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FENG - Q2 2019 Phoenix New Media Ltd Earnings Call

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## CORPORATE PARTICIPANTS

**Qing Liu** *Phoenix New Media Limited - Head of IR*

**Shuang Liu** *Phoenix New Media Limited - CEO & Director*

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## CONFERENCE CALL PARTICIPANTS

**Binbin Ding** *JP Morgan Chase & Co, Research Division - Analyst*

**Frank Chen** *Macquarie Research*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by, and welcome to the Phoenix New Media 2019 Second Quarter Earnings Call. (Operator Instructions) I must advise you that this conference is being recorded today, Tuesday, the 13th of August 2019.

I would like to hand the conference over to your first speaker today, Mr. Qing Liu. Thank you. Please go ahead.

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**Qing Liu** - *Phoenix New Media Limited - Head of IR*

Thank you, operator. Welcome to Phoenix New Media Second Quarter 2019 Earnings Conference Call.

I'm joined here by our Chief Executive Officer, Mr. Shuang Liu; and Chief Financial Officer, Ms. Betty Ho. On today's call, management will provide us with a review of the quarter's results and then conduct a Q&A session.

The second quarter 2019 financial results and webcast of this conference call are available on our website at ir.ifeng.com. A replay of the call will be available on the website in a few hours.

Before we continue, I would like to refer you to our safe harbor statement in our earnings press release, which apply to this call as we will make forward-looking statements.

Finally, please note that, unless otherwise stated, all figures mentioned during this conference call are in RMB.

With that, I would like to turn the call over to Mr. Shuang Liu, our CEO.

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**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

Thank you, Qing. Good morning and good evening, everyone.

With the macro environment full of uncertainty, we have held steady fast on to our commitment towards continuing boost and business evolution. Our AI-powered content recommendation, combined with seasoned editorial curation, has constantly delivered highly engaging premium content as well as optimal user experience. Although our evolution as a new media company is by no means lenient, we have been able to accomplish meaningful progress through a series of small steps.

During the quarter, we continuously worked towards refining our content production capabilities, augmenting our premium brand equity and expanding our innovative monetization systems. Furthermore, we expanded our new initiatives in lifestyle verticals and other areas to explore promising future business opportunities. As a result of our efforts, our total revenue surged 38.7% sequentially and exceeded our own guidance.

In regards to ifeng, key operating metrics of our flagship news app have steadily increased as a result of our integration of AI technology and editorial expertise. Such integration has effectively improved our content quality, optimized our distribution efficiency and increased our user stickiness. In addition, we enhanced ifeng's user interface by carefully refining its landing page design and feature page layout. Consequently, ifeng's user retention rate has improve gradually. Starting from our steadily improved operating metrics and positive user feedback and leveraging our unique combination of advanced software (inaudible) with professional editorial judgment, we're confident that not only our user traffic will flourish but also our revenue will grow consistently over the next 2 years. Step by step, we are laying a solid foundation for diversifying our service offerings and monetizing of our premium content.

For advertisers, we have expanded our advertising inventory, modified our advertiser page interface and refined our campaign optimization. These improvements, along with the launch of additional new accounts such as 24-hour news, has further improved our daily inventory view rate. Advertisers are continuously attracted to our platform for our pervasive brand stickiness.

To capitalize on our brand equity and growing user traffic, we continued to augment our brand advertising solution by organizing high-profile branding events. For example, in June, we cohosted the 2019 China Liquor Industry Summit with Moutai Group and livestream the event. Expert discussions on the healthy development of China's liquor industry and commercial potential of Chinese liquor attracted 3.93 million views on our livestreaming channel, (inaudible).

In addition, we worked extensively to localize our media resources in 21 different local markets to expand our brand awareness across China. Through our partnership with local news media, we staff our operation with local talents, customize our advertising solutions to local demands and tailor according to local customs.

Our organization strategy, combined with our vertical channel initiatives, has helped us further build out our brand equity and generate meaningful growth. During the quarter, our utilization factor revenue achieved 17% year-over-year growth. We also continued to deliver a wide range of information content in lifestyle-related categories such as real estate, food and fashion during the period.

