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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 Third Quarter of 2018 Earnings Conference Call. (Operator Instructions) Today's conference call is being recorded.

I would now like to turn the call over to your host today, Ms. [Sharlene Yu], IR Manager of Xunlei.

Unidentified Company Representative

Thank you. Good morning, and good evening. Welcome to Xunlei Third Quarter of 2018 Earnings Call. I'm [Sharlene Yu], Investor Relations Manager at Xunlei. With me today on the call are Mr. Lei Chen, Chief Executive Officer; and Mr. Eric Zhou, Chief Financial Officer.

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 is now also available on our IR website.

Before we get started, please note that the discussions today will contain certain 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 risk and uncertainties that may cause actual results to differ materially from our current expectations. Please refer to our SEC filings for more detailed descriptions of the risk factors that may affect our results. We do not assume any obligations 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 U.S. dollars, unless otherwise stated.

Before starting the question-and-answer session, I would now turn the call over to our CEO, Mr. Lei Chen, for prepared remarks.

Lei Chen - Xunlei Limited - CEO & Director

Good morning, and good evening, everyone. Thank you all for joining our Third Quarter of 2018 Earnings Conference Call today. Let me first provide some general information on our financial results of this quarter. Our total revenue was \$45.3 million, representing an increase of 1.1% year-over-year. We significantly increased gross margin to 52.7% in the third quarter of 2018 from 35.5% in the same period last year. And the gross profits in the third quarter of 2018 were \$23.8 million compared with \$15.9 million in the same quarter last year. The improved gross profits were mainly due to changes in the product mix, where sales of higher-margin products accounted for a larger percentage of total revenue than the same period last year. Net loss was \$15.8 million compared with a net loss of \$25.6 million in the third quarter of 2017.

Before we go through the performance of our major business segments, I'd like to summarize our recent major corporate developments. During the quarter, we established a strategic partnership with Newland Hi-Tech Group Corporation Limited. Newland Group is a highly respected company with several subsidiaries, including a listed company in China. It is a leading international provider of integrated electronic payment service and one of the top global suppliers of POSTs, point of service terminals. Newland also works on national projects and participating developing China's digital economy.



With this partnership, we will explore a variety of opportunities for large-scale blockchain applications together. And we think this will give us opportunities to further develop our leadership in blockchain technology. Subsequent to the strategic partnership, we have further restructured operations of LINK token program. With this move, we will put more focus on research and development of the underlying blockchain technology and infrastructure such as ThunderChain and ThunderChain File System.

The third quarter was a quarter of continuous development and transformation. Xunlei has lately partnered with People Capital to establish a blockchain lab to calculate blockchain applications to serve the real economy. People Capital is a venture capital arm of the People's Daily Online, one of the mainstream media groups in China. We believe this partnership will strengthen our leadership position in the blockchain space. And our efforts have been gaining increased recognition by the industry. For example, Xunlei, as one of the 2018 China's top 100 Internet companies, has lately been certified as a National Priority Software Enterprise by the Development and Reform Commission of Shenzhen Municipality.

In addition, Xunlei was recently awarded Ram Charan Management Practice Award by Harvard Business Review. Furthermore, OneThing Technologies Corporation Limited, a wholly owned operating company at Xunlei, was recently selected by Deloitte as one of the top 25 growing hi-tech companies in Shenzhen in 2018. And finally, OneThing Technologies was selected by the Institute of New Economy and the Industry of China Academy of Management Science as a corporate model for blockchain development. I believe these examples serve as a testimony of our latest accomplishments and illustrate our outstanding ability to carry out some of the industry-leading research and development projects.

Now I'd like to provide a general overview of our major lines of products. Our cloud computing business continued to be an important driver for our long-term growth. Revenues from cloud computing and Internet value-added services amounted to \$19.8 million, representing an 8.3% increase compared with the same period of last year.

During the third quarter, we increased our research and development personnel at OneThing Technologies and formed a new partnership for corporate development. Our businesses are dynamic, evolving and full of exciting opportunities. However, from historic perspective, developing a disruptive and cost-effective blockchain infrastructure by no means an easy endeavor. But with 15 years of related knowledge and experiences, we believe we're uniquely positioned to become a leader of this industry. We expect to announce some great progresses in the near future.

