.

Total net revenues were $69 million, up 47% from last year. Mobile advertising revenues were $68.5 million, up about 47% from a year ago.

With total advertising revenue for the fourth quarter of 2019, portfolio products contributed about 95%; TouchPal Smart Input contributed about 1%; and TouchPal Phonebook contributed about 4%.

Turning now to expenses, GAAP cost and expenses were about $75.2 million, an increase of 58% sequentially and up 74% from the same period last year. Non-GAAP cost and expenses were $74.8 million, an increase of 60% sequentially and an increase of 76% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 108%, down from 150% in previous quarter. The increase in operational expenditures was mainly driven by sales and marketing expenses.

Sales and marketing expenses increased by 99% from the same period last year and 90% sequentially. The largest component of these expenses is user acquisition costs, which grew in line with the overall expansion of our business.

As Karl mentioned, at this stage, our first priorities continue to be aggressively growing user base of our content-rich portfolio applications and to cultivate our content ecosystem. With our current level of ROI and business opportunities, we are confident that as we continue to invest aggressively to grow our user base, we should be able to maintain our fast revenue growth in the coming periods and achieve future profitability.

R&D expenses decreased by 17% sequentially and by 2% year-over-year, primarily due to a decline in average compensation rate with technology R&D staff and the share-based compensation expenses.

We ended the quarter with 553 full-time employees, up 11% from last year and up 8% from last quarter. R&D employees represent about 63% of total employees, the same as last quarter, and compared with 62% last year.

G&A expenses decreased by 19% sequentially and by 24% year-over-year. The sequential and year-over-year decreases were mainly due to a reversal of bad debt provision of US$0.6 million during the fourth quarter of 2019.

Our gross margin was 94.4%, up from 92.6% during the same period last year and an increase from 87.5% last quarter. The improvement of gross margin was primarily due to our efforts to optimize efficiencies related to infrastructure utilization.

We had a GAAP net loss of $6.6 million, which represents a net loss margin of 9.6%. Excluding the effects of stock compensation, our adjusted net loss was approximately $6.2 million, representing a non-GAAP net loss margin of 9%.

I will now quickly run through a few key full year 2019 financial results. Further details can be found in the earnings release.

Net revenue was $178 million, an increase of 33% from $134 million in 2018.

Mobile advertising revenue was $175 million, an increase of 33% from $131 million in 2018. Portfolio products contributed approximately 85%; TouchPal Smart Input contributed about 6%; and TouchPal Phonebook contributed about 9%.

Cost and operating expenses were $215 million, an increase of 73% from $124 million in 2018.

Sales and marketing expenses were $157 million, up 95% year-over-year. As a percentage of total revenue, sales and marketing expenses accounted for 88%, an increase from 60% in 2018, primarily due to increased investment in user acquisition.

R&D expenses were $27 million, an increase of 39% from $19 million in 2018, mainly due to increased costs associated with technology R&D people. As a percentage of total revenue, R&D expenses accounted for 15%, up from 14% in 2018.

G&A expenses were $16 million, an increase of 52% from $10.7 million in 2018, primarily due to an increase of $4.1 million in bad debt provision. As a percentage of total revenue, G&A expenses accounted for 9%, an increase from 8% in 2018.

Gross margin was 91.4%, compared with 88.9% in 2018.

Net loss was $37 million, compared with net income of $10 million in 2018. Adjusted net income was US$33 million, compared with adjusted net income of $12.5 million in 2018.

At the end of year 2019, we had cash, cash equivalents and restricted cash of about US$60 million, compared with US$85 million at the end of year 2018.

On November 26, 2018, we announced a share repurchase program. This program was terminated during the fourth quarter of 2019. We repurchased an aggregate of 1.7 million ADSs for a total consideration of US$13.7 million during this time. During the process, we netted the cancellation of treasury stock with additional paid in capital.

On November 20, 2019, we launched a new share repurchase program where we are authorized to repurchase up to US$6 million of our ADSs during the 6-month period starting on November 20, 2019. As of the end of the year 2019, we had used an aggregate of US$1.1 million to repurchase 0.2 million ADSs.

Turning now to the revenue outlook, we expect total revenue in the first quarter of 2020 to be above US$85 million, representing an increase of over 112% year-over-year. These estimates reflect our current and preliminary view, which is subject to change.

Operator, we are now ready to take questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Hans Chung, KeyBanc Capital Markets.

Unidentified Analyst: This is Zoe on behalf of Hans. Congratulations on the strong results, and thank you for taking my questions. I have two questions. The first one is could you talk a little about the potential impact of the coronavirus outbreak, especially in the overseas market?

The second is what do you think is the upside of the in-house ads as a percentage of the total ad revenue and its contribution to improving of our ARPU?

Karl Zhang: Thank you. Let me answer this question. So the pandemic actually has mixed impact on our business. The travel ban trapped our users at home, which resulted in higher-than-expected usage of our content apps. The app inventory increased accordingly with the increased timespan actually.

