

Xunlei Ltd  
Form 20-F/A  
May 20, 2015  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 20-F/A**  
**(Amendment No. 1)**

**(Mark One)**

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the fiscal year ended December 31, 2014.**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_.**

**OR**

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report**

**Commission file number: 001-35224**

**Xunlei Limited**

**(Exact name of Registrant as specified in its charter)**

**N/A**

**(Translation of Registrant's name into English)**

**Cayman Islands**

**(Jurisdiction of incorporation or organization)**

**4/F, Hans Innovation Mansion, North Ring Road**

**No. 9018 High-Tech Park, Nanshan District**

**Shenzhen, 518057**

**People's Republic of China**

**(Address of principal executive offices)**

**Tao Thomas Wu, Chief Financial Officer**

**Telephone: +86-755-3391-2900**

**Email: tom.wu@xunlei.com**

**4/F, Hans Innovation Mansion, North Ring Road**

**No. 9018 High-Tech Park, Nanshan District**

**Shenzhen, 518057**

**People's Republic of China**

**(Name, Telephone, Email and/or Facsimile number and Address of Company Contact Person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act.**

| <b>Title of each class</b>                  | <b>Name of each exchange on which registered</b> |
|---|--|
| <b>American depositary shares, each</b>     | <b>The NASDAQ Stock Market LLC</b>               |
| <b>representing five common shares</b>      | <b>(The NASDAQ Global Select Market)</b>         |
| <b>Common shares, par value US\$0.00025</b> | <b>The NASDAQ Stock Market LLC</b>               |
| <b>per share*</b>                           | <b>(The NASDAQ Global Select Market)</b>         |

\* Not for trading, but only in connection with the listing on The NASDAQ Global Select Market of American depositary shares.

**Securities registered or to be registered pursuant to Section 12(g) of the Act.**

**NONE**

**(Title of Class)**

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act.**

**NONE**

**(Title of Class)**

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report: 328,693,840 common shares as of December 31, 2014.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

US GAAP  International Financial Reporting Standards as issued  Other

by the International Accounting Standards Board

If Other has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow. Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes  No

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**EXPLANATORY NOTE**

This Amendment No. 1 on Form 20-F/A (this Amendment No. 1) to our annual report on Form 20-F for the year ended December 31, 2014, which was originally filed with the Securities and Exchange Commission on April 20, 2015 (the 2014 Form 20-F), is being filed solely for the purposes of (1) filing Interactive Data File disclosure as Exhibit 101 in accordance with Rule 405 of Regulation S-T, which exhibit was not previously filed, (2) adding the electronic signature of PricewaterhouseCoopers Zhong Tian LLP in the Report of Independent Registered Public Accounting Firm dated April 20, 2015, included in Item 8.A. and Item 18 in the 2014 Form 20-F and (3) making the following corrections to certain typographical errors: changing the total shareholders Share-based compensation - others from 7,532 to 7,644 and the total shareholders Net income/(loss) from 10,924 to 10,812 in the consolidated statements of changes in shareholders equity on page F-11 and changing Adjustments to reconcile net income to net cash generated from operating activities Deferred taxes for the year ended December 31, 2014 from 1,897 to 1,856 and Changes in operating assets and liabilities Accrued liabilities and other payables for the year ended December 31, 2014 from 4,793 to 4,752 in the consolidated statement of cash flows on page F-12. As required by Rule 12b-15 of the Securities and Exchange Act of 1934, as amended, we are also filing and furnishing as exhibits to this Amendment No. 1 the certifications required under Section 302 and Section 906 of the Sarbanes-Oxley Act of 2002, respectively.

This Amendment No. 1 speaks as of the filing date of the 2014 Form 20-F on April 20, 2015. Other than as expressly set forth above, this Amendment No. 1 does not, and does not purport to, amend, update or restate any other information or disclosure included in the 2014 Form 20-F or reflect any events that have occurred since April 20, 2015, when the 2014 Form 20-F was originally filed.

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**Item 18. Financial Statements**

The consolidated financial statements of Xunlei Limited, its subsidiaries and its variable interest entity and its subsidiaries are included at the end of this Amendment No. 1. See pages F-1 through F-86.

**Table of Contents****Item 19. Exhibits**

| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 1.1                   | Eighth amended and restated memorandum and seventh amended and restated articles of association of the Registrant (incorporated by reference to Exhibit 3.2 of our registration statement on Form F-1, as amended (file no. 333-196221), filed with the SEC on June 12, 2014)  |
| 2.1                   | Registrant's specimen American depositary receipt (included in Exhibit 2.3)  |
| 2.2                   | Registrant's specimen certificate for common shares (incorporated by reference to Exhibit 4.2 of our registration statement on Form F-1, as amended (file no. 333-196221), filed with the SEC on June 12, 2014)  |
| 2.3                   | Deposit agreement among the Registrant, the depositary and holders of American depositary receipts, dated June 23, 2014 (incorporated by reference to Exhibit 4.3 to the Registrant's registration statement on Form F-1, as amended (File No. 333-196221), filed with the Securities and Exchange Commission on June 12, 2014)  |
| 4.1                   | Seventh amended and restated shareholders agreement among the Registrant and its subsidiaries, Shenzhen Xunlei Networking Technologies Co., Ltd. and its subsidiaries, shareholders of the Registrant and other parties thereto, dated April 24, 2014 (incorporated by reference to Exhibit 4.4 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on June 12, 2014)                               |
| 4.2                   | Series E preferred share purchase agreement, among the Registrant, Xiaomi Ventures Limited and other parties therein, dated as of February 13, 2014 (incorporated by reference to Exhibit 4.6 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.3                   | Warrant issued by the Registrant to Xiaomi Ventures Limited dated as of March 5, 2014 (incorporated by reference to Exhibit 4.7 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.4                   | Warrant issued by the Registrant to Skyline Global Company Holdings Limited, dated as of March 5, 2014 (incorporated by reference to Exhibit 4.8 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.5                   | Supplemental agreement to Series E preferred share purchase agreement, among the Registrant, Xiaomi Ventures Limited and other parties therein, dated as of March 20, 2014 (incorporated by reference to Exhibit 4.9 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.6                   | Series E preferred share purchase agreement, among the Registrant, King Venture Holdings Limited, Morningside China TMT Special Opportunity Fund, L.P., Morningside China TMT Fund III Co-Investment, L.P. and IDG Technology Venture Investment V, L.P., dated as of April 3, 2014 (incorporated by reference to Exhibit 4.10 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014) |
| 4.7                   | 2010 share incentive plan (incorporated by reference to Exhibit 10.1 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.8                   | 2013 share incentive plan (incorporated by reference to Exhibit 10.2 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |



