

[CTK] - CooTek (Cayman) Inc.
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Company Representatives:

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Karl Zhang, Chairman, Chief Technology Officer, CooTek
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Presentation

Operator: Good day, and welcome to CooTek's Second Quarter 2021 Unaudited Financial Results Conference Call. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to ICA Investor Relations. Please go ahead.

Venus Hu: 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.cootech.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 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 pass the call to Mr. Karl Zhang, Chairman and Chief Technology Officer of CooTek. Karl, please go ahead.

Karl Zhang: Thank you. Thank you, everyone, for joining our second quarter 2021 earnings call. We have reported our second quarter 2021 results with net revenues of US\$83.2 million, which was a bit higher than our previous guidance.

As mentioned in our first quarter earnings call, we have been implementing our strategic roadmap driven by our online literature and mobile games business both in the domestic and overseas markets. We are pleased to return to profitability while keeping a positive quarter-over-quarter revenue growth in the second quarter of 2021, which was in line with our balanced approach between growth and profitability.

As a general comment, despite recent uncertainties in the domestic mobile advertising market related to the stringent regulation and the industry softness in the education, mobility, and property sectors, we remain confident in driving the long-term value by further enhancing the innovative contents and features of our product portfolio on a global basis.

With the continuous optimization of our content platform, we are dedicated to the two-wheeled development focused on online literature and mobile games segments. More importantly, we believe that we are in a good position for delivering the next-step sustainable growth given the gross margin for the 2 segments have been constantly improving since the first quarter of 2021.

Firstly, let me elaborate on the development of our online literature business. For Fengdu Novel, our free online literature product in the Chinese market, we are encouraged by the continuous enhancement of our content ecosystem. The user retention rate continued to be improving, and we concentrated on providing qualified user experience and diversified content to our users.

The overall user base has been more active and engaging, which contributed to the enhancing daily ARPU with a year-over-year growth of 42% and a quarter-over-quarter growth of 50% in the second quarter of 2021.

As of June 2021, the number of signed authors of Fengdu Literature Platform further increased to more than 4,200. And original contract books further increased to more than 5,400 with quarter-over-quarter growth of 17% and 20% respectively.

With rich and diversified contents, Fengdu Literature Platform has cooperated with leading companies such as Ximalaya (喜马拉雅), Soyinke (鸿达以太) and DianZhong Books (点众书城), etc., which offers new opportunities for the subsequent external licensing and derivative intellectual property content creation of its novels.

Through the external licensing of e-books, Fengdu Literature Platform has collaborated with traditional online literature channels such as Mobile Baidu (手机百度), iReader (掌阅) and ShuQi Novel (书旗), to maximize the revenue of each platform with authorized targeted contents.

Fengdu Literature Platform also made strategic cooperation with leading social media channels, such as DianZhong Books (点众书城) and ZhangZhongYun (掌中云) to actively promote the original contents. With the exploration of this new course, Fengdu's original content successfully achieved first place on the Tencent GuangDianTong's rising popularity list of novels in June 2021.

At the same time, Fengdu Literature Platform has aimed to produce derivative IP contents for audiobooks and films. Through various business practices, including content co-development with other parties, audio product output, and audio copyright trading, we have reached strategic cooperation with major audiobook producers.

With such vigorous development in the IP operation, the revenues from the IP business of Fengdu Novel recorded 194% quarter-over-quarter growth.

In addition, we have been expanding and upgrading the business model of our overseas online literature product. With the content inventory expansion and improving user retention rate, we have strengthened the economic model. The ROI level in the U.S. market has been constantly improving. At the same time, we have observed more encouraging performance during our expansion in the South Eastern Asian markets such as Philippines and Malaysia. We are optimistic about the growth potential of the product in the overseas markets.

Secondly, for our mobile games business, we have continued to expand and optimize our mobile games portfolio and pipeline both in the domestic and overseas markets through internal developments and external investments and partnerships.

With own content experience and growth strength, we have continued to attain iterative upgrades and incubation, forming a matrix of independently-developed mobile games with light, fast and thin features. These games are popular among the game-consuming people with a fast-paced lifestyle.

We have formed a mobile game matrix for the global market, releasing dozens of games to date with more than 10 million users. We are strived to ride on the strong performance of Catwalk Beauty, our globally top-ranking casual game, to form a competitive product pipeline.

