

**Cheetah Mobile, Inc. [CMCM]
Q1 2019 Earnings Conference Call
Friday, June 14, 2019, 8:00 AM ET**

Company Participants:

Yi Qu, Manager, IR
Sheng Fu, Chairman, CEO
Vincent Jiang, CFO

Analysts:

Wendy Huang, Macquarie
Hillman Chan, Citigroup

Presentation

Operator: Good day, and welcome to the Cheetah Mobile first quarter 2019 earnings conference call. (Operator Instructions). After today's presentation, there will be an opportunity to ask questions. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Yi Qu of Cheetah Mobile's Investor Relations Department. Please go ahead.

Yi Qu: Thank you, Operator. Welcome to Cheetah Mobile's first quarter 2019 earnings conference call. With us today are our Chairman and CEO, Mr. Fu Sheng, and our Company's CFO, Mr. Vincent Jiang.

Following management's prepared remarks, we will conduct a Q&A session. Before we begin, I refer you to the safe harbor statement in our earnings release, which also applies to our conference call today, as we will make forward-looking statements.

At this time, I would now like to turn the conference call over to our Company's Chairman and CEO, Mr. Fu Sheng. Please go ahead.

Sheng Fu: Thank you, Qu Yi. Hi, everyone.

First, while our first quarter of 2019 financial results met management's expectations, we admit that we still face some challenges to grow our revenues in the near term. Additionally, we plan to increase our investment in AI, which may reduce our profitability in the short term, as our AI business is still in its early stages of development.

The recent global business environment has brought some difficulties to our overseas business. In addition, we are still facing challenges resulted from the misleading statements made by a third party in late November 2018. The impact of the misleading statements on our business was more significant than we expected.

Although we have issued several public statements to clarify and explain the situation, those allegations still inflicted considerable damage to our brand reputation, and led to a pause in our collaboration with some of our business partners in the overseas market.

Cheetah Mobile's audit committee has conducted an independent review of these allegations with outside counsel Skadden Arps and independent data auditing firm AlixPartners. The review did not identify any information inconsistent with the Company's previous disclosures.

We have informed our business partners about the conclusion of the review. Some of them have resumed business relations with us. But some of them still have not, including Facebook, even though Facebook has pre-approved the selection of the auditing firm.

We are committed to providing the highest quality advertising products and services to our business partners. We plan to engage reputable third-party ad fraud intelligence companies to independently monitor our ad services. We hope that by taking this additional step, we can fully address the concerns our overseas business partners may have as a result of last year's allegations.

Second, our utility product business and mobile entertainment business have continued to collectively deliver healthy revenues and profits as well as generate cash flow.

In the quarter, our utility product business earned about RMB500 million in revenue and RMB123 million in operating profit. Revenues from mobile games grew by 73% year-over-year to RMB302 million. In the second half of this year, we will take some measures to allow our utility product business and mobile entertainment business to continue collectively generating decent profits and cash flow. Such measures include, first, we will implement stricter cost controls within our utility product business and mobile entertainment business; second, we will streamline and refine our product lines; third, we will optimize our corporate structures to focus more on AI business.

In addition, we have a strong balance sheet and talented product development team building industry-leading applications for users.

As of the first quarter of 2019, we had \$510 million in cash and cash equivalents, restricted cash, and short-term investments, as well as \$277 million in long-term investments. Within these long-term investments are several well-known projects, such as WIFI Master, Bytedance and Codemao.

Over the years, we have also built up a formidable R&D team, which has been continuously rolled-out chart-topping utility apps. Our robust utility product and mobile entertainment businesses, strong balance sheet, and talented product development team will allow us to protect the downside during these trying times.

Third, we have sharpened our focus on our AI business. Our setbacks in the overseas market made us recognize that our mobile internet business has relied too much on our business partners in the past. And that's also why we decided to focus more on AI, which will allow us to build our own ecosystem and eventually drive our long-term growth.

AI industry is still in its early stages of development. Together with Beijing OrionStar, we already have a full-chain AI technology and several well-known AI-based products to serve both consumers and enterprises. Cheetah Mobile is also the single-largest shareholder of Beijing OrionStar.

Over the years, we have built up a formidable R&D team, which has continuously rolled out chart-topping utility apps. By leveraging our in-house AI technologies and the additional resources received from our collaboration with OrionStar, we believe our R&D team will continue to develop innovative, AI-driven products and services that can help our users to improve their productivity and solve other real-world problems.

