[CTK] - CooTek (Cayman) Inc.
Third Quarter 2020 Financial Results
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Company Representatives:
Karl Zhang, Chairman, Chief Technology Officer
Robert Cui, Chief Financial Officer
Jessie Jin, Institutional Capital Advisory, Investor Relations

Company Participants:
Hunter Diamond, Diamond Equity Research
Chen Xingguang, Haitong
Nelson Cheung, Citibank
Aaron Ju, Tigress Financial Partners

Presentation

Operator: Good day, and welcome to CooTek's third quarter 2020 unaudited financial 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 Jessie Jin from Institutional Capital Advisory. Please go ahead.

Jessie Jin: 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 Technology Officer, and Mr. Robert Cui, Chief Financial Officer. Mr. Zhang will review business operations and Company highlights, followed by Mr. Cui, 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 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. Thank you, everyone, for joining our third quarter 2020 earnings call. So we are excited to report our third quarter performance where we recorded high year-over-year growth. Total net revenue for the quarter grew 238% year-over-year to US$106 million. Driven by the strategic enhancement of our content ecosystem, we further upgraded and strengthened our core products in delivering the sustainable business growth.

Our online literature business achieved its critical milestone this quarter. Now I'd like to take this opportunity to thank our team for an incredible job. With its daily active users, DAUs in brief, exceeding 10 million and monthly active users, MAUs in brief, close to 30 million during the third quarter of 2020, Fengdu Novel constituted the core component of our content-rich portfolio, with a strong emphasis on balancing its user expansion and long-term user retention by enlarging its customized content resource and introducing multiple functions of its interactive community. We consolidated the market position of Fengdu Novel, which ranked number 3 in terms of MAUs in free online literature market in China with continuous growth in our user base.

We believe that online literature is an enormous market globally, and we have been focusing on building up long-term value. For this quarter, our great efforts on improving both user stickiness and content ecosystem achieved significant results. The average daily reading time per daily active reading user of Fengdu Novel increased from 110 minutes in June to approximately 130 minutes in September.

The 30-day and the 60-day user retention rate also increased by about 4% and about 3% respectively compared to June 2020. The user engagement ratio of Fengdu Novel increased from 29% in June to 34% in September. So our strong growth is a testament to the user stickiness of Fengdu community and its huge potential.

We are also dedicated to further cultivate our content ecosystem by increasing the number of signed writers, which grew to over 2,000 in October. Most of them are very active on our literature platform. The books produced by our signed writers contributed more than 50% of total content consumption both in terms of time spent and revenue.

Our philosophy is to build a customized content production model that establishes the data feedback and matrices between our license and our users, so that the content ecosystem is adaptive to users' ever-evolving company. We 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 possibly write books that will perform well from data perspective and generate more revenue accordingly.

And we are also expanding cooperation with other third-party IP and literature resource platforms to increase our book inventory. In addition, we are dedicated to further increase the scale and the depth of our content resource as further increasing the investment in our content ecosystem.

All these results validated the accessibility and the long-term value of our online literature business. I am very confident that Fengdu Novel can remain as one of the top players in the free online literature market, with strong potential to further upgrade the market position.

At the same time, we have been accumulating the growth momentum for our overseas online literature product, which ranked one of the top apps in the book app category in the U.S. market. The 30-day user retention rate and average user reading time both recorded new highs in the third quarter respectively. The high user stickiness made us believe that it is a very strong opportunity for further improving our competitive edge in the online literature sector globally.

Coming back to our overall business update, our mission is to empower everyone to enjoy relevant content in Fengdu. We have focused our content app strategy in 3 categories, online literature, scenario-based content apps and mobile games.

In terms of user base, total DAUs and MAUs for our content-rich portfolio products were 27.7 million and 94.8 million in September this year, up approximately 16% and 40% year-over-year respectively, mainly due to the increase in DAUs and MAUs of our online literature and overseas casual games products.

We believe that the user data is a key performance indicator of our online literature business, but not the most reliable performance indicator of our scenario-based apps and the mobile casual games business, considering the high number of products with different product cycle and ARPU level in different countries and regions. We decided not to report separately the user data for the scenario-based apps and the mobile casual games business going forward.