- 4.9 2014 share incentive plan (incorporated by reference to Exhibit 10.4 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)

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| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 4.10                  | Letter agreement signed by Leading Advice Holdings Limited in relation to 2013 share incentive plan of the Registrant, dated March 20, 2014 (incorporated by reference to Exhibit 10.3 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.11                  | Letter agreement signed by Leading Advice Holdings Limited in relation to 2014 share incentive plan of the Registrant, dated May 5, 2014 (incorporated by reference to Exhibit 10.5 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.12                  | Letter agreement signed by Leading Advice Holdings Limited in relation to 2013 share incentive plan and 2014 share incentive plan of the Registrant, dated May 19, 2014 (incorporated by reference to Exhibit 10.6 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)                                 |
| 4.13                  | Form of indemnification agreement with the Registrant's directors and officers (incorporated by reference to Exhibit 10.7 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on June 12, 2014)   |
| 4.14                  | Form of employment agreement between the Registrant and Executive Officers of the Registrant (incorporated by reference to Exhibit 10.8 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on June 12, 2014)   |
| 4.15                  | English translation of business operation agreement among Giganology Shenzhen, Shenzhen Xunlei and the shareholders of Shenzhen Xunlei, dated November 15, 2006, as amended on March 1, 2012, (incorporated by reference to Exhibit 10.9 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)           |
| 4.16                  | English translation of equity pledge agreement among Giganology Shenzhen and the shareholders of Shenzhen Xunlei dated November 15, 2006, as amended on May 10, 2011, March 1, 2012 and March 10, 2014 (incorporated by reference to Exhibit 10.10 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014) |
| 4.17                  | English translation of power of attorney between Giganology Shenzhen and Shenglong Zou, dated May 10, 2011 (incorporated by reference to Exhibit 10.11 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.18                  | English translation of power of attorney between Giganology Shenzhen and Hao Cheng, dated May 10, 2011 (incorporated by reference to Exhibit 10.12 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.19                  | English translation of power of attorney between Giganology Shenzhen and Fang Wang, dated May 10, 2011 (incorporated by reference to Exhibit 10.13 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |

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| <b>Exhibit Number</b> | <b>Description of Document</b>   |
|-----------------------|--|
| 4.20                  | English translation of power of attorney between Giganology Shenzhen and Jianming Shi, dated May 10, 2011 (incorporated by reference to Exhibit 10.14 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.21                  | English translation of power of attorney between Giganology Shenzhen and Guangzhou Shulian Information Investment Co., Ltd., dated May 10, 2011 (incorporated by reference to Exhibit 10.15 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.22                  | English translation of exclusive technical support and services agreement between Giganology Shenzhen and Shenzhen Xunlei, dated September 16, 2005, as amended on November 15, 2006 and March 10, 2014 (incorporated by reference to Exhibit 10.16 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.23                  | English translation of exclusive technology consulting and training agreement between Giganology Shenzhen and Shenzhen Xunlei, dated September 16, 2005, as amended on November 15, 2006 and March 10, 2014 (incorporated by reference to Exhibit 10.17 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.24                  | English translation of proprietary technology license contract between Giganology Shenzhen and Shenzhen Xunlei, dated March 1, 2012 (incorporated by reference to Exhibit 10.18 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.25                  | English translation of intellectual properties purchase option agreement between Giganology Shenzhen and Shenzhen Xunlei dated March 1, 2012, as amended on March 10, 2014 (incorporated by reference to Exhibit 10.19 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)   |
| 4.26                  | English translation of loan agreement among Giganology Shenzhen, Guangzhou Shulian Information Investment Co., Ltd., Sean Shenglong Zou, Hao Cheng, Fang Wang and Jianming Shi, dated December 22, 2010, as amended on March 1, 2012 and March 10, 2014 (incorporated by reference to Exhibit 10.20 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)    |
| 4.27                  | English translation of loan agreement between Giganology Shenzhen and Sean Shenglong Zou, dated May 10, 2011, as amended on March 1, 2012 (incorporated by reference to Exhibit 10.21 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)  |
| 4.28                  | English translation of equity interests disposal agreement between Giganology Shenzhen, Guangzhou Shulian Information Investment Co., Ltd., Sean Shenglong Zou, Hao Cheng, Fang Wang and Jianming Shi, dated November 15, 2006, as amended on May 10, 2011 (incorporated by reference to Exhibit 10.22 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014) |

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| <b>Exhibit Number</b> | <b>Description of Document</b>  |
|-----------------------|---|
| 4.29                  | English translation of technology development and software license framework agreement between Shenzhen Xunlei and Xunlei Computer dated December 24, 2013 (incorporated by reference to Exhibit 10.23 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on May 23, 2014)                  |
| 4.30                  | Content protection agreement by and between Shenzhen Xunlei Networking Technologies Co., Ltd. and other parties thereto dated May 22, 2014 (incorporated by reference to Exhibit 10.24 of our registration statement on Form F-1 (file no. 333-196221) filed with the SEC on June 12, 2014)                                 |
| 4.31*                 | English summary of Assets and Business Transfer Agreement by and between Shenzhen Xunlei Networking Technologies Co., Ltd., Beijing Kingsoft Cloud Network Technology Co., Ltd., Zhuhai Kingsoft Cloud Science and Technology Co., Ltd. and Beijing Kingsoft Cloud Science and Technology Co., Ltd. dated September 2, 2014 |
| 8.1*                  | List of significant subsidiaries and variable interest entity of the Registrant   |
| 11.1                  | Code of business conduct and ethics of the Registrant (incorporated by reference to Exhibit 99.1 of our Registration Statement on Form F-1 (file no. 333-196221) filed with the Securities and Exchange Commission on June 12, 2014)  |
| 12.1***               | Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 12.2***               | Certification by Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| 13.1**                | Certification by Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 13.2**                | Certification by Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| 15.1*                 | Consent of Maples and Calder  |
| 15.2*                 | Consent of Zhong Lun Law Firm   |
| 15.3*                 | Consent of PricewaterhouseCoopers Zhong Tian LLP, an independent registered public accounting firm  |
| 15.4*                 | Consent of PricewaterhouseCoopers, an independent registered public accounting firm   |
| 16.1*                 | Letter from PricewaterhouseCoopers to the SEC   |
| 101.INS***            | XBRL Instance Document  |
| 101.SCH***            | XBRL Taxonomy Extension Schema Document   |
| 101.CAL***            | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.DEF***            | XBRL Taxonomy Extension Definition Linkbase Document  |
| 101.LAB***            | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE***            | XBRL Taxonomy Extension Presentation Linkbase Document  |

