

[CTK] - CooTek (Cayman) Inc.
Q4 and Fiscal Year 2021 Unaudited Financial Results
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Presentation

Operator: Good day, and welcome to the CooTek's Fourth Quarter and Fiscal Year 2021 Unaudited Financial Results Conference Call. Please note this event is being recorded.

I would now like to turn the conference over to Institutional Capital Advisory. 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 introduce CooTek's Chairman and Chief Technology Officer, Mr. Karl Zhang. Karl, please go ahead.

Karl Zhang: Thank you. Thank you, everyone, for joining our fourth quarter and financial year 2021 earnings call. We have concluded the year of 2021 with our revenue of US\$272.1 million and a non-GAAP profitability for the 3 consecutive quarters starting from the second quarter of 2021.

Under the current circumstances in relation to the uncertainties in the Chinese advertising market, we are confident that our balanced development strategy and second flywheel in the overseas mobile games segment will continue to drive the sustainable growth of the group.

To enhance our balanced development strategy, we optimized our resources and concentrate more on overseas mobile game business. We turned our Chinese domestic online literature business, Fengdu Novel, into profitability since the third quarter of 2021. Meanwhile, we are diversifying our IP monetization business, based on our Fengdu Original books, to increase the revenue and profit and benefit the content ecosystem.

We have been incubating Readict, our overseas online literature apps, since 2020. Based on the current progress, we expect Readict will start to generate profit in April 2022 for the Group. And starting from the fourth quarter of 2021, we performed a series of cost control plans to cut down the overall cost of the Group significantly.

With all the efforts, we expect the Group will generate meaningful net income of the full year of 2022 with operating cash flow turned to be positive in the first half of 2022.

As a sign of the confidence in our long-term growth and the value of our business, I announced that I will purchase up to US\$3 million of our company's ADR during the 6-month period starting today after this earning release.

Firstly, it is worthwhile to address our overseas mobile games business. We have made many breakthroughs in the overseas mobile game business in 2021. Catwalk Beauty and Truth Runner, both casual mobile games, have topped both U.S. iOS and Google Play Store game chart. These achievements showcase our data-driven content production model, outstanding R&D and

distribution capabilities. We continue to apply this methodology to many other game types.

In particular, the success of Love Fantasy, our match-3 game, is a big step for us. It is our first game combining interactive storyline, which is composed from a hot online novel and match-3 game experience. It topped the list of Most Downloaded iOS Chinese Overseas Games in December 2021, with 2.5 million total downloads. On Google Play, it ranked as the second place on the Most Downloaded Chinese Overseas Games list. The success of this game validated the strong synergy between our online literature and the mobile game business.

Love Fantasy targets female mobile game players. Based on the explosive match-3 gameplay, the game added an interactive romance storyline, which fits with the pursuits of contemporary women for life, romance, and career. Since it was launched, Love Fantasy received many good reviews, and has achieved high user ratings of 4.9 out of 5 on App Store and 4.8 out of 5 on Google Play Store.

In 2022, we plan to roll out more match-3 plus interactive storyline games. We will compose more attractive storylines from the hot novels of Readict, our novel app for overseas markets.

In addition, we started to develop vigorously our game publishing business in the overseas market. Hotties Up has achieved exceptional success after it's ranked as top 3 on the U.S. iOS game chart. It is a casual game developed by Wrap Drive and published by Smillage, our invested studio.

We have signed a cooperation agreement with 24 third-party studios for publishing the products in the overseas market. We developed our game publishing SaaS platform, which is based on our unique data-driven content production model. Our content providers will produce their content on this platform. We provide comprehensive data matrix to help them evaluate their ideas, upgrade content in their games, and optimize monetization and user acquisition.

Driven by our internal development and external cooperation, we believe that the mobile games development and publishing business will grow rapidly in the overseas market, and the revenue contribution from the overseas market will continue to grow.

During the fourth quarter of 2021, the total revenue from overseas mobile games business exceeded US\$11 million and Love Fantasy contributed to more than 60% of the revenue.

