

CooTek Inc. [CTK]  
Third-Quarter 2018 Earnings Conference Call  
November 18, 2018

Company Representatives:

Rene Vanguestaine; Christensen & Associates; IR  
Karl Zhang; CooTek Inc.; Chairman and Chief Architect  
Jean Liqin Zhang; CooTek Inc.; Chief Financial Officer

Analysts:

Emerson Chan; Bank of America Merrill Lynch  
Hans Chung; KeyBanc Capital Markets  
Unidentified Analyst; Credit Suisse  
Virginia Yu; Citigroup

Presentation:

Operator: Hello, ladies and gentlemen, and thank you for standing by for CooTek's third-quarter fiscal year 2018 earnings conference call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session. As a reminder, today's conference call is being recorded. (Operator Instructions)

I would now like to turn the meeting over to your host for today's call, to Mr. Rene Vanguestaine. Please go ahead, Rene.

Rene Vanguestaine: Thank you, Andrew. 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](http://ir.CooTek.com) and on PRNewswire.

On the call today from CooTek are Mr. Karl Zhang, Chairman and Chief Architect, and Ms. Jean Liqin Zhang, Chief Financial Officer. Mr. Zhang will review business operations and company highlights, followed by Ms. Zhang, who will discuss financials and guidance. They will be available to answer your questions during the Q&A session that will follow.

Before we begin, I'd like to remind everyone that this conference call may contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are made under the safe harbor provisions of the US 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 US Securities and Exchange Commission, in its annual report to shareholders, in press releases and other written material and in oral statements made by its officers, directors or employees to third parties. Any statement 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 mobile advertising industry; the expected growth of mobile advertising; expectations regarding demand for and market acceptance for our products and services; competition in mobile applications and advertising industry; and relevant government policies and regulations relating to the industry. Further information regarding these and other risks, uncertainties or factors is included in the Company's filings with the US Securities and Exchange Commission.

All information provided on this call is current as the date of this call and CooTek does not undertake any obligation to update such information, except as required under applicable law.

It is now my pleasure to introduce Mr. Karl Zhang. Mr. Zhang, please go ahead.

Karl Zhang: Thank you, Rene. Thank you, everyone, for joining our third-quarter earnings call and the first as a public company since our IPO on New York Stock Exchange on September 28.

We are pleased to be a public company after having spent years building a trusted brand among our global user base, something that we look forward to replicating with our investors as we continue to scale our rapidly growing business. I'm confident that this is only the beginning of a long and fruitful relationship with investors.

We are committed to building an AI-driven global content delivery platform and to realizing our mission, which is to empower everyone to express themselves and enjoy relevant content seamlessly. Our user-centric and data-driven approach has enabled us to [realize] appealing products to capture mobile internet users' ever-evolving content needs and help us rapidly attract targeted users. We have released multiple content-rich portfolio apps covering five verticals: news [and] short videos, fitness, healthcare, lifestyle and entertainment.

We are pleased to report a very successful quarter. Thanks to our proven systematic approach to growing and retaining our user base, we were able to outperform on DAU and revenue growth while remaining profitable. As a result, this September we increased DAUs of our content-rich portfolio apps by nearly 50% from June this year to reach 11 million, surpassing our internal expectations for the quarter. Total net revenue was US\$36.8 million, an increase of 300% from US\$9.2 million in the same period last year. We turned profitable during the first quarter of this year and have expanded our profitability since then with net income growing to US\$2.8 million during this quarter, compared to a net loss of US\$5.2 million during the same period last year. The performance was mainly driven by the fast-growing user base as well as improved performance of our AI-powered global content delivery platform and precise-targeting advertising system.

At the same time, we have been concentrating our efforts on developing our unified personalized content recommendation system to enhance the relevance of the content we delivered through news feeds. This has resulted in an increase in the amount of time spent on our apps by our users. Leveraging our in-depth user insights, we further optimized the performance of our ads. As a

result, average e-CPM during the quarter grew 100% year over year.