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- \* Previously filed with the Annual Report on Form 20-F on April 20, 2015.
- \*\* Furnished with this Amendment No. 1 on Form 20-F/A.
- \*\*\* Filed with this Amendment No. 1 on Form 20-F/A.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing its annual report on Form 20-F and that it has duly caused and authorized the undersigned to sign this Amendment No. 1 to its annual report on its behalf.

**Xunlei Limited**

By: /s/ Sean Shenglong Zou  
Name: Sean Shenglong Zou  
Title: Chairman and Chief Executive  
Officer

Date: May 20, 2015

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**Report of independent registered public accounting firm**

To the Board of Directors and Shareholders of Xunlei Limited:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of comprehensive income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Xunlei Limited and its subsidiaries (collectively, the Group) at December 31, 2013, and the results of their operations and their cash flows for each of the two years in the period ended December 31, 2013 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers  
Hong Kong  
March 21, 2014

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**Report of independent registered public accounting firm**

To the Board of Directors and Shareholders of Xunlei Limited:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of comprehensive income, of changes in shareholders' equity and of cash flows present fairly, in all material respects, the financial position of Xunlei Limited and its subsidiaries (collectively, the Group) at December 31, 2014, and the results of their operations and their cash flows for the year ended December 31, 2014 in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

/s/ PricewaterhouseCoopers Zhong Tian LLP

Shenzhen, the People's Republic of China

April 20, 2015

**Table of Contents****Xunlei Limited****Consolidated Balance Sheets**

(Amounts expressed in thousands of United States dollars ( USD ), except for number of shares and per share data)

|   | Note      | December 31, 2013 | December 31, 2014 |
|---|-----------|-------------------|-------------------|
| <b>Assets</b>   |           |                   |                   |
| <b>Current assets:</b>  |           |                   |                   |
| Cash and cash equivalents   | 4         | 93,906            | 404,275           |
| Short-term investments  | 5         | 40,993            | 29,427            |
| Accounts receivable, net  | 6         | 35,275            | 28,921            |
| Deferred tax assets   | 22        | 1,185             | 2,091             |
| Due from related parties  | 21        | 85                | 22                |
| Prepayments and other current assets  | 7         | 6,319             | 14,560            |
| Content copyrights, current portion   | 9         | 16,018            | 16,013            |
| <b>Total current assets</b>   |           | <b>193,781</b>    | <b>495,309</b>    |
| <b>Non-current assets:</b>  |           |                   |                   |
| Long-term investments   | 10        | 2,949             | 5,498             |
| Deferred tax assets   | 22        | 9,430             | 10,862            |
| Property and equipment, net   | 8         | 20,208            | 17,519            |
| Intangible assets, net  | 9         | 11,958            | 20,097            |
| Goodwill  | 2(k), (l) |                   | 23,237            |
| Prepayments for content copyrights  | 7         | 3,149             | 1,988             |
| Other long-term prepayments and receivables   | 7         | 2,928             | 5,852             |
| <b>Total assets</b>   |           | <b>244,403</b>    | <b>580,362</b>    |
| <b>Liabilities</b>  |           |                   |                   |
| <b>Current liabilities:</b>   |           |                   |                   |
| Accounts payable (including accounts payable of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 62,603 and USD 49,771 as of December 31, 2013 and 2014, respectively)   |           | 39,820            | 40,204            |
| Due to a related party (including due to a related party of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 225 and USD 84 as of December 31, 2013 and 2014, respectively)  | 21        | 225               | 84                |
| Deferred revenue and income, current portion (including deferred revenue and income, current portion of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 29,352 and USD 28,083 as of December 31, 2013 and 2014, respectively) | 11        | 29,352            | 28,294            |
|   |           | 2,581             | 2,554             |

Income tax payable (including income tax payable of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 2,581 and USD 2,554 as of December 31, 2013 and 2014, respectively)

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**Table of Contents****Xunlei Limited****Consolidated Balance Sheets (Continued)**

(Amounts expressed in thousands of United States dollars ( USD ), except for number of shares and per share data)

|   | Note   | December 31,<br>2013 | December 31,<br>2014 |
|---|--------|----------------------|----------------------|
| Accrued liabilities and other payables (including accrued liabilities and other payables of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 49,265 and USD 86,323 as of December 31, 2013 and 2014, respectively)                   | 12     | 33,407               | 31,415               |
|   |        | <b>105,385</b>       | <b>102,551</b>       |
| <b>Liabilities</b>  |        |                      |                      |
| <b>Non-current liabilities:</b>   |        |                      |                      |
| Deferred revenue and income, non-current portion (including deferred revenue and income, non-current portion of the consolidated variable interest entities and VIE s subsidiaries without recourse to the Company of USD 9,190 and USD 6,452 as of December 31, 2013 and 2014, respectively) | 11     | 9,190                | 7,294                |
| Deferred tax liability, non-current portion   | 22     | 8,074                | 8,552                |
| Warrants liabilities  | 14     | 2,186                |                      |
| Due to related parties, non-current portion   | 17, 21 |                      | 4,137                |
| Other long-term payable   | 17     |                      | 807                  |
| <b>Total liabilities</b>  |        | <b>124,835</b>       | <b>123,341</b>       |
| <b>Commitments and contingencies</b>  | 25     |                      |                      |
| <b>Mezzanine equity</b>   |        |                      |                      |
| Series D convertible redeemable preferred shares<br>USD 0.00025 par value, 18,000,000 shares authorized, 10,580,397 shares issued and outstanding as at December 31, 2013 and nil as at December 31, 2014   | 14     | 40,290               |                      |

