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XNET.GSB - Q1 2019 Xunlei Ltd Earnings Call

EVENT DATE/TIME: MAY 13, 2019 / 12:00PM GMT



CORPORATE PARTICIPANTS

Charlene Lu

Lei Chen *Xunlei Limited - CEO & Director*

Zhou Naijiang *Xunlei Limited - CFO*

PRESENTATION

Operator

Good morning. Thank you for standing by for Xunlei's First Quarter 2019 Earnings Conference Call. (Operator Instructions)

I'll now turn the call over to your host today, IR Manager of Ms. Charlene Lu. Please go ahead.

Charlene Lu

Thank you, Enver. Good morning, and good evening, and thank you all for joining us today. Welcome to Xunlei First Quarter of 2019's Earnings Conference Call. I'm Charlene Lu, Investor Relations Manager at Xunlei. With me today 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 afterwards. 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. Such statements are based on management's current expectations under current market conditions and are subject to the risks and uncertainties that are difficult to predict, which will cause actual results to differ materially from those made in the forward-looking statements. 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. Reconciliations of the non-GAAP to comparable GAAP measures can be found in our earnings press release. Please note that all numbers are in U.S. 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 evening, everyone. Thank you all for joining us today. Let me start with a recap of recent developments and the financial highlights of the first quarter of 2019. Then, Eric will provide more details on the financial results and take you through the guidance for the second quarter of 2019.

Our total revenue was approximately USD 41.3 million this quarter. We are delighted to see some encouraging signs of progress and development for our enhanced product and services offerings and rebound of our traditional subscription business over the past month. We also entered into cloud computing contracts with a couple of top Chinese Internet companies, and hence expect to increase our bandwidth sales and expand our cloud computing services in the coming days.

Our revenues from the sale of bandwidth and cloud products are both up this quarter versus the fourth quarter of 2018. We continued our steady growth in our enterprise client base and was able to recover from lower hardware sales in the previous quarter. Revenues from other Internet value-added services experienced a decline this quarter mainly due to a drop in live streaming revenue as the Chinese New Year is a slow season for live streaming. Despite this drop, our gross profit margin improved. We will keep -- pursue different ways to improve this metrics in the coming quarters.



Cloud computing and IVAS business remain our long-term growth driver. We are deeply committed to our strategic initiatives for business development and transformation and continue to advance our mission to empower individuals through technologically -- technological innovation through our development of a shared cloud computing and blockchain-based ecosystem.

We are optimistic about our growth prospect even against a backdrop of macroeconomic uncertainties as we are backed by our long-- by our strong research and development capabilities and our enhanced portfolio of product and services offerings.

Now I'll briefly highlight our momentum and innovation across our businesses. For shared cloud computing, we believe shared cloud computing will be an important industry trend and key driver for our long-term growth. Demand for our cloud computing services remain strong driven by our success in steadily growing our enterprise client base. This is reflected in the continued growth of our bandwidth sales over the last several quarters. In this quarter, we further expanded our product and service offerings by working with some of the top cloud service providers in China. For example, our StellarCloud platform was selected to provide IaaS services for Youku's online video streaming platforms, which contributed to our cloud computing revenue growth in Q1.

To ensure sufficient share cloud computing resource for our growing client base, we are constantly working to expand the scale of our network capacity through product innovation and external cooperation. For instance, we entered into a contract with an enterprise client to explore ways to expand our network bandwidth capacity by aggregating redundant computing resources from business class networking devices and converting them into shared cloud computing services.

In addition, with the incoming 5G era, we expect more intelligent devices with higher computing resources to be developed. These devices can be potential nodes that can be utilized in our shared cloud computing business model.

We are constantly expanding our portfolio of competitively priced high-quality solutions in cloud computing services. StellarCloud, an important part of our developing shared computing and blockchain ecosystem, provides cloud computing services, including edge computing, functional computing and shared [civil] solutions, to enterprises at a much lower cost than the industry average. As more companies go digital, we anticipate significant growth in the IoT space and other related industries, which will drive up demand for edge computing and can lead to a variety of applications.