Secondly, for our online literature business, we have been steadily consolidating the product exposure of Fengdu Novel in the Chinese market and Readict in the overseas market. Under our current balanced approach, we have been continuously improving the efficiency of user and content acquisition and management for Fengdu Novel. The user retention rate and user reading time have been consistently improving in 2021.

Also the signed authors and original contract books also increased by 100% and 113% compared to the same period in 2020.

As part of our IP commercialization plan, we reached a collaboration with Tencent Video's Mars Project, which aims to support micro drama TV adaptation. A batch of high-quality online literature work from Fengdu Novel have entered into the bidding stage, and will be ready for

shooting upon the completion of bidding and coordination with the producers.

We also initiated a dynamic novel-to-drama launching mechanism while seeking external cooperation to maximize the influence and profitability of IP works. The customized launching campaigns using social media and other channels have also achieved substantial results.

In addition, we have been expanding our monetization channels by launching our social media distribution plan. We cooperate with KOLs to distribute our IP content to relevant and targeted audience with a pay-to-read monetization model, which provides a strong complement to our current free-to-read app model. As a result, Fengdu Novel currently constitutes a strong and stable gross profit and net income contributor for the group.

In terms of Readict, the online literature app targeting overseas market, we have been incubating it in a more tailored approach for the positioning of the product in the overseas market. The current focus is to further strengthen the user retention rate and ROI performance. The current 90-day ROI exceeded 100% already. And we are confident that the prospect of the online literature business in the overseas market continues to be strong and will start to contribute profit from April 2022 for the Group.

To summarize, we are glad that we have been mitigating effectively the different level of risks during our business development. We expect that our profitability will be further improved in 2022 with a meaningful net income level to be achieved and an improvement in the cash flow status and cash balance.

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. I'm going to brief our fourth quarter 2021 first.

Net revenue was US\$53 million, a decrease of 48% from US\$102.4 million during the same period last year. 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 55%, online literature accounted for approximately 42%, and scenario-based content apps accounted for approximately 2%.

DAUs of the Company's portfolio products were 18.5 million, a decrease of 33% from 27.8 million in December 2020. MAUs of the Company's portfolio products were 62.6 million, a decrease of 27% from 85.8 million in December 2020.

Our gross profit margin was 88.7%, compared with 93.1% in the same period last year and 83.1% last quarter.

GAAP cost and expenses were about US\$52.4 million, a decrease of 2% sequentially and a

decrease of 57% from the same period last year. Non-GAAP cost and expenses were US\$51.6 million, a decrease of 2% sequentially and a decrease of 57% year-over-year. As a percentage of revenue, GAAP cost and expenses accounted for 98%, down from 119% in the same period last year. The year-over-year decrease in operational expenditures are mainly due to sales and marketing expenses reduction.

Sales and marketing expenses decreased by 63% from the same period last year, an increase of 18% from last quarter. The year-over-year decrease in the sales and marketing expenses was primarily due to the 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.

The sequential increase in sales and marketing expenses was primarily due to the increased investment in user acquisition in connection with our efforts to grow the user base, and was partially offset by decline in salary and payroll expenses associated with sales and marketing staff.

R&D expenses decreased by 1% year-over-year and decreased by 30% sequentially, primarily consist of costs associated with technology R&D staff.

G&A expenses decreased by 13% year-over-year and 15% sequentially. The sequential and year-over-year decreases were mainly due to a decrease in the salary and payroll expenses associated with G&A staff, and also third-party outsourcing fee.

GAAP net loss was US\$0.3 million. Excluding the impact of share-based compensation, adjusted net income was approximately US\$0.5 million.

I will now quickly run through a few key full year 2021 financial results. Further details can be found in the earnings release.

Net revenue was US\$272.1 million, a decrease of 38% from US\$441.5 million in 2020. Online literature accounted for approximately 39%; scenario-based content apps accounted for approximately 8%; and mobile games accounted for approximately 52% of the total net revenue.

