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CORPORATE PARTICIPANTS

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Naijiang Zhou *Xunlei Limited - CFO*

PRESENTATION

Operator

Good morning, and thank you for standing by for Xunlei's Second Quarter of 2018 Earnings Conference Call. (Operator Instructions) Today's conference call is being recorded. I would like to turn the call over to your host today, Ms. [Sharlene Yu], IR Manager of Xunlei. Thank you. Please go ahead.

Unidentified Company Representative

Thank you. Good morning, and good evening. Welcome to Xunlei's Second Quarter of 2018 Earnings Call. I'm [Sharlene Yu], Investor Relations Manager at Xunlei.

With me today on the call are Mr. Lei Chen, our CEO; and Mr. Eric Zhou, our CFO.

Today's conference call is being recorded, and a replay of the call will be available on our IR website following the call. Our earnings press release was distributed earlier today and now is also available on our IR website.

Before we get started, please note that the discussion today will contain forward-looking statements made under the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995. These forward-looking statements are subject to the risks and uncertainties that may cause actual results to differ materially from our current expectations. Please refer to our SEC filings for more detailed description of the risk factors that may affect our results.

We do not assume any obligation to update any forward-looking statements, except as required under applicable laws.

During this call, we will refer to both GAAP and non-GAAP financial measures and the non-GAAP measures are reconciled to the comparable GAAP measures in the table attached to our earnings press release, which can also be found on our website.

Please note that all numbers are in US dollars, unless otherwise stated.

I will now turn the call to our CEO, Mr. Eric -- Mr. Lei Chen.

Lei Chen - Xunlei Limited - CEO & Director

Good morning, and good evening, everyone. Thank you all for joining our second quarter of 2018 earnings conference call today. I'm pleased to report another quarter of progress and achievement. We beat the quarterly guidance and achieved \$65.8 million in revenue in the second quarter of 2018, and this is with a growth of 70.7% on a year-over-year basis. The better-than-expected growth in revenue was primarily driven by increasing demands for our cloud computing, live streaming and mobile advertising products.

Today, I'll start with how shared computing is enabling us to advance the mission of empowering individuals through technological innovation. Then I'll talk about our growing blockchain ecosystem and how it will shape the future of our cloud computing business in new ways. And finally, I'll share with you some updates on our major business segments.

Let's begin with how shared computing is helping realize our mission. As we highlighted last quarter, in as early as 2015, we initiated shared cloud computing solutions as we saw significant growth opportunities with the emergence of Internet of Things, AR, AI and big data. We transformed the user's idle bandwidth and storage to offer cloud computing services to our enterprise customers. With our shared computing model, we help our customers to reduce cost and improve performance.

Lately, we have seen a trend of similar and relevant technologies such as edge computing and Serverless PaaS sprouting out from different technology thinkers and evangelists. We believe this trend will continue for a couple of reasons. First, IoT becomes more important and starts to fundamentally change the way we live and conduct business. This leads to a variety of applications where such technologies provide better solutions. And secondly, the demand for bandwidth, storage and computing power grows rapidly while the cost of CPU, flash and other computing units reduces at a much slower pace. We even saw reversed price trends in some of these units. A solution that can fundamentally reduce costs will become more and more desirable in the market.

That's also why we keep operating our technology and have recently expanded our cloud service through IaaS domain through the company's new cloud platform, StellarCloud. StellarCloud offers edge computing, function computing and shared CDN solutions to the companies in their transition to cloud, including content delivery, live streaming, data storage and artificial intelligence.

Since the launch in May, we have been growing our client base on StellarCloud and deepening the partnerships with existing and new clients such as iQIYI, Kuaishou, [Feng Xing], Quanmin TV, Yidianzixun, et cetera.

So why would personal users be willing to share their idle resources? Blockchain technology is a critical part. It solves the problem with trust and incentives between users and companies. Furthermore, we believe blockchain will unlock new opportunities for not only shared computing, but also every industry and we're committed in helping communities and people benefit from this technology.

