

uCloudlink Group Inc. – Recovery in International Travel Further Driving UCL’s Revenue Growth and Profitability

uCloudlink Group Inc. (NASDAQ:UCL)

Share Price: \$3.95

Current Valuation: \$9.00



Key Statistics

| | |
|------------------------|---------------|
| 52 Week Range | \$0.46-\$6.60 |
| Avg. Volume (3 months) | 60,906 |
| Shares Outstanding | 36.68M |
| Market Capitalization | \$144.87M |
| EV/Revenue | 1.9x |
| Cash Balance* | \$14.92M |
| Analyst Coverage | 1 |

*Cash balance as of Q4 2022

Revenue (in \$mm)

| Dec - FY | 2021A | 2022A | 2023E |
|----------|-------|-------|-------|
| 1Q | 17.7 | 15.6 | 17.9 |
| 2Q | 19.2 | 18.0 | 21.8 |
| 3Q | 19.3 | 18.2 | 23.2 |
| 4Q | 17.6 | 19.6 | 24.1 |
| FY | 73.8 | 71.5 | 86.9 |

Earnings Per ADS (in \$)

| Dec - FY | 2021A | 2022A | 2023E |
|----------|--------|--------|--------|
| 1Q | (0.54) | (0.27) | (0.02) |
| 2Q | (0.29) | (0.22) | 0.00 |
| 3Q | (0.25) | (0.15) | 0.01 |
| 4Q | (0.54) | (0.03) | 0.01 |
| FY | (1.61) | (0.64) | 0.00 |

Stock Price Chart



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Investment Highlights

- Gradual Resumption of International Travel Boosting UCL’s Top-line Growth -** uCloudlink announced its financial results for Q4 2022, with total revenues of \$19.6 million, up 11.6% compared to \$17.6 million in the same period last year, bringing total revenues for the full year 2022 to \$71.4 million. The increase was primarily due to a 30.3% YoY increase in revenue from services as revenues from both international and local data connectivity services grew significantly aided by the gradual recovery of international travel and the continuous development of the company’s local data connectivity business. Margin profile continued to improve in Q4 2022: overall gross margin was 51.3% compared to 31.0% in the same period of 2021, reaching record highs since FY2020. UCL’s operating expenses decreased from \$12.1 million to \$11.2 million, as the company streamlined its cost structure, leading to a narrowed net loss of \$1.1 million, or \$0.03 per basic and diluted ADS in Q4 2022, which is in line with our model. *We believe this growth momentum is likely to continue in 2023 as more countries lift COVID-related travel restrictions and reopen borders, which could accelerate the recovery of international travel and further stimulate demand for international data connectivity services. UCL 1.0 as a higher-margin business line is anticipated to continue to be a key growth driver for the company and help improve profitability. We model the company returning to profitability as early as Q2 2023 potentially, while it continues to optimize its gross margins and operating efficiency.*
- Upcoming UCL 3.0 Business and Various New Product Launches Providing Additional Growth Potential –** According to the management, the company plans to initiate its UCL 3.0 business, a new mobile data traffic sharing marketplace application “GlocalMe App” that capitalizes scalable user base accumulated through UCL 1.0 and 2.0 and supports different application scenarios without limitation of the device. GlocalMe App enables users to share and trade unused mobile data by allocating multiple SIM cards from different operators remotely and dynamically. Additionally, the company plans to launch more CloudSIM and HyperConn enabled products and IoT solutions to meet the diversified needs of enterprise and individual customer, which will further expand UCL’s potential user base and market share.
- Healthy Balance Sheet Supporting UCL’s Further Growth and Business Expansion -** As of December 31, 2022, uCloudlink’s cash and cash equivalents and short-term deposits were \$15.1 million, compared to \$12.5 million as of September 30, 2022. *The company has achieved positive operating cash flow sequentially since Q2 2022, demonstrating UCL’s ability to achieve financial sustainability to support its further growth and business expansion.* The company’s asset-light operating model and continuous positive operating cash flow help it maintain a healthy balance sheet, so it appears to have no immediate financing needs.
- Valuation –** We have adjusted UCL’s valuation to \$9.0, combining discounted cash flow and comparable company analysis, which is contingent on the company maintaining its successful execution.