In our real estate vertical, several events during the quarter demonstrated our monetization potential. We organized the 2019 national campaign, (foreign language), and brought together industry experts, real estate professionals and university student opinion leaders to discuss community development and facilitate creative competitions. This campaign attracted more than 2 million viewers on both our We-media accounts and other third-party media partner platforms. During the campaign, we listed over 1,000 real estate properties on our event page and signed contracts with over 200 advertisers.

We also cohosted the Golden Cicada Cannes International Creative Festival, the first ever festival for real estate creativity at a national level. We signed over 50 contracts with advertisers as a result, once again demonstrating the monetization potential of our lifestyle verticals.

Our real estate vertical has a good track record of over 70% revenue CAGR in the past 5 years. We're confident that we will maintain this blistering growth momentum throughout the course of this year.

Our fashion vertical covers all of our user fashion needs and has become one of the -- our largest and most comprehensive content category. However, to capitalize our fashion vertical's rising popularity, we're exploring the implementation of innovative e-commerce monetization models. For example, we recently launched an e-commerce channel with influential pop culture icons to jointly sell celebrity-endorsed fashion brands. We plan to simultaneously market and promote these fashion brands through both our ifeng channels and other third-party platforms in the coming quarter.

For online reading sector, we continued to acquire more original IP content in order to reinforce our closed-loop IP ecosystem. Notably, we leverage our proprietary catalog of literature by licensing Fanyue and comics. We're exceedingly pleased with Tadu's performance to date. I believe that it is on track to meet our previously agreed-upon valuation adjustment mechanism.

On the gaming front, we are progressing towards the launch of [golf layer] (foreign language), a highly anticipated game produced by our subsidiary, Miaoqiu. During the quarter, Miaoqiu secured partnership agreements with Steam and Nintendo Switch to sell and market [golf layers] on both platforms. Currently, golf layer is already listed on Steam and will be available for searches subsequent to receive government approval. Golf layer has attracted widespread game recognition, receiving a score of 9.6 out of 10 in the Chinese gaming community, TapTap. In fact, 330,000 registered users to TapTap has reserved the game, indicating the excitement and support of the title.

Finally, I will share an update on Yidian. On July 23, we entered into a supplemental agreement with the proposed buyers. The total purchase price would remain unchanged at USD 448 million. We will now sell 34% of our equity stake instead of 32%. As a result, we are still generating a significant return of nearly 6x. Although foreign exchange control and other uncertainty still exist in the market, we have signed a supplemental agreement to both hedge against such potential risks and better protect our company and shareholder interest as much as possible. Going forward, the proceeds that we'll receive from the sale of Yidian will be allocated to our development of smart algorithms, production of in-house IP content, expansion into lifestyle verticals, and the cash injection will allow us to reward our supportive shareholders in the form of dividends.

In summary, we remain committed to providing our users with authentic, professional and premium content. Our seamless integration of AI-powered recommendation engine with refined editorial curation, our rich library of original and proprietary content and our expanding growth initiative should help to increase our brand value, build our new media business and foster a healthier news community. Such value, in turn, will also bolster our relationships with advertisers and create win-win partnerships, ultimately resulting in long lasting value for our shareholders.

With that, I will turn the call over to our CFO, Betty Ho, for a financial update on the quarter.

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**Yip Ho** - *Phoenix New Media Limited - CFO & Director*

Thank you, Shuang, and thank you all for joining our conference call today.

ifeng's total revenue in 2019 Q2 were RMB 395.1 million, representing an increase of 8.6% from RMB 363.9 million, caused by the consolidation of revenues of RMB 49.2 million in the second quarter of 2019 from Tadu and the consolidated revenues of RMB 84.6 million from Tianbo starting from April 1, 2019. The company's net advertising revenues from traditional business decreased by 28.5% due to the macroeconomic uncertainties and increased competitions.

Secondly, I will provide details on our revenue for the second quarter of 2019. Consolidated net advertising revenues for the second quarter of 2019 were RMB 324.8 million, representing an increase of 2.3% in the same period last year. The increase was primarily attributable to the consolidation of advertising revenues from Tianbo. However, the company's net advertising revenues from traditional business declined due to the above-stated reason.

