

**CMCM - Cheetah Mobile, Inc. [CMCM]
Q2 2015 Earnings Call
August 18, 2015, 8:00 AM EST**

Company Representatives:

*Helen Jing Zhu; Cheetah Mobile, Inc.; Director, Investor Relations
Sheng Fu; Cheetah Mobile, Inc.; CEO
Andy Yeung; Cheetah Mobile, Inc.; CFO*

Analysts:

*Alvin Jiang; Morgan Stanley
Evan Zhou; Credit Suisse
Henry Guo; Summit Research
Jeff Hao; China Merchants Securities
Wendy Huang; Macquarie
Thomas Chong; Citigroup*

Presentation:

Helen Jing Zhu: Welcome to Cheetah Mobile's second-quarter earnings conference call. With us today are Mr. Fu Sheng, our CEO, and Mr. Andy Yeung, our 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 CEO, Mr. Fu Sheng. Please go ahead, Fu Sheng.

Sheng Fu: Thank you, Helen. Hi, everyone. Thank you for joining our call today.

We are very happy to report another quarter of strong results. Q2 revenues came in at RMB871 million, much higher than our previous guidance of RMB785 to RMB795 million, due to stronger than expected demand for our mobile advertising service from both overseas and domestic advertisers.

More importantly, we continued to make very solid progress in our mobile and global strategies, which should lay a strong foundation for our future growth. Only a year ago we launched our overseas monetization effort.

In the second quarter this year we celebrated another key milestone with our overseas mobile revenues now accounting for 50% of total revenues for the first time. In Q2 mobile accounted for 64% of our revenues. We are happy with our transformation into a truly global and mobile company.

About three years ago we decided to launch CleanMaster in overseas markets. As of June this year five of our apps have now [reached] among the top 14 most downloaded apps on Google Play worldwide. Today we have over 494 million mobile MAUs globally and 71% of our mobile user base came from overseas.

Additionally, about two years ago we began our mobile monetization effort. Today mobile now accounts for 54% of our total revenues. As I mentioned earlier, we launched our overseas monetization effort a year ago and in a very short amount of time overseas revenue has grown extremely fast and now accounts for 50% of our total revenues and 77% of our mobile revenues.

Our solid progress in mobile and global was due to our continued improvements in [commercial] (inaudible) and big data analytics, expansion of direct sales and original capabilities worldwide, as well as our strong partnerships with key global internet players.

First, with our continued success of CleanMaster and CM Security as a base, we are able to effectively close the sale of other apps with high frequency of use, such as CM Launcher, CM Browser and CM Locker. This layering of products is creating a powerful matrix of utility apps that not only have helped us expand our user base, but also increased our user time spent and user engagements.

Second, by integrating the demographic and the interest data of our 494 million mobile MAUs with ad [compend] data of mobile partners, 200 million monthly advertising audience, we are greatly expanding our global reach and are developing a richer user data group.

But just having a lot of data is not enough. We need to be able to analyze the data and [to draw] insights from the data. So far we have conducted more than 100 user (inaudible) that can help us better understand our user base and improve our ad packing and repacking capabilities. Big data analytics plays an important role in creating [values] for mobile and advertising platforms and will remain a key focus for our investment in coming quarters.

Third, we continue to expand our direct sales and operational capabilities worldwide with the integration of our mobile partner and our own organic [efforts] we now have sales in 10 countries and more than 200 overseas employees. We plan to continue to build out our overseas [comparative] with [deeper,] better and more localized service to our advertisers.

Fourth, our mobile monetization capabilities, in particularly in overseas markets have also benefited from strong partnership we have built with key global internet players. For example, by allowing [advertisers] to play their ads on our mobile apps through Facebook Audience Network we are able to [replay], expand our global reach without actually building a large-scale

network. As of today, advertisers on FAN contribute a large portion of our mobile revenues and we are already one of the biggest publisher partner for Facebook Audience Network, if not the biggest.

Recently we have (inaudible) expanding our partnership with Facebook beyond (inaudible) ads. In addition to Facebook, we continue to build and stronger our partnerships with other key industry players, including Google and Tencent.

In addition we launched our global ad platform, Cheetah Ad Platform, in June, an important step for us in building one of the most robust mobile and advertising platforms in the world to have help publishers, including ourselves, to deliver more relevant ads to mobile users, getting better results and to generate higher ROI for our advertisers.

We are continuing to enhance our global ad platform with new services such as [video] ads and new capability such as RTB.

In short, we are happy with the progress we have made so far. But it is just beginning for us. We know there is still a lot of work ahead of us. But we are very excited about the opportunities. We will continue to focus on the opportunities and invest our resource and efforts into achieving our goals. We're looking forward to providing you more updates on our progress next time.

