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CORPORATE PARTICIPANTS

Lei Chen *Xunlei Limited - CEO & Director*

Zhou Naijiang *Xunlei Limited - CFO*

PRESENTATION

Unidentified Company Representative

Thank you, Annie. Good morning, and good evening. And thank you all for joining us today. Welcome to Xunlei Fourth Quarter and Full Year's 2018 Earnings Conference Call. I'm [Charlene Hue], Investor Relations Manager at Xunlei. With me today on the call are Mr. Lei Chen, our CEO; and Mr. Eric Zhou, our CFO. (Operator Instructions).

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 risks 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 would -- 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 US dollars, unless otherwise stated. With that, let me hand over to our CEO, Mr. Lei Chen, for prepared remarks.

Lei Chen - Xunlei Limited - CEO & Director

Good morning, and good meaning, everyone. Thank you all for joining us today. Let me start with a recap of the recent developments and the financial highlights of the fourth quarter and of the full year of 2018. Then Eric will provide more details on the financial results and take you through the guidance for the first quarter of 2019. 2018 was a year of transformation for Xunlei. We have transitioned from a traditional Internet company into an innovative technology provider, driven by the power of sharing economy and the potential of blockchain technology. Our shared cloud computing enables us to advance the mission of empowering individuals through technological innovation. As early as 2015, we initiated shared cloud computing solutions as we saw significant growth opportunities. The emergence of Internet of Things, AR, AI and big data. We transformed the users' idle bandwidth and storage to offer cloud computing services to our enterprise customers. With our shared cloud computing model, we help our enterprise customers to reduce cost and improve performance. Our cloud computing and IVAS business is our long-term growth driver, and revenue grew 29.6% on a year-over-year basis and accounted for approximately 52.8% of our total revenue in the fiscal year of 2018. We substantially expanded scale of our network through innovative products, signed contracts with several well-established Internet companies in China and our sold bandwidth reached its historical high in December 2018. And we plan to continue to expand our bandwidth capacity in 2019. We believe shared cloud computing will be an important industry trend and key driver for our long-term growth. We believe this trend will continue for a couple of reasons. First, with the deployment of 5G technology, we expect significant growth in the IoT space and other industries, which drives more demand for edge computing and starts to fundamentally change our lives and the way we come conduct business. This leads to a variety of applications, making more intelligent devices available in the market and create more demand for edge computing device-to-device communications as well as providing potential nodes to deploy our technology. 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 a reverse price trend in some of these unit.

A solution that can fundamentally reduce cost will become more and more desirable in this market. We believe our head start and technological advantages position us well in capturing this great opportunity. And that's also why we invest heavily in this technology.



In light of the coming era of 5G technology, we're looking for opportunities to deploy our edge computing technology. As announced in May 2018, our shared cloud computing platform, StellarCloud, has already being offering edge computing and function computing solutions to our clients. We have also increased our effort to underpin new cross business and cross industry networks and have established a strategic partnership with the China Mobile IoT, a wholly-owned subsidiary of China Mobile to jointly invest in the research and development of innovative applications of shared cloud computing, blockchain and IoT technologies. China Mobile is a world-leading telecommunications service provider and leads the way in IoT adoption in China. We expect this partnership will facilitate our efforts to integrate our technology, like shared cloud computing and blockchain, into the emerging IoT technologies to enhance efficiency and security.

Thanks to our growing blockchain ecosystem, we also became a well-known blockchain player, providing blockchain services with high performance, which opened the door for significant opportunities as the market matures in the future. We have accumulated extensive experience as a part of applications for a number of industries. Blockchain solves the problem of trust incentives between users and companies, and we believe blockchain will unlock exciting opportunities for not only shared cloud computing but also for a variety of other applications. In 2018, we submitted dozens of patent applications for our research and developments in blockchain, and believe we will be positioned to reap the benefits of our investments.

We continue to deliver value-added services on our traditional business. And the reversed trend in declining subscription numbers in the fourth quarter, we have a positive momentum carried over into 2019. Even though there are some headwinds in the macroeconomic environment, we remain optimistic. We expect continued growth in our shared computing business in 2019, and we'll continue to seek initiatives to improve the performance of our traditional business.

For the fourth quarter, our total revenue was approximately \$42.3 million and met our quarterly guidance, despite declined revenue in the recent quarter, we hold to our innovation and believe in our business value in the long term. As you can see that the bandwidth-cost ratio continued to decrease in the fourth quarter, which was mainly attributable to increased leverage of lower cost cloud-sourced bandwidth capacity obtained through our shared cloud computing services.

Over the year, our gross margin increased from 41% to 49.5%. We believe the improved gross profit margin clearly illustrates that our products and services were well received by the markets.