**Table of Contents****Xunlei Limited****Consolidated Balance Sheets (Continued)**

| <b>(Amounts expressed in thousands of USD, except for number of shares and per share data)</b>  | <b>Note</b> | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---|-------------|------------------------------|------------------------------|
| <b>Equity</b>   |             |                              |                              |
| Series C convertible non-redeemable preferred shares<br>USD0.00025 par value, 5,728,264 shares authorized, 5,728,264 shares issued and outstanding as at<br>December 31, 2013 and nil as at December 31, 2014   | 15          | 1                            |                              |
| Series B convertible non-redeemable preferred shares<br>USD0.00025 par value, 30,308,284 shares authorized, 30,308,284 shares issued and outstanding as<br>at December 31, 2013 and nil as at December 31, 2014   | 15          | 8                            |                              |
| Series A-1 convertible non-redeemable preferred shares<br>USD0.00025 par value, 36,400,000 shares authorized, 36,400,000 shares issued and outstanding as<br>at December 31, 2013 and nil as at December 31, 2014   | 15          | 9                            |                              |
| Series A convertible non-redeemable preferred shares<br>USD0.00025 par value, 27,932,000 shares authorized, 26,416,560 shares issued and outstanding as<br>at December 31, 2013 and nil as at December 31, 2014   | 15          | 7                            |                              |
| Common shares<br>USD0.00025 par value, 195,504,449 shares authorized, 70,521,104 shares issued and 61,447,372<br>shares outstanding as at December 31, 2013; 1,000,000,000 shares authorized, 357,886,089 shares<br>issued and 327,611,487 shares outstanding as at December 31, 2014 | 16          | 15                           | 82                           |
| Additional paid-in-capital  |             | 61,634                       | 446,202                      |
| Accumulated other comprehensive income  |             | 6,003                        | 5,894                        |
| Statutory reserves  |             | 4,478                        | 5,132                        |
| Treasury shares<br>9,073,732 shares and 30,274,602 shares as at December 31, 2013 and 2014, respectively  | 16          | 2                            | 7                            |
| Retained earnings   |             | 7,037                        | 574                          |
| <b>Total Xunlei Limited's shareholders' equity</b>  |             | <b>79,194</b>                | <b>457,891</b>               |
| <b>Non-controlling interest</b>   | 18          | 84                           | (870)                        |
| <b>Total liabilities, mezzanine equity and shareholders' equity</b>   |             | <b>244,403</b>               | <b>580,362</b>               |

*The accompanying notes are an integral part of these consolidated financial statements.*

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## Xunlei Limited

## Consolidated Statements of Comprehensive income

| (Amounts expressed in thousands of USD, except for number of shares and per share data)         | Note | Years ended December 31, |                 |                 |
|---|------|--------------------------|-----------------|-----------------|
|   |      | 2012                     | 2013            | 2014            |
| Revenues, net of rebates and discounts  | 2(q) | 148,200                  | 180,244         | 182,887         |
| Business taxes and surcharges   |      | (7,679)                  | (5,650)         | (3,358)         |
| <b>Net revenues</b>   |      | <b>140,521</b>           | <b>174,594</b>  | <b>179,529</b>  |
| Cost of revenues  | 13   | (84,012)                 | (93,260)        | (98,459)        |
| <b>Gross profit</b>   |      | <b>56,509</b>            | <b>81,334</b>   | <b>81,070</b>   |
| <b>Operating expenses</b>   |      |                          |                 |                 |
| Research and development expenses   |      | (20,357)                 | (28,832)        | (35,287)        |
| Sales and marketing expenses  |      | (20,219)                 | (26,610)        | (29,253)        |
| General and administrative expenses   |      | (18,474)                 | (23,073)        | (29,960)        |
| <b>Total operating expenses</b>   |      | <b>(59,050)</b>          | <b>(78,515)</b> | <b>(94,500)</b> |
| Net gain from exchanges of content copyrights   | 2(r) | 4,666                    | 1,020           | 1,556           |
| <b>Operating income / (loss)</b>  |      | <b>2,125</b>             | <b>3,839</b>    | <b>(11,874)</b> |
| Interest income   |      | 1,377                    | 1,189           | 6,733           |
| Interest expense  |      | (1,400)                  |                 | (163)           |
| Other income, net   | 24   | 564                      | 4,679           | 13,966          |
| Share of (loss) / income from an equity investee  |      | (45)                     | 25              | (259)           |
| <b>Income before income tax</b>   |      | <b>2,621</b>             | <b>9,732</b>    | <b>8,403</b>    |
| Income tax benefit / (expense)  | 22   | (2,239)                  | 647             | 1,459           |
| <b>Net income</b>   |      | <b>382</b>               | <b>10,379</b>   | <b>9,862</b>    |
| Less: net loss attributable to the non-controlling interest                                     |      | (121)                    | (283)           | (950)           |
| <b>Net income attributable to Xunlei Limited</b>  |      | <b>503</b>               | <b>10,662</b>   | <b>10,812</b>   |
| Allocation of net income to participating preferred shareholders                                |      |                          | (4,094)         |                 |
| Beneficial conversion feature of Series C convertible preferred shares from their modifications | 15   | (286)                    |                 |                 |
| Deemed contribution from Series C preferred shareholders  | 15   | 2,979                    |                 |                 |
| Accretion of Series D to convertible redeemable preferred shares redemption value               | 14   | (3,509)                  | (4,300)         | (1,870)         |
| Contingent beneficial conversion feature of series C to one Series C shareholder                | 14   |                          |                 | (57)            |
| Deemed dividend to Series D shareholder from its modification                                   | 14   |                          |                 | (279)           |
|   | 14   |                          |                 | (12,754)        |