Since we realize that mobile casual games is one of the key business segments which we can prove the strong synergy in growing simultaneously with our online literature business in terms of user base and IP layer, we have continued to invest meaningfully since the fourth quarter of last year. Although our gaming products still reflected profitability, we observed the typical volatility in relation to the revenue and ROI performance of certain mobile casual games products closing to the end of their lifetime cycle, which result in the fluctuation compared to the second quarter of 2020.

So we are going to release more competing we are going to release more competing casual games to form the foundation of our games business. And we will gradually reduce the proportion of highly casual game types with shorter product cycles to reduce the impact of revenue and net profit for the group. And we will further strengthen the development of mid-core games, so that the business can serve as a stable source of revenue and net profit for the Group. I am convinced that the execution capability of our team can contribute to the strategy upgrade and growth remediation.

Our scenario-based apps remain one of the stable revenue and net profit contributors since our IPO. We have been successfully streamlining the product mix for key focus on user-oriented products with selected vertical areas as such as sports and fitness. We will further upgrade the function of the products while ensuring the positive ROI level. It is expected that the scenario-based apps will continuously serve as a sustainable growth driver for the revenue and net profit of the Group with reasonable growth.

If I had to use one word to describe our year-to-date performance, it is resilient. Our business development since 2019 shows that we are not afraid to make big changes for the long-term success of our business. We continue to grow and apply our AI and big data technologies to provide the content product to our users.

We built a solid foundation around the global online literature ecosystem. We became one of the leading online reading apps in China. At the same time, our global content-rich apps are experiencing rapid growth. We have been very excited to deliver our regular plan for user growth, content enhancements and technology upgrades.

There will be continuous and proven growth in the business and the financial performance growth of the Group in the next 1 or 2 years. In addition, the quality and the sustainability of the revenue growth will continue to improve.

I never felt more optimistic about the future of CooTek than we do today. We would like to also take this opportunity to thank all our investors who stayed with us.

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

Robert Cui: Thanks, Karl. Hello, everyone. Thanks again for joining us tonight. Despite the growth pressure in global mobile internet advertising market, the Group's net revenues during the third quarter of 2020 were still up 238% year-over-year to US$106 million.

The net revenues are mainly generated from 3 categories of our content-rich apps: online literature, scenario-based content app and casual games. For online literature, which was launched in 2019, it already constituted 34% of our total revenue in the third quarter of 2020. As mentioned, MAUs reached 29.5 million in September 2020 and average DAUs already exceeded 10 million in September 2020. That is a very significant increase from a year ago.

Fengdu Novel, the core product, ranked one of the top 3 players in terms of MAUs for free online literature products, according to Quest Mobile, in the Chinese market. We have been seeing the rapid growth of the user base of the product, and we are expecting a continued growth in the coming years.

Casual games and scenario-based content apps accounted for about 41% and 24% of total revenue in the third quarter of 2020 respectively. They continue to generate considerable revenue and stable profits to our business.

Now turning to expenses, GAAP cost and expenses were about US$128 million, up 3% sequentially and up 168% year-over-year. Non-GAAP cost and expenses were US$126 million, up 3% sequentially and up 170% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 119%, up from 97% in the second quarter 2020.

Sales and marketing expenses increased by 222% from the same period last year and 2% sequentially. The largest component of these expenses is the 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 18% year-over-year and by 1% sequentially, primarily due to an increase in costs associated with technology R&D staff and share-based compensation expenses. We ended the quarter with 720 full-time employees, up 40% year-over-year. R&D employees represent about 60% of our total employees, compared with 63% last year.

G&A expenses decreased by 10% sequentially and increased by 9% compared with the same period last year. The sequential decrease was mainly due to the reversal of accrued provision for bad debts on the collection of accounts receivables. The year-over-year increase was mainly due to an increase in costs associated with G&A staff and share-based compensation expenses. G&A expenses, as a percentage to total net revenue, were 4%, up from 3% last quarter. We are keeping expenses under control.