Now I will now turn microphone to our CFO, Andy.

Andy Yeung: Thank you, Fu Sheng. Good evening, everyone.

We had a very strong performance in the second quarter, both operationally and financially. A key highlight this quarter continues to be the strong progress in our mobile and global strategy, especially the sustained momentum in our overseas operation.

The better than expected top-line results flowed through our business model, resulting in 180% year-over-year increase in growth in our GAAP operating income and 43% year-over-year increase in non-GAAP operating income.

But as Sheng mentioned, this is just the beginning for us. The global mobile internet industry as a whole is still at its infancy. We continue to see significant opportunity in the global mobile space. Looking ahead, we will continue to invest incisively in building up our overseas capability in big data analytics and mobile ad technology in order to better support our business goals in the future.

Now, I will walk you through the details of our financial performance. All financial numbers are in RMB unless otherwise noted.

Total revenue grew 129% year over year and 30% quarter over quarter to a record high of

RMB871 million in the quarter.

Mobile remains the key driver of our growth, driven by ongoing strong demand for our mobile advertising services, both domestically and overseas. Mobile revenues surged 634% year over year and 52% quarter over quarter to RMB560 million in the quarter, contributed 64% of our total revenue, up from 20% last year.

Most notable, having begun only one year ago, overseas revenue now accounts for 50% of our total revenue and 77% of our mobile revenues.

By segment, revenues from online marketing services for the second quarter were RMB752 million, an increase of 166% year over year and 34% quarter over quarter. The increase were primarily driven by strong demand for our mobile advertising solutions, especially in the overseas market. Mobile advertising business already accounts for 58% of our total revenue and 90% of our mobile revenues in the quarter.

The recent acquisition of MobPartner also contributed modestly to our revenue growth, accounting for a little more than 5% of our total revenues in the quarter.

Revenues from IVAS for the second quarter were RMB109 million, an increase of 29% year over year and 13% quarter over quarter. The increases primarily reflect the growth of revenue from mobile and PC games published by the Company.

Revenues from internet security services and other for the second quarter were RMB9 million, an increase of 29% year over year and 42% quarter over quarter. The increases were mainly due to the Company ceasing to promote subscription services in a strategic reorientation which started in 2011.

Now moving to costs and expenses, shared-based compensation expenses for the second quarter were approximately RMB56 million compared to RMB52 million in same period last year and RMB46 million in the previous quarter. As we've stated in the past, we will incur higher SBC expenses this year mainly due to shares and options granted to our management and employees for attracting and retaining top talent.

(Inaudible) a discussion of the Company's operating performance. The following discussion will be on a non-GAAP basis, which excludes stock-based compensation. For financial information presented in accordance with US GAAP, please refer to our press release, which is available on our website.

Non-GAAP cost of revenues for the second quarter were RMB222 million, up 171% year over year and 54% quarter over quarter. The increase was primarily due to higher traffic acquisition costs associated with the MobPartner business, higher band width and IDC costs [associated] with increased user traffic and big data analytics, as well as high amortization costs from the intangible assets resulting from acquisitions.

Non-GAAP gross profit for the quarter was RMB649 million, up 117% year over year and 23% quarter over quarter.

Non-GAAP gross margin for the second quarter was 74.5% compared to 78.5% in the second quarter of 2014 and the first quarter of 2015, respectively. We expect gross margin to remain flattish in the coming quarters.

Non-GAAP R&D expenses for the second quarter were RMB130 million, up 46% year over year and 10% quarter over quarter. The increases were primarily due to personnel-related costs associated with the expansion of our mobile business.

And the end of the second quarter we had more than 1,500 R&D personnel. We'll continue to invest in mobile product development, and in [and in the latest] mobile app technologies in order to be able to [grow a] robust global mobile advertising platform.

Non-GAAP sales and marketing expenses for the second quarter were RMB338 million, up 193% year over year and 37% quarter over quarter. The increases were mainly due to promotional expenses for our mobile business. Our strong mobile traffic growth underpins our continued robust financial performance. So going forward, we will continue to invest in our newest acquisition.

Non-GAAP G&A expenses for the second quarter were RMB87 million, up 203% year over year and 33% quarter over quarter. The year-over-year increase was due to increased professional fees and headcount associated with being a public company. The sequential increase was primarily due to increased professional services.

Non-GAAP operating profit for the second quarter was RMB94 million, an increase of 43% year over year. Non-GAAP net income for the second quarter was RMB116 million, an increase of 77% year over year and 51% quarter over quarter.