Our live streaming business -- for our live streaming business, we're very pleased with the performance of our new voice streaming product, which was launched in the second quarter of 2018. It has generated consecutive outstanding quarterly growth and we expect the momentum will continue into the coming quarter.

We believe the domestic live voice streaming market is highly fragmented and, though intensively competitive, has tremendous growth opportunities in the future. In addition, we may extend the product to selected overseas markets.

Over the years, our membership subscription business has provided us with stable cash flows to pursue growth and innovation opportunities and support Xunlei in its transition from a traditional Internet company into an innovative technology provider driven by the power of sharing economy and the potential of blockchain technology. Although the number of membership declined on a year-over-year basis, the revenues of our membership business were largely in line with our expectations with the improved ARPU value during the third quarter. We will enhance our efforts and revitalize the membership subscription program by operating the download accelerator and introducing new functionalities.

As we highlighted last quarter, a trial version of flagship download accelerator, ThunderX, which was a desktop application to support a wide range of 4K high-quality display solutions, has lately made a full release. In this release, ThunderX has included additional forms of interactions, such as Xunlei cloud for sharing download apps to provide (inaudible) user experience.

In addition, we have been improving our VIP program to target new customers and better retaining existing ones. Our goal is to continuously improve user experience by making the membership program more useful and rewarding.

Our online advertising revenues grew 11.3% on a year-over-year basis, driven by increased advertising demand for our mobile advertising business. We achieved quarterly growth despite the fact that gaming sector has encountered some headwinds lately. Historically, gaming websites were important sources of online advertising revenues. We will diversify the sources of revenues and have explored new means to retain growth momentum.

Before I close, I'd like to reiterate that we're developing an innovative shared computing and blockchain-based ecosystem for the next wave of technological breakthroughs. We're making steady progresses in helping developers and enterprises unleash the real value of blockchain technology. I believe our business is a dynamic business and full of new opportunities. I also believe we are one of the few companies with dedicated resources and a strategic focus on blockchain and selected applications for real economies. And we're well positioned for growth and creating long-term shareholder value.

That being said, however, I want to point out that from historic perspective, most technological breakthroughs are by no means easy endeavors. Innovation brings us both challenges and opportunities. While we have lately seen reduced enthusiasm from both investors and consumers in blockchain, we're confident of its long-term prospects and committed to building a cloud computing and blockchain infrastructure to benefit all stakeholders.

With that, I'll now turn the call over to Eric to review the third quarter financial results. Eric, please?

Naijiang Zhou - Xunlei Limited - CFO

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

And now, I'd like to go through the details of our financial results. Our total revenues were \$45.3 million, representing an increase of approximately 1.1% as compared with the same period last year. Revenues from cloud computing and Internet value-added services were at \$19.8 million, representing an increase of 8.3% on a year-over-year basis. Cloud computing revenues grew by 1.5% on a year-over-year basis. Revenues from subscriptions were \$19.1 million, representing a decrease of 8% on a year-over-year basis. The year-over-year decrease in subscription revenues was mainly attributable to several factors. First, RMB depreciated against the U.S. dollars during the period; secondly, decreased number of subscription members; and finally, the impact of foreign exchange and membership was partially offset by increased average revenue per subscriber. The average revenue per subscriber for the third quarter of 2018 was RMB 38.5 and increase from RMB 33.2 for the same period last year. The number of subscribers were 3.4 million as of September 30, 2018, decreased from 4.18 million as of September 30, 2017.

Revenues from online advertising were \$6.4 million, representing an increase of 11.3% on a year-over-year basis, mainly due to increased demand for our mobile advertising business. Cost of revenues were \$21.2 million, representing 46.8% of our total revenues. The decreased amount of cost of revenues was mainly due to reduced bandwidth costs. Bandwidth costs in the third quarter of 2018 were \$10.2 million, representing 22.6% of our total revenues compared with \$17.1 million or 38.2% of the total revenues in the same period last year. The decrease was mainly attributable to the use of crowd source bandwidth capacity. The remaining cost of revenues was largely revenue-sharing costs for our growing live streaming business. Gross profits for the third quarter of 2018 were \$23.8 million, representing a year-over-year increase of 50%. Gross margin was 52.7% in the third quarter of 2018 compared with 35.5% in the same period last year.