Gross margin was 93.6%, up from 87.5% during the same period last year and a slight decrease from 95.5% last quarter. The increases are mainly due to greater economies of scale, as we better utilize our infrastructure, and partially offset by the increase in content cost.

GAAP net loss was US$22 million. Excluding the effects of stock compensation, adjusted net loss was approximately US$20.5 million.

As of September 30, 2020, we had cash, cash equivalents and restricted cash of about US$61 million, compared with US$60 million at the end of year 2019. Net cash outflow from operating activities during the third quarter of 2020 was US$14.4 million, mainly due to loss from operations.

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 September 30, 2020, we had used an aggregate of US$3.3 million to repurchase 0.5 million ADSs.

Turning now to our revenue outlook, we expect total revenue in the fourth quarter of 2020 to be around US$106 million, representing an increase of around 54% year-over-year. For the full year of 2020, we expect total revenue to be around US$445 million, representing an increase of around 150% 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). Hunter Diamond of Diamond Equity Research.

Hunter Diamond: Congratulations on the very strong quarter in this tough environment. So with the new lockdown returning, at least in the U.S., in the fourth quarter, how do you anticipate the impact to the overall online ad budget affecting the platform in China and the global market? And can you disclose roughly the amount of revenues brought by advertisers in China and then the overseas market?

Robert Cui: Okay. I will take the first question. We have seen a growth pressure obviously in the online advertising market both in Chinese and overseas regions. According to Quest Mobile, the market size of the Chinese internet advertising market in 2020 is projected to be RMB528 billion, with a year-on-year growth of 12.4%, which is lower actually than the year-on-year growth of 14.8% in 2019. Also global internet advertising will remain flat with a small decline of 0.1% in 2020, as the overall global advertising market is expected to decline by at least 7.4% per Omdia, a technology research company. But at the same time, we also witnessed some positive development, in particular, in the Chinese markets.

On the internet advertising market size, it has restored growth since Q2 2020 despite the negative trend in the third quarter of 2020 due to the coronavirus pandemic. As China is one of the few countries with good control of the pandemic, and the overall economy has resumed growth, we expect that the advertising market will also gain growth momentum in 2021, which will be beneficial for supporting our business growth.

In relation to our own platform, we have a similar observation in relation to the advertising inventory and eCPM. We believe that our content-driven model with high user spending time will still be very competitive for attracting relevant advertisers. For the overseas market, we remain more cautious. Given our current advertising revenue mainly comes from the Chinese markets with a percentage more than 90%, we will also be more resilient to the growth pressure in the global internet advertising market.

Hunter Diamond: Great. Thank you very much for the additional details. So my second question is the Company obviously is targeting the global online literature market and plans to launch apps overseas. Can you just give us some color and details on the prospects of expanding overseas, how you expect that contributing to daily active users and top line growth?

Karl Zhang: Well, I will take this one. So yes, we have been incubating our online literature apps for global market, especially for English-speaking countries as the first steps since early this year. So during the past couple of quarters, we have validated that our growth model and our philosophy of cultivating content ecosystem, which have been validated on Fengdu Novel in China domestic market, work pretty well in global market as well.

So what's more, we found that the entire book publishing industry is more traditional compared to the Chinese market. So we believe that by introducing AI and data-driven technology and philosophy to cultivate the content ecosystem, we have the opportunity to reshape the industry globally. And we have attracted a lot of U.S. local writers and assigned a lot of English native books and the community has formed.

At the same time, we have been accumulating the growth momentum for our overseas online literature products, which ranked as one of the top apps in the book category app ranking in the U.S. market on both App Store and Google Play. And the 30 days user retention rate and average user reading time both recorded new high in the third quarter respectively. The average ARPU of our online literature app in U.S. market is higher than Fengdu in Chinese market.

The high user stickiness made us believe that it is a very strong opportunity for further improving our competitive edge in the online literature sector globally. And now we are tweaking its ROI, and considering the long-term value and the potential to bringing multiple monetization models, we think that global market deserves more investment in both short-term and long-term. Thank you.

Hunter Diamond: Great. Thank you for taking the questions and the additional details. And again, congratulations on the strong quarter.