Non-GAAP diluted earnings per ADS for the second quarter grew 65% year over year and 49% quarter over quarter, to RMB0.81 or USD0.15.

In order to [see] a better understanding of the impact of amortization of intangible assets resulting from acquisitions on our operating expenses, we have started reporting adjusted EBITDA since first quarter 2015. Adjusted EBITDA is a non-GAAP measure that is defined as earnings before interest, taxes, depreciation, amortization, other nonoperating income, and share-based compensation expenses.

Adjusted EBITDA for the second quarter was RMB132 million, an increase of 59% year over year and 2% quarter over quarter.

Now let me provide you with our guidance. We currently expect total revenues for the third

quarter to be between RMB990 million and RMB1.01 billion, representing a 107% to 111% yearly increase. Please note, this forecast reflects the Company's current and preliminary view and is subject to change.

And this concludes our prepared remarks for today. Operator, we are now ready for the questions.

Questions & Answers:

Operator: Alvin Jiang; Morgan Stanley.

Alvin Jiang: Congratulations on a strong quarter. I have two questions. The first question is on your investment plan in the second half of 2015, and also the investment plan in 2016, because in the last two quarters I think we are doing better on margins than what we expected or we guided. So, do we still hold our guidance for full year zero profits?

And my second question is on the revenue growth. Can you give us some color on how big is the organic revenue growth and how big is the impact from all those acquisitions?

(Repeats question in Chinese)

Sheng Fu: (Speaks in Chinese)

Andy Yeung: So, Mr. Fu would like to answer the first part of your question and then I will answer the second part of your question.

Sheng Fu: (As translated by Mr. Yeung) Regarding our margins, yes, the margins for our quarters were better than expected. And as we have mentioned, we have a pretty aggressive plan to invest in sales and marketing expenditure this year to acquire users. Even though the overall expenses or the costs of user acquisitions globally we have been increasing, we are very cautious and very careful in terms of how we spend our marketing dollars.

And so I think if you think about what we have forecast or have guided to investors, probably was the worst case scenario. But, again, like we have mentioned before, the (inaudible) costs was never our strategy. But, again, I guess (inaudible) be a focus, but may not be as low we have previously forecast in terms of margin.

Andy Yeung: And the second part of your question regarding organic growth, as I mentioned to you on our prepared remarks, MobPartner accounted for slightly more than 5% of revenues in the second quarter, so since how like more than like 95% revenues come from organic and organic growth is definitely the primary driver for our revenue growth.

Alvin Jiang: Okay.

Andy Yeung: So if you look at our quarter, right, our total revenue grew 129% year over year. And as we mentioned, MobPartner only accounted for about 5% of that contribution in the second quarter.

Alvin Jiang: Good. Thank you.

Operator: Evan Zhou; Credit Suisse.

Evan Zhou: (Speaks in Chinese, then English)

I'll do translation. So first is regarding the product update, if you could provide some color on how (inaudible) you break down by products and what kind of the monetization contribution from products, and your growth rate by product, especially the [fact sheet] Cheetah Mobile CleanMaster. And also if you have some mid-to-long-term plan for the product update in the next coming quarters would be very helpful. Thank you.

Sheng Fu: (As translated) So if you look at today, CleanMaster is still our flagship product and still grows at very robust pace. Of course, if you look at another product, CM Security, it's also growing at very fast pace right now. But in terms of absolute size, it still has some distance from the size of CleanMaster.

So if you think about it, again, we have to remind people that our MAU, our monthly active user, is defined on a per-device basis. So one device could have multiple applications. So it's not so easy to say, like, which one product has accounted for how many MAUs. But, still, if you look at the overall picture, CleanMaster still really has the largest penetration, probably close to I think -- yes, more than 60% of our users would have CleanMaster.

So if you look at our monetization, on the other hand, we [already] have to go from a single point of monetization strategy, which we never were, to a very diversified monetization revenue stream coming from different product. In fact, even the CleanMaster is no longer the largest contributor to our mobile monetization.

So in terms of our product development, certainly we have a very good plan for new product development. And we do expect potential nice surprises in terms of our product development side. But if you look at our product [layer] today you will see that besides our two applications like CleanMaster, CM Security, Battery Doctor, we already have layer of products, like CM Launcher, CM AppLock, and [Lock Boost] products that are growing also very nicely right now.

So, if you look at our -- on the game (inaudible) side, last week we launched a game called Piano Tiles II. And that product right now is probably one of the top games in a lot of countries. And that I think is very representative in terms of the direction where we want to go with selling [product] and games.

And then on the [complement] side, we were an angel investor for a small development team that

developed a product called [Mamma Mia]. And that team, that product launched recently and has a -- at one point it was number one app in the US, and still today is still on the top 10 apps in the US.