At the same time, since the first quarter of 2021, we have strengthened our investment in external studios aiming at enriching and expanding our product portfolio, which can provide additional upside for the segment business performance. Through our invested studios, we launched more than 4 new casual games in the second quarter of 2021.

In addition, we will also continue to aggregate upstream and downstream resources in the industry to provide developers with one-stop distribution and full-process services. We started to cooperate with 3 studios to provide game publishing and operations, which enhanced our involvement in the entire operation chain. We are dedicated to further increase the scale of the third-party game publishing business.

As a special note, for the second half of 2021, we expect a strong mobile games pipeline with more than 15 games in the domestic market, and more than 20 games in the overseas market under the smooth combination of our internal development and external cooperation.

Going forward, we will maintain our strategic focus on building a user-oriented content ecosystem on a global basis targeting at the sustainable growth and overall profitability.

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

Robert Cui: Thanks, Karl. Hello, everyone. Thanks again for joining us tonight. As focusing on upgrading our business model, we have been optimizing the balance between our marketing and monetization strategies, which resulted in the achievement of group-level profitability in the second quarter of 2021. We will further expand the scale of our product portfolio, improve our user experience and user stickiness and enhance our monetization capabilities. We are confident in delivering a robust and stable long-term growth.

I'm going to brief our second quarter of 2021. Net revenues were US\$83.2 million, a decrease of 34% from US\$126.4 million during the same period last year and an increase of 2% from US\$81.6 million during the last quarter. The decrease, compared with the same quarter of 2020, was primarily due to a decrease in mobile advertising revenue with the continuous restructuring of our portfolio products.

The net revenues are mainly generated from 3 categories of our content-rich apps. Mobile games accounted for approximately 55%, online literature accounted for approximately 37%, and scenario-based content apps accounted for approximately 7% of total net revenues.

DAUs of the Company's portfolio products were 23.5 million, a decrease of 2% from 23.9 million in June 2020. MAUs of the Company's portfolio products were 70 million, a decrease of 16% from 83.5 million in June 2020.

DAUs of the Company's online literature products were 6.7 million, a decrease of 17% from 8.1 million in June 2020. MAUs of the Company's online literature products were 18.1 million, decreased from 28.4 million in June 2020.

The average daily reading time¹ of the key product Fengdu Novel's users was approximately 153 minutes in June 2021, which continued to grow steadily compared with 148 minutes in March 2021.

Our gross profit margin was 89.4%, compared with 95.5% in the same period last year and 89.1% last quarter.

Cost and expenses were about \$81.7 million, a decrease of 13% sequentially and decrease of 34% from the same period last year.

Sales and marketing expenses were US\$59.8 million, a decrease of 44% from the same period last year, and a decrease of 15% from last quarter. As a percentage of total revenues, sales and marketing expenses accounted for 72%, compared with 84% during the same period last year and 87% last quarter. The sequential and year-over-year decrease in the sales and marketing expenses, as a percentage of total net revenues, was primarily due to the continuous transition of the strategy in relation to the acquisition of new users and the retention of existing users, which resulted in the reduction of the user acquisition costs.

R&D expenses increased by 20% year-over-year and increased by 7% sequentially, primarily due to an increase in salary and payroll expenses associated with technology R&D staff, and was partially offset by decline in share-based compensation expenses. As a percentage of total net revenues, R&D expenses accounted for 12%, compared with 6% during the same period last year and 11% last quarter.

G&A expenses increased by 18% year-over-year and a decrease of 12% sequentially. The sequential decrease was mainly due to a decrease in share-based compensation and third-party outsourcing fee, and was partially offset by a rise in professional service fee. The year-over-year increases were mainly due to an increase in salary and payroll expenses associated with G&A staff, professional service fee and third-party outsourcing fee, and was partially offset by decline in share-based compensation. As a percentage of total revenues, G&A expenses accounted for 6%, compared with 3% during the same period last year and 7% during last quarter.

Net income was US\$0.3 million, compared with net income of US\$3.1 million during the same period last year and a net loss of US\$12.4 million last quarter.

