

uCloudlink Group Inc. – Revenue and EPS Beat Expectations with Effective Cost Control and Optimization Returning UCL to Profitability

uCloudlink Group Inc. (NASDAQ:UCL)

Share Price: \$3.96

Current Valuation: \$10.00



Key Statistics

52 Week Range	\$0.46-\$6.60
Avg. Volume (3 months)	37,867
Shares Outstanding	36.98M
Market Capitalization	\$146.44M
EV/Revenue	1.7x
Cash Balance*	\$16.52M
Analyst Coverage	2

*Cash balance as of Q1 2023

Revenue (in \$mm)

Dec - FY	2021A	2022A	2023E
1Q	17.7	15.6	18.0
2Q	19.2	18.0	21.8
3Q	19.3	18.2	23.2
4Q	17.6	19.6	23.9
FY	73.8	71.5	86.9

Earnings Per ADS (in \$)

Dec - FY	2021A	2022A	2023E
1Q	(0.54)	(0.27)	0.06
2Q	(0.29)	(0.22)	0.02
3Q	(0.25)	(0.15)	0.03
4Q	(0.54)	(0.03)	0.01
FY	(1.61)	(0.64)	0.12

Stock Price Chart



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Investment Highlights

- UCL Returning to Profitability for the First Time Since 2020** - uCloudlink announced its financial results for Q1 2023, with total revenues of \$18.0 million, up 15.3% year over year, *exceeding our estimate of \$17.9 million*. The increase was primarily due to a 31.4% YoY increase in revenue from services, as revenues from both international and local data connectivity services grew aided by the gradual recovery of international travel and the continuous development of the company's local data connectivity business. Overall gross margin was 47.8% compared to 37.4% in the same period of 2022, primarily due to a greater mix of services. UCL's operating expenses decreased significantly from \$10.1 million to \$7.6 million as the company streamlined its cost structure, with a net income of \$2.1 million, or \$0.06 per basic and diluted ADS in Q1 2023, exceeding our estimate of a net loss of \$0.7 million, or \$0.02 per basic and diluted ADS. *UCL's return to profitability in Q1 2023 is in line with our expectations. We believe this growth momentum has the potential to continue as the company optimizes its operating efficiency through effective cost control while launching new products with its innovative HyperConn Technology in 2023 and generating greater revenue from the resuming international data connectivity business during peak tourist seasons.*
- PaaS and SaaS Business Continuing to Expand** – UCL reported revenue from PaaS and SaaS services of \$2.6 million, up 3.7% YoY, with the average daily active terminals reaching a record high of more than 300,000 in Q1 2023. We expect this business to continue to expand given the company's continuous development in its PaaS and SaaS ecosystem and accelerated demand across the global market.
- UCL Keeps Generating Positive Operating Cash Flow Strengthening its Financial Position** - As of March 31, 2023, uCloudlink's cash and cash equivalents and short-term deposits were \$16.7 million, compared to \$15.1 million as of December 31, 2022. *The company has achieved positive operating cash flow sequentially since Q2 2022, demonstrating UCL's ability to achieve financial sustainability to support its long-term operations and growth.* The company's asset-light operating model and continuous positive operating cash flow strengthened its balance sheet.
- Valuation Adjusted to \$10.0** - UCL's beating on revenue and EPS strengthens investors' confidence and reinforces our view that shares trading at a materially lower valuation compared with peer communication services companies may not be long-term. We have raised UCL's valuation to \$10.0, combining discounted cash flow and comparable company analysis, which is contingent on the company maintaining its successful execution.

