[CTK] - CooTek (Cayman) Inc.
First Quarter 2020 Financial Results
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Company Representatives:
Christian Arnell, Christensen
Karl Zhang, CooTek Inc., Chairman, Chief Technology Officer
Jacky Lin, CooTek Inc., Chief Financial Officer

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

Presentation

Operator: Good day and good evening. Welcome to CooTek's first quarter 2020 unaudited financial results conference call. [Operator Instructions]. Please note this event is being recorded.

I would now like to turn the conference over to Christian Arnell at Christensen. Please go ahead.

Christian Arnell: Thank you. 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 through PR Newswire Services.

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 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 oral forward-looking statements in its reports filed and furnished with 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 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 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 today, and CooTek does not undertake any obligation to update any such information except as required under applicable law.

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

Karl Zhang: Thank you. Thank you, everyone, for joining our first 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 55% sequentially to be US$107 million, exceeding our guidance of $85 million by 26%.

Total MAU for our content-rich portfolio of apps grew nearly 20% sequentially to be 89 million. Thanks to the strong growth of our in-house ads network and other business segments, cash flow turned positive during the quarter.

These exciting results demonstrate our ability to derive sophisticated user insights and drive growth in both our user base and top line.

Our mission is to empower everyone to enjoy relevant content seamlessly, and we are confident in our ability to sustain healthy and strong growth momentum across all 3 content categories we are now focused on: online literature, scenario-based content apps and casual games.

Based on our current estimates, we believe growth momentum will remain strong with revenue from the second quarter of 2020 expected to be around US$120 million, representing a year-over-year increase of around 219% despite the impact of the global coronavirus pandemic.

As a demonstration of our confidence in the long-term growth prospects of our business, we also announced a new share repurchase plan.

Our focus remains on developing and growing our portfolio of content-rich apps to meet the evolving needs of users. MAU of our content-rich portfolio of apps increased to be 89.2 million in March this year, up nearly 20% sequentially from 74.6 million in December last year. We are happy to see such strong growth in our active user base.

Average DAU was 25.2 million in March, up from 24.7 million in December. We have been seeing a drop in DAU from certain apps removed by Google from the Google Play in July last year.

Since we are not able to update those apps, nor use Google Push Notification to reach and activate users, the drop of the DAU from those apps is expected and accelerating. We expect that it will take another 2 quarters to fully digest the impact this is having on our total DAU. And we are working to aggressively grow new apps to offset this impact. Thanks to the strong growth momentum generated by our new apps and games, we are very optimistic on DAU growth prospects over the long term.

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 of development and presents enormous opportunities. We have focused our content app strategy on 3 categories: online literature, scenario-based content apps and casual games.

Our sophisticated user-insight driven growth platform, together with our in-house ads network, forms a solid foundation, and the 3 focused content categories are being built as 3 pillars on top of this foundation. Our platform and apps are working together as a whole to ensure our competitiveness on ROI, user retention and other key growth metrics.

For example, online literature is a strategic content segment we began to invest starting during the middle of last year. By leveraging our sophisticated growth platform, the DAU of our online literature apps grew rapidly from scratch over the past 3 quarters, particularly in China.

We also established an online literature content ecosystem to support long-term growth in this content segment. Online literature is an enormous and global opportunity for us, and we are taking advantage of it by incubating our online literature apps in multiple countries and regions.

Another example is our causal game business, traditionally part of the entertainment content segment, which we continue to invest in meaningfully since the fourth quarter of last year. By leveraging our user-insight driven growth platform, our casual games business delivered better-than-expected ROI.

Average DAU of our causal games grew to 2.6 million from scratch in the past 2 quarters, and contributed 32% of our total revenue during the quarter. This leaves us more confident in its enormous growth potential and will continue to invest more in the entertainment content segment.

Our focus for now, however, remains on developing and growing our portfolio of content-rich apps to meet the evolving needs of users. We believe that our deep experience and leading operational capabilities will help us generate more success and penetrate deeper into the 3 content categories going forward.

Here I want to re-emphasize that our priority at this stage is to grow the user base of our content-rich portfolio apps aggressively and further cultivate our content ecosystem. We will continue to adopt this strategy and will make decisions with long-term growth in mind.

One of our strategic goals is to strengthen our advertising business by reducing our dependence on external parties. In the first quarter of last year, we officially launched the CooTek Advertising Platform, our in-house ads network. Throughout April 2020, we were generating over 70% 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 acting CFO Jacky to walk you through our financial results for the quarter. Thank you.

Jacky Lin: 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. All comparisons are on a year-over-year basis unless otherwise stated.

So let's talk about our users first. MAU, monthly active users, for our portfolio products reached 89.2 million in March, which was up 49% from a year ago, mainly because we continued to successfully develop and enlarge our basket of content-rich apps. For example, the MAU of casual games in March were 24.5 million, while it was close to zero from a year ago.