|  |        |              |                  |
|--|--------|--------------|------------------|
| Accretion of Series E to convertible redeemable preferred shares redemption value                      |        |              |                  |
| Amortization of beneficial conversion feature of Series E  | 14     |              | (4,139)          |
| Acceleration of amortization of beneficial conversion feature of Series E upon initial public offering |        |              | (49,346)         |
| Deemed dividend to certain shareholders from repurchase of shares                                      | 17     |              | (14,926)         |
| Deemed dividend to preferred shareholders upon initial public offering                                 | 14, 15 |              | (32,807)         |
| <b>Net (loss) / income attributable to Xunlei Limited's common shareholders</b>                        |        | <b>(313)</b> | <b>2,268</b>     |
|  |        |              | <b>(105,366)</b> |
| Net income   |        | 382          | 10,379           |
| Other comprehensive income / (loss): Foreign currency translation adjustment, net of tax               |        | 490          | 2,775            |
|  |        |              | (114)            |
| <b>Comprehensive income</b>  |        | <b>872</b>   | <b>13,154</b>    |
|  |        |              | <b>9,748</b>     |
| Less: comprehensive income attributable to non-controlling interest shareholders                       |        | (120)        | (276)            |
|  |        |              | (955)            |

Table of Contents**Xunlei Limited****Consolidated Statements of Comprehensive income (Continued)**

| (Amounts expressed in thousands of USD, except for<br>number of shares and per share data) | Note | Years ended December 31, |               |               |
|--|------|--------------------------|---------------|---------------|
|  |      | 2012                     | 2013          | 2014          |
| <b>Comprehensive income attributable to Xunlei Limited</b>                                 |      | <b>992</b>               | <b>13,430</b> | <b>10,703</b> |
| Basic net (loss) / income per share attributable to Xunlei Limited                         | 20   | (0.01)                   | 0.04          | (0.54)        |
| Weighted average number of common shares outstanding basic                                 | 20   | 61,447,372               | 61,447,372    | 194,711,227   |
| Diluted net (loss) / income per share attributable to Xunlei Limited                       | 20   | (0.01)                   | 0.01          | (0.54)        |
| Weighted average number of common shares outstanding diluted                               | 20   | 61,447,372               | 76,065,898    | 194,711,227   |

*The accompanying notes are an integral part of these consolidated financial statements.*



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**Xunlei Limited**

**Consolidated statements of changes in shareholders' equity**

|  | Series C convertible non-redeemable preferred share |        | Series B convertible non-redeemable preferred shares |        | Series A-1 convertible non-redeemable preferred shares |        | Series A convertible non-redeemable preferred shares |        | Common shares |        | Treasury stock |        | Additional paid-in capital | Retained earnings |
|--|---|--------|--|--------|--|--------|--|--------|---------------|--------|----------------|--------|----------------------------|-------------------|
|  | Shares  | Amount | Shares   | Amount | Shares   | Amount | Shares   | Amount | Shares        | Amount | Shares         | Amount |                            |                   |
|  | 5,728,264   | 1      | 30,308,284   | 8      | 36,400,000   | 9      | 26,416,560   | 7      | 61,447,372    | 15     |                |        | 60,000                     | 2,324             |
|  |   |        |  |        |  |        |  |        |               |        |                |        | 2,233                      |                   |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            |                   |
|  |   |        |  |        |  |        |  |        |               |        |                |        | 286                        | (286)             |
|  |   |        |  |        |  |        |  |        |               |        |                |        | (2,979)                    | 2,979             |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            | (3,509)           |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            | 503               |
|  | 5,728,264   | 1      | 30,308,284   | 8      | 36,400,000   | 9      | 26,416,560   | 7      | 61,447,372    | 15     |                |        | 59,540                     | 2,011             |
|  |   |        |  |        |  |        |  |        |               |        | 9,073,732      | 2      | (2)                        |                   |
|  |   |        |  |        |  |        |  |        |               |        |                |        | 2,096                      |                   |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            | (4,300)           |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            | (1,336)           |
|  |   |        |  |        |  |        |  |        |               |        |                |        |                            | 10,662            |
|  | 5,728,264   | 1      | 30,308,284   | 8      | 36,400,000   | 9      | 26,416,560   | 7      | 61,447,372    | 15     | 9,073,732      | 2      | 61,634                     | 7,037             |

*The accompanying notes are an integral part of these consolidated financial statements.*

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**Xunlei Limited**

**Consolidated statements of changes in shareholders equity (Continued)**

| Series C convertible non-redeemable preferred share |        | Series B convertible non-redeemable preferred shares |        | Series A-1 convertible non-redeemable preferred shares |        | Series A convertible non-redeemable preferred shares |        | Common shares |        | Treasury stock |        | Additional paid-in capital |          | Retained earnings |
|---|--------|--|--------|--|--------|--|--------|---------------|--------|----------------|--------|----------------------------|----------|-------------------|
| Shares  | Amount | Shares   | Amount | Shares   | Amount | Shares   | Amount | Shares        | Amount | Shares         | Amount | Amount                     | Amount   | Amount            |
| 5,728,264   | 1      | 30,308,284   | 8      | 36,400,000   | 9      | 26,416,560   | 7      | 61,447,372    | 15     | 9,073,732      | 2      | 61,634                     | 7,       |                   |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | (717)    | (1,               |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | 52,377   |                   |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | 1,109    |                   |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | (10,229) | (2,               |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | (3,206)  | (                 |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | 57       |                   |
|   |        |  |        |  |        |  |        |               |        |                |        |                            |          | (                 |
|   |        | (3,756,065)  | (1)    | (591,451)  |        | (477,180)  |        | (14,664,637)  | (4)    |                |        |                            | (47,403) | (11,              |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | (49,346) |                   |
|   |        |  |        |  |        |  |        |               |        |                |        |                            | (32,807) |                   |