Our super app, TouchPal Smart Input, continued to gain growth momentum as we improved user engagement to about 74% in September. This brings the product to approximately 133 million daily active users in more than 240 countries. The increase is partially due to the TouchPal's popular new AI-powered virtual personal assistant, Talia. Supported by cutting-edge AI technology, Talia is integrated seamlessly with TouchPal Smart Input and serves as a personal assistant to our users by providing them accurate predictions, smart replies, and timely relevant content and service recommendations, all conveniently accessible through the same interface. Talia is being widely adopted by our strategic partners. For example, Oppo, launched their flagship smartphone in August with TouchPal and Talia bundled. We will continue to leverage our strengths in deep analytics and AI to effectively grow our user base, optimize user engagement and continuously expand our in-depth user insights.

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

Jean Liqin Zhang: Thank you, Karl, and thanks everyone for joining us on the call today. I'm going to walk you through our third-quarter progress against our key financial metrics related to users, revenue and expenses. All comparisons are on a year-on-year basis unless otherwise noted.

Let's start with users. We ended September with approximately 214 million people using our global products, up 60% from a year ago. Approximately 144 million people accessed our global products each day on average in September, up 61% from the prior year.

Monthly active users on portfolio products reached 33.7 million in September, up 13.5x from a year ago. The average daily active users on our portfolio products in September reached 11 million, up 14.7x compared to the last year.

Average daily active users on TouchPal Smart Input in September were approximately 133 million, up 50% from last year. This number represented about 74% of 180 million monthly active users. The MAU was up about 37% compared to last year.

Now turning to revenue, as Karl mentioned, total revenue in the third quarter was up 300%, and advertising revenue was up about 320%. We are seeing a positive impact from our investments in user growth and advertising monetization. We estimate that, of the total advertising revenue for the third quarter of 2018, portfolio products contributed approximately 67%, TouchPal Smart Input contributed approximately 18% and TouchPal Phonebook contributed about 15%.

Turning now to expenses, our Quarter 3 GAAP expenses were US\$34 million, an increase of 135% from last year. It represented 92.7% of revenue, improved from 157.8% last year and remained stable from last quarter. The increase in expenses was driven mainly by continuous investments in user growth and headcount growth.

We achieved portfolio products DAU growth of 14.7x year on year and of 50.7% quarter end

over quarter end, while sales and marketing expenses up 3.8x year on year and 44% sequentially. Most of the increase in sales and marketing expenses was invested in portfolio products user growth, in line with our business development priority. We plan to continue to invest to grow our global user base in the fourth quarter, with a sharp focus on our content-rich portfolio applications, as Karl described.

We ended the quarter with 451 full-time employees, up 21% from last year and 17% from last quarter. R&D employees represent 63% of total employees, compared to 57.8% last year.

Our gross margin was 90.7%, up 43-point -- percentage points from last year. We turned profitable in the first half of this year and continued the trend this quarter. We had GAAP net income of \$2.8 million, representing a 7.6% profit margin. Excluding the effect of stock compensation, our adjusted net income was approximately \$3.5 million, representing a 9.4% non-GAAP profit margin.

We generated US\$5.3 million from operating activity and ended the quarter with approximately US\$29.4 million in cash and cash equivalents compared to US\$26.7 million as of December 31st of last year.

No loans remained as we repaid all bank borrowings in the third quarter of this year.

The proceeds from our IPO on the New York Stock Exchange on September 28 this year were not received yet by us until the closing date of the IPO which was October 2. And the shareholders' equity and convertible redeemable preferred shares as of September 30 do not reflect the effects of this IPO.

Turning now to the revenue outlook. We are encouraged by our solid and sustainable growth and for the last quarter of this year we expect total revenue to be between US\$46 million and US\$47 million, representing a 141.7 % to 146.9% increase year on year. These estimates reflect the Company's current and preliminary view, which is subject to change.

Operator, we are now ready to take questions.

Questions & Answers:

Operator: We will now begin the question-and-answer session. (Operator Instructions) The first question comes from Emerson Chan of BAML.