Company Description

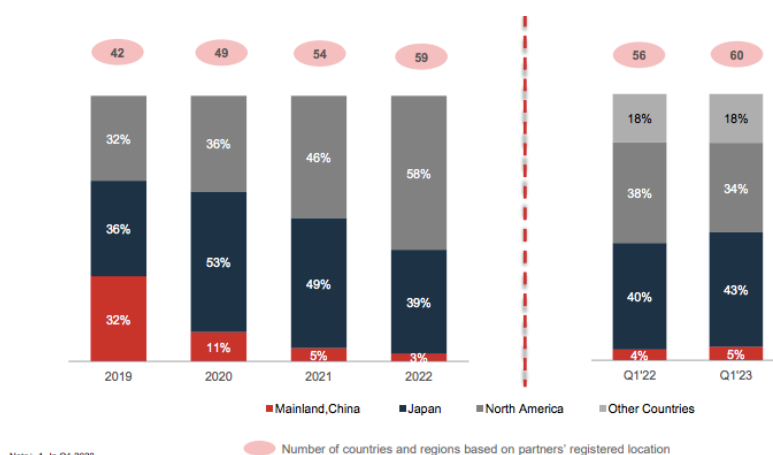
uCloudlink operates as an innovative mobile technology company that offers the world's first and leading mobile data traffic sharing marketplace to users globally. Leveraging its integral cloud SIM technology, it allows users to enjoy a smooth mobile connectivity experience without limitation to one MNO. uCloudlink was incorporated in 2014 and is headquartered in Kowloon, Hong Kong.

First Quarter 2023 Results

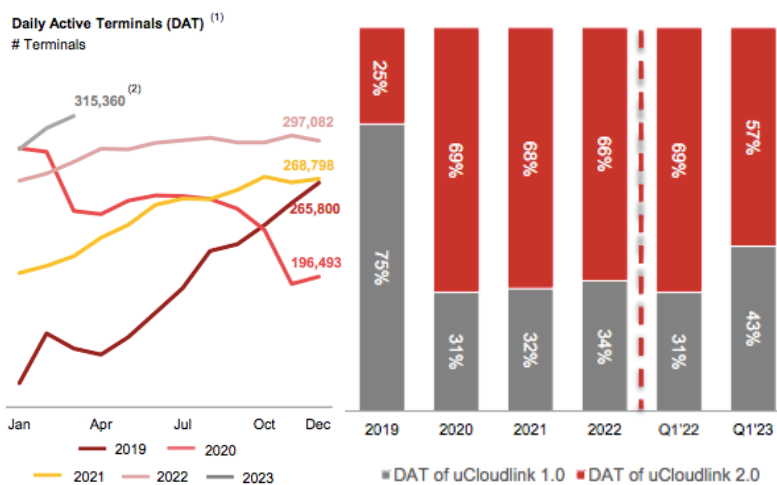
For the three months ending March 31, 2023, uCloudlink reported total revenues of \$18.0 million, up 15.3% from \$15.6 million in Q1 2022, primarily due to the increase in revenues from services which went from \$9.8 million to \$12.9 million over the year. Revenues from data connectivity services were \$10.0 million, up 38.2% compared with \$7.2 million in the year-ago period, primarily due to higher international and local data connectivity services which grew 39.3% YoY to \$7.8 million and 37.5% YoY to \$2.2 million, respectively, aided by the gradual recovery of international travel and UCL’s continuous investment in its local data connectivity business. Revenues from PaaS and SaaS services were \$2.6 million, up 3.7% from \$2.5 million in the same period of 2022. Revenues from sales of products decreased from \$5.8 million to \$5.1 million due to the decrease in sales of data-related products. In terms of geographic distribution, Japan as UCL’s largest market contributed 43.1% of total revenues, North America contributed 33.6%, while mainland China and other countries contributed 5.1% and the remaining 18.2%, respectively, compared to 40.2%, 37.9%, 3.9%, and 18.0%, respectively, in Q1 2022. Overall gross profit was \$8.6 million, or 47.8% in gross margin, compared to \$5.8 million, or 37.4% in gross margin in the same period last year, with improved gross margins on services. Total operating expenses were \$7.6 million, compared to \$10.1 million in Q1 2022, a roughly 31.5% decrease, as the company continued streamlining its costs to improve profitability: R&D expenses declined by 51.4% YoY to \$1.3 million due to the decrease in staff costs and testing and certification expenses; S&M expenses decreased to \$2.9 million, down 4.8% over the year; and G&A expenses decreased by 25.0% to \$4.6 million, which is due to the decrease in professional service fees and the decrease in staff costs related to cost control measures. uCloudlink’s net income for Q1 2023 reached \$2.1 million, or \$0.06 per basic and diluted ADS, compared to a net loss of \$7.92 million, or \$0.27 per basic and diluted ADS in the year-ago period, *the first time UCL has returned to profitability since the Covid-19 outbreak in 2020. We believe this bottom-line growth momentum has the potential to continue as the company continues to take measures to optimize its cost structure, while generating more revenue from the resuming international data connectivity business and the launch of new products with improved gross margins.*