We have accelerated our efforts on blockchain in the past few months. For example, we launched a high-performance blockchain platform, ThunderChain Open Platform and ThunderChain File System. With the technology to perform over 1 million transactions per second, ThunderChain helps application developers and entrepreneurs to create large-scale practical blockchain applications in different sectors. The ThunderChain File System enables developers and enterprises to build decentralized applications with distributed data storage and integration for blockchain platforms.

We also concluded the Xunlei Blockchain Applications Global Challenge in early July. We are very pleased to see a large number of participants from China and overseas came together and developed the blockchain applications across multiple sectors, including public welfare, healthcare, education, gaming, social network, transportation and copyright protection.

Notably, over the past few months, our blockchain and shared computing solutions were recognized by a number of authorities and institutions in China. For example, in May, our cloud computing business was affirmed in the White Paper issued by China's MIIT information center. In this authoritative document for -- survey for blockchain industry, our blockchain-based hardware, OneThing Cloud, is cited for utilizing the idle computing resources for individuals to help enterprises reduce operating costs while protecting the environment. In July, ThunderChain was recognized as one of Outstanding Entrepreneurship and Innovation Projects by China's official news agency, Xinhua Net.

Now let me go through the financial updates of major business segments. Our blockchain-based cloud computing business continues to be an important driver for our long-term growth. Revenues from cloud computing as well as Internet value-added services amounted to \$36.5 million and enjoyed a 186.9% increase compared to the same period in 2017. Notably, OneThing Cloud achieved solid sales results during the June '18 festival initiated by JD.com, which is an important midyear online promotion event. We also partnered with JD to expand into offline retail stores. We believe cloud computing and other Internet value-added services will be an important industry trend and a key driver for our long-term growth. That's why we invest heavily in these products.

As to our live streaming business, we have successfully launched both video and voice live streaming products and had a significant rise in revenue. We also celebrated the first annual live streaming festival in June and are glad to see the fruits of our growth initiatives.

Our online advertising revenues grew 57.2% on a year-over-year basis, driven by strong advertising demand during the mid-year marketing and sales campaign.

Moreover, I'd also like to touch on our membership subscription business. Over the years, our membership subscription business has provided us with stable cash flows to pursue growth and innovation opportunities to support Xunlei in its transition from a traditional Internet company into an innovative technology provider, driven by the power of shared economy and the potential of blockchain technology.

Recently, we unveiled a trial version of flagship download accelerator, ThunderX, which was a desktop application to support a wide range of 4K high-definition display solutions. Since then, we have been receiving positive and constructive feedback from users. And we will continue to enhance user experience and service quality for our subscription members.

Before I close, I'd like to mention that we're developing a shared computing- and blockchain-based ecosystem for the next wave of technological breakthroughs. We will continue to invest in innovation and new capabilities to drive future revenue growth and enhance long-term shareholder value.

With that, I will now turn the call over to Eric to review the second quarter financial results. Eric, please?

Naijiang Zhou - Xunlei Limited - CFO

Thank you, Lei. Hello, everyone, and once again, thank you for joining Xunlei's Second Quarter Of 2018 Conference Call.

And now, I'd like to go through the details of our financial results. Our total revenues were \$65.8 million, which exceeded our high-end guidance and representing an increase of approximately 72.7% (sic) [70.7%] as compared with the same period last year. The increase in total revenues was mainly attributable to the growth of cloud computing, live streaming and mobile advertising business.

Revenues from cloud computing and Internet value-added services were \$36.5 million, representing an increase of 186.9% on a year-over-year basis. Cloud computing revenues grew by 183.5% on a year-over-year basis.

