

[CTK] - CooTek (Cayman) Inc.
Q1 2021 Unaudited Financial Results
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Company Representatives:

Claire Yung, Investor Relations, ICA (Institutional Capital Advisory)
Karl Zhang, CooTek Inc., Chairman, Chief Technology Officer
Robert Cui, CooTek Inc., Chief Financial Officer

Company Participants:

Nelson Cheung, Citi
Steve Silver, Argus Research
Vivian Zhang, Diamond Equity Research
Ken Gao, Tigress Financial Partners

Presentation

Operator: Good day, and welcome to CooTek's First Quarter 2021 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.

Claire Yung: 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 first quarter 2021 earnings call. We have reported our first quarter 2021 results with revenue of US\$81.6 million, which was a bit higher than our previous guidance. After the rapid revenue growth in 2020, we have been committed to implementing a balanced approach in consolidating our business fundamental. We are confident that the current focused strategy will result in a robust and a profitable business model targeting at a sustainable growth. We expect that the second quarter revenue will be around US\$83 million with a significantly improved bottom line towards profitability.

Firstly, let me still address specifically on the recap of our online literature business.

For Fengdu Novel, our free online literature product in the Chinese market, we have been upgrading the business model with a strong focus on improving user retention rate and ROI.

By leveraging our continued investment in the content resource with our original content platform, Fengdu's Literature Platform, we have continued to enrich the scale and depth of our content ecosystem. As of May 2021, the number of signed authors increased to more than 4,100. Fengdu Literature Platform currently covers 25 major categories of male and female-preferred contents. Besides urban context and ancient romance, modern romance and fantasy are the newly-emerged popular categories.

On the other side, Fengdu Novel has expanded cooperation agreements with well-known corporate partners such as Tadu Literature, YY Novel and Ali Literature, and others. For example, Li Hu, also known as Heavenly Silkworm Potato, a popular online literature author, officially published his new fantasy book, King of All Xiang. Fengdu Novel was the first online literature platform to debut this new book on April 10, 2021.

We have been intensifying the community-driven approach for Fengdu Novel. The average daily reading time per daily active user further grew to approximately 148 minutes in March 2021. The average 30-day new user retention rate of March 2021 increased by 15% than that of December 2020, and the average 90-day new user retention rate of March 2021 increased by 20% than that of December 2020, which also contributed to the steady growth of lifetime value of users on our

platform.

As a result, the operational efficiency further strengthened in the first quarter of 2021. We are encouraged to see the expectation of achieving profitability for Fengdu Novel while keeping a solid and sizable user base.

In addition, our overseas online literature product consistently recorded MAUs close to 1 million. The content inventory exceeded 1,300 books in March 2021 with continuous improvement of the new user retention rate. We are dedicated to gain more market share in the U.S. and the overall global online literature market.

Secondly, we also upgraded our mobile games portfolio and pipeline both in the domestic and overseas markets through internal developments and external investments and partnerships. The revenue and net profit contributed by mobile games business returned to quarter-over-quarter growth. We maintained our strong focus on game types with higher ROI and longer product cycles.

Catwalk Beauty, a casual game designed and released in the global market by our invested game studio, recently reached #1 in the U.S. and other 57 countries and regions on App Store and Google Play Games section.

The success of Catwalk Beauty in the global market stemmed from our R&D capability in gaming and experience in localized operations in the global market. We drove the whole process of the incubation of Catwalk Beauty, from the creation to the development and its final debut.

In addition to the creative gameplay, localized UI design is the crucial factor to the game's outstanding performance. We have brought an enhanced entertainment experience to its users through expertise in game innovation and development.

Catwalk Beauty has attracted a group of loyal fans internationally. We notice that they actively share their game among their friends, taking videos and share to YouTube. The popularity signifies those mobile games developed by us are gaining more market share in the global market.

Looking forward, through a holistic incubation mechanism, which fuels rapid iteration and innovation, we are confident in achieving a large-scale game production and growing exponentially in the global market.

We have further cooperated with third-party content producer partners in the mobile game industry to accelerate the growth of our mobile game business by producing and publishing more high-quality mobile games. We recently invested and cooperated with two game studios in Shanghai. The investment and partnership with experienced industry veterans can further expand our product portfolio and enlarge our business exposure to publishing and distribution of mobile games.

As mentioned during the earnings release call in the previous quarter, our strategy remains stable. We will continue to cultivate the global pan-entertainment content ecosystem and focus on the three key business sectors: online literature, mobile games, and scenario-based content

apps. We are optimistic about achieving steady growth and profitability as the core components of our strategic goals.

