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Q3 2022 Lizhi Inc Earnings Call

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CORPORATE PARTICIPANTS

Effy Kang LIZHI Inc. - Head of Capital Markets

Zelong Li LIZHI Inc. - COO

Chengfang Lu LIZHI Inc. - Acting CFO

Marco Lai LIZHI Inc. - Founder and CEO

CONFERENCE CALL PARTICIPANTS

Vicky Wei Citi - Analyst

PRESENTATION

Operator

Hello, ladies and gentlemen. Thank you for standing by for LIZHI Inc.'s Third Quarter 2022 Earnings Conference Call. (Operator Instructions) 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. - Head of Capital Markets

Thank you very much. Hello, everyone, and welcome to LIZHI Inc.'s third 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 the Q&A session.

As a reminder, this conference is being recorded. In addition, our 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 discussion will contain forward-looking statements made under the safe harbor provision 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, advisers, 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 includes 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. Please go ahead.

Zelong Li LIZHI Inc. - COO

Hello, everyone. Thank you for joining our third quarter 2022 earnings conference call. In the third quarter of 2022, we continue to advance our dual pillar approach of the interactive entertainment plus audio-based social networking business. We maintained steady growth in our overall business development while achieving new highs in both revenue and net income. In the third quarter, our total average mobile MAUs totaled \$49.7 million.

Average monthly paying users amounted to 477,000, and the revenue reached RMB565 million, up 12% year-over-year and 10% quarter-over-quarter. We also made great strides to optimize our products and operational strategies while promoting the development of our core technologies and boosting organizational efficiency across our global business.

Thanks to these efforts, we achieved our fourth consecutive quarter of net income on a GAAP basis, which rose 5% quarter-over-quarter to RMB19.8 million in the third quarter. Amidst the current macro conditions, our steady business growth and continued profitability are a strong testament to our market competitiveness and the sustainability of our business model. Next, I'd like to share more details

regarding our business development in the third quarter.

In terms of the audio entertainment business, we continued cultivating our audio community ecosystem by enriching our product matrix and enhancing our product competitiveness to create a highly active and engaged interactive audio entertainment community, further unlocking commercialization potential of our audio entertainment business, we unveiled the diverse product features and functions in the third quarter to elevate the user experience. Notably, based on our original interactive entertainment ecosystem.

We launched a short audio content module, enabling users to enjoy immersive listening and producing short audio content. Meanwhile, leveraging a broad array of audio activities in our platform to boost the interactivity within our community.

We encourage the users to explore the innovative and interactive format of combining short audio content with audio-based social networking. In addition, to further strengthen user stickiness and engagement, we optimized our user management mechanism to achieve dynamic upgrading user services and improving user experiences.

In the third quarter, the average mobile MAUs of our interactive audio entertainment business grew to \$9.5 million with its user penetration rate climbing to 19.1%, accompanied by an improvement in the average spend per paying user, contributing to our audio entertainment business's revenue growth.

In terms of our content creator ecosystem, with our focus on developing mid- and long-tail content creators, we upgraded our creator support policies to encourage the creation of high-quality content. We continued to improve our creation tools and functions, including audio-scrip synchronization, AI noise reduction and BGM reception to enhance the overall creation experience.

For example, we rolled out one-minute visual recording tools, 3D immersive audio filters and other features in the newly launched short-term audio content module. These features foster a flexible and easy-to-use audio creation environment, attracting more creators to produce and share high-quality audio content on our platform.

In addition, through targeted operational activities, we generated diverse live streaming topics and launched a variety of contests and events while upgrading and innovating the creator competition system to motivate creators and drive their enthusiasm. We also launched new functions with a range of innovative, customized virtual gifting options to help creators generate income and enhance the commercialization efficiency.

Regarding our global development, we have pivoted and focused on enhancing our globalization capabilities. As a result, we further advanced our global team-building and continued exploring overseas market opportunities and refining our product matrix ecosystem.

On the product end, we continued to optimize the features of our global social product, TIYA App by integrating real-time interactions and online entertainment as part of our continuous efforts to build an interactive online space and a well-rounded product system. The iteration of our social tools, together with simplified user paths, enables users to enter their personal online space with one-click and call on their friends or interact in real-time in their public audio space, hence improving users' real-time social networking experience.

As a result, TIYA's user engagement and activity grew further, and both the new user friend interaction rates and average time spent per user maintained upward trends. In the third quarter, the average daily time spent per user increased by 34% year-over-year and the monthly average user group participation rate rose 94% year-over-year. As of the end of September, the number of friends' connections grew by 56% compared with the same period last year.