Emerson Chan: Thank you, Management. To my understanding the retention rate of our portfolio apps should not be high. So, how we will improve the user intention going forward? This is my first question. My second question is how do we strike a balance between user growth and profitability? What is our priority in terms of business development in the next few years? Thank you.

Karl Zhang: Thanks. We don't disclose retention rate, but we believe that the retention rate of our products is good compared to the industry peers. We can refer to the increasing user engagement rate of our products, like 74% DAU over MAU for TouchPal Keyboard, and a 33% for our portfolio apps.

But, yes, there is still room to improve the retention rate of our products. In Q3, we restructured our organizations and create a dedicated team, which is led by our CTO, Jim, directly to build up our company's growth platform to support key metrics growth, including retention. And we are hiring very senior people [of growth sectors]. We believe that the experienced people with the right methodologies are quite important. We are optimistic about this. And for example, we noticed very strong correlations through the growth platform between the quality of the content we delivered and the retention rate. We are improving our content recommendation systems based on the data and meanwhile we build up our content management team already to improve the quality of the content.

And, second, we have identified some aha moments for our products through the growth platform as well, and we are testing different design solutions to have more users to enjoy the aha moment, which in turn will benefit the retention. And because for most of our products users are storing their personal data in the apps, so we can introduce user recall program as well to improve retention. So basically we have a lot of approaches to improve the retention and we will try that and based on the data.

And let me answer your second question. And first let me remind you that we are profitable already and we are happy with the bottom line. And that gives us the flexibility to dynamically adjust our spending based on our strategy. So given our priority at this moment is to enlarge our user base rapidly, so we will continue to invest heavily on sales and marketing, but still remain profitable. And the unit cost and economics of our investments to acquire users remains stable despite the enlarged scale of our user base and acquisition volume.

Our revenue is generated from our accumulated user base, but the cost is mainly to acquire new users. And our gross margin exceeds 90% already. That means the more active users we are accumulating, the more profit we potentially will have.

And we have a couple of approaches to improve the ARPU of our products to improve profitability. For example, by investing in our content recommendation system, we can improve the relevance of the content we deliver, which in turn will increase the time spent. The more time spent, the more ads we can show.

And by investing in our advertising system, we can also improve our ad performance, which is the eCPM. And we believe that the data we accumulate from our super app TouchPal Keyboard is a very unique asset and the foundation for success in the ad industry. By leveraging our in-depth user insights we have been continuously improving our advertising systems to deliver more relevant ads within the news feed and other ad formats to increase monetization efficiency. And we will continue to work to improve user retention, which will improve ROI and benefit profits.

So in terms of priority, I will say that the efforts to grow and retain users are taking priority at this stage. But we are also investing in monetizing users. That is to improve the ARPU. Thank you.

Operator: The next question comes from Hans Chung of KeyBanc Capital Markets.

Hans Chung: Thank you for taking my question. Congratulation on strong quarters. So first question is, I think, we have some upside in the user growth in both the TouchPal Input and also the portfolio apps in terms of DAU. So I just wanted to know, is that driven by the probably higher spending on the user acquisition, or just was driven by the data conversion rate, or retention rate, or both?

And then the second question is just can you provide any color about the time-spent trends overall in third quarter? And also the -- I mean we have -- we are now in the first half of the fourth quarter. And then what's the overall content trend, I mean particularly for the portfolio app? Thank you.

Karl Zhang: Thank you, Hans. Let me answer these questions. So for Q3 the key drivers of the DAU growth is mainly from the enlarged new users we acquired. And other key metrics continued improving as well in Q3. For example, the retention rate is improving as well. So we are happy with this for Q3 because usually when you enlarge user acquisition volume dramatically some of the key metrics may jump. But we are still in good shape. So this is the answer to the first question.

And your second question is about the time-spent trend of our product, especially the portfolio product. So despite we don't disclose the number of the time spent at this moment for our portfolio apps, but basically the trend is pretty good. So the average time spent per user for our portfolio apps increasing in the past couple quarters and we expect this trend to be continue for this quarter.

