

**[CMCM] - Cheetah Mobile, Inc.
Fourth Quarter and Full Year 2017 Earnings Conference Call
Monday, March 19, 2018, 8:00 AM Eastern Time**

Officers

Ms. Helen Jing Zhu, Director, IR
Mr. Fu Sheng, CEO, Director
Mr. Vincent Jiang, CFO

Analysts

Thomas Chong, Credit Suisse
Wendy Huang, Macquarie Group
Andrew Orchard, Nomura
Liping Zhao, CICC

Presentation

Operator: Good day, and welcome to the Cheetah Mobile fourth quarter and full year 2017 earnings conference call. (Operator Instructions). Please note this event is being recorded.

I would now like to turn the conference over to Helen Zhu, IR Director. Please go ahead.

Helen Jing Zhu: Thank you, Operator. Welcome to Cheetah Mobile's fourth quarter 2017 earnings conference call. With us today are Mr. Fu Sheng, CEO and Chairman, and Mr. Vincent Jiang, CFO.

Following management's prepared remarks, we will conduct a Q&A session. Before we begin, I refer you to the safe harbor statements 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 Chairman and CEO, Mr. Fu Sheng. Please go ahead.

Fu Sheng: Thanks, Helen, and hi, everyone. We had strong results in Q4. Total revenues grew by 9% year-over-year and 16% quarter-over-quarter to RMB1.4 billion.

Operating profits grew by almost 2.6 times year-over-year and 68% quarter-over-quarter to RMB222 million.

Now let me give you more details on each of our business lines. Our utility products and related service continued to earn strong profits and cash flow.

The non-GAAP operating margin for our utility products and related service increased to 34% in Q4, from 32% in Q3 and last year, thanks to our strategy to continue to optimize the cost and expense structure for the utility products business. For the full year of 2017, our utility products earned a record RMB980 million in operating profit.

Our utility products, such as Clean Master and CM Security, experienced some headwinds in the overseas markets. Facebook stopped using certain ad format, i.e., ads on mobile phone lock screens since May 2017. Google made the same decision in January 2018. These changes impact all app developers that monetize through ads, including Cheetah Mobile.

As a result, we saw a year-over-year decrease in revenue from the utility products in the overseas markets starting the second half of 2017. The decrease was because lock screen ads were a large part of our ad inventory for Clean Master and CM Security in the overseas market. That effect will continue in 2018.

On the bright side, we believe these changes will help remove many small app developers and foster a cleaner and more user-friendly mobile ad industry, which will benefit Cheetah Mobile in the long run.

For example, the make-up of revenues from our mobile utility products in the overseas market is now very healthy, because they are mainly from result-page ads, to which are well liked by our users. The profit margin for our utility products overseas stay very healthy, and its outlook remains good in 2018.

Our utility products that offer personalized services to our users continue to do well. For example, our AI-powered Cheetah Keyboard has grown into a leading third-party input app on the Android platform. Google Play featured it on its global homepage four times in the second half of last year.

The DAU of Cheetah Keyboard grew by 33% quarter-over-quarter in Q4, and we expect the figure to continue its growth trend in 2018.

Also, the DAU of CM Launcher has continued its fast growth even though the app has been on the market for a while.

Most notably, mobile revenues once again grew in our home market in Q4, showing strong year-over-year and quarter-over-quarter increases in both impressions and eCPM. The eCPM gain was helped by our strong direct sales team in China. Today, almost 70% of our mobile revenues in China come from direct sales. Our key customers include short-form video, news, social, and fintech firms. Also, our use of big data analytics has improved our targeting power and boosted eCPM in China.

Our mobile game business continues to grow and will be a key focus for Cheetah Mobile in 2018. We are confident of growing both revenues and profits for our mobile game business in 2018. We plan to actively expand our game portfolio by publishing third-party casual games and launching casual games developed in-house. As of the end of Q4, we operate seven major casual games.

In 2018, we expect to more than double the number of casual games we operate. In fact, we have four games in our pipeline for the coming next quarter of 2018. We have lately gained the rights to publish a dozen of small casual games, which will help to enrich our game portfolio future.