Paid services revenues for the second quarter of 2019 increased by 51.1%. Revenues from paid content for the second quarter of 2019 increased by 126.7%, mainly due to the consolidation of Tadu. Revenues from games for the second quarter were RMB 2.6 million, representing a decrease of 34.7%. Revenues from MVAS for the second quarter were RMB 6.7 million, representing a decrease of 62%. Revenues from others for the second quarter of 2019 were RMB 7 million, representing an increase of 513.4%, which was mainly caused by the increase in revenues from e-commerce and online real estate-related services.

Non-GAAP gross profit for the second quarter of 2019 was RMB 212 million compared with RMB 230.2 million in the same period last year. Non-GAAP gross margin for the second quarter was 53.7%, decreased from 63.3%. It was mainly due to a combined effect of decrease in gross margin of the company's traditional advertising business and the margin contributions from Tianbo and Tadu. Non-GAAP content and operational cost as a percentage of total revenue was 39.1% as compared to 29.8% in the same period last year. It was mainly due to the consolidation of content and operational costs of Tianbo and Tadu and due to an increase in IP protection costs.

Revenue sharing fees as a percentage of total revenue was 3.5% as compared to 3.1% last year. Bandwidth cost as a percentage of revenue was same as last year at 18%.

Non-GAAP operating expenses for the second quarter of 2019 were RMB 286.8 million. Non-GAAP operating loss for the second quarter was RMB 74.8 million. Non-GAAP operating margin for the second quarter was negative 18.9%.

Net loss attributable to ifeng for the second quarter of 2019 was RMB 70.1 million as compared to net income of RMB 49.2 million in the same period last year. Non-GAAP net loss attributable to ifeng for the second quarter of 2019 was RMB 66.4 million. Non-GAAP net loss per diluted ADS for the second quarter was RMB 0.91.

In terms of balance sheet, as of June 30, 2019, the company's cash and cash equivalents, term deposits, short-term investments and restricted cash were RMB 1.69 billion or approximately USD 245.8 million, which included RMB 251.6 million from Tadu (sic) [Tianbo] and RMB 16.3 million from Tadu.

Finally, I'd like to provide our business outlook for the third quarter of 2019. We are forecasting total revenues to be between RMB 373.4 million and RMB 393.4 million, representing an increase of 13.4% to 19.5% year-over-year. For net advertising revenues, we are forecasting between RMB 312 million and RMB 327 million, representing an increase of 10.9% to 60.2% year-over-year. For paid service revenues, we are forecasting between RMB 61.4 million and RMB 66.4 million, representing an increase of 28.3% to 38.7%.

Half of 2019 has gone by. The macroeconomics is not getting any better and the contents are being further regulated towards the next half of 2019. Thanks to our diversification strategy in Tadu and Tianbo, the strong growth in second quarter has driven to the increase of our total consolidated revenue to about 9%. We are confident that our total consolidated revenue will be increased by around 20% in full year of 2019. In terms of bottom line, we are aiming to breaking even in the next couple of years by implementing a very tight cost effective structure.

This concludes the prepared portion of our call. We are now ready for questions. Operator, please go ahead.

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Your first question comes from the line of Frank Chen from Macquarie.

**Frank Chen** - *Macquarie Research*

In the prepared remarks, Betty reaffirmed that you are targeting at least 20% year-over-year revenue growth for this year. However, given your third quarter guidance, it only implies mid-teens revenue growth for third quarter. And how should we think our -- think about fourth quarter revenue growth to help you achieve the full year guidance?

And I also want to ask more about your view on 2020. I understand that the visibility into next year is still limited. However, it would be great if you can share any thought on your revenue targeting next year.

And my second question is also on margin. You are talking about breakeven in next couple of years. Do you have any more clear idea about when you are breakeven and turn back to profit?

And my third question is on the use of proceeds from Yidian disposal. Can you update us on the time line of the dividend payment, dividend arrangement? And also, do you have any plan on share buyback given the current weak share price performance?