Hans Chung: Thank you.

Operator: The next question comes from Thomas Chong of Credit Suisse.

Unidentified Analyst: Hi, Management This is [Arib Rhee] speaking on behalf of Thomas. First, congratulations on the successful listing and the strong quarter. I have three questions currently. So the first question is mainly regarding does the macro economic situation or the macro headwinds actually having effects on our business? So understanding our businesses is a more global business just wanted to get some color if this has impact as well.

The second question that we're interested is can management share some color of the geographic mix of the TouchPal Smart Input and the other global portfolios products that, like, probably by regions, about the MAUs or DAUs?

And the third question that we want to ask is about can management share some recent development of the verticals or recent developments on the global portfolio apps development

here, so if any like new verticals that we're targeting to get into or any new apps that we are focusing to launch by year end? Thanks.

Karl Zhang: Okay. Thank you. So let me answer the first question; it's about the macro economy. This is kind of mixed on our side. So for our global business, which contributes over 85% of our revenue, we didn't see any significant change in the market. So the demand is still strong. The global ad industry is still growing and we see relatively strong needs on ads. And this benefits our business a lot. And the average eCPM grew over 100% year on year this quarter. And in most of the countries other than US, EU and China, the eCPM is still relatively low. So we believe that the global digital ad industry is huge, fast-growing and predictable.

And we also believe that the data we accumulate from our super app TouchPal Keyboard, is a very unique asset which help us to improve our advertising system to deliver more relevant ads through newsfeed and other ad formats.

But in our China domestic business we noticed the growth in the ads demand is slowing down. As a result, the average eCPM of our China domestic product, TouchPal Phonebook, is relatively flat in Q3. And due to the industry and the regulation impacts, ad demand from some segments, for example, P2P and online gaming seems dropping. But on the other hand, we saw strong ad demand from China -- Chinese mobile internet companies expanding business overseas. We believe that we can benefit from this trend.

And your second question is about the -- and let me introduce more about our portfolio apps. So our user-centric and the data-driven approach have enabled us to release appealing product to capture mobile internet users' ever-evolving content needs and help us to rapidly attract targeted users. So we have released multiple content-rich portfolio apps covering five verticals like short videos, fitness, health care, lifestyle and entertainment. So actually we analyzed the user interaction data accumulated through TouchPal Keyboard and identified those five content verticals which have relatively wide interest, bigger addressable markets and growth potential globally. So while we don't disclose detail number for each individual portfolio apps, I can tell you that in Q3 we saw strong momentum in all of these five verticals.

We are confident in our growth perspectives and our proven systematic approach to grow, retain, and monetize our users effectively, which give us a tremendous advantage over vertical competitors. So our strategy is to focus on these selective content verticals and grow our user base rapidly. We've worked a lot on contents for our portfolio apps in Q3 to improve user experience and engagement. For example, we enhanced the discussion tab in our health care content app Cherry to encourage content aggregation -- sorry, encourage content generation and consumption. So Cherry is well received in North and the South American countries. We see strong potential on our short video app VeeU in South American and Asian countries such as Brazil and Thailand. Users are spending much more time VeeU every day. The average time spend of each DAU improved significantly in Q3.

And our fitness apps, which take relatively a big portion of portfolio DAU, are growing well in North and South American countries. We redesigned the apps to organize professional fitness content and made fitness-related short video feeds more visible. These efforts resulted in longer

time spend as well.

The one thing I want to remind you of is that although we develop and run multiple content-rich apps, we actually have an AI-driven unified content recommendation systems working behind to support all apps. And we will continue to invest in AI and big-data technologies to improve the relevance of the content we deliver.

And the last -- the latest geographical distribution of our user base is relatively stable compared to last quarter. The absolute number of users are increasing in all the regions for both content-rich portfolio apps and the TouchPal Keyboard.

As for our portfolio apps, over 32% of MAU is from Tier 1 countries in Q3, including North American, Europe and the Asian -- ocean countries. In Q2, this number was 36%. So we expect this percentage will be stable in Q4.