So if you look at those two, they are sort of a representative example of the progress that we've made in terms of our product [diversification] and also building up an ecosystem for our product.

So, when we look at the [outflow] of organically developed games and products as well as the teams that we have invested in some of the other apps and other software, I think next year we'll probably see some nice surprises coming from those efforts. And hopefully we will have more good news to report to you guys this year.

Evan Zhou: Thank you.

Operator: Henry Guo; Summit Research.

Henry Guo: Very quick one on the Cheetah Mobile Ad Platform. So I think you guys announced the platform in June, so almost two months already. So can you just provide some color in terms of the traction over there? And also, are you going to see -- I mean, for example, by the end of this year, what portion of the mobile advertising revenue and mobile traffic can really come from this Cheetah Mobile Ad Platform? Thank you.

Sheng Fu: (As translated) Yes, so we have launched our mobile advertising network for almost two months now. It's still pretty early for the development cycle. If you look at Facebook and other app networks, they're all in place for years now. So we know where we want to go and what we need to do for our mobile advertising network. And we'll continue to invest and focus on that. But I think that right now it's too early to talk about the progress at this moment.

So as a latecomer to the mobile advertising industry, we definitely take a very cooperative strategy. We like to cooperate with all the large mobile advertising networks and then develop a differentiated strategy that's [partnered] with that. So that's how we look at the mobile advertising platform development.

Henry Guo: Thank you.

Operator: Jeff Hao; China Merchant Securities.

Jeff Hao: (Speaks in Chinese, repeats in English)

So, I have two questions. The first question is about overseas competition. So, I've noticed that the competition on the two apps in the overseas market is still very heavy, for example, from other Chinese companies such as QiHoo. I was just wondering what Management's thoughts are on the outlook of the competitive landscape, especially if you look at 2016. Do you think the competition will still be very heavy like this year?

And my second question is about the other income item in the income statement. Just wondering, where does that come from? Thank you.

Sheng Fu: (As translated) So, just one clarification first; I think if you look at QiHoo 360's QE, the product is actually not owned by QiHoo 360. It's sort of like they a product [and management agreement] with another company. So they're not (inaudible).

So in terms of others, from the data that we have, we think (inaudible) have actually declined, actually have not increased at all.

Again, as we have mentioned previously, it's one thing to look at the number of downloads and it's another thing to look at the monthly active users. And so, I think they're still at very early stage of development and they're spending a lot of money in terms of channels and to acquire downloads or installations. But I think from our point of view, that is not something that is useful at this time.

So if you look at the overall scheme of things, even though sometimes you would see the down numbers, we go up and go down in some quarters. But the overall size of those others, very distant competitor in terms of the total user base for us. And our advantage is that we also have a lot of organic downloads.

So, one final way you would notice that a company has moved from a [single-product] company to a company with a diversified portfolio of products, and also in the process of moving to what we call an ecosystem kind of environment. So I think we're a few steps ahead of our competitors and what they are doing right now, as you can see, have no impact on our overall I guess download number and our overall monthly active users (inaudible).

So, actually the competitor that you mentioned, not Qi, the one that keep us from slipping, but because we are thinking very far of moving ourselves from a mobile-[based] application developers to multi (inaudible) and now we're how can we move that to a platform and then to a new ecosystem that can sustain our long-term growth.

Andy Yeung: The second question, I will answer the second question, which is about our other income. You look at other income (inaudible) I think that's mostly coming from some of the investment gains that we have. As you can see, from time to time we may have impairments or gains from our investments. This quarter we have about [RMB7] million or so investment gain.

We would also note that we have impairments for our investments, which mostly were to our lottery business that we acquired last year. So (inaudible). If you look at last quarter, it's the same thing. That's looking at some impairments for [some of those] investments. That's not a big deal.

Jeff Hao: Thank you.

Operator: (Operator Instructions) Wendy Huang; Macquarie.

Wendy Huang: (Speaks in Chinese, repeats in English)

So my first question is mainly related to your different marketing channels. So can you elaborate on what kind of channels that you are using to acquire the new users? And also, how effective are those channels to actually convert the user traffic to sticky traffic on your own platform? And also, can you provide more details about your collaboration with Google and Tencent that you mentioned in the prepared remarks?

The second question is about -- it's related to the R&D depreciation. So what is Cheetah's exposure to that? As far as what we are seeing, you currently have 50% of revenue coming from overseas. So if the Management can provide some color on your business sensitivity to the currency changes, that would be helpful as well. Thank you.