In addition to casual games, we have added multiplayer social games, and we plan to add middle-core games in 2018. For example, in Q4, we launched SkidStorm, a racing game that features multiple racers and a full portfolio of cars. Initial results have been very promising. The game has recently become one of the top 10 racing games in the U.S. on Google Play. Revenues from SkidStorm have grown a great deal since early 2018.

In 2017, Cheetah Mobile became a top game publisher on Google Play in the United States. Three mobile games were among Apple's Best of 2017 list. These top results were due to our efforts to enhance our games.

In the quarter, new features, shortcuts, and levels were added to improve game experience and increase user engagement. For example, we added Deceleration, an in-game purchase feature, to Piano Tiles 2 to slow down faster tiles and help players complete the game.

We also continue to bring our games to our home market in China. For example, the DAU of Piano Tiles 2, Rolling Sky and Dancing Line hit record highs in China during the Chinese New Year.

Live.me is Cheetah Mobile's first subsidiary to raise funds from outside investors. Its revenues continued to grow due to our efforts during the quarter to drive platform stickiness and user engagement.

On the product side, we launched engaging video-based social games, such as QuizBiz, a live trivia game. Users can play every day to answer questions for cash prizes. The cash prizes and fun element have attracted many users.

On the operations front, we launched premium services to the top hosts and core users. Now they can buy special filters, stickers, and other virtual items to build up their social brands in the mobile Internet space.

We have also grown our content by working more with local talent agencies. For example, pop star Victoria Monet added her favorite song into Cheez, a social short-form video app that Live.me launched in the quarter. Users can now have a dance-off with Victoria using the Dance Off feature, which shows users a set of dance moves for them to match. Cheez then detects how well the user can match all of Victoria's moves.

In addition to growing our existing businesses, Cheetah Mobile is committed to staying at the forefront of the latest advances in tech. We believe we are able to do so due to our talented R&D team, massive user base and strong cash position.

Over the past year, we have invested a great deal in AI, including in voice and facial recognition. We plan to use this tech in new products to meet user needs.

On March 21, 2018, Cheetah Mobile will launch an AI speaker that uses some of Beijing OrionStar's technologies. Beijing OrionStar will also launch some robotic products that day. Cheetah Mobile has about 30% equity interest in Beijing OrionStar and has a 2-year warrant to gain more equity interest at the same valuation to achieve a controlling position.

We also believe blockchain technologies may create additional opportunities for us. For example, we will encourage users of our AI speakers to complete tasks, such as certain interaction with the device, to earn points. Users can use these points to consume value-added services on our platform, such as premium content and cloud storage, which enhances user engagement and user stickiness. We can also use our data to better understand our users and improve our products and services.

We welcome you to join us at the media event on March 21 for more details about our planned products and services.

With that, I will now turn the call to our CFO, Vincent Jiang, for Q4 financial updates.

Vincent Jiang: Thank you, Mr. Fu Sheng. Hello, everyone. We are pleased to report that Cheetah Mobile closed out 2017 with a strong quarter.

Total revenues grew by 9% year-over-year and 16% quarter-over-quarter to RMB1,388 million in Q4 and exceeded the high end of our guidance range by 6%.

Driven by strength in the Live.me, mobile game, and domestic utility apps businesses, we posted stronger-than-expected revenue growth in the quarter.

By platform, mobile revenues grew by 18% year-over-year and 16% quarter-over-quarter to RMB1,218 million, which accounted for 88% of our total revenues in the quarter.

By region, although overseas revenue growth decelerated from the previous quarters, revenues generated from the Chinese market accelerated its growth to increase 23% year-over-year and 38% quarter-over-quarter to RMB544 million.

Profits continued to expand in the quarter. Gross profit increased by 14% year-over-year and 17% quarter-over-quarter to RMB926 million in Q4 2017.

Operating profit increased to RMB222 million from RMB62 million in the same period last year and RMB132 million in Q3 2017.

The expanded profits and margins resulted from higher revenues, our strategy to optimize the cost and expense structures for our utility products and our initiative to offload the loss-making business News Republic.

In Q4, the total operating expenses decreased by 6% year-over-year to RMB704 million.

Our core business continued to generate strong cash flow in the quarter. We made RMB267 million in net cash from operating activities and RMB259 million in free cash flow in Q4 2017.