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**Xunlei Limited**

**Consolidated statements of changes in shareholders' equity (Continued)**

|        | Series B convertible non-redeemable preferred shares |        | Series A-1 convertible non-redeemable preferred shares |        | Series A convertible non-redeemable preferred shares |        | Common shares |        | Treasury stock |        | Additional paid-in capital | Retained earnings | Statutory reserves |
|--------|--|--------|--|--------|--|--------|---------------|--------|----------------|--------|----------------------------|-------------------|--------------------|
| Amount | Shares   | Amount | Shares   | Amount | Shares   | Amount | Shares        | Amount | Shares         | Amount |                            |                   |                    |
| 1)     | (26,552,219)   | (7)    | (35,808,549)   | (9)    | (25,939,380)   | (7)    | 277,834,210   | 71     |                |        | 470,712                    | (4,216)           |                    |
|        |  |        |  |        |  |        |               |        | 24,195,412     | 5      | (5)                        |                   |                    |
|        |  |        |  |        |  |        | 1,431,320     |        | (1,431,320)    |        | 295                        |                   |                    |
|        |  |        |  |        |  |        | 1,563,222     |        | (1,563,222)    |        |                            |                   |                    |
|        |  |        |  |        |  |        |               |        |                |        |                            | 303               |                    |
|        |  |        |  |        |  |        |               |        |                |        | 7,644                      |                   |                    |
|        |  |        |  |        |  |        |               |        |                |        |                            | (654)             | 6                  |
|        |  |        |  |        |  |        |               |        |                |        |                            |                   | 10,812             |

327,611,487 82 30,274,602 7 446,202 574 5,1

*The accompanying notes are an integral part of these consolidated financial statements.*

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**Table of Contents****Xunlei Limited****Consolidated Statement of Cash Flows**

| <b>(Amounts expressed in thousands of USD except for number of shares and per share data)</b> | <b>Years ended December 31,</b> |               |               |
|---|---------------------------------|---------------|---------------|
|   | <b>2012</b>                     | <b>2013</b>   | <b>2014</b>   |
| <b>Cash flows from operating activities</b>   |                                 |               |               |
| Net income  | 382                             | 10,379        | 9,862         |
| Adjustments to reconcile net income to net cash generated from operating activities           |                                 |               |               |
| Depreciation of property and equipment  | 3,994                           | 5,112         | 6,500         |
| Amortization of intangible assets   | 50,578                          | 38,314        | 38,741        |
| Allowance for doubtful accounts   | 3,700                           | 4,921         | 1,767         |
| Loss on disposal of property and equipment  | 5                               |               |               |
| Gain from barter transactions   | (7,472)                         | (2,059)       | (4,428)       |
| Share-based compensation  | 2,233                           | 2,096         | 7,644         |
| Increase/(decrease) in fair value of warrants   | 710                             | (1,531)       | (8,054)       |
| Share of loss / (income) from equity investee   | 45                              | (25)          | 259           |
| Investment income on short-term investments   | (2)                             | (356)         | (317)         |
| Impairment of intangible assets   |                                 | 808           |               |
| Loss on exchange of warrants  |                                 |               | 405           |
| Deemed disposal gain of long-term investments   |                                 |               | (449)         |
| Interest expense accrued for long-term payable  |                                 |               | 163           |
| Deferred taxes  | (123)                           | (822)         | (1,856)       |
| Deferred government grants  | (1,363)                         | (1,284)       | (2,059)       |
| Changes in operating assets and liabilities:  |                                 |               |               |
| Accounts receivable   | (17,831)                        | 13,655        | 4,699         |
| Prepayments and other assets  | (458)                           | (333)         | (9,180)       |
| Due from/to related parties   | 310                             | (96)          | (168)         |
| Accounts payable  | 3,428                           | 5,924         | 2,569         |
| Deferred revenue  | 8,543                           | 12,630        | (2,643)       |
| Income tax payable  | 2,362                           | 116           | (5)           |
| Accrued liabilities and other payables  | 10,873                          | (1,916)       | 4,752         |
| <b>Net cash generated from operating activities</b>   | <b>59,914</b>                   | <b>85,533</b> | <b>48,202</b> |
| <b>Cash flows from investing activities</b>   |                                 |               |               |
| Acquisition of property and equipment   | (7,447)                         | (7,372)       | (7,770)       |
| Proceeds from disposal of fixed assets  | 5                               |               |               |
| Purchase of short-term investments  | (6,523)                         | (246,153)     | (330,471)     |
| Proceeds from disposal of short-term investments  | 2                               | 213,506       | 341,792       |
| Purchase of intangible assets   | (32,554)                        | (36,005)      | (38,056)      |
| Acquisition of long-term investments  | (952)                           | (1,390)       | (2,359)       |
| Acquisition of Kingsoft Cloud Storage business  |                                 |               | (33,000)      |
| Loans to employees  | (2,021)                         | (856)         | (767)         |
| Advance to or repayment of advance from a shareholder   |                                 | (82)          | 85            |

|   |                 |                 |                 |
|---|-----------------|-----------------|-----------------|
| Net cash used in investing activities   | <b>(49,490)</b> | <b>(78,352)</b> | <b>(70,546)</b> |
| <b>Cash flows from financing activities</b>   |                 |                 |                 |
| Issuance of Series D preferred shares   | 32,481          |                 |                 |
| Issuance of Series D warrants   | 3,007           |                 |                 |
| Issuance of Series E preferred shares   |                 |                 | 275,314         |
| Issuance of Series E warrants   |                 |                 | 34,686          |
| Payment of Series E financing expenses  |                 |                 | (343)           |
| Repurchase of shares  |                 |                 | (69,303)        |
| Proceeds from initial public offering (net of underwriters' commissions of USD 7,066) |                 |                 | 93,881          |
| Payment of initial public offering expenses   |                 |                 | (3,504)         |
| Prepayment for share repurchase plan  |                 |                 | (1,000)         |
| Proceeds from bank borrowings   | 20,519          |                 |                 |
| Repayment of bank borrowings  | (41,151)        |                 |                 |
| Governments grants received   | 2,836           | 2,487           | 856             |
| Proceeds from exercise of vested share options  |                 |                 | 1,523           |
| Initial public offering expenses reimbursement received                               |                 |                 | 1,158           |
| Net cash generated from financing activities  | <b>17,692</b>   | <b>2,487</b>    | <b>333,268</b>  |