We saw strong growth from South America, where it's grown from 25% to 28% this quarter. The percentage of other regions are stable but, again, we're experiencing growth in all regions. To emphasize, despite such geographical distribution change the average ARPU for our portfolio apps remained stable, thanks to the improved monetization efficiency and the user engagement. Here I want to emphasize that our strategy to build portfolio apps for multiple countries or verticals really give us the flexibility to capture mobile internet users' ever-evolving content needs and helps us rapidly attract [targeted] users globally. For example, our fitness and health care apps are well received in North and South America. And we are optimistic about the potential growth in our short video apps VeeU in Asian countries.

As for TouchPal Keyboard, the user distribution remained stable compared to Q2 overall. Approximately 11% users are from Tier 1 countries. South Asia remains the number one region of the user base. Thank you.

Unidentified Analyst: Thanks.

Operator: (Operator Instructions) The next question comes from Virginia Yu of Citigroup.

Virginia Yu: Hi, Karl and Jean. Thanks for taking my question and congratulations on your first public release. I just got a couple follow-up questions on the previous questions. The number one is a follow-up on the macro question that you just answered. Can I interpret that for your 4Q guidance, just like what you said, probably the oversea sentiment is better than China sentiment? So can we expect when breaking down the 4Q guidance, the overseas actually taking more than 85% of the revenue like this quarter?

Number two, regarding the verticals makes just like what you mentioned just now, like, quite a lot of China companies are actually going overseas. Do you see any typical verticals that are doing a lot more than the others; like gaming or whatever verticals that is performing a little bit better in overseas that will change our mix in terms of advertisers?

Number three, a separate question, which is on your sales and marketing costs. I noticed that the

sales and marketing costs as a percentage of revenue is a bit higher compared with previous quarters. Can Management give us more guidance on how you will spend going forward and in what areas that you will make use of these sales and marketing expenses? Thank you.

Karl Zhang: Thank you. And I will answer the first two questions and I will leave the third question to Jean to answer.

So basically, as I mentioned that the macroeconomic change is kind of mixed on us. And our global business is still strong. And we're actually expecting that the global business is going to generate more percentage of the revenue for the coming quarter actually. That is the current projection we have. So which means that for our China domestic market, the percentage of the revenue this business generates, is going to decrease, I think.

And, yes, we did notice that there are some obvious strong demand that's some Chinese Internet companies going global. And there are some -- for example, the gaming, the online gaming industry, we noticed some obvious change and increased demand for the advertise from this industry. That's one obvious industry that we noticed.

And for the third question, I will hand over to Jean to answer about the sales and marketing.

Jean Liqin Zhang: Yes. Currently, we are profitable and we are very happy with the bottom line now. This gives us the flexibility to dynamically adjust our spending based on our strategy. Given our priority at this stage is to enlarge our user base rapidly, we will continue to invest in sales and marketing, but still remain profitable. We achieved almost 50% quarter-over-quarter DAU growth for our content-rich portfolio applications, which exceed our expectations.

Most of the sales and marketing expenses were spent to grow our user base, especially the user base of content-rich portfolio. This quarter, the sales and marketing expenses increased 44% quarter over quarter, which effectively drove the DAU of our portfolio products. And the unit cost and economics are remaining stable despite the enlarged scale of user base and acquisition volume. We are very satisfied with this. We are confident also about the performance of our proven growth platform to sustain the unit economics and the balanced user growth and our profitability, the bottom line. Yes, so that is the general guidance for our thinking regarding the sales and marketing expenses.

Virginia Yu: Got it. Thank you, and congratulations again.

Operator: [Operator Instructions] This concludes our question-and-answer session. I would like to turn the conference back over to Rene Vanguestaine for any closing remarks.

Rene Vanguestaine: Thanks, Andrew. Thank you all for joining us tonight and for your interest in CooTek. If you have any questions, please do not hesitate to contact us any time. This concludes our call. Good night.

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