Gross margin was 87.9%, compared with 94.5% in 2020.

Total cost and operating expenses were US\$280.9 million, a decrease of 43% from \$489.4 million in 2020.

Sales and marketing expenses were US\$200.2 million, a decrease of 52% from US\$418.3 million in 2020. As a percentage of total net revenue, sales and marketing expenses accounted for 73%, a decrease from 95% in 2020, primarily due to the continuous transition of our 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 were US\$34.4 million, an increase of 16% from US\$29.7 million in 2020, mainly due to an increase in the salary and payroll expenses associated with technology R&D staff and third-party outsourcing fee. As a percentage of total revenue, R&D expenses accounted for 13%, increasing from 7% in 2020.

G&A expenses were US\$17.8 million, an increase of 19% from US\$15 million in 2020, primarily due to an increase in salary and payroll expenses associated with the G&A staff, professional service fee, third-party outsourcing fee and listing expenses, and was partially offset by a decrease in the bad debt provision. As a percentage of total revenue, G&A expenses accounted for 7%, increasing from 3% in 2020.

Net loss was US\$13.9 million, compared with net loss of US\$47.4 million in 2020. Adjusted net loss was US\$10.2 million in 2021, compared with adjusted net loss of US\$42 million in 2020.

At the end of year 2021, we had cash, cash equivalents and restricted cash of about US\$18.4 million, compared with US\$49.6 million as of December 31, 2020.

Operator, we are now ready to take questions.

Questions and Answers

Operator: (Operator Instructions). We will now take our first question from Steve.

Steve Silver: Some questions, a few. So first, you mentioned in the commentary some examples of the integration between the online literature and game segments under the unified content ecosystem. I was hoping you could a little more color about how those two initiatives are expected to come together further in 2022.

Karl Zhang: Okay. Thank you. I'll take this question, this is a great question. So mobile games and online literature are two major content business for us. So both are typical entertainment content business. There are many synergies between them despite their user experience being different. So first, we fully leverage our data-driven philosophy to build up these two business. We believe that the data-driven content production is disruptive to traditional content production model in these two fields. For example, most of the game companies usually incubate new games based on key person's experience, and their understanding of the market needs.

What we do is to implement a statistic IP evaluation platform with comprehensive data metrics to evaluate each idea about its potential market size, targeted user profile and even its ROI. When successful projects such as Catwalk Beauty actually came out of 50 idea evaluations, so we do similar things for our online literature. We have already made the data-driven content production SaaS platform available for our signed novel authors and our signed game content providers. So this is our core competency. By integrating and developing this unique data-driven content production platform, we can evolve this model, and the algorithm behind efficiently and to benefit both businesses.

And second, online literature and mobile game business have strong synergy on content level as well. So when we kick-off our game business back to the end of 2019, we planned to linked this to business with content, so that we compose storylines based on the hot novels from our novel app and make them available as a game. So Love Fantasy is a big step for us because it is our

first game combining interactive storyline and match-3 game experience. The success of this game validated the strong synergy between our online literature and mobile game basis.

And we will produce more games with attractive storylines from Readict, and potentially from Fengdu Novel as well. And we are merging internal talents related to this business chain from novels to games to make the flow more efficient. Thank you.

Steve Silver: Great. And thank you for the outlook for net income generation in 2022. I was hoping you could just discuss briefly the company's flexibility in managing expenses to maintain that outlook if the macro environment remains challenging?

Robert Cui: Yes, okay, I'll take this question. So obviously, as consistently mentioned during our previous earnings calls and also this earnings call as well, we will continue to maintain a reasonable spending for the cost and expenses. And in particular, for the sales and marketing expenses, we are targeting a stable 70% as a revenue level for the next few quarters, in particular, for 2022.

And also we have seen continuous space for improving the efficiency of R&D and G&A expenses as well. So our targets for the R&D expenses as a revenue and G&A expenses as a revenue are around 10% and 6% for the current year. Thank you.