**Table of Contents****Xunlei Limited****Consolidated Statement of Cash Flows**

| (Amounts expressed in thousands of USD except for number of shares and per share data)                 | Years ended December 31, |               |                |
|--|--------------------------|---------------|----------------|
|  | 2012                     | 2013          | 2014           |
| <b>Net increase in cash and cash equivalents</b>   | <b>28,116</b>            | <b>9,668</b>  | <b>310,924</b> |
| Cash and cash equivalents at beginning of year   | 53,349                   | 81,906        | 93,906         |
| Effect of exchange rates on cash and cash equivalents  | 441                      | 2,332         | (555)          |
| <b>Cash and cash equivalents at end of year</b>  | <b>81,906</b>            | <b>93,906</b> | <b>404,275</b> |
| <b>Supplemental disclosure of cash flow information</b>  |                          |               |                |
| Interests paid   | 1,438                    |               |                |
| Income tax paid  |                          |               | 241            |
| Non cash investing and financing activities  |                          |               |                |
| Acquisition of property and equipment in form of other payables  | 1,344                    | 4,157         | 240            |
| Initial public offering expenses in form of other payables   |                          |               | 712            |
| Purchase of intangible assets in form of accounts payable  | 25,048                   | 25,695        | 21,860         |
| Acquisition of intangible assets in form of barter transactions  | 6,650                    | 4,058         | 4,030          |
| Beneficial Conversion Feature of Series C convertible preferred shares from their modifications        | 286                      |               |                |
| Deemed contribution from Series C preferred shareholders   | (2,979)                  |               |                |
| Accretion to Series D preferred shares redemption value  | 3,509                    | 4,300         | 1,870          |
| Contingent beneficial conversion feature of series C to one Series C shareholder                       |                          |               | 57             |
| Deemed dividend to Series D shareholder from its modification  |                          |               | 279            |
| Accretion of Series E to convertible redeemable preferred shares redemption value                      |                          |               | 12,754         |
| Amortization of beneficial conversion feature of Series E  |                          |               | 4,139          |
| Deemed dividend to certain shareholders from repurchase of shares                                      |                          |               | 14,926         |
| Acceleration of amortization of beneficial conversion feature of Series E upon initial public offering |                          |               | 49,346         |
| Deemed dividend to preferred shareholders upon initial public offering                                 |                          |               | 32,807         |

*The accompanying notes are an integral part of these consolidated financial statements.*

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****1. Organization and nature of operations**

Xunlei Limited, previously known as Giganology Limited, (the Company) was incorporated under the law of the Cayman Islands (Cayman) as a limited liability company on February 3, 2005. The accompanying consolidated financial statements include the financial statements of the Company, its subsidiaries, its variable interest entity (VIE) and the VIE's subsidiaries (collectively referred to as the Group) as follows:

| <b>Name of entities</b>   | <b>Place of incorporation</b> | <b>Date of incorporation</b> | <b>Relationship</b> | <b>% of direct or indirect economic ownership</b> | <b>Principal activities</b>   |
|---|-------------------------------|------------------------------|---------------------|---|---|
| Shenzhen Xunlei Networking Technologies, Co., Ltd (Shenzhen Xunlei)   | China                         | January 2003                 | VIE                 | 100%  | Development of software, provision of online and related advertising, membership subscription and online game services; as well as sales of software licenses |
| Giganology (Shenzhen) Co. Ltd (Giganology Shenzhen)   | China                         | June 2005                    | Subsidiary          | 100%  | Development of computer software and provision of information technology services to related companies  |
| Shenzhen Fengdong Networking Technologies, Co., Ltd. (Fengdong)   | China                         | December 2005                | VIE's subsidiary    | 100%  | Development of software for related companies   |
| Shenzhen Xunlei Kankan Information Technologies Co., Ltd (formerly known as 155 Networking (Shenzhen) Co., Ltd) | China                         | August 2008                  | VIE's subsidiary    | 100%  | Development of software for related companies   |
| Xunlei Software (Beijing) Co., Ltd (Xunlei  | China                         | June 2009                    | VIE's subsidiary    | 100%  | Development of software for related   |



|  |       |              |                     |      |   |
|--|-------|--------------|---------------------|------|---|
| Beijing )  |       |              |                     |      | companies   |
| Xunlei Software (Shenzhen)<br>Co., Ltd ( Xunlei Software ) | China | January 2010 | VIE s<br>subsidiary | 100% | Provision of software<br>technology<br>development for related<br>companies |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****1. Organization and nature of operations (Continued)**

| <b>Name of entities</b>                                    | <b>Place of incorporation</b> | <b>Date of incorporation</b> | <b>Relationship</b> | <b>% of direct or indirect economic ownership</b> | <b>Principal activities</b>  |
|--|-------------------------------|------------------------------|---------------------|---|--|
| Xunlei Software (Nanjing) Co., Ltd.<br>( Xunlei Nanjing )  | China                         | January 2010                 | VIE s subsidiary    | 100%  | Development of computer software and online games for related companies and provision of advertising services (note a) |
| Xunlei Games Development (Shenzhen) Co., Ltd.              | China                         | February 2010                | VIE s subsidiary    | 70%   | Development of online game and computer software for related companies and provision of advertising services           |
| Xunlei Network Technologies Limited<br>( Xunlei BVI )      | British Virgin Islands        | February 2011                | Subsidiary          | 100%  | Holding company  |
| Xunlei Network Technologies Limited<br>( Xunlei HK )       | Hongkong                      | March 2011                   | Subsidiary          | 100%  | Development computer software of related companies and provision of advertising services                               |
| Xunlei Computer (Shenzhen) Co., Ltd<br>( Xunlei Computer ) | China                         | November 2011                | Subsidiary          | 100%  | Development of computer software and provision of information technology services to related companies                 |
| Shenzhen Wangxin Technologies Co., Ltd<br>( Wangxin )      | China                         | September 2013               | VIE s subsidiary    | 100%  | Development of computer software and provision of information technology services to related                           |

Note a: In January 2011, the equity owners of Xunlei Nanjing resolved to liquidate the subsidiary. In May 2012, Xunlei Nanjing was approved to be de-registered by the relevant government authorities. There was no significant financial impact to the consolidated financial statements of the Group.