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. We have been concentrated on optimizing the resource allocation to deliver the balanced development strategy. With the continued improvement of the monetization capabilities of our online literature business and the enrichment of the product portfolio with the competitive margin of our mobile games business, we are optimistic about the profitability achievement of our user-oriented content business model. The first quarter of 2021 constituted a good foundation for the execution of the overall business plan.

I'm going to brief our first quarter of 2021. Net revenue was US\$81.6 million, a decrease of 24% from US\$107 million during the same period last year and a decrease of 20% from US\$102.4 million during the last quarter. The decrease was primarily due to the restructuring of our portfolio products.

The net revenues are mainly generated from 3 categories of our content-rich apps: Online literature accounted for approximately 40%, scenario-based content apps accounted for approximately 14%, and mobile games accounted for approximately 45% of the total revenue.

DAUs of the Company's portfolio products were 20.3 million, a decrease of 19% from 25.2 million in March 2020. MAUs of the Company's portfolio products were 58.6 million, a decrease of 34% from 89.2 million in March 2020. DAUs of the Company's online literature products were 7.5 million, an increase of 3% from 7.3 million in March 2020. MAUs of the Company's online literature products were 20.1 million, decreased from 29.1 million in March 2020.

The average daily reading time¹ of the key product Fengdu Novel's users was approximately 148 minutes in March 2021, which continued to grow steadily compared with 130 minutes in December 2020.

Our gross profit margin was 89.1%, compared with 95.7% in the same period last year and 93.1% last quarter.

GAAP cost and expenses were about \$93.4 million, a decrease of 23% sequentially and a decrease of 20% from the same period last year.

Sales and marketing expenses were US\$70.7 million, a decrease of 31% from the same period last year, and a decrease of 31% from last quarter. As a percentage of total revenue, sales and marketing expenses accounted for 87%, compared with 96% during the same period last year, and 100% last quarter. The sequential and year-over-year decrease in sales and marketing expenses as a percentage of total net revenue was primarily due to the optimization of the

¹ "Average daily reading time" for any day is calculated by dividing (i) the sum of time spent on reading books on our Fengdu Novel for such day, by (ii) the number of Fengdu Novel users who spent time on reading books for such day. The average daily reading time for any month is calculated by dividing (i) the sum of average daily reading time for each day in such month, by (ii) the number of days in such month.

operational efficiency in relation to the acquisition of new users and the retention of existing users.

R&D expenses increased by 32% year-over-year and increased by 39% sequentially, primarily due to an increase in costs associated with technology R&D staff and share-based compensation expenses. As a percentage of total net revenue, R&D expenses accounted for 11%, compared with 6% during the same period last year and also 6% last quarter.

G&A expenses increased by 68% year-over-year and 43% sequentially. The sequential increase was mainly due to an increase in costs associated with G&A staff and third-party outsourcing fee. The year-over-year increases were mainly due to increases in costs associated with G&A staff, share-based compensation and third-party outsourcing fee. As a percentage of total net revenue, G&A expenses accounted for 7%, compared with 3% during the same period last year and 4% during last quarter.

GAAP net loss was US\$12.4 million. Excluding the effects of stock compensation, adjusted net loss (non-GAAP) was approximately US\$11.1 million, compared with adjusted net loss (non-GAAP), US\$17.3 million last quarter, and adjusted net loss (non-GAAP) of US\$8.8 million during the same period last year. The sequential narrowing of the adjusted net loss was mainly due to the decrease in the sales and marketing expenses as a percentage of total revenue, driven by the optimization of the operational efficiency in relation to the acquisition of new users and the retention of existing users.

As of March 31, 2021, we had cash, cash equivalents and restricted cash of about \$56.1 million, compared with \$49.6 million at the end of 2020. At the same time, we have been committed to delivering a balanced financial approach by improving the overall operating leverage.

On May 18, 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 18, 2020. We expect to fund the repurchases under this program with our existing cash balance. As of March 31, 2021, we had used an aggregate of US\$5.9 million to repurchase 1.3 million ADSs under the 2020 Program and recorded as treasury stock.

Looking at the second quarter of 2021, we expect total net revenue to be about US\$83 million. This outlook is based on information available as of the date of this press release, 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. As a whole, we are committed to executing our well-structured dedicated growth plan focused on continuously delivering revenue growth and steadily achieving profitability.

Operator, we are now ready to take questions.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Nelson Cheung with Citi.

Nelson Cheung: I have two questions. Number one, can you please elaborate more on the overall landscape in the literature and Novel app? And do you have any updates to your strategy on acquiring the mobile app uses? And do you have any targets of market share or DAU to be achieved by end of this year?