Steve Silver: Great. And last one from me. Just if there's any guidance around the piece of new game launches in 2022, whether that might match or stay around the same range that we saw in the second half of 2021? And also just to clarify, this is Steve Silver from Argus Research. Thanks so much.

Karl Zhang: Okay. I will take this question. So we have made many breakthroughs in the overseas mobile game business in 2021. So Catwalk and Truth Runner, both casual mobile games have targeted the U.S. game chart. And these achievements showcased our unique data-driven content production model. And we continue to apply this capability to other game types. So for example, Love Fantasy, our match-3 game, topping the list of the most downloaded iOS and iOS Chinese overseas games in December 2021. And on Google Play, it's ranked in the second place as well.

So to extend the success, we started to develop vigorously our game publishing business in the overseas market. And we have already released the Hotties Up, and which is exceptional success app is ranked as top 3 on the U.S. game chart. And it is actually a casual game developed by Wrap Drive and published by Smillage.

So 2022, we expect to accelerate the pace to launch new games by the following facts. So one, we have signed over 20 external game studios with our publishing business. And we developed our game publishing SaaS platform already, which is based on our unique data-driven content production model. And our content provider will produce their content on this platform, and we provide comprehensive data metrics to help them evaluate their ideas involving content in their games and optimize monetization acquire users.

So we believe this approach to enable our partners will help us to scale out our new game release, and form a more competitive content ecosystem. And we have 3 games almost ready to

go and we expect more from this coverage model in the coming quarters. And Love Fantasy is a big step for us because it is our first game combining interactive storyline and match-3 game experience. So the success of this game validated the strong synergy between our online literature and the mobile game business.

The way we explored and composed more attractive storyline from the hot novels of Readict, our novel app from overseas markets. And in 2022, we plan to roll out more match-3 plus interactive storyline games. I think in the end of the second quarter of this year, you will see another one coming out, which is another match-3 game as well. And we are expecting more in the second half of this year. Thank you.

Operator: (Operator Instructions). Vivian Zhang from Diamond Equity Research.

Vivian Zhang: My first question is about the game studios you've invested in. We know that Smillage is one of them, and has launched a lot of high-downloaded games for example Catwalk Beauty and Love Fantasy. So how do you work with these third-party studios to ensure they deliver successful games and generate significant revenue?

My second question is that with a continued tightening of Chinese government policies on the internet and gaming industries affected the company's fields on the industry's prospects?

Karl Zhang: Thank you for your questions, I will take both of them. So the first question is about our game studios, interactive game studios. And as I mentioned, we fully leverage our data-driven philosophy to build up our business. So we believe that the data-driven content production is disruptive to traditional content production model.

And we have already implemented our data-driven content production and the publishing service as SaaS platform, and built in all our data metrics, user growth engine, monetization optimization, and related algorithm about content production and the distribution in this SaaS platform. And all our invested studios and our signed game content providers have access to this SaaS platform. In this way, we enable our partners ensure their success to establish a healthy content ecosystem.

In terms of the second question is about the Chinese government's policy. So I don't think I'm in the right position to comment or predict the government's policies. But the macro economics, especially internet advertising on demand side, is relatively weak since the third quarter of 2021 in Chinese domestic markets. So I think this is correlated to government's regulation, which I think some of them have positive long-term benefit to the industry. And there are still uncertainties about the Chinese domestic mobile game regulations.

But as I mentioned, to enhance our balanced development strategy, we have optimized our resources and concentrate more on our overseas business, especially overseas mobile games. We made a bunch of critical breakthroughs in the overseas mobile game business and we targeted all our new game projects to overseas markets. And the pipeline is solid for the coming years.

And we have been incubating Readict, our online novel app for the overseas market. It has made phenomenon progress and will start to contribute profit to the group from April 2022, I believe. Thank you.

Vivian Zhang: Thank you.

Operator: (Operator Instructions). As there are no further questions at this time, I'd like to turn the conference back to your speaker for any additional 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 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.