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Q1 2022 LIZHI INC. Earnings Call

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CORPORATE PARTICIPANTS

Effy Kang LIZHI INC. - IR
Marco Lai LIZHI INC. - Founder, CEO
Zelong Li LIZHI INC. - COO
Chengfang Lu LIZHI INC. - Acting CFO

CONFERENCE CALL PARTICIPANTS

Vicky Wei Citi - Analyst
Carol Southwest Securities - Analyst

PRESENTATION

Operator

Hello, ladies and gentlemen. Thank you for standing by for LIZHI, INC.'s First Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. After management's remarks, there will be a question-and-answer session. Today's conference call is being recorded.

I will now turn the call over to your host, Effy Kang, Head of Capital Markets for the Company. Please go ahead.

Effy Kang LIZHI INC. - IR

Thank you very much. Hello everyone and welcome to the LIZHI, INC.'s First Quarter 2022 Earnings Conference Call. We released our financial and operating results via newswire services earlier today and they are available online.

Participants on today's call will include our Founder and CEO Mr. Marco Lai; our COO Mr. Zelong Li; and our Acting CFO, Ms. Chengfang Lu. Mr. Li and Ms. Lu will begin with prepared remarks and the call will conclude with a Q&A session.

As a reminder, this conference is being recorded.

In addition, an Earnings Highlights presentation and a webcast replay of this conference call will be available on the IR section of our website at ir.lizhi.fm.

Before we continue, please note that today's discussions will contain forward-looking statements made under the Safe Harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These statements typically contain words such as "may," "will," "expect," "target," "estimate," "intend," "believe," "potential," "continue," or other similar expressions.

Forward-looking statements involve inherent risks and uncertainties. The accuracy of these statements may be impacted by a number of business risks and uncertainties that could cause actual results to differ materially from those projected or anticipated, many of which factors are beyond our control.

The Company, its affiliates, advisors, representatives, and underwriters do not undertake any obligation to update this forward-looking information, except as required under the applicable law. Please also note that LIZHI's earnings press release and this conference call include discussions of unaudited GAAP financial measures as well as unaudited non-GAAP financial measures.

Please refer to LIZHI's earnings press release for a reconciliation of unaudited non-GAAP measures to unaudited GAAP measures.

I will now turn the call over to our COO, Mr. Zelong Li. Please go ahead.

Zelong Li LIZHI INC. - COO

(interpreted) Hello everyone and thank you for joining our first quarter 2022 earning conference call. After becoming profitable for the first time on a GAAP basis in the fourth quarter of 2021, we continued to optimize our organizational structure and technology platform in the first quarter of 2022 which boosted our operating efficiency and contributed to stable operating results.

Notably our first quarter revenue rose 4.4% year-over-year to RMB517 million, our gross margin increased by 700 basis points year-over-year to 32% and we have achieved a profit on a GAAP basis for the second consecutive quarter with net income surging 84% quarter-over-quarter to RMB16.42 million.

In the first quarter, we remained focused on building a competitive auto-centric ecosystem, improving production functionality, elevating overall user experience and actively exploring overseas markets to implement our globalization strategy. Meanwhile, we continued to reinforce our in-house suite of technologies to empower product innovation and business development.

In terms of operational data, total average mobile MAUs amounted to 51.5 million and average mobile MAUs of our audio entertainment business increased by 11% year-over-year to 9.14 million. Thanks to the continuous optimization of our operational strategy average monthly paying users maintained year-over-year growth in the first quarter to reach 482,000. Next, I will share more color on the development of different business segments.

With respect to audio entertainment, we continued to enhance the competitiveness of our audio-centric ecosystem by focusing on core content categories, and the audio entertainment business to drive user growth and commercialization performance. In the first quarter of 2022, the user penetration rate of our audio entertainment business expanded from 13.8% in the same period last year to 17.7%.

Furthermore, we continued to launch a series of operational campaigns featuring various trending topics and holiday themes. With our diversified operational strategy, more content creators were encouraged and motivated to engage in content creation, which in turn attracted more users to join real-time audio interactions, further unleashing the commercialization potential of our audio entertainment business.

