[CTK] - CooTek (Cayman) Inc.
Q4 and Fiscal Year 2020 Unaudited Financial Results
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Company Representatives:
 Jessie Jin, Investor Relations, ICA (Institutional Capital Advisory)
 Karl Zhang, CooTek Inc., Chairman, Chief Technology Officer
 Robert Cui, CooTek Inc., Chief Financial Officer

Company Participants:
 Vicky Wei, Citi
 Hunter Diamond, Diamond Equity Research
 Aaron Ju, Tigress Financial Partners
 Steve Silver, Argus Research

Presentation

Operator: Good day, and welcome to CooTek's Fourth Quarter and Fiscal Year 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 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 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.

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 and full year 2020 earnings call. We are pleased to conclude the year of 2020 with our revenue reaching US$442 million representing the growth of 148% compared to 2019. Since our IPO in 2018, our annual revenue grew approximately 80% from US$134 million.

We executed our strategic roadmap to expand our content app portfolio and cultivate the global pan-entertainment content ecosystem firmly. While keeping the scale of our scenario-based content apps since our IPO, we successfully developed our online literature and casual games business from scratch, which respectively contributed 38% and 37% to the total revenue in 2020. We are delighted to announce these results and feel very confident on our future growth. Based on our current estimates, we expect 2021 full year revenue will continue to grow steadily.

I would like to say that it has been a solid year for the company in 2020. Our mission is to empower everyone to enjoy relevant content seamlessly. We have focused our content app strategy in 3 pillars: online literature, scenario-based content apps and casual games. In terms of user base, the DAUs and MAUs of our portfolio products reached 27.8 million and 85.8 million in December 2020 with the continuous improvement of the user engagement ratio.

Firstly, let me address specifically on the recap of our online literature business. In particular for Fengdu Novel, our core online literature product, which consistently ranked the number 3 in terms of MAUs in the free online literature market in China in 2020, we have enriched our content resource by increasing efficiently the number of the signed authors and the third-party content partners targeting at further improving the user stickiness.

We are encouraged to see the positive indicators of the intensified Fengdu Novel community. The average daily reading time per daily active user exceeded 130 minutes in December 2020. We actually saw further increase of average daily reading time in January and February 2021. The monthly new user retention rate from the 1st month to the 12th month also increased steadily in 2020.

Our philosophy is to build a customized content production model that establishes the data feedback and matrices between our signed authors and readers, so that the content ecosystem is adaptive to users' ever-evolving content preferences. We launched Fengdu Literature Platform to develop our original content ecosystem at the end of 2019. Since December 2019, Fengdu Literature Platform has accumulated around 3,000 signed authors and 3,600 original contract books. Compared to licensed books, the books produced by our signed authors obtained more than 50% of total reading time of Fengdu's readers and total revenue.

Fengdu Literature Platform is deemed as diverse in category, covering 13 major categories of male and female preferred content. More than 70% of content focus on gender specialized stories in urban context and ancient romance.

In addition, we are actively diversifying our IP business based on the original books from Fengdu Literature Platform. We developed Fengdu Audiobook, a new feature incorporated in Fengdu Novel app to meet the evolving needs of readers. More than 2,000 audible books are available on the platform.

We also created short video series based on Fengdu Literature Platform content and IP resources. The first short video drama series named The Proud Wanwan Su, produced from content on Fengdu Literature Platform, is based on a piece of literature with a substantial and exciting storyline. The video series is divided into 20 episodes with a running time of 2 or 3 minutes for each. The short drama has been redistributed on major short video sites such as Douyin, the Chinese version of TikTok, and Kuaishou, Bilibili and Xigua Video, among others, and can be watched by searching FengDu Theater.

At the same time, we have also advanced our monetization capabilities to create additional growth momentum for the group. Although the Average Revenue Per User, ARPU in short, incurred volatility with the overall internet advertising market, we still delivered satisfactory return on investment. As a result, the DAUs and the revenues of Fengdu Novel recorded significant year-over-year growth of 106% and 360% in 2020.

