

China Digital TV
First Quarter 2015 Earnings Conference Call Script

Operator:

Good evening and welcome to China Digital TV's First Quarter 2015 Earnings Conference Call. All participants are now in listen-only mode. Should you need assistance, please signal a Conference Specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question you may press * then 1 on your touch-tone phone. To withdraw your question, please press * then 2.

Please note: this event is being recorded.

I would now like to turn the conference over to your host for today, Charles Eveslage. Please go ahead.

Charles Eveslage:

Thank you, operator.

Good morning and good evening everyone, and thank you for joining China Digital TV's first quarter 2015 earnings conference call. At this time, all participants are in listen-only mode. After management's prepared remarks, there will be a question-and-answer session.

The company's earnings results were released earlier today, and are available on the company's IR website at ir.chinadtv.cn, as well as through newswire distribution.

Today, you will hear from Mr. Hao Nan, China Digital TV's investor relations manager, who will provide the CEO's remarks regarding the strategic highlights and future objectives, followed by Ms. Yue Qian, the Company's acting Chief Financial Officer, who will discuss the financial results. After the prepared remarks, China Digital TV's chief executive officer, Dr. Zengxiang Lu will join the call to answer your questions.

Before we continue, please note that the discussion today will contain certain forward-looking statements made under the "safe harbor" provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the company's results may be materially different from the views expressed today.

Further information regarding these and other risks and uncertainties is included in the company's registration statement on Form 20-F and other documents filed with the U.S. Securities and Exchange Commission. China Digital TV does not assume any obligation to update any forward-looking statements except as required under applicable law.

As a reminder, this conference is being recorded. In addition, a webcast of this conference call will be available on China Digital TV's investor relations website. I will now turn the call over to China Digital TV's investor relations manager Mr. Hao Nan.

Hao Nan

Hello everyone. Welcome to our first quarter 2015 earnings conference call. Today I will give an overview of the quarter.

During the first quarter we made further progress in our evolution from being the leading smart card supplier to China's cable operators, to being a diversified content services enabler, driving the pervasion of live television programming outside the home and mobile applications inside the home. On the call today, I will first provide an update regarding the ongoing asset restructuring. Next, I will articulate the future strategy of the business over the next 12 to 24 months, and then I will provide an update on our various emerging business segments, including: cloud computing and network broadcasting platform or NBP.

With regards to the pending asset restructuring, we submitted all relevant documents to the Chinese Commercial Bureau on April 28th, where they remain pending regulatory approval. As is common in China, regulating entities can be slow moving, but we and Tongda Venture are maintaining ongoing dialogue with the officials at the Bureau and are hopeful that the approval will happen sometime in the early third quarter. Then, the next step is to pass the documents to the Chinese Exchange Commission. This is the last stage before approval, and though it is difficult to estimate, if all goes well, we may be able to close the deal in late 2015 or early 2016.

Just to remind investors, as part of the restructuring China Digital TV is selling its conditional access system or CA business, the equipment sales portion of its network broadcasting platform or NBP business, and its video-on-demand business to Tongda Venture, a Shanghai-listed shell company. The deal will be financed through a combination cash and equity and after the close China Digital TV will maintain a 17.2% equity stake in Tongda Venture.

The asset restructuring is a key element of our strategy going forward. Once complete, we will focus on our cloud-based content platform and NBP operations, which we will maintain post-restructuring. Furthermore, our long-standing dominion in China's smart card segment with 51% market share and key relationships with 29 out of China's 32 cable operators will empower us to conquer these emerging frontiers.

Our cloud-based content platform is an exciting new offering which enables cable operators to essentially offer their household subscribers a TV-enabled app store. From here the possibilities are limitless: games, fitness applications, motion-sensing activities similar to Nintendo Wee, educational programs and much more, all based in the cloud and brought into the living room. Seen in this way, the platform we are building is more like an ecosystem that offers value to multiple parties than a simple product or service. More specifically, it is an ecosystem that incentivizes content providers to offer programs through our revenue sharing model, allows cable providers to diversify their content offering and enriches subscribers' TV viewing experience.

As the clear first mover in this emerging frontier, we are serious about contributing to shaping the industry's development. In late April, we hosted a seminar with Beijing Gehua Cable TV that brought together 100 gaming content providers to discuss our emerging cloud-platform and begin to foster connections among the creative class of developers. We are now cooperating with more than 50 content providers and have expanded our cloud offering to several cities.

More specifically, we continued to expand our cloud cooperation with Beijing Gehua CATV Network to 1,400 streams, and are happy to report that we currently have 300,000 registered users for cloud services under this partnership and expect to double that figure by year-end. Furthermore, we inked an agreement with the city of Zibo in Shandong province to deploy our cloud platform, and continue to explore partnerships with other cities to further expand our cloud services into new regions. In total, we are now deployed our cloud platform to over 19 cable operators and 6 IPTV operators.

Our network broadcasting platform or NBP segment is another exciting emerging business with attractive growth potential. As our cloud-platform enables operators to diversify content, NBP enables them to extend the reach of their content, by facilitating access to live television programming for subscribers over any mobile device. Going forward, we will continue to work with cable operators to deploy our platform in airports, train stations, office buildings and many other public places across China.

Currently, we are in a transition period and these emerging businesses are still in their early stages. But as we leverage our position as the leading smart card provider to Chinese cable operators, and our cloud-based content platform gathers momentum, we believe we uniquely well-positioned to take advantage of these emerging growth avenues.