Variance Table (\$ in millions, except per share data)			
	Q1 2023E	Q1 2023A	Variance (Actual Versus Result)
Revenue	17.9	18.0	0.10
Earnings per ADS	(0.02)	0.06	0.08

Source: Diamond Equity Research



Source: UCL Investor Presentation May 2023



Source: UCL Investor Presentation May 2023

Liquidity and Balance Sheet

As of March 31, 2023, uCloudlink’s cash and cash equivalents, and short-term deposits totaled \$16.7 million, compared to \$15.1 million as of December 31, 2022, primarily due to the net inflow of \$1.6 million from operations and net proceeds of \$2.6 million from bank borrowings, partially offset by repayments of \$2.4 million for bank and other borrowings.

Management Guidance

uCloudlink expects total revenues to be between \$21.5 and \$22.5 million for Q2 2023, representing an increase of 19.4% to 25.0% compared to the same period of 2022.

Investment Thesis

uCloudlink is targeting the large mobile data connectivity service market driven by the increasing adoption of mobile devices and internet penetration. This includes the local data connectivity market, the international roaming market as well as the global IoT market. In addition, the robust development of the entire IoT industry further drives the demand for the data usage and connectivity services as we approach 5G widespread adoption, where entirely new applications will be possible in various application scenarios such as mobile broadband (MBB) and fixed broadband (FBB), industrial automation, autonomous driving, AR/VR, internet of vehicles, cargo transportation and logistics and cloud computing, which may require new mobile data connectivity solution for users, hardware vendors and carriers with higher speed and more reliable connections. uCloudlink operates as an innovative mobile technology company that offers the world’s first and leading mobile data traffic sharing marketplace to billions of users globally, serving 2,377 business partners in 60 countries and regions, with aggregated mobile data allowances from 351 mobile network operators (MNOs) globally as of March 31, 2023. Leveraging its integral cloud SIM technology and architecture, which allows dynamic selection of network services based on signal coverage and cost, and intelligent distribution of data traffic in the SIM card pool to terminals that may support multiple end devices through its cloud SIM platform, the company provides mobile data connectivity services with reliable connections, high speeds and competitive pricing, allowing users to enjoy a smooth mobile connectivity experience without limitation to one particular MNO. Currently the company operates its business under what they refer to as uCloudlink 1.0 and uCloudlink 2.0 models, and plan to launch uCloudlink 3.0 model in the future. Under the UCL1.0, the company primarily offers pocket WIFI leasing, mobile WIFI retail, GMI mobile phone roaming, and other related services for international travelers that need mobile data connectivity services across different countries, although we note various products also are compatible in local markets. Products of UCL 2.0 stage includes home broadband, GMI mobile phone data service, IoT data service and other related services, and aim to provide mobile data connectivity services to local users across different MNOs in a single country. uCloudlink 3.0 is in trials, which is technologically ready. We note each segment has clear growth roadmaps and are targeting large market opportunities. uCloudlink is well positioned to capture growing mobile data connectivity service market segments by leveraging its sophisticated cloud SIM technology and architecture, distinct mobile data traffic sharing marketplace enabling a smooth mobile connectivity experience, and seasonable management team with years of operational experience in industry. We also note the recently launched HyperConn™-Enabled 5G Mobile WiFi Device, which uses AI to ensure users always have the best WiFi connection, opens new markets such as education, IoT, remote work, and surveillance. HyperConn™ products can also help MNOs develop data connectivity markets globally, including 5G markets. Additionally, HyperConn™ products will allow the company to target IoT opportunities in new industries. In the second half of year 2021, the company released the GlocalMe Numen (first HyperConn 5G mobile Wi-Fi device, MSRP \$599), GlocalMe Genie, a 4G pad device powered by HyperConn™ (unpriced), and Mini Turbo, portable Wi-Fi Hotspot equipped with HyperConn. As of March 2023, UCL had 177 patents with 139 approved and 38 pending approval. The Company expects strong growth momentum to continue over the next couple of years given its aggressive marketing strategy, increasing mobile penetration, and the resumption of international travel. *Given uCloudlink’s growth potential and relatively inexpensive valuation, the company in our view offers investors a unique opportunity to invest in the growing data connectivity industry, as 5G adoption expands, which is likely to benefit from the institutional money flowing into the global mobile data connectivity service industry.*