In addition, we achieved significant milestone in the development of our overseas online literature business. The product consistently ranks as one of the top apps in the Book Category in the U.S. with MAUs close to 1 million.

We have also seen the stable improvement of the monthly new user retention rate. Guided by our unique content acquisition strategy, we have successfully secured the contract with a series of best-selling authors, and the content inventory reached 1,000 books after just 1 year's operation. We are even more confident to strengthen our competitive edge in the global online literature or even publishing market.

Secondly, for our mobile games business, we also delivered rapid growth in 2020 which contributed to the revenue and profitability of the group. As a highly synergetic business to online literature, we have successfully self-developed and self-distributed more than 20 casual games. They typically reflected high ROI but shorter product cycles, which illustrated the rationale of optimizing our games product pipeline.

We are strived to upgrade our strategy by investing and partnering with other experienced studios and teams for delivering a more diversified product portfolio with casual games and mid-

core games. We are still convinced that the business can serve as a stable source of revenue and profitability for the Group.

Thirdly, as the vibrant business segment since our IPO, the scenario-based content apps have been further streamlined and upgraded. We have focused on selected verticals such as sports and fitness, but also developed new products. The key priority of this business is to maintain the ROI and to serve as a strong foundation of the growth of the Group.

As we move forward in 2021, our strategy remains stable. We will continue to cultivate the global pan-entertainment content ecosystem and focus on the 3 synergized pillars: online literature, mobile game and scenario-based content apps.

Our key strategic initiatives will be, one, growing Fengdu Novel by providing the interactive and quality user experience and cultivating an engaging and attractive community; two, optimizing our casual games products by strengthening internal development and third-party investment and partnership; three, intensifying the overseas market expansion with our core strength built in the online literature segment; four, upgrading our monetization capabilities by exploring user paid content, e-commerce and IP asset adaptation.

We strongly believe that we can further improve our business model with a more balanced approach by delivering revenue growth and achieving profitability. We are excited to deliver the robust performance and maximize our long-term shareholder value.

With that, I will hand the call to Robert, our CFO, 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. As mentioned, our firm strategy of the pan-entertainment content ecosystem has been demonstrated by our robust growth in our user base and revenue in 2020. As our business scale reached a new high on a yearly basis, we are confident that our commitment will further contribute to the continuous enhancement of our product portfolio.

I'm going to brief you our fourth quarter and full year of 2020. To start with the fourth quarter, net revenue was US$102.4 million, an increase of 48% from US$69 million during the same period last year. The net revenues are mainly generated from 3 categories of our content-rich apps: Online literature accounted for approximately 47%; scenario-based content apps accounted for approximately 24%; and casual games accounted for approximately 28% of the total net revenue.

For online literature business, we are excited to report that our Fengdu Novel delivered solid business growth in the fourth quarter of 2020 with the sequential Average Revenue Per User, ARPU, growth of 22% and revenue growth of 28% reflecting the upgraded monetization strategy.

The average DAUs of the Company's portfolio products were 27.8 million, an increase of 13% from 24.7 million in December 2019. MAUs of the Company's portfolio products were 85.8 million, an increase of 15% from 74.6 million in December 2019.

Our gross profit margin was 93.1%, compared with 94.4% in the same period last year and 93.6% last quarter.

GAAP cost and expenses were about US$121.5 million, a decrease of 5% sequentially and up 62% from the same period last year. Non-GAAP cost and expenses were US$120 million, a decrease of 5% sequentially and an increase of 60% year-over-year. As a percentage of revenue, non-GAAP cost and expenses accounted for 117%, down from 119% in previous quarter. The decrease in operational expenditures were mainly due to the sales and marketing expenses.

Sales and marketing expenses increased by 61% from the same period last year, and a decrease of 5% from last quarter. The largest component of these expenses is the user acquisition costs, which is in line with the overall expansion of our content-related business.

R&D expenses increased by 14% year-over-year and decreased by 21% sequentially, primarily consist of costs associated with technology R&D staff and share-based compensation expenses. We ended the quarter with 759 full-time employees, up 37% from last year and up 5% from last quarter. R&D employees represented about 60% of the total employees, the same as last quarter, and compared with 63% last year.