In March, we launched a new product in our StellarCloud platform that will improve the connectivity of IoT devices under complex network conditions. We believe our advanced technologies will enable StellarCloud to provide its enterprise users with efficient and cost-effective access to powerful cloud computing solutions and can help these companies in their transition to cloud computing including content delivery, live streaming, data storage and artificial intelligence. And we believe our shared cloud computing model and advanced technology will redefine cloud computing and bring more possibilities to the industry's future developments.

We believe that not only are we record-breaking in shared cloud computing but also we lead in commercializing blockchain for consumer uses. Recently, we announced technical cooperation with the Copyright Protection Center of China to build a blockchain powered digital copyright identifier system. Xunlei, as a blockchain services provider, will leverage its high-performing blockchain technology capabilities to support the operations of CPCC's digital copyright identifier system, particularly in the copyright registration of fine arts and photographic works. Through this cooperation, we expect that Xunlei's high-performance blockchain services can help the CPCC's copyright authorization transaction system to become more efficient.

We are dedicated to exploring practical adoptions of blockchain in various industries and sectors and providing tools, frameworks and guidelines for blockchain development. In May 2018, we launched ThunderChain, a high-performance blockchain platform, that is another important part of our developing shared computing and blockchain ecosystem. We hope ThunderChain can become the solution for blockchain's scalability dilemma with its ability to concurrently process millions of transactions per second. We're constantly improving the performance of ThunderChain. This April, we upgraded underlying technology of ThunderChain and completed a number of enhancements. For example, we improved the platform compatibility to help our developers to build large-scale and practical blockchain applications more easily.

Moreover, we believe we are leading the charge on the commercialization for blockchain by establishing cooperation and partnerships with companies in different industries to develop blockchain applications with real-world uses. We already assisted in developing dozens of blockchain projects with our high-performance blockchain service. Our first-hand industry insight and hands-on experiences contributed to a recent win on a project to provide technical support and practical solutions for the development of a blockchain technology in digital media copyright protection for Guangdong South New Media Corporation Limited, a Shenzhen stock exchange listed company that develops a variety of new media services in China such as IPTV, Internet TV, mobile TV, et cetera.

Compared with the previous quarter, live streaming revenue declined in Q1 as the Chinese New Year is usually a slow season for our live streaming business. In general, the live streaming industry is highly competitive and already have several established and successful players. Therefore, we intend to develop a niche market by enhancing product features and improving user experience. We saw improved gross profit margin in this service. Thus, we will continue to drive improvement on such metric.

Now turning to our traditional business. Our cloud acceleration subscription services began in March 2009. We earn a time-based subscription fee by providing our users with exclusive services such as access to high-speed online transmission, premium acceleration or access privileges. Revenues from subscriptions were USD 21.1 million in Q1, up 16.1% from the previous quarter. We're pleased to see these encouraging initial results of our restructure efforts and hope to continue this positive momentum.

Our subscriber base was 4.57 million as of March 31, 2019, up from 3.78 million as of December 31, 2018. We strive for continuous improvement of user experience by making the membership program more entertaining, useful and rewarding. Over the years, revenue from membership subscription has been a stable source of cash flow for us to pursue growth and innovation. We will continue to increase our engagement and improve product performance with this momentum and excitement.

Our revenues generated from online advertising is down significantly in the first quarter of 2019 due to decreased demand for our online advertising platform primarily from the mobile gaming industry. As mentioned in our previous conference call, we expected softness in advertising revenue in the near term due to a concentration of our advertising demand in game advertisers as well as a backdrop of macroeconomic uncertainties. Hence, we're trying to diversify our sources of online advertising revenues to mitigate the impact from the gaming sector.

In closing, I'd like to reiterate that we're dedicated to shared cloud computing and blockchain technology. The innovative shared cloud computing and blockchain-based ecosystem we are developing for the next wave of technological breakthrough is key to our mission of empowering individuals through technical innovation. We expect significant growth opportunities in both fields in the future. We believe our business is dynamic and full of opportunities. With the solid customer base and our strong R&D capabilities, we believe we are well positioned for growth and creating long-term shareholder value. At Xunlei, we strive to build a blockchain enabled shared cloud computing platform and become a driving force for technological innovation.