Operator: Chen Xingguang of Haitong.

Chen Xingguang: (Speaking foreign language).

Jessie Jin: So this is Jessie speaking. I will briefly translate the questions from Xingguang. So the first question is regarding the growth strategy and competitive edge between Fengdu and Toutiao (Bytedance). What are the advantages of Fengdu that you would like to elaborate?

And the second question is regarding the regulations in Chinese market. What would you say regarding your AI strategy? And there has been some technological issues, strategies within your core products. How would you like to work around the regulations and to further improve the growth?

And the third question is regarding the future, the outlook and further future positioning of your casual game products.

Karl Zhang: Okay. I am going to take all the three questions. The first question is about the core competency of our Fengdu Novel and how we compete with our competitors. I am 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. So at this stage, we are maintaining first-year user retention rate among all the competitors. That is the user stickiness of Fengdu Novel is competitive and seem very strong.

For long term, as it is a typical content app, we are actually spending a lot of our efforts to cultivate our differentiated writer ecosystem. Our philosophy is to build a customized content production model that establish the data feedback and metrics between our writers and readers, so that the content ecosystem is adaptive to users as the evolving companies. For example, when we established our ecosystem, we think more about how to enable our science writers with AI-enabled data platform and metrics.

And 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 ads based on proper data metrics, so that even an average writer could possibly write books that will perform well from data perspective and generate more revenue accordingly. So instead of focusing on quantity of our books, we focus more on quality. The books produced by our science writers contributed more than 50% of total consumption both in terms of time spent and revenue.

And online literature is an enormous market globally, and such kind of market has never been dominated by any single player simply because of users' diverse and ever-evolving companies and the existing huge writer base. We are confident to sustain the growth momentum in China market and at the same time, explore the global opportunity.

And the second question is about the regulation, so it is a good question. I think to make our online literature business sound and sustainable, it's very important to compliance with evolving regulations. To ensure this, we established and added a team and at the same time, we introduced technology solutions to reveal and filter our content from the very beginning. And thanks to our customized content production model, it is much easier for us to ensure the compliance of our content because we control the entire ecosystem.

And the third question is about the game business. we launched our first mobile casual game in the fourth quarter of last year. As I mentioned that the mobile game business has very strong synergy with online literature business in terms of user base and IP layer. Thanks to the rapid growth of our online literature business, mobile game business has benefited and achieved significant growth in this year. But anyway, our mobile game business has only 1-year history, so it is still in its early stage. Although our game product still reflected profitability, we observed the typical volatility in relation to the revenue and online performance of certain mobile casual game products closing to the end of their lifetime cycle, which results in the fluctuation compared to the second quarter of 2020.

And firstly, we will expand our success on casual game by developing and releasing more competing casual games to form foundation of our game business, so as to reduce the impact of revenue and net profit for the Group. And secondly, we are incubating some new concept casual game, which has relatively longer lifetime and improved user stickiness. At the same time, we will further strengthen the development of mid-core games, so that the business can serve as a stable source of revenue and net profit for the Group. Thank you.

Operator: And was there a follow-up, Mr. Chen? Okay. We will go to the next question, that is from Nelson Cheung from Citi.

Nelson Cheung: This is Nelson Cheung from Citi asking on behalf of Alicia. Two questions -- first, regarding your guidance, could you elaborate more on the flattish revenue guidance implied for fourth quarter? Is that mainly due to seasonality or weakness in gaming or novel? And what should we think about the first quarter 2021 trend and overall 2021 outlook?

And my second question is on the selling and marketing spending because it seems like this quarter, the spending is a bit higher than expected. Can management explain the reason behind it? Is it due to the user retention or the channel for user acquisition is not that effective? How should we think about selling and marketing dollars in next quarter and going forward?

Robert Cui: Okay. Thank you, Nelson. I will take these two questions. The first one regarding the revenue guidance, the revenue guidance for Q4 this year is reflecting mainly the restructuring of our game product portfolio, targeting that, building a more balanced pipeline to avoid further volatility in relation to the revenue, to the overall revenue. Given it will not have imminent effect for supporting our total revenue, we believe that the Q4 revenue will be flat compared to Q3 revenue. But at the same time, our online literature business will continue to grow in terms of user base and ARPU. So it will also have a larger revenue contribution in Q4 compared to Q3 as well.