G&A expenses increased by 41% year-over-year and 4% sequentially. The sequential and year-over-year increases were mainly due to an increase in costs associated with G&A staff and share-based compensation.

GAAP net loss was US$18.8 million. Excluding the effects of stock compensation, adjusted net loss was approximately US$22 million.

I will now quickly run through a few key full year 2020 financial results. Further details can be found in the earnings release.

Net revenue was US$441.5 million, an increase of 148% from US$177.9 million in 2019. As a full year basis, online literature accounted for approximately 38%; scenario-based content apps accounted for approximately 24%; and casual games accounted for approximately 37% of the total net revenue.

Gross margin was 94.5%, compared with 91.4% in 2019.

Total cost and operating expenses were US$489.4 million, an increase of 128% from US$214.6 million in 2019.

Sales and marketing expenses were US$418.3 million, an increase of 166% from US$157 million in 2019. As a percentage of total net revenue, sales and marketing expenses accounted for 95%, an increase from 88% in 2019, primarily due to increased investment in user acquisition.

R&D expenses were US$29.7 million, an increase of 10% from US$26.9 million in 2019, mainly due to an increase in costs associated with technology R&D staff. As a percentage of total net revenue, R&D expenses accounted for 7%, decreasing from 15% in 2019.

G&A expenses were US$15 million, a decrease of 8% from US$16.3 million in 2019, primarily due to accrued bad debt provision of US$0.4 million in 2020, a decrease by US$3.7 million from US$4.1 million in 2019, and was partially offset by an increase in professional expenses and an increase in costs associated with G&A staff and share-based compensation expenses. As a percentage of total net revenue, G&A expenses accounted for 3%, decreasing from 9% in 2019.

Net loss was US$47.4 million, compared with net loss of US$36.8 million in 2019. Adjusted net loss was US$42 million in 2020, compared with adjusted net loss of US$33.2 million in 2019.

At the end of year 2020, we had cash, cash equivalents and restricted cash of about US$49.6 million, compared with US$60 million at the end of 2019.

On May the 18th, 2020, we announced a share repurchase program, the 2020 Program, where we are authorized to repurchase our Class A ordinary shares in the form of ADSs with an aggregate value of up to US$20 million during the 12-month period starting from May the 18th, 2020. We expect to fund the repurchases under this program with existing cash balance. As of end of year 2020, we had used an aggregate of US$4.7 million to repurchase 0.9 million ADSs under the 2020 Program and recorded as treasury stock.

For the first quarter of 2021, we expect total revenue to be about US$80 million. This outlook is based on information available as of the date of this press release and conference call, and reflects the Company's current and preliminary expectations, which are subject to change in light of various uncertainties, including those related to the ongoing COVID-19 pandemic.

Looking at the overall 2021, we are committed to further execute our well-structured dedicated growth plan focused on continuously delivering the revenue growth and steadily achieving profitability. At the same time, we are also committed to deliver a balanced financial approach by improving the overall operating leverage.

Operator, we are now ready to take questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Vicky Wei from Citi.

Vicky Wei: This is Vicky Wei on behalf of Alicia Yap, and we've got 3 questions here. So can management comment on latest competition landscape for online reading market? What is the latest market share of Fengdu and do you have any market share target to achieve?

Our second question is what type of content creators are typically on the platform? What are the main differentiation of these content creators versus competitors?

And our third question is what is the company's sales and marketing spend target and overall user acquisition price?

Karl Zhang: Thank you, Vicky, for your questions. Let me answer the first 2 questions and I will hand over to Robert to answer the last question. So in terms of the competitive landscape of free reading market, I separate this question into 2 regions; the China domestic market and the overseas market.

So in China domestic market, Fengdu Novel raised from scratch within 2 years period, and it remains the number 3 position of free literature market under the market competition. So now

our focus is more on cultivating our unique content ecosystem to build up a competition barrier and sustained long-term growth. So we believe that the competition is long-run and the content ecosystem is the core to win the game eventually.

As for the overseas market, we are a pioneer of free reading model. So thanks to the strong global content app experience, our long-term goal is to become the number one online literature community in multiple countries.