In addition, we have been consistently enriching and optimizing our product features and entertainment interaction formats to facilitate business model innovation, and expand the commercialization of high-quality content. In March, LIZHI started collaborating with the designer toy brand Koliliko to integrate Koliliko's brand IP image into an array of interactive functions in the audio entertainment section of the LIZHI App, creating online interactive scenarios for the brand IP and providing users with a diversified online entertainment experience.

The collaboration has gained traction among the LIZHI App's younger generation of users, and has effectively boosted close interactions between content creators and users on the platform. Going forward, LIZHI expects to collaborate with more brand IPs to further diversify usage scenarios for online interactive entertainment, leveraging the strengths of both parties to maximize mutual benefits.

Turning to our global expansion, we continued to refine the features and functions of our global social product TIYA. Since launching TIYA's "real-time interactive group space," we have improved the product versatility and usability by upgrading the group space's interactive functions based on our insights into user demands, making online connections and social engagement easier for our users.

We also continued to enrich the features of the group space, in line with our users' diversified preferences. Through product strategies such as upgrading the acquisition of friends' connections, and simplifying invitation pathways, we optimized that the product's invitation mechanism and boosted their social efficiency among users. Notably building on our in-house suite of technologies and AI capacity, we elevated the user experience by improving the recommendation feature, giving users direct access to the interactive group with just one click so that we can attract the more active users to join the group space and promote real-time interaction and connectivity. Furthermore, we unveiled more innovative functions on TIYA, including a voice changer that allows users to alter their voice using various vocal tones and effects, making real-time interactions more fun and lively.

The optimization and iteration of product features and enriched interactive functions have further boosted TIYA's user engagement and the user activeness. In the first quarter, the average daily time spent on the App per user increased by 42% year-over-year, and the number of daily messages sent per user rose 57% year-over-year. As of the end of March, the number of pairs of friends' connections grew 3.87 times compared with the same period last year.

In addition, the continuous optimization of in-group interactive functions also effectively drove the group penetration rate and the user engagement. In March, the group penetration rate grew 257% year-over-year, while the number of active groups grew 3.77 times compared with the same period last year. The group penetration rate of new users continued to rise, reaching almost 70% along with a significant expansion in the percentage of new users who are setting up groups on their own initiative.

Looking ahead, we will continue to enrich TIYA's product features based on user experience and launch more innovative functions and interactive features to meet users' online social needs in a more diversified range of scenarios and building a global social product with wider applicability, versatility and the usability.

Alongside our substantial progress in product improvement during the first quarter, we also continued to advance the development of our core technologies, reinforcing our in-house technologies' contribution to business growth. For example, by building and improving our versatile product technology platform, we enhanced both product reusability and product development efficiency. Also by strengthening our smart advertising system and optimizing our marketing campaigns and the promotional strategies, we effectively boosted our overall operating efficiency.

Furthermore, we improved various key technical metrics by solidifying our core technology foundation. Our in-house instant voice messaging platform VoderX and real-time audio and video streaming technology platform DOREME provide our products with technological support on multiple fronts, including enabling the implementation of customized voice related functions, while also offering a seamless, real-time interactive experience.

Going forward, we plan to continue expanding the coverage of our in-house technology. We expect to achieve 100% application of VoderX on TIYA in the second quarter, which will lower our technology costs, while also supporting the development of more innovative and customized function and enhancing our product differentiation advantages.

Our leading in-house suite of technologies and product optimizations and innovations also bolstered LIZHI's strategic multi-device product roadmap. In March, our in-car audio product was integrated into the vehicle operating system of Leapmotor a technology oriented Smart EV automaker through the in-car Xiaomi Quick APP Platform, bringing selected premium podcast content and immersive audio experience to a broader user base. Looking ahead, we will continue to deepen our presence in the in-car audio market hoping to provide more users with high-quality wide-ranging and customized in-car audio experiences.

