

[CTK] - CooTek (Cayman) Inc.
Q3 2021 Unaudited Financial Results
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Company Representatives:

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Karl Zhang, Chairman, Chief Technology Officer, CooTek
Robert Cui, CooTek Inc., Chief Financial Officer

Analysts

Steve Silver, Argus Research
Vivian Zhang, Diamond Equity Research

Presentation

Operator: Good day, and welcome to the CooTek's Third 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.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 the 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, everyone, for joining our third quarter 2021 earnings call. We have reported our third quarter 2021 results with net revenues of US\$51.1 million and non-GAAP net income of US\$0.4 million.

As consistently mentioned, we have been implementing the two-wheeled development strategy focused on online literature and mobile games segments. The balanced approach between growth and profitability has been partially impacted by the persistent uncertainties in the Chinese domestic advertising market. But we remain focused on the achievement of the group-level profitability.

In addition, we have rapidly increased our exposure in the overseas mobile games and online literature segments. And the revenue contribution from overseas business was 17% in the third quarter of 2021 compared to 12% in the second quarter of 2021. We expect the revenue contribution from our overseas business will continue to increase.

As a special note, for our mobile games business, the continuous optimization of the product portfolio and pipeline resulted in a stable contribution to the overall profitability of the group.

In the third quarter of 2021, Taptek, our invested game studio, launched Truth Runner, another parkour game following the lead of Catwalk Beauty. A week into its debut, Truth Runner topped the U.S. IOS game charts. The other expected hit match-3 game, Love Fantasy, has also started to gain momentum in the app ranking. The enrichment of the match-3 games will also further increase the lifecycle of the products, which can help increase the scale of the revenue and net income of the mobile games business.

We are also encouraged by the efficiency achieved in the development of the new mobile game products. We developed and published 14 new mobile games in the third quarter of 2021, and has a pipeline of 15 to 20 games in the fourth quarter of 2021. And we have secured the relationship with more than 20 third-party CPs to provide game publishing and operations service. We are continuously dedicated to increase the scale of the third-party game publishing business.

Coming back to our online literature business, for Fengdu Novel, our free online literature

product in the Chinese market, it constituted a stable contributor to the revenue and the gross margin of the group. With the continuously increasing signed authors and original contract books, we can keep an engaging and active platform for our users.

In the third quarter of 2021, Fengdu Novel has launched a new online community for book lovers, where readers can comment on novels and authors can get instant feedback on their works. This new community will boost the authors' creativity and the readers' engagement, and further create momentum to the development of Fengdu Novel's content ecology. Building a high-quality content ecology has been the primary goal of Fengdu Novel. Since the beginning of the year, Fengdu has further improved its novel quality and reader engagement by hosting a series of creative events, including contests, new writer support programs, and new media content incubations.

At the same time, we have been moving forward the IP operations business with licensing of e-books, audible book production and short drama production. The revenues from the IP business of Fengdu Online literature platform recorded another 165% high quarter-over-quarter growth in the third quarter of 2021.

For our overseas online literature product, the business fundamental has been constantly improving. In addition to the expansion in the Southeast Asian and North African markets, the ROI and user engagement level in the US market have demonstrated very positive improvement. We are confident that the product will become the next growth driver of the group.

Most recently, we have announced our initial Metaverse and NFT plan and formed an internal work group to study and implement such attempt. Our Metaverse plan takes full advantage of our two dominant businesses, online literature, and gaming, to create a new world of entertainment. On the one hand, our online literature apps have produced quality original content with numerous exceptional novels emerging from different categories, such as fantasy, war, and science-fiction. The immersive experience provided by these works is essential to the creation of the Metaverse.

We can also tokenize the origin digital books and the visualized virtual items of the books, such as weapons and dresses, to be NFTs, allowing those NFTs to be collected and traded both within and outside of our apps.

On the other hand, our full-stack global operation and distribution capability has enabled us to launch dozens of chart-topping games, including Catwalk Beauty and Truth Runner. With the emergence of Metaverse, we are well-positioned to leverage the strengths from these two businesses to create synergy.