For the overall 2021 trend, we expect a continuously solid and high growth rate for our online literature business. The scenario-based content apps business will grow stably, and the casual game business will start to regain the growth momentum. So for the total revenue, we still forecast more than around 30% to 40% year-over-year growth in 2021 with the key growth driver of our online literature business.

The second question regarding the sales and marketing spend, it’s true that the sales and marketing expenses, as a percentage of revenue in Q3, was higher than Q2, given our revenue slightly decreased compared to Q2. But actually, the exact number of the sales and marketing expense was pretty much the same. And the user acquisition costs remained as the key component of the sales and marketing expense. In particular, the CPA in Q3 has been increasing due to the competition of online education and gaming products for the mobile internet traffic in the Chinese market. We do expect similar situation in Q4.

But going forward, we expect that the sales and marketing expenses will decrease stably as a percentage of revenue in the coming quarters with our continued and increased investment in the content resource on our platform, which will help increase the user retention rates for our existing users and also the user acquisition efficiency for our new users. Thank you.

Nelson Cheung: Thank you.

Operator: Aaron Ju of Tigress Financial Partners.

Aaron Ju: So I have a question also regarding the Fengdu Novel. The life in China is basically go back to normal, and we still see the DAU and the user reading time of Fengdu Novel continue to grow very well sequentially as [opposed] to the Covid in China. So could you please elaborate what are the main reasons to drive this growth? And is there any guidance on the DAU, ARPU and retention rate for the next year on the Fengdu Novel?

Robert Cui: Yes, thank you, Aaron. I will take this question as well. Yes, in relation to the key reason of the continuous growth in our average daily reading time for active users in the third quarter, it is mainly due to our continuous enhancement and upgrade of our content resource within our platform because we continue to invest in this area by leveraging our core competency in the science writers' platform and also by increasing the continuous input of our partners' third-party IT contributors.

So at the same time, in the coming quarters, we are still dedicated to further upgrade our content ecosystem by further investing in this area. So we believe there is still significant potential in further increasing the average reading time, or spending time on our platform for our Fengdu Novel users in particular for our existing users. And at the same time, we are, as you have seen, we are continuing to invest in the users’ acquisition.

In relation to the key data guidance, so you have seen that after the pandemic in Q1 2020 in China, between March and October 2020, the DAUs of Fengdu Novel has continued to increase from 7 million to 10 million, and in particular, the user retention rate and also the long-term user retention rate has improved rapidly. The 7-day user retention rate increased by about 12%; the 30-days user retention rate increased by about 10%; and the 60-days user retention rate increased by about 7%. So it is all in a very good direction in relation to further increasing our user stickiness.

On the ARPU side, it was slightly higher during the pandemic period in China in Q1 this year, given there is longer user spending time during the lockdown period. And also due to our continuous efforts in improving the user experience by limiting a certain kind of app strategy is that we have slightly lower ARPU in Q2 and Q3 this year compared to Q1 this year. But we still believe that the ARPU will start to regain the growth momentum in the coming quarters with, first of all, the diversification of our revenue stream on the Fengdu platform and also the improvement of our overall advertising strategy.

For 2021, our target for the DAUs will still be a high growth, so up to 60% or 70% growth compared to the DAUs at the current level. And also we aim to deliver obviously higher ARPU returning to or even higher level compared to the Q1 pandemic period, and also the continuous improvement in the user retention rates with 30-days retention rates and 60-days retention rates, aiming at delivering continuously competitive levels in the coming quarters. Thank you.

Aaron Ju: Thank you.

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

Jessie Jin: Okay. Thank you, operator. In closing, on behalf of the entire management team of CooTek, we'd like to thank you again for joining this conference call tonight. If you have any further inquiries in the future, please feel free to contact us at ir@cootek.com or at cootek@icaasia.com. Thank you.

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