Apart from the above financial highlights, we have made steady headway on several strategic initiatives during the fourth quarter and throughout the year. In 2018, by the means of strategic alliances, we have hosted or cosponsored a series of contests technologies salons and tutorials for participants who are interested in gaining first-hand blockchain industry insight and hands-on experience. We also have been in contact or forged partnerships with companies in different industries to develop commercial blockchain applications. Some projects have been successfully launched and deployed on our ThunderChain's Open Platform. I'm very pleased to say that we are embarking blockchain projects that will be truly beneficial to our economy and we expect more to come.

We also explored new business opportunities in shared cloud computing. It was reported that about 350 million mobile phones would be replaced or disposed in China in 2019. Based on our market survey, about 94% respondents say, they have at least one cell phone at home, which was often left unused, and the number of [unused] cell phones is expected to increase.

In January this year, we unveiled a conceptual shared cloud computing phone-based smart device, OneThing Cloud mini, at the CES 2019. The new conceptual product, OneThing Cloud mini, is designed to aggregate idle computing resources from spare smartphones and to convert these resources into underpriced level cloud services. We're pleased to report that OneThing Cloud mini stood out among a wide [fraction] of entries and won the TWICE Picks Award at CES 2019.

Now let me briefly go through our traditional products and services. Over the years our membership subscription business has provided us with stable cash flows to pursue growth and innovation opportunities. Revenues from subscription business were relatively stable and accounted for about 43.1% of our total revenues in the fourth quarter of 2018. Compared to the previous quarter, we saw a reverse of the declining trend for the membership number. We were encouraged, the number of subscribers rose to 3.78 million as of December 31, 2018, and the momentum continued into the first 2 months of 2019. We will continue to enhance product features and improve user experience.

It is worth noting that earlier this year, we officially enabled IPv6 support on the latest version of ThunderX and Xunlei Mobile. With implementation of IPv6, we became an early adopter of China's next-generation Internet project.

For the fourth quarter, our online advertising revenues were adversely affected by a decline in demand from game advertisers, and the revenues decreased 6.3% on a sequential basis. As mobile gaming was a major source of our online advertising revenues, we expect softness in advertising revenue in the near term, due to concentration in game advertisers as well as general weakness in this sector. Hence, we're trying to diversify our sources of online advertising revenues to mitigate the impact of the gaming sector.

As to our live streaming business, both video and voice live streaming products generated consecutive outstanding quarterly growths, mainly due to the year-end promotion campaigns. Despite the increasing competition from other live streaming platforms, we intend to develop a niche market by enhancing product features and improving user experience.

Before I close, I'd like to reiterate that we're developing an innovative shared cloud computing and blockchain-based ecosystem for the next wave of technological breakthroughs. I believe our business is dynamic and full of exciting opportunities. With solid customer base and our strong R&D capabilities, we're well positioned for growth and creating long-term shareholder value.

With that, I will now turn the call over to Eric to review the financial results and the guidance for first quarter of 2019. Eric, please.

Zhou Naijiang - Xunlei Limited - CFO

Thank you, Lei. Hello, everyone. And once again, thank you for joining Xunlei's Fourth Quarter and Full Year 2018 Conference Call. And now I'd like to go through the details of our financial results.

Our total revenues for the fourth quarter were \$42.3 million and within our guidance, representing a decrease of 6.6% from the previous quarter. The decrease in total revenues on a sequential basis was mainly attributable to a decline in cloud computing and IVAS business and subscription business.

Revenues from cloud computing and Internet value-added services were \$18.1 million, representing a decrease of 8.5% from the previous quarter, mainly due to a decline in sales of hardware.

Revenues from subscriptions were \$18.2 million, representing a decrease of 4.8% from the previous quarter. These sequential decreases in the subscription revenues was mainly due to a drop in average revenue per user during the period. The average revenue per subscriber for the fourth quarter of 2018 was RMB 33.1, and a decrease from RMB 38.5 as of September 30, 2018. The number of subscribers were -- was 3.78 million as of December 31, 2018, increased from 3.4 million as of September 30, 2018.

Revenues from online advertising were \$6 million, representing a decrease of 6.3% from the previous quarter, mainly due to decreased demand from game advertisers.

Cost of revenues were \$23.2 million, representing 54.9% of our total revenues. The decreased amount of the cost of revenues was mainly due to reduced bandwidth costs.

Bandwidth costs in the fourth quarter of 2018 were \$9.3 million, representing 22% of our total revenues compared with \$10.2 million or 22.6% of the total revenues in the previous quarter. The decrease was mainly attributable to the increased use of the crowd-sourced bandwidth capacity, the remaining cost of revenues was largely the revenue sharing costs for our live streaming business.

Gross profit for the fourth quarter of 2018 were \$18.7 million, representing a decrease of 21.4% in a sequential basis.