Average DAU, daily active users, for our portfolio products in March reached about 25.2 million, up 9% compared with last year. Within this, the average DAUs of the casual games in March were 2.6 million.

Average DAU of our TouchPal smart input product in March were about 136.5 million, down 6% from last year. MAU were 178.8 million, down 7% from last year.

Total net revenues were $107 million, up 167% from last year. Mobile advertising revenues were $106 million, up about 170% from a year ago.

With total net revenues for the first quarter of 2020, online literature and scenario-based content apps contributed about 66%. Casual games contributed about 32%. TouchPal Smart Input contributed about 0.2%, and TouchPal Phonebook contributed about 1%.

Now turning to expenses, GAAP cost and expenses were about $117 million, an increase of 55% sequentially and up 193% from the same period last year. Non-GAAP cost and expenses were $116 million, an increase of 55% sequentially and an increase of 200% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 108%, it's flat with previous quarter.

Sales and marketing expenses increased by 274% from the same period last year and 61% sequentially. The largest component of these expenses is user acquisition costs.

Currently, we are focusing on the content-rich portfolio strategy. As such, we are investing to expand the user bases of these portfolio products and cultivate content ecosystem. And thanks to our user-insight-driven growth platform, we now have a strong growth momentum with a decent level of ROI and user retention. We are confident that we will be able to maintain fast revenue growth in the coming periods and achieve future profitability.

R&D expenses increased by 19% sequentially and by 3% year-over-year, primarily due to an increase in costs associated with technology R&D staff and share-based compensation expenses.

We ended the quarter with 577 full-time employees, up 7% from last year. R&D employees represent about 61% of the total employees, compared with 63% last year.

G&A expenses increased by 20% sequentially and by 41% year-over-year. The sequential increase was mainly due to a reversal of bad debt provision during last quarter of US$0.6 million. The year-over-year increase was mainly due to an increase in costs associated with the G&A staff and share-based compensation expenses. While nevertheless, G&A expenses, as a percentage to total net revenue, was 3%, decreased from 4% last quarter. And we are keeping expenses under control.

Our gross margin was 95.7%, up from 91.2% during the same period last year and an increase from 94.4% last quarter. The increases are mainly due to the greater economies of scales, as we better utilize our infrastructure.

We had a GAAP net loss of US$9.7 million, which represents a net loss margin of 9.1%. Excluding the effects of stock compensation, our adjusted net loss was approximately US$8.8 million, representing a non-GAAP net loss margin of 8.2%.

As of March 31, 2020, we had cash, cash equivalents and restricted cash of about US$70 million, compared with US$60 million at the end of year 2019.

We had positive operating cash flow this quarter, despite the turbulence of the macro environment. This was primarily because we grew our in-house ads network, which helped us achieve a quicker turnaround of working capital.

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. Until the end of April 30, we had used an aggregate of US$5.8 million to repurchase 1 million ADSs.

And we will early terminate the 2019 Program on May 18, 2020, and take effect a new share repurchase program on the same day. In the new share repurchase program, we are authorized to repurchase up to US$20 million during the 12-month period starting from May 18, 2020. And we expect to fund the repurchases with our existing cash balance.

Turning now to our revenue outlook, we expect total revenue in the second quarter of 2020 to be around US$120 million, representing an increase of 219% year-over-year and 12% quarter-over-quarter. These estimates reflect our current and preliminary view, which is subject to change.

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

Questions and Answers

Operator: We will now begin the question-and-answer session. [Operator Instructions]. Ivy Liu,

Credit Suisse.
Ivy Liu: So my question is what is your current growth strategy and common strategy on your online literature reading app?

Karl Zhang: Thank you. Thank you for your question. So we are very optimistic and passionate about online literature market. So reading is one of the very fundamental contents need, no doubt, and a lot of people enjoy reading books in different categories. So we are actually talking about up to 100 million DAU global market size potentially.

So online literature is not a new segment in mobile internet industry, but we believe by taking advantage of new technology and new growth philosophy, there are opportunities to disrupt this market. And the point is when the existing market is disrupted, the really huge potential of this market will be released, which makes the market that much bigger than ever before.

So I'm not -- maybe I'm not in the right position to comment or judge our competitors, but we believe that we have different growth philosophy and point of view on this market. But our proven sophisticated user-insight-driven growth platform, and together with our in-house ad network, forms a solid foundation of our growth capability.

Our platform and apps are working together as a whole to ensure our competitiveness on ROI, user retention and other key metrics. So the content ecosystem is also a key success factor for online literature market for sure. But we don’t think that it's about the size of the ecosystem, so we are establishing an online literature content ecosystem in very cost-effective way with our growth philosophy to support long-term growth in this content segment. But we have already launched our in-house online literature marketplace to directly work with writers, and help them submitting novels and making money.

And also, as I mentioned, that we see online literature as an enormous global opportunity. So we are incubating our online literature app in multiple countries and regions. We will disclose more detailed information when it's ready. Thank you.