Now let's talk about Fengdu Literature Platform. So since December 2019, Fengdu Literature Platform has accumulated around 3,000 signed authors and 3,600 original content contract books. So compared to license books, the books produced by our signed authors obtained more than 50% of total reading time of Fengdu readers and total revenue.

Fengdu Literature Platform is deemed as diverse in category, so covering 13 major categories of male and female preferred content. So compared to other platform, more than 70% of content's focus are gender-specialized stories in urban context and Asian romance. So besides we are not only focusing on traditional online book formats which are usually long to over 1 million words, but also cultivating middle length format stories. So these specialized stories we are bringing our community diverse user base and provides our users different content to enjoy. Thank you.

Robert Cui: Okay. So for the third question on the sales and marketing spend targets, so as we have seen, we have invested in the customer or user acquisition, given we have started to build our online literature and casual games business since the fourth quarter of 2019. And we are encouraged to see we have achieved important milestones with our user base and revenue reaching new highs. But as a result, our sales and marketing expenses as of revenue indeed increased from about 60% in 2018 to 95% in 2020.

As a key component of our growth strategy, we have also been committed to optimize the cost and expense structure, targeting and moving forward toward profitability. So there are several important initiatives in relation to this strategy. So first, we have been launching diversified and innovative marketing campaigns to improve the efficiency of the new user acquisition.

Second, with the enrichment of our content resource on our online literature platform, we have seen stable improvement of the user retention rates, which then contribute to the marginal reduction of the sales and marketing expenses in relation to the management of the existing users.

And at the same time, we are also diversifying the monetization strategy for our online literature products with paid content, e-commerce and IP adaptation, which will support the growth of the ARPU and ROI.

And third, we have also been striving to increase the ROI for our casual games products and to diversify the pipeline. Given the casual games business represent higher ARPU and shorter investment return period, the contribution from all the performing products can also help increase the operating efficiency.

So with all these efforts, we are convinced that we have steadily implemented this balanced approach of achieving user base and revenue growth, and at the same time, the Group level profitability.

So to summarize, we forecast a stable reduction of the sales and marketing expense as of revenue for the percentage in the coming quarters. And on a yearly basis, the sales and the marketing expenses as of revenue is expected to decrease by 10% to 15% in 2021, while keeping the growth momentum of our user base and revenue so -- and we are confident in delivering this operating leverage. Thank you.

Vicky Wei: Thank you.

Operator: Hunter Diamond from Diamond Equity Research.

Hunter Diamond: Firstly, congratulations on the strong earnings. So we want to just get an update on your strategy for expanding the overseas market, whatever additional information you can tell us on that approach.

Karl Zhang: Okay. So I'm going to take this question. So yes, we will stick with our mission to empower everyone to enjoy relevant content. So in 2021, we will continue to grow our overseas market business with priorities. So we believe global online literature is a tremendous opportunity for us. So by leveraging our AI and big data technology, we get a chance to improve the efficiency and precision of long reading content production and the distribution process, not only in China domestic market, but overseas market as well.

We were focused on English-speaking countries as the first step to reach this goal. So we will strive to cultivate local content ecosystem, so cooperating with local content partners and enabling local authors with our AI technology are our priorities. So at the same time, we are expanding our mobile game business to the overseas market as well. So we have already launched nearly 10 mobile games to overseas market and have achieved success for most of them.

So we are exploring the synergy between online literature and mobile game business in overseas market. So the strategic goal is to establish a strong synergy to connect online literature and mobile game business, just as what we are really realized with Fengdu Novel and mobile games in China domestic market. Thank you.

Hunter Diamond: Great, thank you for the additional information on the approach. Our next question was obviously, global mobile content is experiencing very high growth in 2020 or 2021 as well, given COVID-19 stimulated demands for entertainment-based applications. So we wanted to see your expectations on the outlook for the company and the industry in the post-pandemic period. And what measures will CooTek take to maintain the level of growth it's seeing after COVID-19?