We also closed two significant disposals, including News Republic and our interests in Musical.ly, which generated a gain of RMB1,089 million in Q4 and greatly boosted our earnings and balance sheet.

In Q4, we reported a diluted income per ADS of RMB7.27, up from RMB0.41 in the same period last year and RMB0.95 in Q3 2017.

As of December 31, 2017, our cash, cash equivalents, restricted cash, and short-term investments were RMB3.8 billion.

Moving on to each of our reporting segments. Please note that all financial numbers are in RMB unless otherwise noted.

For our utility products and related services, revenues decreased by 4% year-over-year, but increased by 17% quarter-over-quarter to RMB967 million in Q4 2017. The year-over-year decrease was due to, first, a decline in revenues from mobile utility products in the overseas markets.

As Mr. Fu Sheng just mentioned, Facebook and Google discontinued the placement of ads on mobile phone lock screens since May 2017 and January 2018 respectively, which reduced our ad inventory. Second, a decline in PC revenues as Internet traffic continued to migrate from PC to mobile.

The decrease was largely offset by the solid operation and the robust growth of our mobile utility products in China. As both our eCPM and impressions continue to rise, our revenues from mobile utility products in China is getting very close to those from the overseas markets.

The quarter-over-quarter growth of this segment was due to seasonal effects, as the fourth quarter is typically our strongest quarter of the year.

Non-GAAP operating profits for our utility product and related services increased by 3% year-over-year and 26% quarter-over-quarter to RMB327 million in the fourth quarter of 2017. The non-GAAP operating margin for our utility product and related services expanded to 34% in the quarter, up from 32% in the fourth quarter of 2016 and in the third quarter of 2017.

As we stated in the past, the profit improvements were the result of our strategy to optimize the cost and expense structures for our utility products.

In Q4, we continued to improve collaboration across our product teams and focus our marketing dollars on our core products in key markets. These initiatives, coupled with the resilient revenues, have allowed this segment to improve profitability and generate strong cash flow. For the full year of 2017, our utility product and related services segment reported a record non-GAAP operating profit of RMB979 million.

For our mobile entertainment business, revenue increased by 50% year-over-year and 10% quarter-over-quarter to RMB399 million in the fourth quarter 2017. For the full year of 2017, our mobile entertainment business earned RMB1,496 million in revenue, up [116]% year-over-year.

Specifically, revenues from our content-driven products increased by 58% year-over-year and 13% quarter-over-quarter to RMB228 million in the quarter. Live.me, the live video streaming app serving overseas users, is the majority contributor to our content revenues. The fast-rising revenue was mainly due to strong growth in average revenue per user, supported by the initiatives mentioned by Mr. Fu Sheng earlier.

Revenues from the mobile game business increased by 41% year-over-year and 7% quarter-over-quarter to RMB171 million in the quarter. The year-over-year increase was due to our efforts to expand the mobile game portfolio by introducing several new mobile games in early 2017 and launching in-game purchase features in some of our well-known titles.

The sequential increase resulted from our efforts to bring some of our favorite mobile games in the overseas markets to our home market. For example, both Piano Tiles 2 and Dancing Line have been among the top mobile games in China.

Our non-GAAP operating losses for the mobile entertainment business shrank to RMB62 million in the quarter from RMB201 million last year and RMB105 million last quarter. The reduced losses were primarily attributable to increased revenue in the Live.me and mobile game businesses, and reduced expenses from the News Republic business, partially offset by our increased investments in Live.me and Cheez, the short video business operated by Live.me in overseas markets.

Also, our mobile game business continued to improve its profitability in the quarter thanks to its steady revenue improvement.

We would now like to provide revenue guidance. For the first quarter of 2018, we expect total revenues to be between RMB1.1 billion and RMB1.14 billion.

I would like to point out that the depreciation of the U.S. dollar against RMB in 2017 added some pressure on the yearly comparison for our overseas revenues, as the majority of our overseas revenues, which accounted for 67% of our total revenues in 2017, are recognized in US dollars, but reported in RMB.

Another negative impact on our revenues is our reduced ad inventory for our utility products in overseas markets, as Facebook and Google Play discontinued lock screen ads. This will affect all app developers, including Cheetah Mobile.

