[CTK] - CooTek (Cayman) Inc.
Second Quarter 2020 Financial Results
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Company Representatives:
Rene Vanguestaine, Christensen, IR
Karl Zhang, CooTek Inc., Chairman, Chief Technology Officer
Jacky Lin, CooTek Inc., Chief Financial Officer

Company Participants:
Nelson Cheung, Citibank
Zoe Deng, KeyBanc Capital Markets

Presentation

Operator: Good day, and welcome to CooTek announcement second quarter 2020 unaudited results conference call. [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, Brent. 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 Technology Officer, and Mr. Jacky Lin, Chief Financial Officer. Mr. Zhang will review business operations and Company highlights, followed by Mr. Lin, 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 Commission 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 the 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 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 second quarter 2020 earnings call. We are excited to report yet another strong quarter where we outperformed our expectations.

Total net revenue for the quarter grew 236% year-over-year to US$126 million. More importantly, we returned to profitability with non-GAAP net profit of US$4.5 million. This result is a strong validation of our sustainable business model and a strategic shift to content ecosystem.

Based on our current estimates, for the fiscal year of 2020, we expect the annual revenue to be around US$500 million, representing a year-over-year increase of around 181%.

Especially, the monthly average DAUs of our core content app, Fengdu Novel, grew to 8.1 million in June. Its daily DAUs has by now already exceeded 10 million. The July’s MAUs of Fengdu Novel exceeded 30 million and the average time spent per daily active reading user is approximately 110 minutes per day.

According to Quest Mobile, a professional business intelligence services provider in China’s mobile internet market, Fengdu Novel ranked #3 in terms of MAUs in the free online literature market.

Online literature is a strategic content segment we began to invest in about this time last year. By leveraging our sophisticated growth platform, the DAUs of our online literature apps grew rapidly from nothing over the past 12 months. This is indeed a major milestone for us, showcasing the success of our content ecosystem strategy.

Long content reading, long and short video and fragmented reading are 4 key content tracks which have acquired huge user bases and meaningful time-spent. We believe that online literature market is enormous, and we have the potential to be a global sector leader in this market.

The exceptional growth of Fengdu Novel made us confident to invest more aggressively in online literature market to drive the DAU growth, cultivate our content ecosystem and establish the brand awareness.

To support long-term growth, we launched the Fengdu Literature writer platform to partner directly with writers in the first quarter of this year. Now we have accumulated over 1,600 registered writers, and the books they published on our platform supported nearly 50% of total content consumption in terms of time-spent.

We also developed an AI and data-driven system to enable our writers to produce more suitable content for our users and continuously adapt to changing demand based on data feedback. The platform that we are building is not just a place for writers to publish books, but also a platform to really enable them to improve their art based on a proper data matrix, so that even an average writer could possible produce content that will perform well. I am confident that all these efforts will ensure our long-term value and success in this track.

Our mission is to empower everyone to enjoy relevant content seamlessly. We have focused our content app strategy in 3 categories: online literature, scenario-based content apps and casual games. Because online literature is one of the foundations of IP and copyright, and the content could be adapted to other entertainment content formats such as movie, video or audio, physical books and online games, it is actually the root of our content strategy. With the strong growth of our online literature apps, we further refined our overall strategy to focus on global online literature and its synergistic effect on other content segments at this stage.

We realized that our causal game business has very strong synergy with online literature business. First and most obvious, there is a big overlap between online literature users and casual game users. Second, there is a natural synergy at the IP layer. That is why we have continued to invest meaningfully since the fourth quarter of last year. The strong growth of our online literature apps explains why our casual game business ramped up so quickly since the fourth quarter of last year, validating the strong synergy between these 2 businesses.

In the second quarter of this year, our casual games business delivered better-than-expected ROI. It contributed 45% of our total revenue during the quarter. This leaves us more confident in its enormous growth potential, and we will continue to invest more in the entertainment content segment.

As I mentioned, online literature is one of the foundations of IP and copyright, and its content can be adapted to other entertainment content format. We believe that there are other synergistic business opportunities that we can capture based on our online literature business. Besides the online gaming business, we started to explore other opportunities this quarter.

MAUs for our content-rich portfolio apps were 83.5 million in June this year, down approximately 6% sequentially, mainly due to a drop in MAUs for our casual games. We expected this because our focus during this quarter for online game business was to optimize user engagement for long-term growth.

Despite the drop in MAUs of online games, the DAUs remained essentially flat, which means the user engagement of our online games improved from 10.6% to 12.4%. And we also have seen strong DAU and MAU growth since the beginning of the third quarter.

Our mission is to empower everyone to enjoy relevant content seamlessly. Our focus for now, however, remains on developing and growing our portfolio of content-rich apps to meet the evolving needs of users globally. With the strong growth of our online literature apps, we refined our overall strategy to focus on global online literature. To enlarge the user base and improve market position, we will invest more aggressively in online literature market.