In terms of global team-building and capability improvement, we continued to expand our global talent pool in core business regions, cooperating with international colleges and attracting local talents. We aim to enhance our globalization capabilities, spanning talent cultivation, and product operation to technology advancement in order to achieve breakthroughs in our international business.

As for technology development, since unveiling our in-house hybrid cloud computing platform "Voice Cloud" in August, we have continued to integrate core technologies and services. At the same time, we have promoted Voice Cloud's application to various business

segments to boost our business's back-end and middle-platform support. By upgrading the automation capabilities of our testing platform, we improved our team's testing efficiency and shortened the entire process from research and development to product launch. In addition, we have been ramping up the technical capabilities of our self-developed RTC real-time audio and video streaming technology platform DOREME and instant messaging platform, VoderX. Our initiatives include expanding their business scope, promoting their application in diverse scenarios, facilitating the continuous innovation of audio products, and ultimately empowering our business.

Our long-standing philosophy is to prioritize our users' interests and strive to create value for them. While developing our global business, we have placed a significant emphasis on user data security and privacy protection.

Recently, we have also been actively working on obtaining the certification of ISO 27001, the standard for Information Security Management System and ISO 277001, the standard for Privacy Information Management Systems. Through continuously improving our platform's data protection system, we are committed to complying with the highest international standards in data security and privacy to fully protect users' right and interests and fortifying a relationship of trust with our users.

In mid-October, we celebrated LIZHI's 9th Anniversary and announced our brand-new mission and vision: "to be the world's biggest audio platform. Using sound to make people feel closer and live happier", Driven by our mission and vision, we will actively promote our strategic development with an unwavering effort to advance globalization, pursue excellence, and create greater value for our users and society at large.

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

Chengfang Lu LIZHI Inc. - Acting CFO

Okay. Thank you, Zelong, and hello, everyone. Our third quarter results are a testament to our strategic execution ability, with quarterly revenues growing by 12% year-over-year and 10% quarter-over-quarter to a new record high of RMB565.2 million.

As we unceasingly endeavor to optimize our operational efficiency, we achieved a profit for the fourth consecutive quarter on a GAAP basis in the third quarter of 2022, with net income growing 5% sequentially to RMB19.8 million. Going forward, we aim to continuously develop our product matrix, strengthening core technological capabilities and unleash our commercialization potential to achieve sustainable growth over the long-term.

Now, I would like to provide a brief overview of our financial results for the third quarter of 2022. In the third quarter, our total net revenues were RMB565.2 million, representing an increase of 12% year-over-year, primarily due to the growth in average user spending on our audio entertainment products.

Cost of revenues was RMB376.2 million in the third quarter of 2022, representing an increase of 6% year-over-year, primarily due to an increase in the revenue sharing fees to our content creators as the company's revenue grew and partially offset by decreases in the salary and welfare benefits expenses related to a decrease in our operation's headcount and share-based compensation expenses.

Gross profit was RMB189.1 million in the third quarter of 2022, representing an increase of 25% year-over-year. Non-GAAP gross profit was RMB180.8 million in the third quarter of 2022, representing an increase of 24% year-over-year.

Gross margin for the third quarter of 2022 increased to 33% from 30% in the third quarter of 2021. And non-GAAP gross margin for the third quarter of 2022 grew to 34% from 31% in the third quarter of 2021.

Operating expenses were RMB176.6 million in the third quarter of 2022 compared to RMB191.3 million in the third quarter of 2021. Research and development expenses were RMB78.3 million in the third quarter of 2022, representing a year-over-year increase of 7%. The increase was primarily due to the higher salary and welfare benefits expenses and rental expenses.

Selling and marketing expenses were RMB71.2 million in the third quarter of 2022 compared to RMB88.2 million in the third quarter of 2021, primarily due to the decrease in branding and marketing expenses, partially offset by the increased salary and welfare benefits expenses.

The company will evaluate and adjust its marketing strategy and budget based on the company's performance, operational lease and market conditions. General and administrative expenses were RMB27.1 million in the third quarter of 2022, compared to RMB29.7 million in the third quarter of 2021, mainly driven by a decrease in share-based compensation expenses and other miscellaneous expenses.

Operating income was RMB12.5 million in the third quarter of 2022, compared to a loss of RMB40.1 million in the third quarter of 2021. Non-GAAP operating income was RMB20.2 million in the third quarter of 2022 compared to a loss of RMB30.1 million in the third quarter of 2021.

Net income was RMB19.8 million in the third quarter of 2022 compared to a net loss of RMB37.1 million in the third quarter of 2021. And non-GAAP net income was RMB27.5 million compared to non-GAAP net loss of RMB27.2 million in the third quarter of 2021.

