

## **YOUDAO 1Q 2024 CONFERENCE CALL SCRIPT**

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Conference ID: Youdao, Inc.

### **Operator introduction**

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Good day and welcome to the Youdao 2024 first quarter earnings conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Mr. Jeffrey Wang, investor relations director of Youdao. Please go ahead.

### **Jeffrey Wang**

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Thank you, operator. Please note the discussion today will contain forward-looking statements, related to the future performance of the Company, which are intended to qualify for the Safe Harbor from liability, as established by the U.S. Private Securities Litigation Reform Act. Such statements are not guarantees of future performance and are subject to certain risks and uncertainties, assumptions and other factors. Some of these risks are beyond the Company's control and could cause actual results to differ materially from those mentioned in today's press release and this discussion.

A general discussion of the risk factors that could affect Youdao's business and financial results is included in certain Company filings with the U.S. Securities and Exchange Commission. The Company does not undertake any obligation to update this forward-looking information, except as required by law.

During today's call, management will also discuss certain non-GAAP financial measures, for comparison purposes only. For the definitions of non-GAAP financial measures, and reconciliations of GAAP to non-GAAP financial results, please see the 2024 first quarter financial results news release issued earlier today.

As a reminder, this conference is being recorded. A webcast replay of this conference call will be also available on Youdao's corporate website at [ir.youdao.com](http://ir.youdao.com). Joining us today on the call from Youdao's senior management are Dr. Feng Zhou, our Chief Executive Officer, Mr. Lei Jin, our President, Mr. Peng Su, our VP of Strategy and Capital Markets, and Mr. Wayne Li, our VP of Finance. I will now turn the call over to Dr. Zhou to review some of our recent highlights and strategic direction.

## Feng Zhou

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Thank you, Jeffrey. And thank you all for participating in today's call. Before we begin, I would like to remind everyone that all numbers are based on Renminbi, unless otherwise specifically stated.

We had a solid quarter in Q1 2024. Net revenues reached RMB1.4 billion, marking 19.7% year-over-year growth. Income from operations amounted to RMB29.9 million, a significant turnaround from the RMB195.8 million loss from operations in the same period of last year. This marks our first-ever profitable first quarter, and our first-ever consecutive two-quarters of profitability. In terms of the cash flow used in operating activities in the first quarter was RMB391 million, as Q1 is seasonally low on course renewals. This represents an improvement of 10.5% year-over-year.

Now let's review the developments across our business lines.

Learning services revenues reached RMB718.0 million, largely flat compared with the same period last year. Within the segment, **digital content services** maintained strong momentum, with net revenues of RMB499.8 million in Q1, marking an 11% year-over-year growth. Gross margin has consistently exceeded 70% for three consecutive quarters. Furthermore, the net revenues generated by digital content services covered the costs and operating expenses, and yielded meaningful profits. In terms of product enhancements, we upgraded Youdao Lingshi in Q1 by introducing a tiered teaching approach tailored to individual needs and capabilities. More recently, we concluded the spring renewals for Youdao Lingshi students, and the retention rate reached a historic high of over 70%, up more than 10 percentage points year over year. This retention rate is remarkably high for this age group and competitive with offline service, while offering higher gross margins. Additionally, we launched a new product for Youdao Literature called "Virtual Tour of Twenty Four Cities" (云游二十四城), designed to help students improve their reading and writing abilities. Lastly, leveraging our AI capabilities, we efficiently offered over 30,000 high-quality writing refinements in the first quarter through AI writing refinement, 80% more than last quarter.