We believe that our business at this stage is strong and our strategy is solid enough. It gives us confidence to shift all our efforts to focus on our new strategy.

This quarter, we terminated the monetization of our legacy apps to mitigate the risks. Those legacy apps were removed by Google from Google Play in July last year. So we are unable to upgrade those apps, fix any bugs or enforce any new rules, which bring risks. These actions have a short-term negative impact on both our top and bottom lines, but we are strongly confident that we will fully absorb impacts because our core business remains strong.

Nevertheless, let me re-emphasize that our global-reach strategy remains unchanged. We will continue to fine-tune this strategy with a focus on long-term growth.

With that, I will hand the call to our acting CFO Jacky, who will walk you through our financial results for the quarter. Thank you.

Jacky Lin: Thanks, Karl. Hi, everyone. I am pleased you could join us tonight. And we had a strong second quarter.

Net revenues were US$126 million, up 236% year-over-year, and 18% sequentially, beating our guidance by US$6 million. So far, we have sustained our rapid revenue growth rate in 2020.

Net revenues are mainly generated from 3 categories of content-rich apps: online literature, scenario-based content app and casual games. For online literature, which was launched in 2019, MAUs reached 28.4 million in June 2020. Average DAUs reached 8.1 million in June 2020. That is a significant increase from a year ago.

Fengdu Novel is now one of the top 3 players in terms of MAUs for free online literature according to Quest Mobile. We have seen the rapid growth of user base to continue after the period end. Just a few days before our earning call, DAUs of Fengdu Novel grew further to 10 million, representing a higher than 10% month-over-month growth rate.

MAUs of casual games were 20.2 million in June. Casual games accounted for about 45% of total net revenue. They continued to generate considerable revenue and profit to our business, and to provide strong synergy to online literature products.

DAUs for TouchPal Smart Input product in June were about 133.3 million, down 7% from last year. MAUs were 174.3 million, down 8% from last year. Since we are unable to acquire or activate users using Google services, we expect the DAU and MAU for this product will continue to drop. But we are not too concerned at this point in time because we have succeeded in transiting to the content-rich apps strategy, and the revenue from TouchPal Smart Input only consists of less than 1% of the total net revenue.

Now turning to expenses, GAAP cost and expenses were about US$123 million, up 6% sequentially and up 137% year-over-year. Non-GAAP cost and expenses were US$122 million, up 5% sequentially and up 140% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 97%, down from 108% in the first quarter.

Sales and marketing expenses increased by 224% from the same period last year and 3% sequentially. The largest component of these expenses is user acquisition costs. As we continue to execute on our content-rich portfolio strategy, we need to keep investing to expand the user bases of these portfolio products and cultivate our content ecosystem.

R&D expenses increased by 6% year-over-year and by 18% sequentially, primarily due to an increase in costs associated with technology R&D staff and share-based compensation expenses. We ended the quarter with 643 full-time employees, up 9% year-over-year. R&D employees represent about 61% of the total employees, compared with 63% last year.

G&A expenses increased by 25% sequentially and decreased by 47% compared with the same period last year. The sequential increase was mainly due to the increase of payroll expenses and professional services. The year-over-year decrease was mainly due to a decline in accrued provision for bad debts compared with the same period last year. G&A expenses, as a percentage to total net revenue, were 3%, in line with last quarter. We are keeping expenses under control.

Gross margin was 95.5%, up from 89.4% during the same period last year and a slight decrease from 95.7% last quarter. The increases are mainly due to greater economies of scale, as we better utilize our infrastructure, and content procurement efficiency.

GAAP net income was US$3.1 million, which represents a net margin of 2.5%. Excluding the effects of stock compensation, adjusted net income was approximately US$4.5 million, representing a non-GAAP net margin of 3.6%. This is the first quarter we turned profitable since Google removed our apps from Play Store in 2019, which demonstrates our solid recovery from the crisis. And we are now more confident to perform strategic moves to capitalize on opportunities in any vertical content industry as they arise.

As of June 30, 2020, we had cash, cash equivalents and restricted cash of about US$64.9 million, compared with US$60 million at the end of year 2019. We generated US$5.4 million net cash inflow from operating activities during this quarter.

Last year, we launched a 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. We used an aggregate of US$5.9 million to repurchase 1 million ADSs before the plan was terminated early on May 18, 2020.

On May 18, 2020, we launched a new share repurchase program where we are authorized to repurchase up to US$20 million of our ADSs during the 12-month period starting from May 18, 2020. As of June 2020, we had used an aggregate of US$1.0 million to repurchase 0.2 million ADSs.