Basic and diluted net income per ADS were RMB0.38 in the third quarter of 2022, compared to a basic and diluted net loss per ADS of RMB0.73 in the third quarter of 2021. Non-GAAP basic and diluted net income per ADS were RMB0.53 in the third quarter of 2022, compared to non-GAAP basic and diluted net loss of RMB0.54 in the third quarter of 2021.

As of September 30, 2022, we had cash and cash equivalents, short-term investments and restricted cash of RMB623.1 million. Okay. This concludes all of our prepared remarks today. I will now open the call to questions. Operator, please go ahead.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have a question from the line of Vicky Wei from Citi.

Vicky Wei Citi - Analyst

I have two questions. The first one is, will management share some color about the overseas business development as well as the amount of investment expense. My second question is will management share some color about your thoughts. So when domestic product profitability potential in the longer term amid low in growth and challenging macro conditions.

Marco Lai LIZHI Inc. - Founder and CEO

The first question is answered by Marco and I will translate for him. So the first question is about the overseas business development and investment expense. And for the development of our overseas business, we actually mainly focused on three aspects, product, technology and the team. In terms of product development, we are incubating new products targeting different overseas markets and focusing on our diversified product metric strategy.

And we are aiming to leverage our core technology capabilities and experiences in product operation to achieve breakthroughs in our international business. So for the U.S. market, we are also continuously optimizing and integrating the TIYA App to improve user experience of real-time interaction and online social networking. And we are seeing that in the third quarter, the users' interruption rates and average time spent per user continued a very good upward trend.

Operator

Thank you for the questions. Ms. Wei, do you have any follow-up questions?

Effy Kang LIZHI Inc. - Head of Capital Markets

Yes. I think Marco has some disconnection problem; we answered the questions. I will continue his answers. As he mentioned about the technology and the products and the team; so next, I can share more insights about the technology. So on the technology front, we

actually further strengthen the application of our in-house hybrid cloud computing platform called "Voice Cloud" in many different business segments, and we also expanded our business growth, as mentioned by our COO, Mr. Li earlier.

And throughout continuously unleashing the technical potential, we actually achieved more innovations in voice technology. And we have also promoted refined and customized adjustments and integrations for our overseas products. and this has improved the user experience and foster the business development.

In addition, and regarding the team building, Marco has mentioned and the talent changing our overseas markets, we actually continue to focus on the target markets to actively expand the local teams and improve our operational capabilities in both the international and the local front, this has actually made a solid foundation for our globalization strategy.

And in terms of the actual investment expense in the third quarter, our overall investment in overseas operations accounted for no more than 10% of the total operating expenses. It includes the expenses related to sales and marketing and local office operations in the international team building, et cetera. So overall, we make long-term plans for resource location and based on different stages of business development, this has balanced our input and output.

We also strictly control and dynamically adjust the investment scale and including the timing and the specific strategies of the investment to ultimately maximize the operational efficiency.

And in the future, we hope that our overseas business will bring us more diversified revenue sources and improve the overall profitability of the group and achieve solid business development. I think Marco has returned to the call. So Marco can answer the next question about the challenging macro and future profitability potential.

Marco Lai LIZHI Inc. - Founder and CEO

I'll translate for Marco for the second question. During the third quarter, we reached a very good performance and new record highs for both total revenues and net income and achieved a profit for the fourth consecutive quarter. The audio entertainment business is actually a relatively mature segment within our group.

And under the current macro environment, we are able to make timely and quick adjustments to our strategy based on our insights in the market environment. And in terms of the product function, we focused on meeting the core needs of our users, and in terms of the operation-wise, we continued to refine our management of the users' entire lifecycle and content creator ecosystem. This strategic adjustment also helped us to improve our operational efficiency and increase the profitability effectively.

Marco Lai LIZHI Inc. - Founder and CEO

In the mid to long term, the domestic business still has tremendous growth potential. And with the increase in the user penetration rate of the audio entertainment business, the market scale is also further expanding. And in the future, we will continue to expand the core user groups in the audio entertainment sector and increased users' willingness to pay through diversified operational activities and innovative function and ultimately promoting the growth of paying user conversion rates and our overall revenue.

In terms of our cost and expense structure, we will also dynamically adjust it based on the market feedback at different stages and continue to refine our user acquisition strategy and improve overall operational efficiency, help us achieve sustainable profitability in the domestic business. Overall, we are very confident about the stable growth and sustainable development in the future.

Operator

Thank you. This concludes our question-and-answer session. Thank you very much. If there are no further questions now, I would like to turn the call back over to the company for closing remarks.

Effy Kang LIZHI Inc. - Head of Capital Markets

Well, thank you once again, everyone, for joining us today. If you have any further questions, please feel free to contact the company and our Investor Relations through the contact information provided on our IR 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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