During the quarter, some of our AI products have already shown some early encouraging progress. We have built more use cases for our AI products, such as English language learning, international travel, voice assistant, and others.

Finally, we recognize the challenges that lay ahead, and our AI business will take some time to show meaningful revenue contributions. However, I am confident that our AI strategy is on the right track and we believe, with focus and determination, that we will be able to rejuvenate our Company's growth.

With that, we will now turn the call to our CFO, Vincent Jiang, to go through the details of our first quarter financial results.

Vincent Jiang: Thank you, Sheng, and hello, everyone.

Total revenue in the first quarter of 2019 was RMB1.09 billion, reaching the high end of our revenue guidance. This result was primarily driven by our mobile entertainment business, which saw revenue increase by 42% to RMB556 million year-over-year, and represented 51% of our total revenue.

We also incurred an operating loss of RMB18 million on a GAAP basis. On a non-GAAP basis, we generated an operating profit of RMB9 million. The decline in the operating profit, compared to previous quarters, was mainly attributable to our increased investments in AI technologies, which amounted to roughly RMB98 million in the first quarter of 2019.

Our utility products and related services business continued to earn profits. Losses from our mobile entertainment business narrowed significantly, and non-GAAP net income attributable to Cheetah Mobile shareholders was RMB34 million in the quarter.

I will now expand on the results of the quarter. Please note that all financial numbers are in RMB terms unless otherwise noted.

In the first quarter, revenue from mobile entertainment business increased by 42% year-over-year to RMB556 million. In particular, this increase is attributable to increases in revenues from mobile games and LiveMe, our live streaming business.

Revenues from our mobile games grew by 73% year-over-year to RMB302 million, mainly due to the incremental revenue contributions from Bricks n Balls, which is a game that started to ramp up towards the end of Q2 2018.

Additionally, our flagship titles, including Piano Tiles 2, Rolling Sky, and Dancing Line, were still very strong in the first quarter of 2019. We also launched several casual games during the quarter. Although these casual games contributed to revenue growth, such contributions were insignificant.

Revenue from LiveMe was up 17% year-over-year to RMB255 million. This increase was primarily driven by several initiatives introduced at the beginning of the year, which helped to improve ARPPU. These initiatives also helped to improve user interaction, competition, and engagement for broadcasting hosts, so paying users can spend more on our platform.

Revenues from utility products and related services were RMB498 million, decreasing by 33% year-over-year.

In terms of monetization, our legacy utility products business has faced some headwinds. For example, first, PC revenue continued to decline as our user traffic continued its migration to mobile. In the first quarter of 2019, PC revenue decreased by 5% to RMB120 million.

Second, some of our business partners in overseas markets have paused their collaborations with us as a result of the allegations made by a third party last year. As we mentioned in the CEO's script, Cheetah Mobile's audit committee has conducted an independent review of these allegations with outside counsel from experts at both Skadden Arps and AlixPartners. The review did not identify any information inconsistent with the Company's previous disclosures.

In the first quarter of 2019, revenue from our mobile utility product business in overseas markets decreased by 54% year-over-year to RMB145 million, accounting for 13% of our total revenue and representing a decrease of 28% from the prior-year period.

Third, similar to other internet companies, our utility product business in the domestic market has been negatively affected by the unfavorable macro environment, as we use an advertising model to monetize traffic.

Other revenues grew by 299% year-over-year to RMB31 million, largely benefiting from the sales of Cheetah Mobile Translator in China, which Fu Sheng mentioned in his script.

Turning to profits and margins, our gross profit decreased by 5% year-over-year to RMB719 million in the first quarter of 2019. Gross margin remained stable at 66% year-over-year in the same period.

Non-GAAP operating profits were RMB9 million in the quarter, down from RMB145 million in the prior-year period.

I will now turn to profits and margins for specific segments.

In the first quarter of 2019, non-GAAP operating profit for utility products and related services decreased to RMB123 million from RMB265 million in the first quarter of 2018, mainly due to a decrease in revenue from overseas markets.

Non-GAAP operating losses from our mobile entertainment business reduced to RMB44 million from RMB75 million in the prior-year period. Such improvement was attributable to our increasing operational leverage and stricter management of costs and expenses for LiveMe. It was also attributable to our improved operating profits for flagship games, which were partially offset by our initiatives to launch new titles.

Non-GAAP operating loss for other business was RMB70 million, mostly due to our investments in AI technologies and businesses.

Now, turning to our revenue outlook please note that the following forward statements only reflect our current and preliminary views and are subject to change.