However, we would like to point out that our revenues from mobile utility products in the overseas market now have a very healthy composition as the result-page ad is the major ad format now. Our result-page ads are well-received by our users and have a track record of solid performances in the past.

Further, we expect the profit margin for our utility products in the overseas markets to stay very healthy and its outlook for 2018 remains positive.

In addition, we believe that the revenues from our mobile utility products in China will continue its strong year-over-year growth trajectory in the coming quarters, and will become an important revenue contributor similar to our mobile utility products from the overseas markets.

Overall, we expect that our core utility products and related services business will remain healthy and continue to generate strong profits and cash flow in 2018. We expect the revenues from our mobile entertainment business to continue its growth, driven by our mobile games and Live.me business.

Please note that this forecast reflects our current and preliminary views and is subject to change.

This concludes our prepared remarks. Operator, we are now ready to take questions. Thank you.

Questions and Answers

Operator: We will now begin the question-and-answer session. (Operator Instructions). Thomas Chong of Credit Suisse.

Thomas Chong: (Speaking Chinese). I'll say my questions in English. First, can management talk about the robotics and blockchain initiative and how we should think about the monetization potential?

And my second question is about our system business Live.me and mobile games. How should we think about the revenue trend? Thank you.

Fu Sheng: (Speaking Chinese).

(Translated). Okay. Now I'll translate. So Live.me had a healthy revenue growth year-over-year, and right now its structure of revenues is actually is more balanced because the marketing

expenses for Live.me is decreasing and the top line increased, and we are confident that the Live.me revenue will continue to increase.

And on other hand, we understand that just like the live broadcasting business in China, it also has certain negative impact from the short video part of business from other players. That's why Live.me has launched a short video business called Cheez. We think that this is a strategic movement, and if that strategic move can materialize and generate good return, and then the overall Live.me business can be very prosperous.

Fu Sheng: (Speaking Chinese).

(Translated). While we think that robots that has certain perceptions they can do certain job, they do exist today. And so of course, all the robots are facing challenges about the cost of production and sales price. We have been trying very hard to reduce the cost of robots.

We think that a general purpose robot doesn't exist yet because of the technology increasing, but we believe that robots, for a certain vertical area and for certain scenarios, do exist. For example, for a robot in the household, for a company purpose, do exist; and the technology, including visual and language, that can help achieve this goal.

And the day after tomorrow, we will have a product launch event that will showcase our family of robot products. We think that if the product can reach our expectation, including the hardware production and manufacturing part, and we think that the future of robot market can be a huge and high-growth market.

Fu Sheng: (Speaking Chinese).

(Translated). As the human costs are getting high and high, and with the high expectation people are expecting, we think that this is a global issue. We think that the general direction is very good; we are concerned about it.

Fu Sheng: (Speaking Chinese).

(Translated). We think that blockchain technology is really innovation and we highly -- we agree on this trend and we are following this trend as well. And blockchain will cause a change in many different applications. Right now with the computer and cell phone getting very popular, and everybody is online now, so that makes decentralization become possibilities.

Also, blockchain technology, while Cheetah Mobile has its own advantage in developing blockchain technologies because blockchain technology requires security, and also it's a utility product as well. And people will prefer a good user experience and safety of using blockchain products.

Because Cheetah Mobile has a global user base, and this provides a basis for a massive user of a blockchain technology-related products, also security and utility, those are the extension of

Cheetah Mobile's capabilities. So that's natural for Cheetah Mobile to develop blockchain technologies.

Thomas Chong: Okay. Thank you.

Vincent Jiang: Also, actually in terms of blockchain, I also wanted to add a few things. Recently, Cheetah Mobile has already released a couple of products. One is the SafeWallet, and it also has released a decentralized app browser and there are a few other products in the pipeline, yes. So just keep tuned.

Operator: (Operator Instructions). Wendy Huang of Macquarie.

Wendy Huang: (Speaking Chinese). I will translate the question myself. So my first question is about your domestic value. When should we expect your domestic value configuration to surpass 50%? (Inaudible) a margin of your domestic being different from overseas spending?

Second question, I'm trying to get some clarification on the Live.me strategy. I think previously, you mentioned that Live.me just raised some money and priority is not really monetization. So in your prepared remarks just now, you actually mentioned that Live.me was currently trying to control the cost and below the top line? So can you give us some clarification on this? Thank you.