Operator: Was there a follow-up, Ms. Liu?

Ivy Liu: Thank you. The answer is very detailed and helpful. Thank you.

Operator: Thank you. The next question comes from the location of Nelson Chung and Alicia Yap of Citigroup.

Nelson Chung: Congratulations on the solid quarter. I have two questions for management. My first question is for online gaming. Given 2.6 million DAU is around 32% revenue mix, could you share what your rough breakdown of DAU coming from China and overseas market?

Given the global lockdown continues in second quarter, do you think the DAU and revenue for overseas games will increase more meaningfully, or do you think the increase will still come from domestic gaming users? How much of the strong performance of gaming was driven by stay-at-home versus your ability to come out with more interesting games? So do we anticipate the users and gaming revenue for second quarter in China to remain strong despite work resumption?

My second question is regarding the advertising outlook. With the global slowdown coming off from the Covid-19, how do you anticipate the impact to overall online ad budget as it relates to CooTek's platform? Have you seen more cautious budget allocation so far from global advertisers and domestic advertisers? And do you see any shift of the advertising industry category within your ad revenue?

Karl Zhang: Thank you for your question. Let me answer one by one. So the first question is about the online gaming. When you talk about the game business, we are focusing on casual games at this moment because they are more suitable for our advertising business model.

So as of today, we have already released over 10 casual games, and our first wave of successful casual games includes merge games such as Idle Land King Tycoon (嗨收租), and simulation games such as Farm Hero (嗨农场) and puzzle games such as Crazy Painting (开心图图乐), in which we run ads. And in Q1, we extended our success to elimination game by Hamster series, such as Hi Hamster ((嗨仓鼠)).

By leveraging our user-insight-driven growth platform, these casual games delivered better-than-expected ROI and contributed 32% of our total revenue. We do expect the revenue contribution from casual games will continue to increase in the coming quarters.

Although we don’t disclose detail breakdown on user distribution, I'm willing, still willing, to give some general information about these topics; because all of our games have initially released in China market, so most of the DAU for our casual games at this moment is mainly in China region. Besides, we have already rolled out a couple of games to overseas market and we anticipate seeing strong growth in the second half of this year in overseas market confidently.

Actually, I don’t think that our game benefits a lot from the quarantine. With our casual game business in the starting stage from Q2, we started to focus on improving game quality, localization and user retention. So we expect to see improvement in terms of the retention rate and ARPU in Q2, which continue to provide the strong performance of our casual game business. We are very confident on that. Thank you for the question.

And another question is actually about the pandemic. So the pandemic impacted Chinese domestic advertising industry because some of the major advertisers were cutting budgets, which caused the ARPU to be approximately 10% to 15% lower than our expectations, mainly in February and March. And I think the worst case -- the worst time has passed, and the market is recovering, although not that strong, but still recovering. So we expect that the market will return to its normal status in June for China market.

But frankly, this year is not a good year for ad business even without this pandemic in China. It takes time to digest the increasing ad inventory and the relatively weak demand sentiment. And this is about the China market.

And the global advertising industry is pretty much replicating the trend happening in China. So now, the worst panic moments have passed in U.S. ad industry, based on our observations. The budget is recovering, not that strong, but recovering, and eCPM is recovering as well. And I think with the reopen of U.S. and other countries, the market will return to its normal track. I think it's going to be early Q3.

And in terms of the advertiser industry categories, there was no significant change on our platforms, but online games, local services, such as the food delivery service and e-commerce are growing fast, which compensated the strength of other services. Thank you.

Nelson Chung: Thank you.

Operator: Hans Chung, KeyBanc Capital Markets.

Unidentified Analyst: This is Zoe on behalf of Hans. My question is regarding the second quarter guidance. Can you share some color on what's the drivers of the second quarter revenue growth? And how do you see the profitability in second quarter?

Karl Zhang: Thank you for your question, and let me answer this question. So by leveraging our sophisticated growth platform, we replicated our success in 3 content categories already. And we believe that our sophisticated growth platform and our advanced growth philosophy is a key factor to content ad categories today. So it makes us confident on not only Q2, but our long-term growth.

In terms of Q2 specifically, all I can say at this moment is that we are executing pretty well. As I mentioned, that our priority at this stage is to grow the user base of our content portfolio of apps rapidly, and further cultivate our content ecosystem. Meanwhile, we are also optimizing the profitability. With the strong revenue growth and ROI improvement, we expect our percentage of total revenue of sales and marketing expense will decrease about 8% in the second quarter, which drives the profitability much better than Q1, I think. Thank you.

Operator: And was there any follow-up?

Unidentified Analyst: No, thank you.

Operator: Thank you very much. This concludes our question-and-answer session. I would like to turn the conference back over to Christian Arnell for any closing remarks.

Christian Arnell: Thank you. This concludes our call for today. If you have any further questions or comments, please don't hesitate to reach out to the CooTek IR team. Thank you for joining. Have a good day or evening. Goodbye.

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