Revenues from subscriptions were \$21.1 million, representing an increase of 2.5% on a year-over-year basis. The year-over-year increase in subscription revenues was primarily attributable to increase in average revenue per subscriber. The average revenue per subscriber for the second quarter of 2018 was RMB 37, an increase from RMB 34.4 for the same period last year. The number of subscribers was 3.69 million as of June 30, 2018, a decrease from 4.09 million as of June 30, 2017. The company continues to transform from a traditional Internet company to one with growth drivers coming from innovation and investments in cloud computing and blockchain-related products and services.

Revenues from online advertising were \$8.2 million, representing an increase of 57.2% on a year-over-year basis, mainly due to increased demand for our mobile advertising business during mid-year campaigns.

Cost of revenues was \$30.7 million, representing 46.7% of our total revenues. The increased amount of the costs of revenues was mainly due to increased OneThing costs, hardware costs and partially offset by reduced bandwidth costs.

Bandwidth cost in the second quarter of 2018 were \$12.1 million, representing 18.4% of our total revenues compared with \$18.8 million or 48.8% of the total revenues in the same period last year. The decrease was mainly attributable to the crowdsourced bandwidth capacity. The remaining cost of revenues was largely the revenue-sharing costs for our growing live streaming business.

Gross profit for the second quarter of 2018 was \$34.7 million, representing a year-over-year increase of 143%. Gross margin was 52.7% in the second quarter of 2018 compared with 37% in the same period last year.

Research and development expenses for the second quarter of 2018 were \$19.2 million, representing 29.2% of total revenues compared with \$14.7 million or 38.1% of the total revenues in the same period last year. The significant decrease in the percentage of research and development expenses

in our total revenues was mainly due to increased total revenues while we managed expenses. We continued investments in blockchain research and development to strengthen our competitive position and expand our products and services.

Sales and marketing expenses for the second quarter of 2018 were \$9.5 million, representing 14.5% of the total revenues, compared with \$4.4 million or 11.4% of our total revenues in the same period last year. The increase was mainly due to the marketing and promotion activities for our OneThing Cloud device, which was launched in the third quarter of 2017.

General and administrative expenses for the second quarter of 2018 were \$9.7 million, representing 14.8% of our total revenues compared with \$8.2 million or 21.4% of our total revenues in the same period last year. The increase was mainly due to higher employee benefits and professional and consultancy fees to support and expand our business.

Operating loss was \$3.7 million in the second quarter of 2018 compared with operating loss of \$13 million in the same period last year.

Net income from continuing operations was \$0.7 million in the second quarter of 2018, compared with net loss of \$11.2 million in the second quarter of 2017. Non-GAAP net income from continuing operations was \$2 million in the second quarter of 2018, compared with non-GAAP net loss of \$9 million in the same period last year.

Diluted earnings per ADS from continuing operations in the second quarter of 2018 was \$0.01, compared with a loss of \$0.17 in the same period last year.

As of June 30, 2018, the company had cash, cash equivalents and short-term investments of \$345 million, compared with \$355.6 million as of June 31, 2018 (sic) [March 31, 2018]. The cash position dropped \$10.6 million primarily due to an increase in accounts receivables as a result of a large amount of OneThing Cloud device sold in a midyear shopping festival in the second half of June 2018.

And finally, I'd like to turn to our guidance for the third quarter of 2018. We expect total revenues to be between \$54 million and \$60 million for the third quarter of 2018. The midpoint of the range represents a year-over-year increase of about 27.2%.

With that, we conclude our prepared remarks for today, and I will now turn the call over to the operator for your questions. Operator, we are now open to the questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) There are no further questions at this time. Please continue, sir.

Lei Chen - Xunlei Limited - CEO & Director

If there's no further questions, will -- should we just stop the call? Or should we wait a few more minutes or just end the call?

Okay, (inaudible), if there's no questions, then I think we -- let's just close the call.

Okay. With that, I will now turn the call over -- I'm sorry. Operator, in this case then, let's just end the call. And everyone, thanks, again, for your attention and joining this call. Bye.



Naijiang Zhou - Xunlei Limited - CFO

Thank you. Bye-bye.

Operator

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

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