Gross margin was 44.3% in the fourth quarter of 2018 compared with 52.7% in the previous quarter.

Research and development expenses for the fourth quarter of 2018 were \$21.5 million, representing 50.7% of the total revenues compared with \$19.7 million or 43.4% of the total revenues in the previous quarter.

Sales and marketing expenses for the fourth quarter of 2018 were \$9 million, representing 21.3% of the total revenues compared with \$10 million or 22.1% of our total revenues in the previous quarter.

General and administrative expenses for the fourth quarter of 2018 were \$11.8 million, representing 27.8% of our total revenues compared with \$12.4 million or 27.3% of our total revenues in the previous quarter.

Impairment of assets net for the fourth quarter were \$6.3 million, accounting for 15% of our total revenues, which represented the receivables written off after impairment and recoverability assessment net of recovered amount of impaired assets.

Operating loss was \$29.8 million compared with an operating loss of \$18.2 million in the previous quarter. The increase in operating loss was primarily due to a decline in revenue and a onetime impairment of assets, as discussed.

Net loss from continuing operations was \$32.4 million in the fourth quarter of 2018 compared with a net loss of \$15.9 million in the previous quarter. Non-GAAP net loss from continuing operations was \$30.9 million in the fourth quarter of 2018 compared with non-GAAP net loss of \$14.5 million in the previous quarter.

Diluted loss per ADS from continuing operations in the fourth quarter of 2018 was \$0.48 compared with a loss of \$0.24 in the previous quarter.

For the full year 2018, total revenues were \$232.1 million, representing an increase of 15% on a year-over-year basis. The increase in total revenues was mainly attributable to the growth of shared cloud computing, live streaming and mobile advertising business.

Revenues from cloud computing and IVAS were \$122.5 million, representing an increase of 29.6% on a year-over-year basis. The increase in cloud computing and IVAS revenues was mainly attributable to increase in sales of hardware and growth of our live streaming business.

Revenues from subscriptions were \$81.9 million, representing a decrease of 3.6% on a year-over-year basis. The decrease in subscription revenues was mainly attributable to a decline in the average number of subscribers during the year.

Revenues from online advertising were \$27.8 million, representing an increase of 23.6% on a year-over-year basis.

Cost of revenues was \$115.7 million, representing 49.8% of our total revenues.

Bandwidth costs were \$48.1 million, representing 20.7% of our total revenues compared with \$68.4 million or 33.9% of our total revenues in the previous year. The decrease was mainly attributable to increased use of the lower cost cloud-sourced bandwidth capacity obtained through our shared cloud computing services.

Gross profit for the year was \$114.9 million, representing an increase of 39% on a year-over-year basis. Gross margin was 49.5% compared with 41% in the previous year. The increase in gross profit was mainly due to improved cloud computing business and a decrease in bandwidth cost.

Research and development expenses for the year were \$76.8 million, representing 33.1% of our total revenues compared with \$66.9 million or 33.2% of our total revenues in the previous year. The increase was because we continued to hire employees to strengthen strengthening our competitive position and expand our product and service offerings.

Sales and marketing expenses for the year were \$35.3 million, representing 15.2% of our total revenues compared with \$19.9 million or 9.8% of our total revenues in the previous year. The increase was primarily due to more marketing and promotional expenses incurred during the year as a result of more business activities.



General and administrative expenses for the year were \$40.8 million, representing 17.6% of our total revenues compared with \$36.5 million or 18.1% of our total revenues in the previous year. The increase was primarily due to an increase in staff costs and related expenses.

Net impairment of assets for the year was \$6.3 million, accounting for 2.7% of our total revenues, which represented the receivables written off after impairment and recoverability assessment net of the recovered amount of impaired assets during the year.

Prior year balance of impairment of assets was \$13.6 million, accounting for 6.7% of our total revenues.

Operating loss was \$44.3 million compared with an operating loss of \$54.2 million in the previous year. The decrease in operating loss was mainly due to a nonrecurring write-off in amount of approximately \$11.7 million in 2017 related to our disposal of Xunlei Kankan business in 2015. Net loss from continuing operations was \$40.8 million in 2018 compared with a net loss of \$44.2 million in the previous year.

Non-GAAP net loss from continuing operations was \$35.5 million in 2018 compared with a loss of \$35.9 million in the previous year. The decreased net loss from continuing operations and in non-GAAP net loss from continuing operations were primarily because there were less onetime write-offs in 2018 as compared with that in 2017.

Diluted loss per ADS from continuing operations in 2018 was \$0.61 as compared with a loss of \$0.67 in the previous year.

As of December 31, 2018, the company had cash, cash equivalents and short-term investments of \$319.5 million, and the amount per ADS was \$4.77.