Research and development expenses for the third quarter of 2018 were \$19.7 million, representing 43.4% of the total revenues compared with \$15.5 million or 34.6% of the total revenues in the same period last year. The increase was mainly due to higher staff headcount and employee compensation for our blockchain research and development to strengthen our competitive position and expand our product offerings.

Sales and marketing expenses for the third quarter of 2018 were \$10 million, representing 22.1% of the total revenues, compared with \$5.5 million or 12.2% of our total revenues in the same period last year. The increase was mainly due to marketing and promotional activities for our products.

General and administrative expenses for the third quarter of 2018 were \$12.4 million representing 27.3% of our total revenues, compared with \$13.2 million or 29.5% of our total revenues in the same period last year. The reduction was due to our effective cost control measures.

Operating loss was \$18.2 million in the third quarter of 2018 compared with operating loss of \$31.8 million in the same period last year. The decrease was mainly due to several assets impairment in the amount of \$13.6 million in the same period last year, which were one-time in nature.

Net loss from continuing operations was \$15.9 million in the third quarter of 2018 compared with net loss of \$26.8 million in the third quarter of 2017. Non-GAAP net loss from continuing operations was \$14.5 million in the same period of 2018 compared with non-GAAP net loss of \$24.7 million in the same period last year.

Diluted loss per ADS from continuing operations in the third quarter of 2018 was \$0.24 compared with the loss of \$0.40 in the same period of last year.

As of September 30, 2018, the company had cash, cash equivalents and short-term investments of \$331.3 million compared with \$345 million as of June 30, 2018. The cash position dropped \$13.7 million primarily due to the operating losses in the third quarter of 2018.

And finally, I'd like to turn to our guidance for the fourth quarter of 2018. We expect total revenues will be between \$40 million and \$45 million for the fourth quarter of 2018. The midpoint of the range represents a year-over-year decrease of approximately 48.4%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) (foreign language) We have our first question from the line of [Chang Wei].

Unidentified Analyst

(foreign language)

Lei Chen - Xunlei Limited - CEO & Director

(foreign language) Okay, the first question is whether the management is satisfied with this quarter's financial performance? And whether there is plan to improve financial performance for the coming quarters? In this quarter, we're seeing reduced enthusiasm from both investors and consumers in blockchain. This has affected part of our business performance, impacted our short-term financial performance especially in the sales of OneThing Cloud product. However, we remain confident of the long-term prospect of the blockchain technology as well as our ability to continue to perform well in this particular domain. We will continue to innovate our products and enhance customer experience. We believe customers will then tender interest in OneThing Cloud in the foreseeable future. The second question Mr. Chang asked was what is management's perspective on OneThing Cloud sales decline and whether there is decline in the online units? If it is true that OneThing Cloud's sales did decline in this quarter, but the online -- number of online units of OneThing Cloud is very steady. The reasons for the decline in OneThing Cloud sales, I've just mentioned before, it is true that we're seeing reduced enthusiasm from investors and consumers in the blockchain space. But again, we're confident that for the long-term, we'll be able to continue our progress in the blockchain industry -- in the blockchain space. The third question was how we evaluate the value of OneThing Cloud, the large number of OneThing Cloud that has been online and -- for the past year? So OneThing Cloud is a very important component of our cloud computing business and is our -- it is our first application and endeavor in blockchain application domain. It is a pretty large-scale blockchain application indeed. The distributed OneThing Cloud collected redundant computing resources from the society and provided the basis of our shared cloud computing business. The shared cloud computing business in the past couple of quarters, we've seen the demand for our distributed cloud computing business -- cloud computing solutions has been increasing. And our sales -- the limitation factor of our sales now is rather -- is not the demand for our products, it's rather we don't have enough collected resources, computing resources to meet all the demand. So to meet cloud demand, we're exploring different strategies and channels to increase access to redundant computing resources that can be shared by individuals. This will include collaborating with vendors beyond the OneThing Cloud ecosystem. On the other hand, we have been expanding our existing CDN services to (inaudible) based IaaS, offering EDGE computing, function computing and shared CDN solutions. We