Fourth Quarter 2022 Results

For the three months ending December 31, 2022, uCloudlink reported total revenues of \$19.6 million, up 11.6% from \$17.6 million in Q4 2021, primarily due to the increase in revenues from services which went from \$9.6 million to \$12.5 million over the year. Revenues from data connectivity services were \$9.6 million, up 43.2% compared with \$6.7 million in the year-ago period, primarily due to higher international and local data connectivity services which grew 48.1% YoY to \$7.7 million and 26.7% YoY to \$1.9 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 \$2.5 million, down 6.3% from \$2.7 million in the same period of 2021. Revenues from sales of products decreased from \$8.0 million to \$7.1 million due to the decrease in sales of data related products and others. In terms of geographic distribution, Japan as UCL's largest market contributed 43.7% of total revenues, while mainland China and other countries contributed 3.0% and the remaining 53.3%, respectively, compared to 37.4%, 3.1%, and 59.5%, respectively, in Q4 2021. Overall gross profit was \$10.1 million, or 51.3% in gross margin, compared to \$5.4 million, or 31.0% in gross margin in the same period last year, with improved gross margins on both services and sales of products. Total operating expenses were \$11.2 million, compared to \$12.1 million in Q4 2021, a roughly 7.4% decrease, as the company continued streamlining its costs to improve profitability: R&D expenses declined by 44.8% YoY to \$1.9 million due to the decrease in staff costs; S&M expenses decreased to \$2.9 million, down 13.4% over the year, primarily due to the decrease in staff costs and promotional fees; and G&A expenses increased by 18.4% to \$6.4 million, which is due to the increase in provision of bad debt expense and the increase in staff costs, partially offset by the decrease in professional service fees and share-based compensation expenses. uCloudlink's net loss for Q4 2022 further narrowed to \$1.1 million, or \$0.03 per basic and diluted ADS, compared to a net loss of \$15.5 million, or \$0.54 per basic and diluted ADS in the year-ago period. *We expect a steady topline growth from the company's core UCL 1.0 business with further improved profitability as it generates more revenue from the resuming international data connectivity business with higher gross margins while continuing to launch new products and streamline its cost structure.*

| Variance Table (\$ in millions, except per share data) | | | | | | |
|--|----------|----------|---------------------------------|---------|---------|---------------------------------|
| | Q4 2022E | Q4 2022A | Variance (Actual Versus Result) | FY2022E | FY2022A | Variance (Actual Versus Result) |
| Revenue | 20.2 | 19.6 | (0.60) | 72.0 | 71.5 | (0.50) |
| EPS | (0.08) | (0.03) | 0.05 | (0.73) | (0.64) | 0.09 |

Source: Diamond Equity Research

Liquidity and Balance Sheet

As of December 31, 2022, uCloudlink's cash and cash equivalents, and short-term deposits totaled \$15.1 million, compared to \$12.5 million as of September 30, 2022, primarily due to the net inflow of \$5.2 million from operations and net proceeds of \$0.9 million from bank borrowings, partially offset by repayment of \$2.7 million for bank borrowings and \$1.1 million redemption of convertible bonds in Q4 2022.

Management Guidance

uCloudlink expects total revenues to be between \$17.5 and \$18.5 million for Q1 2023 and \$85.0 and \$100.0 million for 2023, representing an increase of 12.2% to 18.6% compared to the same period of 2022 and an increase of 19.0% to 40.1% from that of 2022, respectively.