As we integrate the two businesses to construct our own Metaverse ecosystem, the boundaries between novels and games will gradually merge to create a unique user experience of reading a novel and playing games. Readers can interact with the characters and other readers in the form of games, with the possibility of adjusting their roles, appearance, skills, and props. All these virtual items can be turned into NFTs, allowing users to take them to other story worlds for continuous usage. We are confident in creating such a highly immersive Metaverse.

Going forward, we will use our best endeavors to execute our strategic roadmap in building our

content-rich and user-oriented ecosystem.

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: Thank you, Karl. Hello, everyone. Thanks again for joining us. I'm going to brief our third quarter of 2021. Net revenues were US\$51.1 million, a decrease of 52% from US\$105.7 million during the same period last year and a decrease of 39% from US\$83.2 million during the last quarter. The decrease compared with the same quarter of 2020 was primarily due to a decrease in mobile advertising revenues.

The net revenues are mainly generated from 3 categories of our content-rich apps: Mobile games accounted for approximately 56%, online literature accounted for approximately 39%, and scenario-based content apps accounted for approximately 4% of total net revenues.

DAUs of the Company's portfolio products were 18.7 million, a decrease of 32% from 27.7 million in September 2020. MAUs of the Company's portfolio products were 57.2 million, decreased from 94.8 million in September 2020. DAUs of the Company's online literature products were 5.0 million, decreased from 10.0 million in September 2020. MAUs of the Company's online literature products were 13.5 million, decreased from 29.5 million in September 2020.

The average daily reading time¹ of the key product Fengdu Novel's users was approximately 153 minutes in September 2021, which remained stable compared with 153 minutes in June 2021.

Our gross profit margin was 82.2%, compared with 93.6% in the same period last year and 89.4% last quarter.

Cost and expenses were about US\$50.1 million, a decrease of 39% sequentially and a decrease of 61% from the same period last year.

Sales and marketing expenses were US\$28.7 million, a decrease of 73% from the same period last year, and a decrease of 52% from last quarter. As a percentage of total revenues, sales and marketing expenses accounted for 56%, compared with 102% during the same period last year, and 72% 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 12% year-over-year and decreased by 5% sequentially. The sequential decrease was primarily due to a decrease in salary and payroll expenses associated with technology R&D staff and share-based compensation expenses, and was partially offset by

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.

increase in third-party outsourcing fee. The year-over-year increase was 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 revenues, R&D expenses accounted for 18%, compared with 8% during the same period last year and 12% last quarter.

G&A expenses increased by 8% year-over-year and a decrease of 18% sequentially. The sequential decrease was mainly due to a decrease in listing expenses and bad debt provision, and was partially offset by a rise in share-based compensation. The year-over-year increase was mainly due to an increase in salary and payroll expenses associated with G&A staff and bad debt provision, and was partially offset by decline in listing expenses and professional service fee.

As a percentage of total net revenues, G&A expenses accounted for 8%, compared with 4% during the same period last year and 6% during last quarter.

Net loss was US\$0.4 million, compared with net loss of US\$22.0 million during the same period last year and a net income of US\$0.3 million last quarter.

Adjusted net income was US\$0.4 million, compared with adjusted net loss of US\$20.5 million in the same period last year and adjusted net income of US\$1.1 million last quarter. The sequential decrease of profitability compared with the adjusted net income in last quarter was mainly due to the decrease in revenues. The achievement of profitability compared with the adjusted net loss the same quarter last year was mainly due to the decrease in the 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 September 30, 2021, we had cash, cash equivalents and restricted cash of about US\$36.2 million, compared with US\$39.0 million as of June 30, 2021.

Operator, we are now ready to take questions.

Questions and Answers

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

Steve Silver: Congratulations on the recent Metaverse announcement. I had a quick question about -- or at least your thoughts on the impact of the Metaverse initiative in terms of the R&D behind it or the operating costs behind that; and how the launch of this new strategy will work in conjunction with the previously announced plans to balance growth with profitability, and just whether the Metaverse changes you're thinking along those lines?