also released app storage service, which offers a stable and secure storage on StellarCloud. So blockchain is an integral part of our cloud computing ecosystem and it has generated revenues in our blockchain-based hardware products. Lately, we have also launched StellarCloud and ThunderChain open platform in an attempt to build a blockchain ecosystem involving companies, developers and end-users. We believe blockchain is a revolutionary technology and thus, at this moment, we will put priority on research and development together with market education to encourage more participants in our blockchain ecosystem, and hopefully, we can reap larger benefits in the long run. That concludes my answers to Mr. Chang's questions. Thank you very much, Mr. Chang, for your questions.

Operator

I will now take the next questions from the line of [Steve Chen].

Unidentified Analyst

My first question is regarding your partnership with the Newland Group. And can you elaborate more on your opinion for this partnership? And my second question is regarding about company's growth. Do you have any plans to explore the growth opportunities overseas for blockchain?

Lei Chen - Xunlei Limited - CEO & Director

Thank you very much, sir. Xunlei is a technology company and have always been perceived by our users as a company who has very strong technological capabilities. By partnering with Newland and restructuring our LINK token business, we will be fully committed to becoming a dedicated provider of the underlying blockchain technology and infrastructure such as ThunderChain and the ThunderChain File System. We're also working together with our partners to leverage these technologies and to explore further applications of blockchain technology. Newland Group is a highly respected company with several subsidiaries, including a listed company in China. It is a leading international provider of integrated electronic payments service and one of the top global suppliers of point of service terminals. Newland also works on some national projects and participates in developing China's digital economy. We believe with this partnership, we have opportunity to explore a variety of possible domains for large-scale blockchain application. And we regard Newland as a very reliable and a strategic partner, while Newland realized our solid payment expertise and extensive network. Our expertise in blockchain technology will play a complementary role in bringing blockchain technology into Newland's business. So this is a mutually beneficial partnership. The second question was how we are doing in exploring overseas opportunities. Well, blockchain is a global technology. Many countries put strong emphasis on blockchain technology as part of their long-term development strategies. We're actively seeking opportunities in some of these countries as we are seeing increased demand for blockchain technology in both the public and private sectors in the overseas markets. However, it is still at a very early stage of our exploration and business development in these markets. We will continue to explore potential opportunities and make relevant update as a corporate in the coming days. Again, thank you very much for the questions.

Operator

I will now take the next questions from the line of Larry law.

Unidentified Analyst

(foreign language)

Naijiang Zhou - Xunlei Limited - CFO

(foreign language) I'll as one thing very quickly. (foreign language) Question to English first, now I'll answer it. (inaudible) if the blockchain space and the capital market going to (inaudible) winter and the capital market becomes -- the resources become less available, will it affect our operations



and will Xunlei need to issue stocks with money? And his second question is, if Renminbi continues to devalue, will it affect Xunlei's financial strength? I think at the end of the third quarter, we had approximately \$331 million in cash and short-term investments. We believe they will enable us to operate for the foreseeable future, and we believe we have very good financial strength to meet any foreseeable changes in the near future. Second is for the evaluation of Renminbi. If it happens, I think it's won't affect us, because out of the \$331 million in cash, more than 2/3 of the cash positions are in U.S. dollars. So if Renminbi devaluates, I don't think it will affect our financial strength. On the contrary, it may give us more Renminbi, should we convert them into Renminbi. Thank you.

Lei Chen - Xunlei Limited - CEO & Director

I'll just add a little bit to the answer. So the second question also addressed the issue of foreign markets. So given that RMB may devalue, whether or not we can -- whether or not it affect our performance in the foreign market. As Eric has explained, we have very strong cash position in US dollars. So when we come back to business in the overseas market, we don't think it will be affected by positions of RMB, whether it's increased or -- or whether the value increase or decrease. Thank you very much for question.

Operator

(Operator Instructions) (foreign language) There are no more questions at this time. May I hand the call back to the management for closing.

Naijiang Zhou - Xunlei Limited - CFO

Okay. Thank you again for your kind attention and we look forward to speaking with you again next time. Goodbye.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. You may now disconnect your lines.

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