With this I'll hand it to Yue Qian to discuss our traditional smart card business and the financial results.

Yue Qian:

Thanks Nan and hello everyone.

First let me give you an update on the traditional smart card business and the overall cable market in China. As expected and guided in our last earnings call, revenues, shipment volumes and average selling prices were all down year over year. The decline was due to the negative impact of seasonality in the first quarter as well as the overall maturity of the market. With the digital television penetration rate in China already nearing 90%, we expect a continuing downward trend in this segment for two to three years as cable services approach ubiquity. Going forward, the opportunity in this segment will be driven by smaller third and fourth tier cities signing on at what is typically a lower rate, subscriber upgrades from SD to HD terminals and subscribers installing additional set-up boxes in their homes for multiple-screen TV viewing.

Despite the secular headwinds of seasonality and market saturation, we met our guidance in terms of revenues and volumes, and continue to maintain a 51% market share in China's smart

card market. Even as we prepare to sell this segment to Tongda, we will continue to be actively involved as we will hold a 17.2% equity stake after the transaction. We will leverage our traditional market leadership and long-standing relationships with cable operators across China to grow our emerging business segments and spearhead the development of our cloud-based diversified content ecosystem for cable operators and their subscribers.

Turning to the financial highlights for the first quarter. Please note that, unless otherwise stated, all monetary amounts are in US dollars.

In the first quarter of 2015, China Digital TV's **smart card** shipments decreased by 17.1% to approximately 2.95 million from 3.56 million in the prior year period.

Net revenues decreased by 22.7% to US\$14.0 million from US\$18.2 million in the prior year period. The decrease was primarily due to decreases in revenues from the sales of smart cards and other products caused by the general market decline of the mature CA business.

Revenues from our top five customers accounted for 28.4% of total revenues, as compared to 25% in the prior year period.

Revenues from smart cards decreased by 17.7% to US\$12.8 million in the first quarter of 2015 from US\$15.6 million in the prior year period. The decrease was mainly due to a decrease in shipment volumes of smart cards. Sales of smart cards accounted for 89.4% of total revenues in the first quarter of 2015, as compared to 83.9% in the prior year period.

Revenues from other products decreased by 75.8% to US\$0.4 million in the first quarter of 2015 from US\$1.6 million in the prior year period. The decrease was mainly attributable to lower sales of surface mounted chips. Sales of other products accounted for 2.6% of total revenues in the first quarter of 2015, as compared to 8.4% in the prior year period.

Revenues from services decreased by 19.8% to US\$1.1 million in the first quarter of 2015 from US\$1.4 million in the prior year period. The decrease was primarily due to the decline in licensing and royalty income, which was partially offset by an increase in head-end system integration. Revenues from services accounted for 8.0% of total revenues in the first quarter of 2015, as compared to 7.7% in the prior year period.

Cost of revenues from smart cards and other products decreased by 22.3% to US\$2.2 million in the first quarter of 2015 from US\$2.8 million in the prior year period. The decrease was mainly due to a decline in cost of revenues from smart cards resulting from decreased shipment volumes of smart cards. Cost of revenues from smart cards and other products accounted for 65.0% and 3.4% of total cost of revenues, as compared to 66.0% and 6.6% in the prior year period.

Cost of revenues from services decreased by 5.1% to US\$1.0 million in the first quarter of 2015 from US\$1.1 million in the prior year period. The decrease was mainly due to a decline in revenues from services. Cost of revenues from services accounted for 31.5% of total cost of revenues, as compared to 27.4% in the prior year period.

Gross profit in the first quarter of 2015 decreased by 24.1% to US\$10.8 million from US\$14.3 million in the prior year period. Gross margin, which is equal to gross profit divided by net revenues, was 77.1% in the first quarter of 2015, as compared to 78.6% in the prior year period. The decline in gross margin was primarily due to a decrease in revenues from other products, such as surface mounted chips, which carry a relatively high gross margin.

Operating expenses in the first quarter of 2015 decreased by 8.4% to US\$9.6 million from US\$10.5 million in the prior year period.

Income from operations in the first quarter of 2015 decreased by 67.7% to US\$1.2 million from US\$3.8 million in the prior year period. **Operating margin** in the first quarter of 2015 was 8.7%, as compared to 20.8% in the prior year period.

Income tax expenses in the first quarter of 2015 increased by 56.7% to US\$1.4 million from US\$0.9 million in income tax expense in the prior year period.

Net income attributable to China Digital TV in the first quarter of 2015 decreased by 91.1% to US\$0.4 million from US\$4.1 million in the prior year period. **Net margin** in the first quarter of 2015 was 2.6%, as compared to 22.3% in the prior year period.

Non-GAAP net income attributable to holders of ordinary shares in the first quarter of 2015 decreased by 89.7% to US\$0.4 million from US\$4.4 million in the prior year period.

As of March 31, 2015, China Digital TV had cash, cash equivalents and restricted cash totaling US\$61.3 million. In the first quarter of 2015, cash flow used in operations was approximately US\$3.5 million.

Now, let me provide you our business outlook.

Based on information available as of June 8, 2015, China Digital TV expects smart card shipments for Q2 2015 to be in the range of 2.1 million and 2.4 million. Net revenues for Q2 2015 are expected to be in the range of 8.77 million and 9.93 million dollars.

Thank you for listening; we will now take your questions.

Closing Remarks from Hao Nan:

Once again, thank you for joining us today. Please don't hesitate to contact us if you have any further questions. Thank you for your continued support and we look forward to talking with you in the coming months.