And my second question is related to gaming. Can management share your view on the landscape, competitive landscape, in domestic markets and your marketing strategies in penetrating into the overseas market?

Karl Zhang: Thank you for your questions. And I'm going to take the first question and I'll have Robert take the second one. We believe that global online literature is a tremendous opportunity for us, and the long-reading content is the fundamental content needs for global users. But the traditional online publishing industry cannot meet the users' evolving needs. So to me, in Chinese domestic market, the competition landscape did not changed too much in the past couple of months. And Fanqie Novel is still the number one in the free reading app sector.

And we believe it is a long run. Our priority at this stage is to cultivate our content ecosystem to improve users' stickiness, and we have been taking great efforts to optimize our user retention rate and the users' content consumption of Fengdu Novel app from this year because we believe this is the key factor to ensure long-term success. So the average daily reading time per daily active user further grow to approximately 148 minutes in March 2021.

And the user retention rate increased a lot in the past couple of months for Fengdu Novel, which makes us very confident that the business is going to be better and better. So as a result, the operational efficiency further strengthened in the first quarter of 2021, but we are encouraged to see that our online literature business achieved profitability recently.

And now, our strategy for online literature business is to maintain top-tier long-term user retention rates, and cultivate our content ecosystem for long-term sustainability, while keeping the business profitable. To implement this strategy, we will strictly keep high ROI and the long-term user retention rate standard, while acquiring reading time -- and reading users. And we expect the DAU of our online literature section will increase by the end of this year, comparing to the same period last year. Thank you.

Robert Cui: Okay. I will address on the second question. For the gaming market landscape, as we all know that online gaming or mobile gaming is a huge entertainment content market. It is like a RMB300 billion value of markets in the domestic Chinese market and US\$150 billion market value in the overseas markets.

There has been an emerging trend of the monetization model in the current mobile games market, which is the IAA (in-apps advertising) for free-to-play mobile games. So while the traditional games market is dominated by Tencent and NetEase in China, we find a big market opportunity for independent players in the free-to-play games segment. With higher entry barrier towards the user growth through embedding AI-based analytics, we are in a good position to leverage our data-focused growth platform for the rapid development of the business by combining the product portfolios of our internal studios and also the third-party partners.

We have witnessed the huge growth potential of the revenue and profits of the performing products since 2020. And we are confident that our current strategy will result in a highly productive portfolio and pipeline.

On the other hand, for the overseas markets, we have also been implementing a differentiated marketing strategy in selecting the initial publishing markets. At the same time, our vibrant game studios are dedicated to develop games products that can meet the evolving popular trends during a specific period. We also pre-test the key features of the games with our sophisticated data platform to ensure a higher possibility of achieving satisfactory revenue and ROI. So Catwalk Beauty has been a strong testament to the rationale of our current strategy. Thank you.

Nelson Cheung: Thank you.

Operator: Steve Silver with Argus Research.

Steve Silver: First of all, congratulations on the expansion of the game segment, in particular, the success of Catwalk Beauty. I guess my question is if we can have a little more color on how the company can leverage the success of Catwalk Beauty in terms of impacting the growth and the visibility of the group in general; but also in terms of how that might affect the marketing spend and the customer acquisition costs going forward, in terms of how one title can drive the visibility of the entire group?

Karl Zhang: Thank you. I'm going to take this one. So Catwalk Beauty is indeed a big success for our global mobile gaming strategy. But it has been ranked as number one in internationally 58 countries and region's App Store and Google Play. So it's validated our holistic incubation mechanism, which fuels rapid iteration and innovation. We believe that we can achieve a larger-scale game production with high-quality content based on the established incubation mechanisms, and to grow rapidly in the global market. So you can expect more and more successful games to be released in the coming quarters.

Our target is to develop 1 or 2 successful products every 2 months going forward. And it is also a strong proven of our sophisticated growth platform, which we are leveraging to publish and distribute mobile games. This makes us confident to extend our mobile game strategy to game publishing business. And as I mentioned, we have further cooperated with third-party content producer partners in the mobile game industry to accelerate the growth of our mobile game business by producing and publishing more high-quality mobile games. So we believe this strategy will release more potential of our growth capability.

So Catwalk Beauty is not only a success on its reputation, but a success on its financial performance. As I mentioned, that we maintain our strong focus on game types with higher ROI and a longer product cycle. While driving its download through user acquisition campaigns, we are actually keeping very high ROI from Catwalk Beauty. So the average return cycle of investment is actually less than 3 days so far. So that is Catwalk Beauty is contributing profit to the group.