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

Zhou Naijiang - Xunlei Limited - CFO

Thank you, Lei. Hello, everyone, and thank you again for joining Xunlei's first quarter of 2019 conference call. And now I'd like to go through the details of our financial results.

Total revenues were \$41.3 million, down to 2.3% from the previous quarter. Revenues from cloud computing and IVAS combined to \$16 million, representing a drop of 11.4% on a sequential basis. This was mainly due to a significant drop in live streaming revenue during the quarter as the Chinese New Year was a slow season for our live streaming business.

Revenues from subscriptions were \$21.2 million, up 16.1% from the previous quarter. The number of subscribers were 4.57 million as of March 31, 2019, compared with 3.78 million as of December 31, 2018. And the average revenue per subscriber was RMB 31.1 compared with RMB 33.1 in the previous quarter. The increase in subscription revenues and the number of subscribers were driven by improved services towards subscribers as well as seasonal marketing and promotional activities launched during the quarter.



Revenues from online advertising were \$4.1 million, down 30.8% from the previous quarter, reflecting decreased demand in online advertising from the mobile gaming industry during the quarter.

Cost of revenues were \$19.9 million, representing 48.1% of our total revenues. Bandwidth costs in the first quarter of 2019 were \$10.8 million, representing 26% of our total revenues compared with \$9.3 million or 22% of the total revenues in the previous quarter. The remaining cost of revenues is made up of live streaming revenue-sharing costs and cloud computing costs.

Gross profit for the first quarter was \$21.2 million, up 13% from the previous quarter. Gross margin was 51.2% in Q1 versus 44.3% in the previous quarter. The increase in gross profit was mainly driven by improved subscription business and a decrease in revenue-sharing costs for our live streaming products.

Research and development expenses for Q1 2019 were \$18.8 million, representing 45.6% of our total revenues, down from \$21.5 million or 50.7% of our total revenues in the previous quarter. The decrease on a sequential basis was mainly due to the staff performance incentives for the year 2018 accrued in the previous quarter.

Sales and marketing expenses for Q1 2019 were \$7.6 million, representing 18.4% of our total revenues, down from \$9 million or 21.3% of total revenues in the previous quarter. The drop was mainly due to less and promotion activities held during the quarter.

General and administrative expenses for Q1 2019 were \$9.4 million, representing 22.6% of our total revenues, down from \$11.8 million or 27.8% of our total revenues in the previous quarter.

Impairment of assets net for the first quarter of 2019 was a credit of \$0.9 million, representing a net recovery of impaired assets during the quarter. Prior quarter, debt balance of \$6.3 million, mainly represented a onetime receivable write-off after impairment and recoverability assessment.

Operating loss was \$13.7 million, down from \$29.8 million in the previous quarter. The decrease was mainly due to less operating expenses incurred during the quarter and a onetime receivable write-off reported in the previous quarter.

Net loss from continuing operations was \$8.6 million in Q1 compared with a net loss of \$32.4 million in the previous quarter. Non-GAAP net loss from continuing operations was \$7.2 million in Q1 compared with a net loss of \$30.9 million in the previous quarter.

Diluted loss per ADS from continuing operations in Q1 was \$0.13 compared with loss of \$0.48 in the previous quarter.

As of March 31, 2019, the company had cash, cash equivalents and short-term investments of \$298.7 million and amount per ADS was \$4.44.

And finally, I'd like to turn into our guidance for the second quarter of 2019. We expect total revenues to be between \$42 million and \$46 million for the next quarter. The midpoint of the range represents a quarter-over-quarter increase of about 6.5%.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of [Tom Ding from Pvt Investor].



Unidentified Analyst

(foreign language)

Lei Chen - *Xunlei Limited - CEO & Director*

[Interpreted] So cloud computing income increased on a sequential basis for this quarter. As for live streaming revenue, we do not anticipate any further declines for the next quarter. We do not expect significant decline for the next quarter, yes.