With respect to the second quarter, we expect our total revenue to be between RMB920 million and RMB950 million.

Looking ahead, we will implement stricter cost controls for our legacy utility product business and mobile entertainment business. We will also commit additional resources to our AI business. We expect our utility product business and our mobile entertainment business to continue collectively generating profits and cash flow. However, we may sacrifice short-term profits to increase our investment into AI initiatives, which would help to secure sustainable, long-term growth for the Company.

Finally, again, we want to emphasize that the Company has a very strong balance sheet. As of the first quarter of 2019, we had US\$510 million in cash and cash equivalents, restricted cash, and short-term investments. We also have US\$277 million in long-term investments.

This concludes our prepared remarks. Operator, we are now ready for taking questions. Thank you.

Questions and Answers

Operator: Thank you. We will now begin the question-and-answer session. (Operator Instructions). Wendy Huang with Macquarie.

Wendy Huang: So I will ask in Chinese first and translate into English. (Speaking Foreign Language). I have two questions. The first is about the revenue model and also the potential monetization from AI. So given the current investment that you are making in AI or AI product you're having now, so what's the most likely revenue models out of it?

And second, so I wonder what's the major structural issue you are facing for your legacy utility business right now. Is it the overall advertising market issue, or is it our overseas market a consistent issue, or there's other problems out there?

And also regarding the recent Huawei and also Google dispute, Huawei is already banned to use Google's android system. How would that actually potentially indirectly impact your overseas business?

Sheng Fu: Okay. (Speaking Foreign Language).

(Translated). Yes, first of all from the traditional utility products, there are two sides of an impact. First of all is the android operating system itself. Right now, the [manufacturers] have been taking more and more of these features into the device by themselves, not to the privileges that may provide it to the developers.

Okay. Huawei event, so it doesn't really have a direct impact on us. But from this event, you can notice that the android operating ecosystem has a major impact on the other players on the ecosystem so --

Also for example, our business partners such as Facebook, and if they start doing business such as providing the third-party advertising business with us, we will lost one of the monetization channels and --

Okay. In terms of the revenue model from the AI business, on the consumer side, we have announced several products such as the one that we call 单词宝, which is a smart device, to help students to learn English. And we are having a very good user growth on that product, but comparing to the overall Cheetah Mobile size, that revenue contribution is still relatively small.

Also from the toB side, we can see that we have a lot of opportunities in the traditional business - - traditional industry that will -- that can be enabled by AI technologies. So we still see a lot of opportunities there, and we do have some product and services available already. But still, comparing those businesses' revenue contribution is still relatively small. So compared to the overall revenue scale of Cheetah Mobile, those contributions are still relatively very small.

Wendy Huang: Thank you.

Operator: (Operator Instruction). Hillman Chan with Citi.

Hillman Chan: I will ask in Chinese first and translate into English. (Speaking Foreign Language). So my first question is about the AI. So could management share more on the product or service

pipeline for the consumer side as well as the enterprise side? And how should we think about the investment budget on the AI business segment this year?

And my second question is on the second quarter guidance. Could management share more into the granularity by business segment on the second quarter outlook?

Sheng Fu: (Speaking Foreign Language).

(Translated). Okay. So first of all, the AItoC product have a very good quarter-over-quarter increase. We are very satisfied with that. In terms of toB business, we all know that it takes a longer period of time for the early investments in AI in the actual business. We have implemented successfully several scenarios, including like shopping malls and libraries. And we have developed some quite successful applications and products for those scenarios. We expect that the revenue from the two business products will be more visible in the next few quarters. We think that probably in the next 1 year or next -- after 2 quarters, we'll see some meaningful revenue contributions from AItoB products and services.

Okay. In terms of the allegations made against us last year, the impact actually is much more than what we expected. And we do need some time to find new business partners to replacing the one we lost as a result of those allegations.

In terms of the Q2 guidance, we think that Q2 is probably the lowest revenue season for us. And we expect that in the second half of the year, we will resume the normal business trajectory that we had in the past.

Also, this event also resulted in the delay of the launch of several of our new products, some games and utility apps. So that actually delayed our overall revenues for Q2. Again, we expect that we will resume the normal version of those games and the products.

Hillman Chan: (Speaking Foreign Language). No, I don't have other -- thank you very much.

Operator: (Operator Instructions). As there are no further questions, this concludes our question-and-answer session. I would like to turn the conference back over to management for any closing remarks.

Yi Qu: Thank you all for joining us today. And if you have any further questions, please do not hesitate to contact us. Thank you so much. Bye.

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