Next in learning service are our AI-driven apps and services. On previous calls, we have discussed extensively our AI initiatives, particularly our large language model (LLM) projects. We believe Youdao is uniquely positioned to bring AI experiences to a lot of users in China and other countries, driving business growth due to our large user base and long-standing experience in algorithm-driven products. Adopting a lean approach, we develop our models and multiple applications simultaneously at a fast pace. I'm pleased to share that the total sales of our AI-driven subscription services **reached approximately RMB50 million for the first time** in Q1, representing a remarkable year-over-year increase of over 140%. Actually, this segment has grown year-over-year by over 50% for five consecutive quarters, and we expect

the trend to continue. These AI-driven subscription services primarily include Youdao Dictionary, Youdao Desktop Translation, Hi Echo and multiple international apps that provide translation, language learning and other services. While we are still in the early days, the future looks incredibly promising. We firmly believe that consumer-facing products are the largest growth opportunity for AI at present, and the combination of LLM and subscriptions are a very natural route for growing AI products. For instance, leveraging our proprietary large language model Ziyue, we have increased the accuracy of Chinese-English translations to approximately 98%, driving more subscriptions. Additionally, we recently launched an upgraded version of Hi Echo in collaboration with the IELTS organization, introducing modules for IELTS speaking practice, simulated exams. and a bilingual teaching mode to better cater to Chinese users' learning needs. Furthermore, Quest Mobile recognized Hi Echo as a pioneer application in the education industry for AI-generated content.

Our **online marketing services** segment continues to demonstrate remarkable growth, with net revenues reaching a historic high of RMB492.7 million in the first quarter, marking an impressive 125.9% year-over-year increase. This segment has sustained robust momentum, achieving over 50% year-over-year growth for six consecutive quarters, driven largely by the strong performance of Real-Time API (RTA) and the rapid expansion of domestic Key Opinion Leader (KOL) advertising verticals, both of which experienced over 100% year-over-year growth in the first quarter, underscoring the segment's strength and our ability to capitalize on emerging trends. Looking ahead, we see multiple avenues for further growth, including leveraging industry trends like data management platforms (DMP), as well as strengthening our collaboration and synergy with the NetEase Group. Our partnership with NetEase brings us the benefit of their vast traffic sources, and access to more customers within the group. In the first quarter, less than 10% of our ad revenues originated from NetEase, indicating significant future growth potential as we deepen the partnership. At the same time, our AI capabilities will empower the group to conduct advertising placements more accurately and efficiently across business lines, creating a mutually beneficial synergy that drives growth for both parties.

Regarding the smart devices segment, net revenues were RMB181.2 million in the first quarter, reflecting a 14.8% year-over-year decline. However, it is encouraging to note that the rate of decline has narrowed by 30 percentage points compared to the previous quarter, indicating a stabilization. On the product front, we recently released Youdao Dictionary Pen S6 Pro, which quickly became the top-selling dictionary pen in terms of sales volume on JD.com after its launch. While we continue to face headwinds in this segment, we remain confident in the medium to long-term outlook for our learning devices, underpinned by our commitment to product innovation and our deep understanding of the educational technology market.

As usual, let me share with you some thoughts about our overall strategy. As our recent financials indicate, our business is nearing the achievement of sustainable profitability. A key

strategic question for us is: How do we cross the sustainable profitability threshold and build long-term growth in this highly competitive education and technology sector? Our strategy is to maintain financial discipline and focus on a few key businesses with high growth and strong competitive advantages.

Currently, we have identified three areas where we are concentrating more energy and resources. Firstly, our focus is on **digital content services, in particular Youdao Lingshi** for high school students. Over the past few years, Lingshi has emerged as the leading player in its segment. We believe there is a healthy multi-year growth trajectory for Lingshi in front of us. Secondly, we are focusing on **online marketing services**, which is approaching RMB500 million in quarterly revenues. We see two main growth drivers working in our favor: the trend of tech-driven advertisement product innovations, including wide applications of RTA, DMP and particularly generative AI in the industry, as well as untapped customer acquisition opportunities as we achieve larger scale and product leadership. Thirdly, our focus is on **AI-driven subscription services**, currently generating around RMB50 million in quarterly total sales. Although relatively small at present, this segment is growing at a high speed, with over 100% YoY growth this quarter. It is a key conduit through which our investment in AI will pay off. I'm pleased to share that we will be launching "Mr. P AI Tutor", the first all-subject AI tutor in China, as a free mobile app in June. We encourage you to try it out and provide us with feedback once it's available.