Vincent Jiang: Well, Wendy, first of all, let me answer the question about the domestic mobile utility product. Right now, the revenue from mobile utility products in China is getting close to the revenue from utility product on the overseas market in Q4 2017. And I think we expect that in Q1, the two portions will to be very similar, so will be kind of equal.

But in terms of the overall overseas revenue, because in the overseas revenue, we still have Live.me and mobile games, which mobile games primarily is from (inaudible) right now, from outside China now. So the overall overseas revenue of DAU is larger than the revenue from the domestic market.

In terms of margins, gross margin in the domestic market and overseas market for the utility product are all very healthy.

Fu Sheng: (Speaking Chinese).

(Translated). Okay. Let me translate. Live.me is an independent company. Although in general, its approach will be in conformity, it will follow the general direction of the Cheetah Mobile, they still have its own independent decision-making process.

For the Live.me itself, the user acquisition cost and the revenue it has achieved a certain healthy balance. So we think that there is no need to reduce the user acquisition cost or marketing expenses for the revenue to continue to grow. The only thing is that we are talking about the Cheez; that's a short video business (inaudible) by Live.me.

Because we think that the short video business has the potential to bring more users to their Live.me platform, so they are continuing to put more user acquisition, more marketing dollars to Cheez. Of course, there's a balance of how much you put in Cheez that would directly impact the bottom line of Live.me and also will impact the bottom line of Cheetah Mobile. That's why we're kind of trying to reach a balance of the user acquisition cost and the user growth.

Wendy Huang: Thank you. (Speaking Chinese).

Operator: (Operator Instructions). Andrew Orchard of Nomura.

Andrew Orchard: (Speaking Chinese). Just a question on the revenue growth guidance. I'm guessing that the weaker guidance for revenue this quarter is due partly due to the disposals of News Republic and Musical.ly. So I'm just trying to get a sense of what the revenue growth would be if we had taken out these two businesses that we sold off now? Thanks.

Fu Sheng: (Speaking Chinese).

(Translated). Okay. So the overall impact resulting from the disposal of the News Republic business actually is not that significant. The main reason for the guideline in the lower range is because first of all, the U.S. dollar depreciation against the RMB, which has quite a significant impact.

And secondly, as we mentioned earlier, Facebook and Google changed their approach. They do not allow ads on cell phone lock screens, which reduced our ad inventory, and that reduced our revenue in turn.

But on the other hand, our two utility products itself have been going well. For example, one of our products is CM Launcher and the other one is Keyboard. Those two products have a very good user growth trajectory. But these two products still are relatively new, so commercialization from those products still needs some time. That's why, in the short term, we do have some pressure in terms of revenue growth from the overseas utility products.

But in the long run, we were very confident because one of the new drivers is our mobile game business. We have started the casual game business in the last couple of years, and we found that the casual game can be a virtually -- have a longer lifecycle -- have a long lifespan and has relatively good revenue and profits.

For example, Piano Tiles 2, which is a causal game, has been around for more than 3 years, and we have added more than 200 [songs] to the product, and it still has a very good user base and good revenues. So we think that in the long term, the mobile game business can be a very significant part of our overseas revenue source.

Andrew Orchard: (Speaking Chinese). Okay. Thanks.

Operator: (Operator Instructions). Liping Zhao of CICC.

Liping Zhao: (Speaking Chinese). I have a small question about the operating margin. So we saw in the fourth quarter last year, the operating margin improved a lot. And what will be the margin trend in first quarter 2018 and full year 2018? Thank you.

Vincent Jiang: Okay. Let me answer that question. The improved margins are mainly from our higher revenues in the fourth quarter. Also, we have been continuing to optimize the cost and expense structure for our utility products; that's another reason. The third one is we disposed News Republic in the fourth quarter, which was a loss-making business. So disposal of it helped our margin in the [first] quarter. Thank you.

Operator: (Operator Instructions). This concludes our question-and-answer session. I would like to turn the conference back over to Helen Zhu for any closing remarks.

Helen Jing Zhu: Thank you all for joining us today. If you have any further questions, please do not hesitate to contact us. Thank you. Bye.

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