And finally, I'd like to turn to our guidance for the first quarter of 2019. We expect total revenues to be between \$39 million and \$43 million for the first quarter of 2019. The midpoint of the range represents a quarter-of-quarter decrease of about 3%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) We have our first question coming from the line of [Steve Chan] of (inaudible).

Unidentified Analyst

I have a one question. What is the growth strategy for 2019? And which business line will be you priority. (foreign language)

Lei Chen - Xunlei Limited - CEO & Director

(foreign language) Xunlei has been dedicated to the distributed computing technologies for over 15 years, and is recognized widely in the cloud accelerated products and services market in China. To consistently meet personal and enterprise users changing needs, we will continue to invest in the future and develop our competitive strengths around cloud acceleration, shared cloud computing and blockchain technologies. In the meantime, we're seeing greater opportunities presented by the incoming era of 5G technologies. It presents a critical trend for the IoT industry, leading to more demand for edge computing solutions. After years of investment, we have built a nationwide network of shared cloud computing nodes and provided edge computing solutions for commercial uses. We believe our head start and technological advantages position us well in capturing this great opportunity. Therefore, in 2019, we will focus on the following priorities. We expect a continued growth in our shared cloud computing business by expanding the bandwidth capacity in our cloud computing services. We will continue to seek initiatives to improve the

performance of our traditional business. As to blockchain technologies, we will continue to support the development of commercial blockchain use cases and keep building our blockchain ecosystem. Thank you very much. That's the answer to your questions.

Unidentified Analyst

Actually, I have a follow-up question regarding blockchain business. So what's the latest developments? And any milestone you will see as will be tipping point for the blockchain business development? (foreign language)

Lei Chen - Xunlei Limited - CEO & Director

(foreign language) Well, recently, we have seen some practical use cases launched or in the progress of deployment our ThunderChain Open Platform. We have entered into cooperation with business partners from different industries, such as media publishing, healthcare, food industry, financial services and IP protection. Our R&D also continued to make progress on some of the key issues facing blockchain technology and its applications. In 2018, we submitted dozens of patent applications, and believe we will be well positioned to reap the benefits of our investments. I believe Xunlei is one of the few companies with dedicated resources and a strategic focus on blockchain technology, especially around its fundamental capabilities and the large-scale applications. I believe our advantages in technical know-how and industry experience will make us well positioned for growth as the market matures in the future. Thank you very much for the question.

Operator

Our next question is from (inaudible) of (inaudible) Investment.

Unidentified Analyst

(foreign language)

Lei Chen - Xunlei Limited - CEO & Director

(foreign language) So to answer your question, the bandwidth sold in our CDN business actually has increased and increased by a large margin as well. However, the CDN cost pricing of 2018 has significantly decreased, the market pricing of CDN services, due to heavy competition among the cloud computing businesses and even with some traditional CDN vendors. Our pricing has always been very competitive in the market, so we lowered our price as well. Thus, when -- even though our sold bandwidth has increased a lot, it doesn't significantly increase our CDN revenue. And again, thank you for the question.

Unidentified Analyst

(foreign language)

Lei Chen - Xunlei Limited - CEO & Director

Well, so we currently don't disclose the specific numbers of our bandwidth sold and revenue -- our (inaudible) specifically, but one thing I can share is that the sold bandwidth as of December 2018 is almost twice as much as the sold bandwidth as December of 2017. So we have sold a lot more bandwidth in 2018, especially in the late part of the 2018. The-- we were not commenting on our other corporations in the same industry, so I cannot comment on Wangsu Technology specifically at this time. But there is tremendous demand of our cloud computing services in the market today. We have also transitioned a lot of our business from -- we have significantly reduced our bandwidth acquired from IDC, our traditional means of bandwidth acquisitions. So today, we deliberately focused on selling bandwidth acquired through our cloud computing infrastructure -- shared



cloud computing infrastructure. So what we're facing now is perhaps a different problem, different challenge, which is, the acquired bandwidth from the sharing economy is not keeping -- so it's near full capacity. So what we need to do is to further expand our ability to acquire more bandwidth through sharing economy, redundant capacities from people's homes. As a -- so by and large, we're very confident that our shared cloud computing services are very desirable in the market today and we expect that business to grow. And I think we have a very strong advantage in our technical capability, and the nodes acquired through the redundant computing and the bandwidth capacity of the homes. So in both aspects, we have a strong lead in the market today, even though we're seeing imitators that are following the approach that we're taking today. So hopefully, that answers your questions.

Operator

(Operator Instructions) No question as of this time. Please continue.

Zhou Naijiang - Xunlei Limited - CFO

All right, that's all for today. Thank you again for your kind attention. Please contact us if you have any questions in the future. Have a good day.

Lei Chen - Xunlei Limited - CEO & Director

Thank you very much.

Operator

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

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