Robert Cui: Okay. Thank you. I will take these two questions. So the recently announced Metaverse and NFT plan does not constitute a change in the existing business, and also in

relation to the financial strategies. We will keep our balanced approach between growth and profitability despite the recent uncertainties in the Chinese mobile advertising markets, which impacted the revenue growth of the group.

So we started to concentrate on products with long product cycles and high ROI performance in the Chinese market. And we expanded our exposure in the mobile games and online literature segments in the overseas markets, which supported the continuous achievements of the group-level profitability.

So this new Metaverse and NFT plan is a natural strategic move to fully utilize our resources in the IP, original contract books, and mobile games, aiming at the execution of the fully-synergistic business combination involving long-term Metaverse and NFT vision. So we started to form, as mentioned, an internal work group to evaluate the reasonable action plan. And we believe that our current core business segments offer significant potential to extract the value in relation to Metaverse and NFT.

However, in the short term, we don't expect significant R&D expenses to implement such plan. It is a long-term and strategic path with further development of the existing business model. Thank you.

Steve Silver: Thanks for that color.

Operator: Vivian Zhang from Diamond Equity Research.

Vivian Zhang: This is Vivian from Diamond Equity Research. So my question is also regarding your newly-announced Metaverse plan. Can you give us some more color on this new business model and your monetization strategy for that?

Karl Zhang: Thank you. I'm going to take this one. Yes, we have been implementing our two-wheeled development strategy focus on online literature and mobile game segment to build up our pan-entertainment ecosystem. The strategy has achieved significant results in both the domestic and overseas markets. We will stick with this strategy, continue to invest and grow in the global online literature and the mobile game segment.

And our new-revealed Metaverse plan is actually a part of this strategy. There is natural connection between online literature gaming and Metaverse. The novels create virtual worlds and stories and are sometimes even the world view, which can be further visualized through games. And the users will be able to interact, explore, trade and live in such virtual settings. The high level of immersion and the all-around and open social structures created by the novel-based games are consistent with the core concept of Metaverse.

As CooTek integrates the 2 business to construct its own Metaverse ecosystem, the boundaries between novels and games will gradually merge to combine user experience of reading a novel and playing games. Readers can interact with the characters and other readers in the form of games, with the possibility of adjusting their roles, appearance, skills and prop, so all of these virtual items will be in that piece, and allowing users to trade and take them to other story world.

Let me give you an example of how we visualize and extend online novels to online games. Our

new hit match-3 game, Love Fantasy, is obtaining very strong growth momentum recently. It hit top-3 ranking position on both Google Play and App Store in U.S. So actually, this innovative and interactive game, its story line is created from an online novel. So it is a testament to link novels with games and the possibility to construct a unique Metaverse.

And on the other hand, we are also looking into the potential disruption that NFT could bring to the entire content industry. We believe that NFT brings new opportunities for us to benefit our content ecosystem and expand the monetization. Our internal Metaverse working group is incubating a product, which tokenizes digital books and the visualized virtual items of the book, such as the dresses, props, weapons, castles, and so on and so forth. Readers who are fascinated by the book get a chance to collect and trade those NFT.

This NFT will be tradable within or outside of our apps. As long as the book gets more and more popular, the NFT holders enjoy the appreciation. One day, a new game is produced on top of the book's story line, they can bring NFT to the game to play and trade. With the emergence of Metaverse, we believe that we are well-positioned to leverage our two dominated business to create synergies and expand our success. Thank you.

Vivian Zhang: Thank you for additional details. That's all my questions.

Operator: There are no further questions on the phone at this time.

Venus Hu: Thank you, operator. In closing, on behalf of the entire management of CooTek, we would like to thank you again for joining us today. If you have further inquiries in the future, please feel free to contact us at ir@cootek.com or cootek@icaasia.com. Thank you. Bye, bye.