uCloudlink is targeting the enormous mobile data connectivity service market driven by the increasing adoption of mobile devices and internet penetration, and the surging demand for optimal mobile data traffic solutions with high speed and reliable connections, as 5G adoption grows

We view uCloudlink as well positioned to capture market segments with its sophisticated cloud SIM technology and architecture, distinct mobile data traffic sharing marketplace enabling a smooth mobile connectivity experience, and seasoned management team with years of operational experience in the industry

Risk Factors

- uCloudlink's business has been and is likely to continue to be materially adversely affected by the outbreak of COVID-19. uCloudlink depends on network operators for their wireless networks, infrastructure, and data traffic. Any disruptions of or limitations on the company's use of such networks, infrastructure and data traffic may adversely affect its business and financial results
- The company's ability to grow its business and user base for its service may be limited unless it can continue to obtain data traffic at favorable rates
- Litigation at uCloudlink is still ongoing. The company is, and may in the future be, subject to intellectual property claims, which are costly to defend, could result in significant damage awards, disrupt its business operation, and could limit its ability to use certain technologies in the future
- Since the governments in countries and regions such as China and Japan have or will strengthen the enforcement of regulation over use of M2M cards and real-name registration for SIM card users, the development of its 2.0 business may be slowed down
- The company is highly regulated in all its areas of operations and could be impacted by regulatory changes
- If expansions into new businesses do not achieve the expected results, the company's future operations and growth prospects may be materially and adversely affected
- Trading range of ADSs are highly volatile, which could result in large losses for investors. The company's ADSs may be delisted under the Holding Foreign Companies Accountable Act if the PCAOB is unable to inspect auditors who are in China
- Founders hold substantial ownership of company; two founders own roughly 50% of outstanding shares and 92% of the aggregate voting power and their interests may not always be aligned with independent shareholders
- uCloudlink has limited liquidity and overall awareness, limiting its ability to obtain fair valuation
- uCloudlink is a small capitalization business and as such may struggle to attract sufficient sell-side coverage and exposure and will face specific executional risk factors because of its smaller size relative to large capitalization equities

These Risk Factors Are Not Comprehensive. For Full List of Risk Factors Please Read uCloudlink Group Inc.'s Latest Prospectus and/or 20F Filing Risk Factors