Karl Zhang: Yes, so we are optimistic on the long-term growth of global mobile content industry, especially entertainment-based apps in the post-pandemic period. So if we look at the time spend distribution on mobile devices of global users, most of users' time is spent on entertainment-based apps today. But if we look at the total time spent on mobile devices of global users, we find that the growth rates of total time spent on mobile devices is mixed.

So in some developed countries, the growth rate is declining, but in emerging countries, it's increasing significantly. So that is, in developed countries, time spent dividend is disappearing and the apps are competing for users' attention. So that brings the opportunity for companies who

focus on cultivating healthy and the quality content ecosystem and improving content efficiently and precision.

So we strive to innovate on both AI technology and the business model to cultivate our content ecosystem, grow and monetize our user base effectively and develop our user community. So we believe the measures will drive our continuous growth. Thank you.

Hunter Diamond: Great. I appreciate the additional information on the strategy. So again, congratulations on the earnings.

Operator: Aaron Ju from Tigress Financial Partners

Aaron Ju: So I have 2 questions. The first question is regarding the Q1 revenue guidance. So what's the main reasons for these (inaudible) as they would be the flattish Q1 revenue guidance?

And the second question is regarding the online literature business in China. So how do you see the current trend of the online literature business in China? And what is the total addressable market for this business in China?

Robert Cui: Okay. Yes, thank you. So I will answer the first question and Karl will answer the second question. For the first quarter 2021 guidance is based on our current estimates. Obviously, it's in line with the seasonality in relation to the domestic online advertising market, in particular, in the Chinese market and the relevant monetization strategy upgrade of our portfolio of products, in particular, for the online literature and mobile games business.

But as a general reminder, we still -- or we are committed to further or continuously deliver growth for the full year revenue user base and for the steadily achievement of the profitability for the coming year. So this is based on the current estimates and our internal management plan for -- given this quarterly guidance.

Karl Zhang: And yes, in terms of the online literature market in China and the global market, so to us, we think that the online literature business, especially the free online literature market, is new area which has tremendous opportunity for us. So we released the Fengdu Novel in 2019 and in a very short period, we've grown the user base to be over 10 million DAUs, so which means that so we actually benefit from the great potential of the market.

And we also believe that the global online literature is a tremendous opportunity for us as well so because long-reading content is a fundamental content need for global users. But the traditional online publishing industry cannot meet users' ever-evolving needs. So by leveraging our AI and big data technology, we get the chance to improve the efficiency and precision of long-reading content production and the distribution process.

So for example, we introduced AI Assistant and the big data technology on Fengdu Literature Platform to establish data feedback loop, which enables our signed authors deep understand the performance of their books, and help them to consistently improve their art. The same thing happened on our global online literature app for English-speaking countries, especially U.S.

So we strive to innovate on both AI technology and the business model to cultivate our content ecosystem, grow and monetize our user base effectively and develop our user community. And so we believe that such innovations on both AI technology and the business model will drive

continuous growth. So in addition, as I mentioned, we believe online literature is a tremendous opportunity globally. So we will actively expand our user base not only in China, but also overseas market to drive growth.

Aaron Ju: Thank you.

Operator: Steve Silver from Argus.

Steve Silver: Congratulations as well on the strong revenue growth and user metrics, very impressive year. Most of my questions have been answered, but I did have one remaining. You guys mentioned the share buyback status as of December 31. I was just curious if you had any color that you could provide as to your current thinking on accessing the program, given the downturn in technology stocks toward the end of the first quarter?

Robert Cui: Okay. Thank you. I will take this question. So as mentioned, as of December 31, 2020, so we have repurchased the US$4.7 million worth of shares. And as a general rule, we will monitor the market and the stock price for evaluating further the plan and the potential next step. But as always, we have higher priority for the business growth and we'll be founded for delivering the long-term value for our shareholders.

So it is really subject to our imminent monitoring of the market and the stock price. And we don't have additional details to be disclosed at current stage.

Steve Silver: Okay, great. Thank you. And congratulations again.

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

Jessie Jin: Thank you, operator. In closing, on behalf of the entire management team of CooTek, we would 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 cootek@icaasia.com. Thank you.

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