**Yip Ho** - *Phoenix New Media Limited - CFO & Director*

Thank you, Frank. I will take the first question and the second and third question will be answered by Shuang.

For the full year of 2019, we are expecting a growth of around 20% because that -- in general, our first quarter is generally the weakest quarter and we are seeing the improvement starting from second quarter, third quarter and fourth quarter. And during the fourth quarter, we are expecting a strong growth because most of our IP will be happening during the fourth quarter. That's why the fourth quarter will be a very strong quarter for the full year. And as a result, we are expecting a growth of around 20% during the full year because -- of course, that's being the -- also being the same case for Tadu and Tianbo because for traditional advertising business, fourth quarter generally is the strongest quarter. This is also the case for Tianbo. Yes, that's why we are expecting a growth of around 20% for the full year of 2019.

**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

This is Shuang. Yes, this is Shuang. I will address your -- the following 3 questions.

Looking forward into 2020, I think despite the macro environment uncertainties and the current state of the industry, as a result of our analyst report -- efforts, improving our news apps, we are actually seeing steady improvement from our operating metrics and positive user feedback. We're confident I think the trend will continue. By leveraging the blistering growth trends via our consolidation of Tadu and online real estate, I think not only our user traffic will flourish, but also our revenue will continue to grow at around 20% year-over-year. So basically, the trend will remain the same, at least 20% year-over-year overall revenue growth in the coming 2 to 3 years.

And then furthermore, as to the -- the third question is about the breakeven point. We are reviewing our contractor and making sure that our core business is going to be profitable. Although we may not be able to breakeven in the short run, but due to our increased investment in new business in the short run due to our increased investment in new business, but we are confident that we'll be able to narrow our loss by next year significantly by implementing effective cost control initiatives and to eventually breakeven in next 2 years. As we refine our production process for premium content, improve the effectiveness of our advertisements and leverage the foundation we have laid to monetize vertical channels and develop new business initiatives, we're confident that our revenue growth will exceed this year's level over the next few years.

Your third question is about dividend. Yes. I think as for the dividend, as for the use of proceeds, in our last call, we mentioned our plan to set aside 15% to 25% of potential special dividend payments, roughly 25% to 35% for investment in content verticals to accelerate our organic growth and general working capital and 40% to 60% for strategic investments.

However, due to the delayed closing of the deal and in order to reward our shareholders for their continued support and patience, now I want to announce that we are planning -- we are thinking about raising the dividend payout ratio to between 25% to 50%. Of course, we will continue to consult with our Board and shareholders to see what is the exact payout ratio so that we can balancing -- we can balance -- we can make a balance between rewarding our supportive shareholders and continuing to make strategic investments.

Furthermore, I will also -- we will also consider a partial payment once we have secured the rest of the USD 50 million deposit. We're very committed to sharing the return on our investment with our investors and shareholders. In order to strike a balance, we are also focused on finding the optimal way to utilize our capital to bolster operations. We'll be sure to update investors who will receive a further cash deposit of USD 50 million upon approval (inaudible).

As to share buyback, we are -- because we are still waiting for the approval of the shareholder for the Yidian deal and also, right now, we have received a total USD 20 million...

**Yip Ho** - *Phoenix New Media Limited - CFO & Director*

USD 200 million.

**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

USD 200 million. USD 200 million. So it's not the time to talk about it, but we want to keep the option open.

**Operator**

Your next question comes from the line of Binbin Ding from JPMorgan.

**Binbin Ding** - *JP Morgan Chase & Co, Research Division - Analyst*

My first question is regarding the sale of Yidian's stake. So you signed a supplemental agreement end of July with another buyer and increased the number of shares being transferred to 212 million at the same price of USD 448 million. So what is the thinking behind such a change?

And my second question is just follow-up on dividend payment. So from the agreement, it seems that you have already received some cash payment as of August of this year. So can you give us some color regarding the timing of the dividend plan in the future? Are you going to do it in the next few months or waiting until the deal is fully closed in 2020?

**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

Yes. They're -- okay. Thank you, Binbin. This is Shuang.

I think there are several reasons for the valuation adjustment. First, both party agreed to close the deal regardless of any dispute raised by any party with respect to satisfaction of the closing conditions under the original share purchase agreement.