Sheng Fu: (As translated) So (inaudible) we spend quite bit of money on sales and marketing. But from the Company's perspective, the most important matrix for us is actually our retention rate and monthly active users versus the total download number. So if you look at our monthly active user and the trend there, we notice that we probably are doing much better than our competitors. And how you ought to notice that, most other competitors will only expose the total user number. But for us, MAU is the important for us and we very much pay attention our user retention.

And then, if you look at when we place our advertising or when we utilize our user [through] channels we also pay very close attention to the quality of the channel in terms of the retention rate and in terms of conversion rate.

And in fact, we also have quickly expanded our [additional] channels beyond (inaudible). In fact, we have signed up more than 70 global smartphone manufacturers, OEM, to help us distribute our applications. So those are our experience and channel strategy that is very hard for our competitor to eliminate or duplicate.

So, honestly, the other advertising platforms are very key important partners for us in terms of our mobile monetization strategy. And so we pay a lot of attention to it, especially Facebook, Google and Tencent.

And if you look at in China, so successful Tencent, most recent quarter one of the highlights for the company was their mobile advertising performance, and [definitely coming from] (inaudible). And so we have very good cooperation with Tencent on (inaudible) as well.

And then if you look at the overseas market, our cooperation with Facebook probably has got some press thanks to their mention of us on their first-quarter earnings call this year.

In terms of cooperation with Google, we were also one of the early participants for their AdWords mobile search area with (inaudible).

Andy Yeung: So in regards to your second question regarding R&D and the impact on financial performance, as we mentioned, 50% of our revenue now comes from overseas markets. Obviously, because of our revenue we also have substantial costs that's also in US dollars.

And so, the net impact for R&D is not that significant for our financial performance. And I think in professional we have a little bit uptick on the top line and little bit negative on the cost side. But net/net I think it was pretty neutral for us.

Sheng Fu: Also, in the future I think our revenue from overseas market will increase just continually. Maybe the (inaudible) revenue, total revenue, overseas revenue for Q3.

Andy Yeung: So if you look at our overseas revenues, I think our expectation is that it will continue to increase as a percentage of our overall revenue.

Sheng Fu: Yes.

Andy Yeung: And at the same time, again, as we mentioned, so that will be an increasingly important part of our overall company operations.

Sheng Fun: (As translated) So as we mentioned before, our ultimate goal is to match our revenue [source] with our user base. And I think potentially we will be able to exceed that in terms of overseas revenue as a percentage of our total revenues (inaudible).

Wendy Huang: Thank you.

Operator: Thomas Chong; Citigroup.

Thomas Chong: I have three questions. The first question is about balance sheet. I notice that the cash and cash equivalents is about RMB113 million. So I'm just wondering whether Cheetah Mobile is thinking about raising new capital to support the fast growth of your business.

And my second question is about MobPartner. Understand that it contributes about 5% of your total revenue, but any color about the [longer] earnings contribution for MobPartner?

And my third question is about Facebook. Any color about the revenue contribution from there?

(Repeats question in Chinese)

Andy Yeung: Thomas, thanks for the question, but first I think we need to clarify that. For the second quarter our cash, short-term investments and cash equivalents was actually higher than the number that you have mentioned. In fact, if you look at our press release and also our

financial statement you will notice that in the second quarter our total cash and short-term investments and cash equivalents were RMB1.3 billion, which is about USD210 million.

So we have a lot of liquidity that is more than sufficient to support our investments. And also, our company has been generating positive cash flow for the past two years. And in fact, in the most recent quarter our operating cash was very positive, with more than RMB150 million.

So from both in terms of cash flow from operations and also the liquidity on the balance sheet we have obviously sufficient liquidity to support what we want to do.

And then, the second question that you had is about MobPartner contribution to our net income. As we mentioned, MobPartner was about RMB15 million in revenues in the quarter. And obviously, as we mentioned during our acquisition, the Company's view [is a scale] right now, so it is still a money-losing operation, but it's not too negative. So the net impact in terms of our overall income is markedly small.

And the third question that you had is about Facebook contribution. As we've mentioned previously, we do not have the policy to discuss our individual customer by contribution and -- unless we're required by disclosure rules. And the reason for that is because we have professional agreement with our suppliers and our customers. We respect that. And also for commercial reasons as well.

However, as we mentioned before, Facebook is a very important partner for us. We are currently probably one of the top partners on the Facebook partners network, if not the largest. And so, they contribute a large portion of our revenue. We won't disclose more than that. Thank you.

Thomas Chong: Thanks, Andy.

Operator: Thank you. And, as there are no more questions at the present time, I would like to turn the call back over to Management for any closing comments.

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

Andy Yeung: Thank you.

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