Adjusted net income was US\$1.1 million, compared with adjusted net income of US\$4.5 million in the same period last year and adjusted net loss of US\$11.1 million last quarter. The achievement of profitability, compared with the adjusted net loss last quarter, was mainly due to the decrease in sales and marketing expenses as a percentage of total revenues, driven by the continuous transition of the strategy in relation to the acquisition of new users and the retention of existing users.

As of June 30, 2021, we had cash, cash equivalents and restricted cash of about \$39 million,

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.

compared with \$56.1 million as of March 31, 2021. As of June 30, 2021, restricted cash were US\$3.3 million, mainly consisting of amount of US\$3.1 million held in the Company's bank account as guarantee deposit for loan facility provided by the bank.

As of March 31, 2021, the long-term restricted cash was US\$21.5 million held in the Company's bank accounts, which were frozen by a local authority in connection with an ongoing investigation related to an alleged illegal act of certain customers. As of June 30, 2021, the relevant bank accounts have been unfrozen.

On May 18, 2020, we announced a share repurchase program (the "2020 Program"), where we are authorized to repurchase the company's 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 its existing cash balance.

As of June 30, 2021, we had used an aggregate of US\$6.0 million to repurchase 1.4 million ADSs under the 2020 Program, and recorded as treasury stock. The 2020 Program was terminated on May 17, 2021.

Operator, we are now ready to take questions.

Questions and Answers

Operator: Thank you. (Operator Instructions). Steve Silber from Argus Research.

Steve Silber: Congratulations on returning to profitability, it's great to see. Just a quick question - I noticed that the percentage of revenue in the second quarter was geared a little bit more toward the gaming section compared to online literature compared to last quarter. Just trying to get your updated thoughts in terms of the long-term revenue breakdown between the 2 groups, or whether you see a lot of fluctuation over time based on the rollout of new games and the continued expansion of the author accounts for the online literature program?

Karl Zhang: Okay. Let me talk about the game release plan, and I will hand over to Robert to answer the revenue distribution. And so our mission is to empower everyone to enjoy relevant content seamlessly, so our strategy at this moment is to focus on entertainment content to build up our content ecosystem. So we released our first in-house developed game in the third quarter of 2019. We have released dozens of games in Chinese market and in overseas market in the past 7 quarters. So we are happy to see such big growth in our game business in such short period and the success of our game business has validated our strategy, execution and data-driven systematic growth capabilities.

So we have formed a mobile game matrix for global markets, releasing dozens of games to date with more than 10 million users. So at the same time, since the first quarter of 2021, we have strengthened our investment in external studios, aiming at enriching and expanding our product portfolio, which can provide additional upside for the segment business performance. So through

our invested studios, we have launched more than 4 new casual games in the second quarter of 2021.

So as of today, our focus is on global mobile casual game sector. So we choose to focus on casual game sectors because so first, we believe casual game sector has bigger growth potential globally. The casual games have a broader user base, and this sector is expanding and growing faster than others globally.

And second, this sector has relatively higher short-term ROI, which benefits our cash flow. So we maintain our strong focus on game types with higher ROI and a longer product cycle. So for example, Catwalk Beauty, a casual game designed and released in the global market reached number one in U.S. and other 57 countries and regions on App Store and Google Play game section. So it's contributed nearly \$3 million gross profit in the first 3 months since it was released. And its overall ROI exceeded 200%.

And three, we can fully utilize our systematic and scalable growth capability to publish successful games of this sector, so this ensures the scale of our game business. So we will also continue to aggregate our upstream and downstream resources in the industry to provide developers with one-stop distribution and full-process services.

And for the second half of this year, we expect a strong mobile game pipeline still focusing on casual game sector with more than 15 games in the domestic market, and more than 20 games in the overseas market under the smooth combination of our internal development and external cooperation. Thank you.

Robert Cui: So regarding the question about the growth and profitability, yes, it is actually encouraging that we achieved the overall profitability while keeping a positive quarter-over-quarter revenue growth in the second quarter of 2021. We believe that we are moving towards the optimization of resources to achieve this balance between growth and profitability. We can expect the overall profitability for the second half of 2021 and further net margin improvements for the coming quarters under our execution of this strategic plan.