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, with aggregated mobile data allowances from 337 mobile network operators (MNOs) globally as of December 31, 2022. 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 seasoned 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. 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 | 1Q23E | 2Q23E | 3Q23E | 4Q23E | FY23E | FY24E | FY25E |
|---|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| REVENUES: | | | | | | | | | | | |
| Revenues from services | 91.11 | 46.15 | 37.80 | 46.23 | 11.78 | 13.82 | 15.48 | 15.67 | 56.74 | 85.17 | 121.30 |
| Sales of products | 67.27 | 43.42 | 36.03 | 25.23 | 6.08 | 7.94 | 7.76 | 8.40 | 30.19 | 38.87 | 50.41 |
| Total net revenues | 158.38 | 89.57 | 73.83 | 71.46 | 17.86 | 21.76 | 23.24 | 24.07 | 86.93 | 124.04 | 171.71 |
| Cost of services | (35.59) | (26.39) | (21.56) | (20.35) | (5.30) | (6.22) | (6.96) | (7.05) | (25.53) | (37.47) | (52.16) |
| Cost of products sold | (57.87) | (34.87) | (30.43) | (18.58) | (4.92) | (6.43) | (6.29) | (6.81) | (24.45) | (29.15) | (36.29) |
| Total cost of revenues | (93.46) | (61.26) | (51.99) | (38.93) | (10.22) | (12.65) | (13.25) | (13.86) | (49.98) | (66.62) | (88.45) |
| Gross (loss) profit | 64.92 | 28.31 | 21.84 | 32.53 | 7.63 | 9.11 | 9.99 | 10.22 | 36.94 | 57.41 | 83.25 |
| OPERATING EXPENSES: | | | | | | | | | | | |
| Sales and marketing expenses | (24.37) | (29.26) | (13.62) | (10.31) | (2.47) | (2.59) | (2.49) | (2.88) | (10.43) | (13.64) | (17.17) |
| Research and development expenses | (15.11) | (26.36) | (13.70) | (8.43) | (2.00) | (2.27) | (2.12) | (2.31) | (8.69) | (9.92) | (10.30) |
| General and administrative expenses | (20.22) | (43.22) | (28.55) | (18.73) | (3.81) | (4.11) | (4.99) | (4.47) | (17.39) | (22.33) | (25.76) |
| Other expense, net | 0.29 | 7.55 | (11.88) | (14.27) | (0.00) | (0.00) | (0.00) | 0.01 | 0.00 | (0.25) | (0.17) |
| Total operating expenses | (59.41) | (91.29) | (67.75) | (51.73) | (8.28) | (8.97) | (9.60) | (9.66) | (36.51) | (46.14) | (53.40) |
| EBIT | 5.51 | (62.98) | (45.91) | (19.19) | (0.65) | 0.14 | 0.39 | 0.56 | 0.43 | 11.27 | 29.85 |
| Interest income | 0.19 | 0.04 | 0.01 | 0.02 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.01 |
| Interest expenses | (0.44) | (0.29) | (0.19) | (0.44) | (0.06) | (0.14) | (0.02) | (0.13) | (0.35) | (0.50) | (0.69) |
| Amortization of beneficial conversion feature | | | | (0.15) | | | | | | | |
| Income (loss) before income tax | 5.26 | (63.23) | (46.08) | (19.76) | (0.71) | 0.00 | 0.36 | 0.43 | 0.09 | 10.77 | 29.17 |
| Income tax expenses (benefits) | (0.06) | (0.19) | (0.24) | (0.16) | 0.00 | (0.00) | (0.09) | 0.07 | (0.02) | (2.69) | (7.29) |
| Share of profit in equity method investment, net of tax | | | 0.29 | 0.07 | | | | | | | |
| Adj. Net profit/(loss) | 5.21 | (63.42) | (46.04) | (19.85) | (0.71) | 0.00 | 0.27 | 0.50 | 0.07 | 8.08 | 21.88 |
| 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) | (0.71) | 0.00 | 0.27 | 0.50 | 0.07 | 8.08 | 21.88 |
| Earnings per share | | | | | | | | | | | |
| Basic | 0.01 | (0.25) | (0.16) | (0.06) | (0.00) | 0.00 | 0.00 | 0.00 | 0.00 | 0.02 | 0.06 |
| Diluted | 0.01 | (0.25) | (0.16) | (0.06) | (0.00) | 0.00 | 0.00 | 0.00 | 0.00 | 0.02 | 0.06 |
| Earnings per ADS (10 Class A equal to 1 ADS) | | | | | | | | | | | |
| Basic | 0.10 | (2.49) | (1.61) | (0.64) | (0.02) | 0.00 | 0.01 | 0.01 | 0.00 | 0.23 | 0.58 |
| Diluted | 0.10 | (2.49) | (1.61) | (0.64) | (0.02) | 0.00 | 0.01 | 0.01 | 0.00 | 0.23 | 0.58 |
| Weighted Average no. of Shares outstanding (in M) | | | | | | | | | | | |
| Basic | 232.18 | 259.85 | 285.98 | 312.49 | 317.49 | 322.49 | 327.49 | 330.49 | 327.49 | 347.49 | 377.49 |
| Diluted | 232.18 | 259.85 | 285.98 | 312.49 | 317.49 | 322.49 | 327.49 | 330.49 | 327.49 | 347.49 | 377.49 |

Source: Diamond Equity Research

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