In summary, our performance in the first quarter laid a solid foundation for our full-year development. Going forward, we will maintain our effective refined operational strategies and remain committed to tapping into more commercialization potential while adjusting resource allocations dynamically to boost operational efficiency.

On the international market front, we will fully leverage our core technology advantages and localized operational strategies to explore different markets, discover new business growth opportunities, expand our overseas user base and boost the commercialization bringing additional upside to the LIZHI Group's overall development. We are fully confident in LIZHI's long-term development and we'll continue to dedicate ourselves to creating greater value for our users and shareholders. Thank you all.

With that, I will now turn the call over to our Acting CFO, Ms. Chengfang Lu, who will discuss our financial results in more detail.

Chengfang Lu LIZHI INC. - Acting CFO

Thank you, Zelong. Hello, everyone.

Our first quarter results demonstrate our growth trajectory. Driven by the continuous improvements in our operating efficiency in the first quarter, our gross margin grew to 32% up 700 basis points year-over-year. More encouragingly, we achieved a net income of RMB16.4 million in this quarter, representing an 84% sequential increase. Going forward, we will carry on building a more competitive audio ecosystem, pursuing diversified commercialization avenues, and advancing our technology capabilities.

We're confident that those endeavors will strengthen our core competencies and empower us to create greater value for our users and

shareholders. I am providing a brief overview of our financial results for the first quarter of 2022.

In the first quarter, our total net revenues were RMB516.7 million representing an increase of 4% year-over-year, primarily driven by the increases in the number of paying users and the average amount of user spending on our audio entertainment products partially offset by the decreasing advertising revenue which was mainly due to the decrease in the number of advertising projects.

Cost of revenues was RMB348.6 million in the first quarter of 2022, representing a decrease of 6% year-over-year, primarily due to the adjustment in the revenue sharing policies, resulting in a decrease in the revenue sharing fees.

Gross profit was RMB168.1 million in the first quarter of 2022 representing an increase of 34% year-over-year. Non-GAAP gross profit was RMB170.7 million in the first quarter of 2022, representing an increase of 34% year-over-year. And our gross margin for the first quarter of this year increased to 32% from 25% in the first quarter of 2021.

And non-GAAP gross margin for the first quarter of this year grew to 33% from 26% in the first quarter of 2021. Operating expenses decreased by 22% year-over-year to RMB153.5 million in the first quarter of this year.

Research and development expenses were RMB71.1 million in the first quarter of 2022, representing a year-over-year increase of 25%. The increase was primarily due to the higher salary and welfare benefits expenses and rental expenses.

Selling and marketing expenses were RMB60.0 million in the first quarter of 2022, representing a decrease of 50% year-over-year, primarily attributable to the decreases in the promotion and marketing expenses, and partially offset by the increased salary and welfare benefits expenses.

General and administrative expenses were RMB22.4 million in the first quarter of this year, representing a year-over-year increase of 14%. The increase was mainly due to the increased salary and welfare benefits expenses and rental expenses.

Operating income was RMB14.6 million in the first quarter of 2022, compared to a loss of RMB72.2 million in the first quarter of 2021.

Non-GAAP operating income was RMB23.4 million in the first quarter of this year, compared to a loss of RMB64.0 million in the first quarter of 2021. And net income was RMB16.4 million in the first quarter of 2022, and compared to a net loss of RMB70.0 million in the first quarter of last year.

Non-GAAP net income was RMB25.2 million, compared to non-GAAP net loss of RMB61.8 million in the first quarter of last year. Basic and diluted net income per ADS were RMB 32 cents in the first quarter of 2022, compared to basic and diluted net loss per ADS of RMB1.50 in the first quarter of 2021.

Non-GAAP basic and diluted net income per ADS were RMB 49 cents in the first quarter of 2022, compared to non-GAAP basic and diluted net loss of RMB1.33 in the first quarter of last year. As of March 31, 2022, we had cash and cash equivalents, short-term investments and restricted cash of RMB515.5 million.