Income Statement

(\$ in M)	FY19A	FY20A	FY21A	FY22A	1Q23A	2Q23E	3Q23E	4Q23E	FY23E	FY24E	FY25E
REVENUES:											
Revenues from services	91.11	46.15	37.80	46.23	12.92	13.82	15.48	14.53	56.74	72.13	101.88
Sales of products	67.27	43.42	36.03	25.23	5.09	7.94	7.76	9.39	30.19	37.68	48.87
Total net revenues	158.38	89.57	73.83	71.46	18.01	21.76	23.24	23.92	86.93	109.82	150.75
Cost of services	(35.59)	(26.39)	(21.56)	(20.35)	(5.10)	(5.94)	(6.50)	(6.29)	(23.83)	(28.85)	(39.73)
Cost of products sold	(57.87)	(34.87)	(30.43)	(18.58)	(4.30)	(6.43)	(6.29)	(7.43)	(24.45)	(28.26)	(35.18)
Total cost of revenues	(93.46)	(61.26)	(51.99)	(38.93)	(9.41)	(12.38)	(12.79)	(13.71)	(48.28)	(57.11)	(74.92)
Gross (loss) profit	64.92	28.31	21.84	32.53	8.60	9.39	10.45	10.21	38.65	52.70	75.83
OPERATING EXPENSES:											
Sales and marketing expenses	(24.37)	(29.26)	(13.62)	(10.31)	(2.92)	(3.02)	(3.19)	(3.04)	(12.17)	(12.08)	(13.57)
Research and development expenses	(15.11)	(26.36)	(13.70)	(8.43)	(1.30)	(1.51)	(1.65)	(1.71)	(6.17)	(7.14)	(9.04)
General and administrative expenses	(20.22)	(43.22)	(28.55)	(18.73)	(3.44)	(3.68)	(3.97)	(4.04)	(15.13)	(17.57)	(22.61)
Other expense, net	0.29	7.55	(11.88)	(14.27)	1.12	(0.00)	(0.00)	(0.00)	1.11	(0.22)	(0.15)
Total operating expenses	(59.41)	(91.29)	(67.75)	(51.73)	(6.54)	(8.21)	(8.81)	(8.79)	(32.35)	(37.01)	(45.38)
EBIT	5.51	(62.98)	(45.91)	(19.19)	2.06	1.18	1.64	1.42	6.29	15.69	30.46
Interest income	0.19	0.04	0.01	0.02	0.01	0.00	0.00	(0.00)	0.00	0.00	0.00
Interest expenses	(0.44)	(0.29)	(0.19)	(0.44)	(0.05)	(0.08)	(0.04)	(0.08)	(0.24)	(0.31)	(0.42)
Amortization of beneficial conversion feature				(0.15)							
Income(loss) before income tax	5.26	(63.23)	(46.08)	(19.76)	2.02	1.10	1.60	1.33	6.05	15.39	30.04
Income tax expenses (benefits)	(0.06)	(0.19)	(0.24)	(0.16)	(0.01)	(0.27)	(0.40)	(0.83)	(1.51)	(3.85)	(7.51)
Share of profit in equity method investment, net of tax			0.29	0.07					0.07		
Adj. Net profit/(loss)	5.21	(63.42)	(46.04)	(19.85)	2.07	0.82	1.20	0.51	4.61	11.54	22.53
Accretion of Series A-2 ordinary shares and Series A Preferred Shares	(2.54)	(1.29)									
Allocation to Series A-2 ordinary shares											
Income allocation to participating preferred shareholders	(0.30)										
Net income/(loss) attributable to Company	2.37	(64.71)	(46.04)	(19.85)	2.07	0.82	1.20	0.51	4.61	11.54	22.53
Earnings per share											
Basic	0.01	(0.25)	(0.16)	(0.06)	0.01	0.00	0.00	0.00	0.01	0.03	0.05
Diluted	0.01	(0.25)	(0.16)	(0.06)	0.01	0.00	0.00	0.00	0.01	0.03	0.05
Earnings per ADS (10 Class A equal to 1 ADS)											
Basic	0.10	(2.49)	(1.61)	(0.64)	0.06	0.02	0.03	0.01	0.12	0.29	0.53
Diluted	0.10	(2.49)	(1.61)	(0.64)	0.06	0.02	0.03	0.01	0.12	0.29	0.53
Weighted Average no. of Shares outstanding (in M)											
Basic	232.18	259.85	285.98	312.49	369.44	374.44	379.44	382.44	376.44	396.44	426.44
Diluted	232.18	259.85	285.98	312.49	369.44	374.44	379.44	382.44	376.44	396.44	426.44

Source: Diamond Equity Research

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