Second, from a competitive point of view, the valuations of our comparable companies have been greatly adjusted in the recent period. We see a significant [down run] of the valuation of comparable companies. This trend has led to major revisions to the old valuation model and, in turn, our previous valuations.

Third, China tightened its foreign exchange control during the China-U. S. trade war. In order to proceed with the transaction, we made a profit adjustment to the definitive agreement. But I want to emphasize, even under the new valuation, we will still receive a very handsome return of almost 6x the original investment via a significant cash injection. So this is a -- from investment point of view, basically, this is home run. We are proud of this.

As to the timing of the further payment, I want to say that after receiving the first tranche of USD 100 million last week, the buyer must pay the remaining USD 50 million to us within 2 working days after receiving approval from the Phoenix TV shareholders' meeting. And after we receive an additional deposit of the USD 50 million, it will distribute USD 200 million in shares and update the register of shareholders. If the USD 50 million deposit is not paid in due time, we will contemplate the total USD 200 million previously received.

So -- and also to further reduce the risk of nonpayment, we have signed a counterparty agreement. After we transferred USD 200 million worth of shares, the voting rights will be shared by the buyer and us, and the buyer will act in concert with us until one of the following 3 conditions is fulfilled. First, the buyer pays the entire -- entirety of the remaining payment within 3 to 6 months after paying the first tranche. Second, within 3 months after first tranche is paid, the buyer makes a payment of the USD 200 million at a valuation of no less than USD 1.4 million. And third, the buyers -- the buyer makes a deposit payment of USD 30 million in addition with the USD 50 million deposit. So therefore, the additional USD 50 million deposit and counterparty agreement will serve to significantly reduce the risk involved in the transaction.

Yes. Binbin, did I answer your question?

**Binbin Ding** - *JP Morgan Chase & Co, Research Division - Analyst*

Yes.

**Operator**

Your next question comes from the line of Chuck Li from First Shanghai Securities.

**Unidentified Analyst**

(inaudible) on behalf of Chuck. Can you share your strategy on the short-form videos?

**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

Okay. Hi. This is Shuang. Currently, I think the development of video content mostly center -- user-generated content and professional media content. The UGC market is incredibly competitive and not where our strength lies traditionally, we have to admit. However, [stand being full] from our expertise in news operation, professional video content remains in our -- remain to be our focus.

The development of high-quality short-form videos is a priority for us. The massive video content library of Phoenix TV covering news, history, celebrity interviews, culture shows and more is at the core of our video app. While the competition is mostly focused on entertainment and variety shows, our rich content library we have is our key differentiator in today's highly homogenized market.

We see a strong demand for this type of culturally rooted and highly differentiated content for our user base. Definitely, more demand than what the market is currently capable of supplying. So this is why we plan to integrate Phoenix TV content with high-quality documentaries and interview shows by creating new categories of media content such as hiking reality shows. We will be able to provide innovative and differentiated premium content for China's media market.

As for right now, we are planning to have a separate team spearhead the implementation of certain project. This team will continuously improve our content management, product optimization, self-controlled development and advertisements. We'll also focus more on the further upgrade of our video app from [subscription]. We plan to update everyone with more details in the coming quarter. Okay?

**Unidentified Analyst**

Okay.

**Operator**

(Operator Instructions) There are no further question at this time. I would now like to hand the conference back to Ms. Qing Liu. Please continue.

**Qing Liu** - *Phoenix New Media Limited - Head of IR*

Thank you, operator. We have come to the end of our Q&A session and our conference call. Please feel free to contact us if you have any further questions. Thank you for joining us on this call. Have a good day.

**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

Thank you.

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**Yip Ho** - *Phoenix New Media Limited - CFO & Director*

Thank you.

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**Shuang Liu** - *Phoenix New Media Limited - CEO & Director*

Thank you, all.

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**Yip Ho** - *Phoenix New Media Limited - CFO & Director*

Bye.

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**Operator**

Ladies and gentlemen, that does conclude our conference for today. Thank you for participating. You may now all disconnect.

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