Okay, this concludes all of our prepared remarks today and we will now open the call to questions. Operator, please go ahead.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions)

Our first question comes from the line of Vicky Wei with Citi. Your line is open. Please go ahead.

Vicky Wei Citi - Analyst

(spoken in foreign language) Thanks for management for taking my question. So what does management think of the live streaming regulations on tipping and how does that impact audio live streaming sector and LIZHI?

My second question is a amid cost optimization in China internet sector. How should we think of the balance of LIZHI between investment in overseas and domestic market? Thank you;

Marco Lai LIZHI INC. - Founder, CEO

(spoken in foreign language)

Effy Kang LIZHI INC. - IR

I will translate for Marco. Yes Vicky's questions were answered by Marco and I will translate for him. So for the first question, recently, competent authorities have further clarified regulatory guidelines on the tipping regarding live streaming. We think the rules were very clear and we believe are beneficial to the long-term development of the audio live streaming sector including promoting a standardized operation mechanisms and strengthening the protection of minors. So that will deliver long-term benefits.

For some specific rules, we have optimized and adjusted products and operations to meet compliance requirements and it takes us time to be prepared. We have launched those special modes for minor users earlier including setting up the exclusive content pool for the minors. For audio entertainment, we have also carried out identity verification set for our hosts and established the risk of control and processing mechanism. So overall, we are very well prepared.

Generally, before the introduction of the new regulatory requirements, we have already made positive adjustments to the product and operations. And we'll continue to improve our mechanisms, according to the detailed requirements. We will dynamically monitor changes in the regulatory framework and actively optimize and adjust the product and operational strategies to better serve our users.

Marco Lai LIZHI INC. - Founder, CEO

(interpreted) The second question is about the balance between the investment in overseas market and domestic market. In the first quarter of this year, we have achieved the profitability on a GAAP basis for the second consecutive quarter with a net profit of RMB16.42 million representing a quarter-over-quarter increase of 84%. So far, our domestic business is already profitable and providing support to the Group's overseas business.

Going forward, we will further improve the operational efficiency of our business and increase the profitability.

We are prudent according to the global business about investment we will make dynamic adjustments according to the development of the product. In terms of customer acquisition strategy from a long-term perspective, our user growth strategy for overseas business mainly focuses on organic growth. We hope to strengthen the network effect of the product through the optimization of products and operational strategies and attract more users and achieve organic growth.

On the other hand, we will also fine-tune marketing investments based on our products' development stages, and target market conditions. As to research and development, we have been accumulating and elevating our core in-house technologies which may enable us to reduce the costs of business expansions on scale, while providing customized the product technology support.

For global expansion it's not only about investments, but also the commercialization opportunities, we are expecting the commercialization of our overseas business may bring diversified revenue streams in the long-term. In short, we will continue to adjust the allocation of resources through the evaluation of different development stages of the business and strictly manage investment scale and timing and strategy to maximize operational efficiency and further improve overall business performance and profitability and achieve a steady development.

Thank you. Thank you, Vicky.

Vicky Wei Citi - Analyst

Thank you.

Operator

Thank you. (Operator Instructions)

And our next question comes from the line of Carol with Southwest Securities. Your line is open. Please go ahead.

Carol Southwest Securities - Analyst

(spoken in foreign language) Thank you management for taking my questions, my first question is about our business planning after the establishment of Singapore headquarters? Thank you.

Marco Lai LIZHI INC. - Founder, CEO

(interpreted) For overseas business, our current focus is to expand the U.S. market through social product TIYA with user experience as the core to meet users' social demands through innovative product functions and features and to promote organic user growth. Furthermore, we are also actively exploring and expanding new markets to launch a richer product matrix, reuse the successful experience of the audio entertainment business and explore new commercialization opportunities.

The establishment of the Singapore headquarters has helped us to attract more talents to support the development of our globalization strategy and drive the business innovation. In addition, we have built local operational teams in various countries and regions except Singapore. We are continuously supporting product optimization and innovation through localized operations to meet the diverse needs of local users as well as the global users.