Turning now to our revenue outlook, we expect total revenue in the third quarter of 2020 to be around US$112 million, representing an increase of around 258% year-over-year. For the full year of 2020, we expect total revenue to be around US$500 million, representing an increase of around 181% year-over-year. These estimates reflect our current and preliminary view, which is subject to change.

Okay. Operator, we are now ready to take questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. [Operator Instructions]. Cheung, Alicia Yap with Citibank.

Nelson Cheung: Congratulations on the solid quarter. I have 2 questions, asking on behalf of Alicia Yap. My first question is regarding your online literature business, because it seems like that the DAUs continue to grow quite well sequentially despite the normalization of user activities after COVID in China. Could you elaborate what are the main reasons contributing to the solid sequential trend in the second quarter? And is there any preliminary target for DAU by the end of this year?

And my second question is regarding the revenue from online games. Given the revenue contribution from online games is roughly at 45% this quarter, will online games become the major growth driver in the coming quarters? What will be the Company's approach of growing the online game business for this online literature? And do we have any ambition of entering into any new categories of apps or new business models?

Karl Zhang: Thank you. I'll take this question. Yes, the video growth trend is quite solid. And I think the most important reason is that we optimized our content ecosystem to generate proper content, which is more suitable for our users to consume. So when we established our content ecosystem, we think more about how to enable our registered writers with AI-enabled data platform and the matrix. Instead of focusing on the quantity of our books, we actually focus more on the quality. So this strategy increased the user stickiness and drives the long-term user retention rate higher. So user retention rate is key to drive DAU growth.

As I mentioned, we see online literature as a global enormous opportunity, so we don’t disclose internal targets, but we do think that we have a chance to be one of the market leaders, not only in China market, but global market too. So we expect the growth momentum remains strong in the coming quarters because of the excellent user retention rate.

And as for our online game business, it actually benefits a lot from the fast-growing online literature business because they are highly synergized in terms of target user base and copyright. As long as we can sustain the growth momentum of our online literature app, our online game business will continue to grow fast. But since the monetization of online literature is also promising, I'd say that both businesses will be the major growth drivers of the Company.

In terms of the plan, we actually released over 10 new games per quarter to sustain the growth. So we do have the plan to enter into new category of games. For example, we will try to release games which mix more like user-pay elements, plus advertisements. Thank you.

Nelson Cheung: Thank you.

Operator: Zoe Deng with KeyBanc Capital Markets.

Zoe Deng: So this is a question on behalf of Hans from KeyBanc. Just wonder, could you provide some color on the third quarter profitability, given third quarter revenue guidance is down sequentially? That does mean that the bottom line is also supposed to be down sequentially?

And how do we think about third quarter net income, given our changes in strategic focus and actually, the legacy advertising business? What's the impact of that on our third quarter profitability?

Karl Zhang: Well, yes, here I want to emphasize that we have experienced profit growth for 3 continuous quarters. And in the second quarter, we turned to profitability. So our core app, Fengdu Novel, is recognized as a future star in the market. So our business has proven strong and sustainable, so we are confident on our long-term growth.

Based on the current business momentum, the management team made the following strategic decision. Firstly, we see strong growth of our online literature app. We refined our overall strategy to focus on global online literature and its synergized content segments at this moment. So to enlarge the user base and improve the market position, we will invest more aggressively in online literature market, so the investment return cycle of our literature app is longer than our online games.

Investing in online literature app results in short-term loss, but its long-term user retention rate is much higher. And the overall ROI of our online literature app is very promising. So the investments we made this quarter will be paid back in the coming quarters, and eventually, bring more profitability. We believe that our business at this stage is very strong, and our strategy is solid in that, so it gives us confidence to shift all our efforts to focus on our new strategy.

So secondly, this quarter, we terminated the monetization of our legacy apps to mitigate the risks. But those legacy apps were removed by Google from Google Play in July last year, and so we are unable to upgrade those apps, fix any bugs or enforce any new rules, which brings risks. So this action has approximately a US$20 million negative impact on both top line and bottom line. But we believe it's the right thing to do, and we are strongly confident that we will fully absorb impacts within the third quarter. And our core business remains very strong, and we expect our annual revenue of fiscal year 2020 to be around US$500 million. And nevertheless, let me re-emphasize that our global-reach strategy remains unchanged.

So thirdly, this guidance also reflected conservativeness about the impact of COVID-19 on global advertising business. So the global advertising industry, especially U.S., is pretty much replicating the trend that happened in China. The budget is recovering, but the eCPM is still below our expectation, about 5% to 10%, so we will see. Thank you.

Operator: This will conclude our question-and-answer session. I'd like to turn the conference back over to Rene Vanguestaine for any closing remarks.

Rene Vanguestaine: Thank you, Brent. This concludes our call for today. Thank you again for joining the call tonight. If you have any questions or comments, please don't hesitate to reach out to us directly. Good night.

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