The product has generated revenue of more than over \$2.3 million in the past couple weeks, and a profit of close to US\$1 million. What's more, as it is now one of the most popular casual game globally, the fans are recommending it to their friends and taking videos and sharing to YouTube. If you search Catwalk Beauty on YouTube, you will find a lot of videos about this

game today. So all these behaviors help us to attract a lot of organic growth, which makes it even more profitable. Thank you.

Steve Silver: Great. Thank you for the additional color. Appreciate it. Congratulations.

Operator: Vivian Zhang with Diamond Equity.

Vivian Zhang: This is Vivian from Diamond Equity Research. Thank you for taking my questions. So my first one is about these -- you recently announced Fengdu you're expanding with IP-based short-form video. Given the growth of TikTok and other short-video platforms, can you provide an update on this project development and how you view its competitive position?

My second question is that recently, Catwalk Beauty was ranked number one in app stores. So can you provide any additional information around the company's approach to creating mobile applications? And more specifically, how the company views the trade-off between invest in-house in research and development versus acquiring other mobile app development firms?

Karl Zhang: Thank you for your question. So I'm going to take these two. So the first question is about Fengdu IP-based short-form video. So we are actively diversifying our IP business based on the original books from Fengdu Literature Platform. So we developed the Fengdu audiobook, new features incorporated in Fengdu Novel app, to meet the evolving needs of readers. And we also created a short-video series based on Fengdu Novel content and IP resource.

The first short-video drama series with a Chinese named Proud Wanwan Su produced from content on Fengdu Novel is based on a piece of literature with a substantial and exciting storyline. And the video series is divided into 20 episodes with a running time of 2 to 3 minutes for each. So the short drama has been redistributed on major short-video sites, such as Douyin, TikTok and Kuaishou, Bilibili and so on so forth.

We believe that exploring and releasing IP values is critical to our content ecosystem growth because we're committed to provide diversified commercial opportunities to our fans also, especially this top-tier one. So we also believe that this is a middle long-term goal for us. We don't have the plan to release our own short-video app products at this moment. And we identify ourselves as a content producer and we will strive to cooperate tightly with those top-tier short-video platforms, such as Douyin, TikTok and Kuaishou and so on.

And as for the second question about our game business, so Catwalk Beauty has been ranked as number one in multiple countries, in the regions, on App Store and Google Play. So it validated our holistic incubation mechanism, which fuels rapid iteration and innovation. The sophisticated growth platform has been our core competency since our IPO. And the success of Catwalk Beauty is yet another strong validation of our sophisticated growth platform.

With that, we believe the key success factor of our mobile game business is to consistently publish high-quality mobile games. Based on that, it is actually not necessary that each game should be produced by us in-house. By embracing the industry and cooperate with more experienced mobile game content producers openly, we can accelerate the growth of our mobile game business by achieving a larger-scale game production and growing rapidly in the global market.

What's more, by opening up our publishing capability to third-party CP partners, we can also activate our in-house game studios to add for acquiring other mobile game studios. We are not keeping it -- we are actually keeping it open as well at this moment. Thank you.

Vivian Zhang: That makes sense. Thank you.

Operator: Ken Gao with -- from Tigress.

Ken Gao: This is Ken from Tigress Financial Partners. Thank you for taking my question. I think most of my questions have been answered, so I have one more question regarding to sales and marketing expense. We have seen great improvement on the sales and marketing margin on the first quarter of 2021. Can you provide any guidance on the margin trend in 2022?

Robert Cui: Okay. Thank you. I will take this question. Yes, our key goal is to, as we always mention, implement a balanced approach in ensuring the stable revenue and user base growth, and implementing highly synergistic operational efficiency. So as you have seen, the sales and marketing expenses as of revenue decreased from more than 95% in the previous quarters to the current 87% in the first quarter of 2021.

We expected that the sales and marketing expenses as of revenue will be further decreasing to below 75% in the coming quarter, and subsequently stabilize in the range of 70% to 75% for the second half of this year.

So the overall target of the operational efficiency to be achieved on this business model is to achieve stabilized and normalized sales and marketing expenses as of revenue to around 60% to 70%, which is in line with the level that we achieved during our IPO stage back in 2018, which can further result in a more healthy and sustainable business model and also the growth plan.

Ken Gao: Thank you.

Operator: This concludes our question-and-answer session. I would like to turn the conference back over to Ms. Claire Yung, Investor Relations, ICA, for any closing remarks.

Claire Yung: 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.