Q3 2022 Earnings Prepared Remarks

November 21, 2022

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Zhao Bin, founder, chairman and CEO

Thanks Fionna, and welcome everyone to our earnings call.

Our revenue for the quarter was 41 million dollars, a decrease of 9% year-over-year, and flat quarter-over-quarter. During this quarter, 36 thousand new applications registered on our platform, and our total number of registered applications exceeded half a million. At the end of September, our number of active customers was close to 3 thousand, adding more than 4 hundred compared to one year ago.

In the past a few quarters, we faced an extremely challenging operating environment. Our revenue was hit by restrictive regulations in certain markets, which was the main reason behind year-over-year revenue decrease. More recently, inflationary pressure, interest rate hikes and continued turbulence in global capital markets have impacted some of our customers' business expansion plans and their ability to raise funding, which in turn limited their usage of our products. Lastly, the appreciation of the US dollar also had a negative impact on non-US dollar denominated revenues.

Despite these macro challenges, we continue to see strong demand for our products from new use cases such as live video shopping, which didn't really exist in the US market 18 months ago. As we have seen again and again in our history, real-time engagement technology can transform any online activity and make it more immersive and engaging. This is why we remain optimistic about the long-term potential of our technology and products.

However, the macro environment will likely remain volatile for some time. To cope with such uncertainties, we must remain nimble, laser-focused and entrepreneurial. In recent months, we have been working hard to improve our operational efficiency and focus our efforts on priorities including enhancing the quality of experience and ease of use of our core products, strengthening our go-to-market efforts, and winning benchmark customers.

We have also made a few management changes to streamline our operations and reduce redundancies, including appointing Mr. Shawn Zhong, our Chief Scientist since 2018, to take on an expanded role as our Chief Technology Officer to oversee our global R&D organization.

Last month, we also made the difficult decision to restructure and reduce our global workforce. Here, I would like to thank again those impacted friends and colleagues for their contribution along our journey. Jingbo will discuss financial impact of the reduction in his remarks.

I believe these moves will help us navigate the uncertainties in the near term. And with the right focus and execution, I think we are well positioned to gain market share and emerge from this challenging period stronger than ever.

<u>Moving onto product updates.</u>

I’m thrilled to announce that in this quarter, we officially launched our next generation real-time engagement SDK, version 4.0, which has major upgrades in three key areas, namely, more flexible, simpler to use, and more powerful.

First on flexibility. Our SDK4.0 has an open and modular architecture by design. It breaks down the entire end-to-end transmission path into dozens of loosely coupled components with standardized interfaces for each module. Developers now enjoy much more granular control over the media pipeline to create the optimal experience for their specific use case.

Next on simplicity. With just a few lines of code, developers can easily integrate a wide range of first-party and third-party extensions with rich and engaging features, such as audio and video effects, virtual backgrounds, transcription, content moderation, spatial audio, AI noise suppression and more.

Being flexible and easy to use does not mean any compromise on performance. For use cases that require high video quality, SDK 4.0 now supports up to 4k video at 60 frames per second. SDK 4.0 also supports multiple media sources from one single user, which is perfect for use cases such as online proctoring or professional music livestreaming. For those that require highly synchronous transmission at ultra-low latency such as online karaoke, we can combine and deliver all soundtracks to all participants precisely at the same time.

With our next generation SDK, developers will be able to create innovative and immersive applications at a faster speed than ever before.

Moving onto new use cases.

The first one is live video shopping, which is growing very fast, and we already have several benchmark customers. For example, a leading collectibles auction marketplace leverages our platform to hold live auctions through real-time video. Its CEO describes the marketplace as a cross between the streaming platform Twitch and the auction site eBay. It provides real-time auctions where customers can engage with the seller and each other in a fast-paced video environment where auctions can be completed in as fast as 30 seconds.

The second one is professional social networking. A globally leading professional social network is leveraging our technology to power its live audio chatrooms. These rooms provide creators and influencers the ability to have live, interactive conversations with people all over the world, and users can join speakers "on stage" and make broader networking connections post-event. Our quality in audio technology and global coverage ensures them a premium quality, perfectly matching their position as a professional social network.

Moving onto our RTE conference.

In October and November, we hosted our iconic global RTE conferences for the eighth consecutive year, where developers, customers and thought leaders from over 100 countries joined together to discuss latest trends and explore the future of real-time engagement. Nearly 500 people attended the in-person program in San Francisco, close to 10 thousand more registered for online sessions, and the total number of session views exceeded 500 thousand. This year also marks the first time that we host a dedicated RTE APAC conference, which has been well received and lively attended by local participants. Here I would like to highlight some of the observations and key messages from the conferences.

First on end user experience. Evidence continues to build across use cases and geographies that our customer's business success is profoundly dependent on the end user experience that they can deliver. For example, a small increase in freeze rate in an audio chat room will reduce users' session lengths and retention rates. Adding AI noise suppression for in-game team audio chat will significantly increase session lengths. Therefore, it is paramount for developers to partner with the most capable and reliable RTE provider in order to have the most advanced building blocks in creating real-time engagement experiences.

Second on the trend of high-definition video. We expect to see the mainstream video resolution in real-time engagement steadily increase from 480p to 720p in response to end users' growing demand for better quality. Based on the usage of our platform, other things being equal, changing video resolution from 480p to 720p leads to an approximately 15% increase in overall session lengths. In case local network conditions cannot accommodate the required bandwidth, our super resolution algorithm can take care of this issue by enhancing video resolution through the same bandwidth, with only 3% increase in CPU and memory usage. This upgrade in video quality and experience will bring more business opportunities for our customers and for us, as we have already seen a huge leap in 720p sessions since the beginning of this year.