So firstly, we have been actively expanding and upgrading the mobile games product portfolio with strong ROI performance. So with our internal development and external investment and cooperation, so we are positioning effectively over the entire games development, publishing and operations chain. We have more than 30 games launched in the second half of 2021, which demonstrates our enhanced pipeline to contribute to the more sustainable growth.

Secondly, we have been strengthening our strategic focus on the content and user management for our online literature products, aiming at improving efficiently both the user stickiness and the product monetization, driven by our intensified author and content resource. We are concentrated on consolidating the existing monetization capabilities with the revenue from advertising and diversifying the revenue stream with revenue from IP operations, including IP licensing, IP contribution to audio book, short drama and film, and also social media distribution with pay-to-read model.

And thirdly, while we have been improving the efficiency of our user acquisition and user management, our cost and expense structure continues to be optimized. We expect further

efficiency achievements for the sales and marketing, R&D and G&A expenses, as a percentage of revenue, for the coming quarters, which will result in the continuous net margin improvement. Thank you.

Steve Silver: Thank you very much.

Operator: Vivian Zhang from Diamond Equity Research.

Vivian Zhang: This is Vivian from Diamond Equity Research. I have two questions. According to the company, Fengdu Novel has been better monetized through social media channels. So can you provide more color on how you attract users from WeChat, Weibo or TikTok, and how you turn them into revenue? Does the company consider developing paid content to attract paid users on this platform?

My second question is regarding copyright monetization. Can you share with us what effort the company has made to monetize copyright and diversify your revenue stream?

Karl Zhang: Okay. Thank you. I will address these two questions. So for the first question, we have initiated the exclusive content distribution through social media channels with the pay-to-read model since the first quarter of 2021. So currently, with more than 4,200 signed authors and more than 5,400 original contract books on the Fengdu literature platform as of June 2021, we are in a very good position to further explore diversified content monetization options.

So the social media channels actually provide a novel way to reach target readers, and demonstrate Fengdu Novel's success in developing a new business model and amplifying the revenue growth. It has become popular to distribute online literature through social media channels, and it is different than distributing through literature apps. The algorithm for user recommendations is more precise in the social media ecology.

The immersive emerged experience of reading standalone books drives better commercialization, as users are more likely to pay for something they are already interested in. So the social media channels mainly targets the novel readers who are accustomed to WeChat, and do not use traditional reading apps. This is a quite difficult segment of readers to reach through regular novel apps.

So in the WeChat ecosystem, Fengdu Novel distributes content in types such as city life, fantasy and romance. With WeChat's matrix of public accounts, Fengdu Novel has attained good user feedback on WeChat in terms of addressing these users' reading needs for short-term reading consumption. We currently offer the social media distribution through internal team and external agents, while our main app is still concentrated on the free-to-read content, we are actively developing this complementary social media channel to position us on the pay-to-read content distribution.

So for the second question about the copyright monetization, we have had very strong focus on the IP and copyright operation with our enriching content resource for Fengdu Novel. As measured through external licensing of e-books, Fengdu Novel has collaborated with traditional online literature channels to maximize the revenue of these platforms. And at the same time, Fengdu Novel has aimed to produce these IP contents for audio books and films. So through

these various business practices, including content co-development with other parties, Fengdu Novel has reached the strategic cooperation with major audio books' producers and also theme producers.

In terms of the film and television, the Fengdu Novel's top-rated online novel in June, called Three Thousand Years Old of Princess (世子妃三千岁), has been successfully recommended to the film and television companies for film production. As of now, there are 2 pieces of content, which have been submitted to the local government for film approvals. And filming is expected to be completed this year.

So through all these innovative initiatives in transforming the online novels into various forms of entertainment, Fengdu Novel has discovered a variety of ways to monetize the copyright. So these tactics will allow different forms of IP to form a synergy to significantly increase the value of the original IP. Thank you.

Vivian Zhang: Thanks. So actually, I have one more question regarding mobile games. We see the Chinese government just imposed the new restrictions that further limits the amount of time under 18 consent on online games. So how do you expect this to affect your mobile game business? Like what percentage of the company's revenue comes from teenagers in China?