On the second question about the business strategy of this company, Xunlei has 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, namely cloud acceleration, shared cloud computing and blockchain technologies. At the same time, we're seeing great opportunities presented by the incoming era of 5G technology. It presents a critical trend for the IoT industry leading to more demand for edge computing solutions. As more companies go digital, we anticipate significant growth in the IoT space and other related industries, which will drive up demands for edge computing and can lead to a variety of applications. So we're preparing ourselves to meet the challenge and to embrace this trend for our future growth.

After years of investment, we're happy with the nationwide network of shared cloud computing nodes and provided edge computing solutions for commercial use. 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 continued growth in our shared cloud computing business by expanding the bandwidth capacity and 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 for your question.

Operator

Your next question comes from the line of from [Chester Young] from [Wes Hong Kong].

Unidentified Analyst

Can you hear year me?

Lei Chen - *Xunlei Limited - CEO & Director*

Yes, please.

Unidentified Analyst

Okay. Yes, this is [Chester] from Hong Kong. I have a couple questions. First, would upcoming 5G mobile, could acceleration service might not be needed as much as before. So what is your mobile strategy, please?

Lei Chen - *Xunlei Limited - CEO & Director*

We actually hold a different view on this question. We believe the incoming era of 5G technology actually presents a greater opportunity for our business, mainly from 2 perspectives. First of all, in our past experience, our acceleration of technology and in particular, our subscription -- our subscribers are tends to be the users who have higher network bandwidth when compared with the general population or the general user base of our applications. So we're actually expecting to have an opportunity to improve our business, our traditional acceleration business, when network

bandwidth increase. We also expect the content industry will capture the opportunity of faster network bandwidth to develop larger, higher-definition content that user will consume.

At the same time, our shared cloud computing platform, StellarCloud, has already been offering edge computing solutions to our clients including some of the top Internet companies in China. This March, we also launched a new product in our StellarCloud platform that will improve the connectivity of IoT devices and complex network conditions. We believe this head start and technological advantages position us well in capturing the great 5G opportunity and stimulate growth in our shared cloud computing business. In the meantime, thanks to the 5G connectivity, we expect mobile users, especially the young generation, with demand more for high-quality digital entertainment experience like videos, games and music. We also expect more and different use cases from our enterprise customers will become -- will increase our opportunity to give them more wider range of services in the future. So thank you very much for your question.

Unidentified Analyst

Okay. Great. I have another. I understand that you are a leader in blockchain in China. The second question is, tell to us your latest developments of the blockchain business, particularly I'd like to know when blockchain will produce revenues and profits for Xunlei?

Lei Chen - Xunlei Limited - CEO & Director

Thank you very much for the question. As I've said, we have seen some practical use cases launched or in progress of development on ThunderChain open platform. We have entered into cooperation with business partners from different industries such as media publishing, health care, food industry, financial services and IP protection. This March, we won a bidding from Guangdong South Media Corporation Limited for blockchain product among the top competitors in this industry. Xunlei, as a blockchain services provider, will provide technical support and practical solutions to the development of blockchain technology in the field of digital media copyright protection.

Our research and development also continues to correct some key issues facing the blockchain technology and its wide applications. First of all, we believe the performance of our blockchain, ThunderChain, is industry leading with its ability to perform more than million transactions per second. We have upgraded the underlying technology of ThunderChain this April. For example, we have completed a number of ThunderChain enhancements including WebAssembly virtual machine, also known as Wasm, to help application developers build large-scale and practical blockchain applications.

I believe Xunlei is one of the new companies with dedicated resources and strategic focus on blockchain technology. I'm not going to reiterate through all the details of technical improvements that have been accomplished in the past quarter and recently, but we're very focused on blockchain's fundamental capabilities and real-world application. Our advantages in technical know-how and industry experience makes us well positioned for growth as the market matures in the future. Again, thank you very much for your question.

Operator

(Operator Instructions)

Zhou Naijiang - Xunlei Limited - CFO

Operator, if we have no -- don't have any more questions, we can end the call now.

Operator

There are no further questions. Please continue.



Zhou Naijiang - *Xunlei Limited - CFO*

Okay. All right. Thank you all for today, and please contact us if you have any questions.

Operator

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

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