Going forward, our overseas business is poised to provide an upside to the Group's long-term revenue growth. Overall, we are confident in the long-term development of overseas business and will firmly implement the globalization strategy to achieve a sustainable business development.

Marco Lai LIZHI INC. - Founder, CEO

Please go ahead.

Carol Southwest Securities - Analyst

(spoken in foreign language) I was talking about overseas system I'd like to know the differentiation of TIYA compared with competitive products?

Marco Lai LIZHI INC. - Founder, CEO

(interpreted) From the perspective of product differentiation our globalization strategy currently focuses on the expansion of online social products with a core of audio centric and is committed to creating simple and easy to use audio social tools, enhancing the effectiveness of real-time interaction and meeting the diverse social needs of younger generation users.

The core differentiation lies in product innovation and in-house technology empowerment. Through the continuous product optimization and upgrading, we have enriched the interactive functions to make real-time interaction more fun and livelier.

I think the most important differentiation of our products is about in-house technology. We see there are many other products. They are using the technology support from third-parties and third agencies which makes the product more homogeneous. And we have got more customized technological support for the product optimization and user experience through our in-house developed instant voice messaging platform like VoderX and the real-time audio and video streaming technology platform DOREME.

So that we have more room to grow customized product features including the personalized voice tools and enhanced the interactive experience stable and the premium real-time interaction to ultimately achieve the differentiated product performance.

We also prioritize the effectiveness of the user interaction. And by simplifying the invitation pathways, optimizing the invitation mechanism, and upgrading the acquisition of friends' connections. We hope to make online social networking more simple, direct and efficient and meet the unmet social needs of users while bringing them a new online social experience.

As mentioned earlier, we also expect to have diversified innovations and attempts in the business model and launch additional monetization models to bring more diversified income sources to the group. Thank you

Carol Southwest Securities - Analyst

(spoken in foreign language) My third question is about gross profit margin when and how will we improve the revenue sharing ratio of audio entertainment? Thank you.

Marco Lai LIZHI INC. - Founder, CEO

(interpreted) In the previous call and earnings call, we've been talking about how we have improved the gross margins. And we have been always working on optimizing the cost structure and have seen positive outcomes of achieving a steady increase in the gross margin over the past several consecutive quarters.

The gross margin in the first quarter of this year increased to 32% with the 700 basis points increase from the same period last year. As for the cost of revenue, it mainly comes from the revenue sharing fees to our content creators and the cost of incentive fees. The revenue sharing ratio in the first quarter was increased by 700 basis points from the same period last year, which was primarily due to our timely adjustments of incentive policies and optimized the revenue sharing mechanism.

In the mid to long-term, we plan to further reduce the cost of revenue ratio in two aspects to improve our overall gross margin. First, we tend to continue to implement a dynamic adjustment strategy for incentive policies in the audio entertainment business through effective target setting and diverse supportive policies.

We will keep motivating our content creators, while also optimizing the revenue sharing ratio. Along with that, we aim to improve the engagement of need to long-term content creators through diversified operational activities and optimize the cost structure to achieve higher gross margin.

In addition, we also plan to realize the innovation of the monetization models through entering new markets and incubating new products, including the introduction of revenue streams with higher gross margins to improve the overall performance. So in summary, we are confident that we are able to further optimize our cost structures in the medium to long-term and improve the operational efficiency and overall profitability. Thank you.

Effy Kang LIZHI INC. - IR

That concludes Marco's answers.

Marco Lai LIZHI INC. - Founder, CEO

Thank you.

Operator

Thank you as there are no further questions, I'd like to now turn the call back over to the company for any closing remarks.

Effy Kang LIZHI INC. - IR

Thank you once again for joining us today. If you have further questions, please feel free to contact me to Investor Relations through the contact information provided on our website at ir.lizhi.fm or The Piacente Group Investor Relations. Thank you.

Operator

This concludes the conference call. You may now disconnect your lines. Thank you.

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