Lastly on the trend of adding RTE capabilities to IoT devices. We are seeing that devices with RTE features are generally sold at high premium compared with “plain vanilla” models without such capabilities. Examples include pet feeders with cameras for real-time video, treadmills and rowing machines with screens for livestreaming classes, and study lamps with AR projection capabilities, enabling students to collaborate with their classmates. This type of “human touch” is only possible thanks to RTE technologies, and we believe these experiences will be one of the fundamental drivers of IoT’s future growth.

Before concluding my prepared remarks for this quarter, I want to thank all Agorans for your hard work and commitment during this challenging period. The fundamentals and long-term potential of real-time engagement technology remain the same despite the turbulent macro environment. We are neither overly optimistic nor overly pessimistic about the future of our industry. And we are still in the early stage of building a great company. As someone once said, “today is difficult, tomorrow is even harder, the day after that will be great, although most people will be dead before that”. I am confident in our strategy for growth, and in your abilities to help Agora succeed. What we need is to keep executing with determination and focus. Thank you all!

With that, let me turn things over to Jingbo, who will review our financial results.

Jingbo Wang, CFO

Thank you, Tony. Hello everyone.

Let me start by first reviewing financial results for Q3 and then I will discuss outlook for the fiscal year of 2022.

Total revenues were $41 million in the third quarter of 2022, a decrease of 9% year over year, and flat compared to last quarter. The year-on-year decrease was mainly due to restrictive regulations in certain markets, which was offset in part by revenue growth in other sectors and regions. If we look at Q3 versus Q2 this year, the recent interest rate hikes and tightening of financing environment had impacted some of our customers' business and their ability to raise funding, which led to reduced usage on our platform. In addition, the continued appreciation of US dollar has impacted our non-US dollar denominated revenues when translated into US dollar amount.

Our trailing-twelve-months Constant Currency Dollar-Based Net Expansion Rate is 84%, excluding Easemob. Specifically, Dollar-Based Net Expansion Rate was above 130% for the US and International business, which remained strong and healthy and approximately 70% for the China business, mainly due to restrictive regulations in certain markets.

Moving onto cost and expenses. For my following comments, I will focus on non-GAAP results, which exclude share-based compensation expenses, acquisition related expenses, financing related expenses, amortization expenses of acquired intangible assets and income tax related to acquired intangible assets.

Non-GAAP gross margin for the third quarter was 59.8%, which was 5.7% lower than Q3 2021, mainly due to increased revenue from our broadcast streaming product, which contributed approximately 8% of our total revenues in the quarter and had lower gross margin.

As Tony mentioned just now, we made the difficult decision to restructure and reduce our global workforce last month. The associated severance costs of $3.2 million are reflected in operating expenses in Q3. We also reduced other operating expenses such as rental, benefits, software, and advertising. Together, we expect to see roughly $9 million cash savings on quarterly non-GAAP operating expenses in Q4 compared to Q3.

Non-GAAP R&D expenses were $25.2 million in Q3, which included a provision of severance costs of $1.9 million. If we exclude the severance costs, the pro-forma R&D expenses decreased approximately 14% from Q2 this year. Non-GAAP R&D expenses was 61.4% of total revenues in the quarter, compared to 50.9% in Q3 last year.

Non-GAAP sales and marketing expenses were $13 million in Q3, up 17.7% year-over-year, mainly due to team expansion in the US and certain international markets and increased advertising and event expenses. Sales and marketing expenses represented 31.8% of total revenues in the quarter, compared to 24.6% in Q3 last year.

Non-GAAP G&A expenses were $7.4 million in Q3, up 8.9% year-over-year, mainly due to team expansion in the US. G&A expenses represented 18.1% of total revenues in the quarter, compared to 15.1% in Q3 last year.

Non-GAAP operating loss was $18.7 million, translating to a 45.7% non-GAAP operating loss margin for the quarter, compared to an operating loss margin of 24.6% in Q3 last year.

Now turning to cash flow, operating cash flow was negative $8.8 million in Q3, compared to negative $14 million last year. Free cash flow was negative $9.9 million, compared to negative $15.6 million last year.

Moving onto balance sheet. We ended Q3 with $483 million in cash, cash equivalents and short-term investments, compared to $641 million at the end of Q2. Net cash outflow in the quarter was mainly due to free cash flow of negative $9.9 million, prepayment for land use right purchase of $137.4 million, net of deposit refunded, cash paid for long-term investments of $3.1 million and share repurchase of $3.1 million. By the end of Q3, we repurchased approximately 13.2 million of our class A ordinary shares, equivalent to approximately 3.3 million ADSs, for approximately $23.2 million, representing 12% of our $200 million share repurchase program.

Now turning to guidance, COVID-19 is still an unprecedented variable to our business model, where historical experience may not apply. Our guidance on full year revenues reflects various assumptions that are subject to change based on uncertainties related to the impact of the COVID-19 pandemic. In addition, challenging macroeconomic environment and the turbulence in global capital markets, had impacted some of our customers' business expansion and their ability to raise funding, which in turn could limit their usage of our products. With that, we expect total revenues for the full year of 2022 to be in the range of $160 million to $162 million.

In closing, we made tough decisions in this quarter under a challenging and uncertain macroeconomic environment. Looking forward, we will stick to our long-term strategy, be laser-focused on key priorities and continue to improve our operational efficiency. With the right focus and execution, I believe we are well positioned to gain market share and emerge from this challenging period stronger than ever. Thank you to the entire Agora team for your hard work and thank you everyone for attending the call today.

Let's open it up for questions.