In conclusion, we are laser-focused on driving robust growth by offering premium online learning services, and spearheading AI innovations for consumers, while concurrently maintaining financial discipline. The future holds immense promise for AI-driven learning, advertisement and consumer services. With that, I will turn the call over to Su Peng to provide you with more detailed insights into our financial performance.

Thank you.

## Peng Su

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Thank you, Dr. Zhou, and hello everyone.

Today I will be presenting some financial highlights from the first quarter of 2024. We encourage you to read through our press release issued earlier today for further details.

For the first quarter, total net revenues were RMB1.4 billion, or US\$192.8 million, representing a 19.7% increase from the same period of 2023.

- Net revenues from our learning services were RMB718.0 million, or US\$99.4 million, representing a 2.0% decrease from the same period of 2023.
- Net revenues from our smart devices were RMB181.2 million, or US\$25.1 million, down 14.8% from the same period of 2023, primarily due to decreased demands for learning products in the first quarter of 2024.
- Net revenues from our online marketing services were RMB492.7 million, or US\$68.2 million, representing a 125.9% increase from the same period of 2023. The year-over-year increase in revenues from online marketing services was primarily due to the increase in the sales of performance-based advertisements through third parties' internet properties, which was driven by our continued investments in cutting-edge AI technology.

For the first quarter, our total gross profit was RMB681.5 million, or US\$94.4 million, representing a 13.2% increase from the first quarter of 2023.

- Gross margin for learning services was 63.1% for the first quarter of 2024, compared with 62.0% for the same period of 2023.
- Gross margin for smart devices was 32.6% for the first quarter of 2024, compared with 39.6% for the same period of 2023.
- Gross margin for online marketing services was 34.3% for the first quarter of 2024, compared with 29.1% for the same period of 2023.

For the first quarter, total operating expenses were RMB651.6 million, or US\$90.2 million, compared with RMB797.6 million for the same period of last year.

With that, for the first quarter, our:

- Sales and marketing expenses were RMB455.4 million, compared with RMB565.2 million in the first quarter of 2023.
- Research and development expenses were RMB146.7 million, compared with RMB182.8 million in the first quarter of 2023.

Our operating income margin was 2.1% in the first quarter of 2024, compared with operating loss margin of 16.8% for the same period of last year.

For the first quarter of 2024, our net income attributable to ordinary shareholders was RMB12.4 million, or US\$1.7 million, compared with net loss attributable to ordinary shareholders of RMB204.4 million for the same period of last year. Non-GAAP net income attributable to ordinary shareholders for the first quarter was RMB20.3 million, or US\$2.8 million, compared with non-GAAP net loss attributable to ordinary shareholders of RMB193.9 million for the same period of last year.

Basic and diluted net income per ADS attributable to ordinary shareholders for the first quarter of 2024 were RMB0.11, or US\$0.02 and RMB0.10, or US\$0.01. Non-GAAP basic and diluted net income per ADS attributable to ordinary shareholders for the first quarter was RMB0.17, or US\$0.02.

Our net cash used in operating activities was RMB391.0 million, or US\$54.1 million, for the first quarter.

Looking at our balance sheet, as of March 31, 2024, our contract liabilities, which mainly consist of deferred revenue generated from our learning services, were RMB769.1 million, or US\$106.5 million, compared with RMB1.1 billion as of December 31, 2023. At the end of the period, our cash, cash equivalents, restricted cash, time deposits, and short-term investments totaled RMB326.0 million, or US\$45.2 million.

This concludes our prepared remarks. Thank you for your attention. We would now like to open the call to your questions. Operator, please go ahead.

**Jeffrey Wang**

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Thank you once again for joining us today. If you have any further questions, please feel free to contact us at Youdao directly, or reach out to Piacente Financial Communications in China or the US. Have a great day.