So on the other side, coronavirus outbreak, that impact the advertisement industry. In China, usually we expect a strong ad budget recovery after the Spring Festival holidays, but this year, we noticed that some of the major advertisers were cutting budgets. So this caused less bidding competition increasing at inventory, which as a result lowered both the ad fill rates and the eCPM. So this was happening throughout all of the February, and we estimate it has approximately 10% to 15% negative impact on our ARPU. The market started to recover recently, but not strong enough. We anticipate that the recovery will happen in the second quarter actually.

As for the oversea market, especially the U.S. market, we didn't notice any significant impact yet, but we are not quite sure about the future impact, as the virus continues to spread. We will see.

But anyway, our guidance has already built in conservative considerations, and the current-hour level of our apps is relatively safe, even taking the pandemic impact into account.

In terms of the CooTek Ad Platform, during the first week of March 2020, we are generating approximately 60% of our revenue from our ad network. So it boosted approximately 20% to 30% of our ARPU. So we are confident that ARPU will continue to improve ongoing. Thank you.

Operator: Nelson Chung, Citi.

Nelson Chung: Congratulations on the solid quarter. I have two questions here. My first question is could you elaborate more details to drivers for your strong performance in fourth quarter 2019, and will the sequential revenue trend, as you guided? While China and global advertisers efforts impacted by the coronavirus outbreak. And will these global trends continue into the rest of 2020?

And my second question is related to the marketing expense. Could you comment on the large increase of the sales and marketing dollars this quarter? What type of marketing expense is that, and is that mainly for user acquisition? And what are the top advertiser categories?

Karl Zhang: Thank you for your question. So I'm going to answer this question. Let me elaborate the key drivers behind our strong performance first. The advertising business is the foundation of CooTek; the in-depth user insight is the blood to seal and cultivate our sophisticated growth platform backbone. And to mention 3 content apps categories, which are long-reading apps, scenario-based vertical content apps, and casual games are actually 3 vertical pillars on top of this foundation. So we are gaining growth momentum for all of these 3 categories. We're optimistic on both short-term and long-term growth despite the impact of the pandemic.

We noticed that some of the major advertisers were cutting budgets, which caused the ARPU approximately 10% to 15% lower than we expect in February for China market, but it's now recovering. And we didn't notice any significant impact on global markets yet. We believe that the impact of the coronavirus outbreak on our business is limited because we have a big portion of advertisers coming from not-impacted industries, such as the mobile gaming industry.

The second question, yes, our sales and marketing cost increased from $33 million to $63 million in the fourth quarter, so up 90% sequentially. Sales and marketing has mainly been to acquire new users, but the total revenue was up 121% sequentially. And the non-GAAP net loss decreased from $15 million to $6 million, down 60% sequentially. But this operating result demonstrated our strong monetization improvement, our great ROI and operational leverage.

Here I want to reinforce that our first priorities at this stage are to grow the user base of our content-rich portfolio aggressively, and to cultivate our content ecosystem. Based on the current state of our business, we will continue to invest on our user acquisition without compromising our ROI level. Thank you for your question.

Operator: Ivy Liu, Credit Suisse.

Ivy Liu: I understand the Company has started to focus on multi-growth drivers since last year. So just want to have a general idea on what is the overall growth strategy or growth target for the new products, including the literature app or casual games app, etc.

And the second question is on the literature app, does that have any differentiated content strategy?

Karl Zhang: Thank you. Our mission is to empower everyone to enjoy relevant content seamlessly. As I mentioned, at this stage, we have focused our content app strategy on 3 special categories and global online novel is actually one of them. So clearly, reading novels, which is an app released in China, is an initiative for the long-reading content app market. We do not disclose this number of any specific app at this moment, but yes, the growth of the Crazy Reading novel is promising.

Here I want to emphasize that our targets for the long-reading content app market are global. Actually, we have already released online novel apps to target the oversea market as well. We believe that we have an opportunity to disrupt the global online novel market, and we're making efforts to cultivate our content ecosystem for our online novel apps. We work with copyright partners to license books in China and oversea markets.

At the same time, we have already established in-house online literature marketplace to directly work with writers, help them submitting novels and making money. Going forward, we expect this business continues to grow, and we believe that the oversea market is a great opportunity for us.

In terms of the new game business category, we are focusing on casual games at this moment because they are more suitable for our advertising business model. As of today, we have developed merge games such as Idle Land King Tycoon, simulation games such as Farm Hero, and puzzle games such as Crazy Painting, in which we run ads.

So with our casual games business in very early stage, we still have plenty of room to improve in terms of game quality and organization and user retention rate. By levering our user insight-driven growth platform, these casual games delivered better-than-expected ROI and started to contribute meaningful revenue. The new casual games business contributed approximately 13% of our total revenue in the fourth quarter of 2019. Our game business is targeting both China and the overseas markets. Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Tip Fleming for closing remarks.

Tip Fleming: Thank you, operator. This concludes our call for today. And thank you, everyone, for joining the call tonight. If you have any questions or comments, please don't hesitate to reach out to us directly. Thank you for joining. Bye-bye.

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