Robert Cui: So we are obviously closely monitoring the local regulation changes. As of now, we are not in a position to materialize on these specific impacts on our games portfolio, given we are concentrated on the in-app advertising model of the mobile games commercialization; while the current regulation is more focused on the in-app's purchase model of the mobile games. So we haven't yet had very precise statistics about the percentage of the users, which are under 18 or the minors within our games portfolio. But obviously, we are monitoring closely this policy evolution and will definitely make appropriate solutions in order to mitigate the negative impact on the potential revenue of our overall game portfolio.

And in addition, as we have been always emphasizing, we are expanding vigorously in the overseas market, which tend to have higher growth potential in terms of the mobile games portfolio and mobile games pipeline. So we remain confident on the further development of our mobile games portfolio and pipeline on a global basis, and not only in the Chinese domestic market. Thank you.

Vivian Zhang: Okay. Thanks, Robert, for additional details. Again, congratulations on the quarter.

Operator: Ken Gao from Tigress Financial Partners.

Ken Gao: So my question is regarding sales and marketing margin. As we know, you started implementing a balanced approach to improve the operational efficiency since last quarter. We wanted to know if the improvement of the sales and marketing margin is still on track, reaching below 70% this year with our overall target around 60% to 70%?

Robert Cui: Thank you. I will address this question as well. So with our continuous optimization of the efficiency in relation to the acquisition of new users and the management of existing users, so we have seen a constant reduction of the sales and marketing expenses as a percentage of

revenue since the third quarter of 2020. The percentage in the second quarter of 2021, as mentioned, was 72%, down from 87% in the first quarter of 2021, which met our expectation.

So we believe that our current balanced strategy will result in a robust improvement of the net margin. On a normalized basis, the sales and marketing expenses, as a percentage of revenue, is still targeted at 60% to 70%. And with the continuous efficiency improvement in relation to the R&D and G&A expenses, we are confident in achieving a double-digit net margin. Thank you.

Ken Gao: Thank you very much.

Operator: Jimmy Qin from Southwest Securities Company.

Jimmy Qin: Congratulations on the strong -- I think most of my questions have been answered. So I have one more question about -- on your strategy for expanding overseas market, whatever additional information you can tell us on that approach.

Karl Zhang: Okay. I'll take this question. Thank you. Yes, we are actually expanding the Chinese domestic market and overseas market at the same time. So as mentioned in our first quarter earnings call, we have been implementing our strategic roadmap, driven by our online literature and mobile games business both in the domestic and overseas markets. And we are pleased to return to profitability, while keeping a positive quarter-over-quarter revenue growth in the second quarter, which was in line with our balanced approach between the growth and profitability.

So with the continuous optimization of our content platform, we are dedicated to this two-wheel development focused on online literature and mobile game segments in both Chinese domestic market and overseas market. So both have big potential. And we saw very strong synergies between online literature and mobile games and the synergy between Chinese domestic market and overseas market.

For example, the foundation of our online literature products for the overseas market from the data-driven growth platform to the AI-based recommendation system and the data-driven content creation platform, which assists authors to write better-performed books are the same. And the same happened to our game business. So we see a strong synergy between global market -- between the overseas market and Chinese domestic market.

And recently, we noticed some stringent regulations related to the internet sector in Chinese domestic market, such as the strength of data privacy protection and the regulating advertising experience. And there are some uncertainties in the domestic mobile advertising market related to the regulations and industry softness in the education, mobility and the property sectors, but we remain confident and positive.

So we are investing more on our overseas business to mitigate the risk. For example, we'll recruit and form a couple of new game studios in different regions, including Taipei, to expand our game pipeline for overseas markets.

In addition, we have been expanding and upgrading the business model of our overseas online literature products. With the content inventory expansion and the stable user retention rate, we

have also strengthened the economic model, so the high level in the U.S. market has been consistently improving.

At the same time, we have observed some encouraging performance during our expansion in the Southeast Asia markets, including for example, Philippines and Malaysia. So we are optimistic about the growth potential of the products in the global market. So we believe that our two-wheel development strategy mitigates the short-term risks and ensure our long-term growth. Thank you.

Jimmy Qin: Okay, great. Thanks, management. Congratulations again.

Operator: I'd like to now turn the call back over to Venus Hu for any additional or closing remarks.

Venus Hu: 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 further questions in the future, please feel free to contact us at ir@cootek.com or cootek@icaasia.com. Thank you.

Operator: This concludes today's call. Thank you for your participation. You may now disconnect.