Note b: The English names of the PRC companies represent management's translation of the Chinese names of these companies as these companies have not adopted formal English names.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**1. Organization and nature of operations (Continued)**

The Group engages primarily in the provision of online advertising services on its websites, premium downloading services to its members, online video sharing and distribution and online game platforms for game developers and users.

To comply with PRC laws and regulations that prohibit or restrict foreign ownership of companies that provide online advertising services, operate online games, and hold Internet Content Provider ( ICP ) license and the License for Transmission of Audio-Visual Programs through the internet ( the Licenses ), the company conducts its business through Shenzhen Xunlei, its consolidated VIE.

Through the various agreements enacted among the Company, Giganology Shenzhen, a wholly owned subsidiary of the Company, Shenzhen Xunlei and legal shareholders of Shenzhen Xunlei (the Restructuring ), the Company received all of the economic benefits and residual interest and absorbed all of the risks and expected losses from Shenzhen Xunlei.

Details of certain key agreements with the VIE are as follows:

**Loan Agreements** between Giganology Shenzhen and the shareholders of Shenzhen Xunlei Giganology Shenzhen provided interest-free loans of RMB 9 million to the shareholders of Shenzhen Xunlei for them to make contributions as registered capital into Shenzhen Xunlei. The term of these agreements last for two years from the date it was signed, and will be automatically extended afterwards on a yearly basis until each shareholder of Shenzhen Xunlei has repaid the loans in its entirety in accordance with the loan agreement. The shareholders would not be allowed to transfer their interests in Shenzhen Xunlei without prior consent of Giganology Shenzhen. According to the loan agreements, the loans can only be repaid in the form of common shares of Shenzhen Xunlei. At any time during the term of the loan agreements, Giganology Shenzhen may, at their sole discretion, requires any of the shareholders of Shenzhen Xunlei to repay all or any portion of their outstanding loan under the agreement.

Under a separate loan agreement between Giganology Shenzhen and Mr. Sean Shenglong Zou as a shareholder of Shenzhen Xunlei, Giganology Shenzhen made an additional interest-free loan of RMB20 million to Mr. Sean Shenglong Zou, the entire amount of which was contributed to the registered capital of Shenzhen Xunlei, increasing the registered capital of Shenzhen Xunlei to RMB30 million. The term of this agreement last for two years from the date it was signed, and will be automatically extended afterwards on a yearly basis until Mr. Zou has repaid the loan in its entirety in accordance with the loan agreement. This loan will be deemed to be repaid when all equity interest held by the shareholders in Shenzhen Xunlei has been transferred to Giganology Shenzhen or its designated parties. At any time during the term of this loan agreement, the Company may, at their sole discretion, require all or any portion of the outstanding loan under the agreement to be repaid.

**Business Operation Agreements** between Giganology Shenzhen and Shenzhen Xunlei Under these agreements, Giganology Shenzhen has the rights to direct the operating activities of Shenzhen Xunlei, including the appointment of senior management. The shareholders of Shenzhen Xunlei also transferred all their shareholders' rights to Giganology Shenzhen. The term of this agreement will expire in 2016 and may be extended with Giganology Shenzhen's confirmation prior to the expiration date. For instance, in May 2011, Shenzhen Xunlei sought and obtained consent from Giganology Shenzhen and the Company to increase its registered capital by RMB20 million and to revise its articles of association accordingly. The term of this agreement will expire in 2016 and may be extended with Giganology Shenzhen's confirmation prior to the expiration date.

**Equity Pledge Agreement** between Giganology Shenzhen and the shareholders of Shenzhen Xunlei Under this agreement, the shareholders of Shenzhen Xunlei pledged all of their equity interests in Shenzhen Xunlei to Giganology Shenzhen. If Shenzhen Xunlei and/or its shareholders breach their contractual obligations under this agreement, Giganology Shenzhen, as pledgee, will be entitled to certain rights, including the right to sell the pledged equity interests.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**1. Organization and nature of operations (Continued)**

**Power of Attorney** Each shareholder of Shenzhen Xunlei appointed Giganology Shenzhen as its attorney-in-fact to exercise their shareholders' rights in Shenzhen Xunlei, including shareholders' voting rights. Each power of attorney will remain in force for 10 years unless the business operation agreement among Giganology Shenzhen, Shenzhen Xunlei and the shareholders of Shenzhen Xunlei is terminated in advance. This period may be extended at Giganology Shenzhen's discretion.

**Service Agreements** between Giganology Shenzhen and Shenzhen Xunlei Under various service agreements, Giganology Shenzhen will provide services including technical support, training, as well as consulting services to Shenzhen Xunlei in exchange for a service fee. These service agreements include the Exclusive Technology Support and Services Agreement, the Exclusive Technology Consulting and Training Agreement and the Software and Proprietary Technology License Contract. Giganology Shenzhen is entitled to service fees equal to 20%, 20% and 40% of the pre-tax operating profit of Shenzhen Xunlei according to the terms and provisions of these agreements, respectively (in aggregate 80% of pre-tax operating profit of Shenzhen Xunlei). In addition, these agreements also allow both parties to review and adjust the above mentioned percentage every six months according to the business operation and income of Shenzhen Xunlei so as to enable Giganology Shenzhen to extract substantially all the after tax operating profit of Shenzhen Xunlei. The amount of service fees payable from Shenzhen Xunlei to Giganology Shenzhen for the years ended December 31, 2012, 2013 and 2014 was USD 1,494 thousand, USD nil and USD 1,228 thousand, respectively.

For the Exclusive Technology Support and Services Agreement and the Exclusive Technology Consulting and Training Agreement, the term of these agreements will expire in 2025 and may be extended with Giganology Shenzhen's written confirmation prior to the expiration date. Giganology Shenzhen is entitled to terminate the agreement at any time by providing 30 days' prior written notice to Shenzhen Xunlei.

For the Proprietary Technology License Contract, the term of this contract will expire in 2022 and may be extended with Giganology Shenzhen's written confirmation prior to the expiration date. Giganology Shenzhen grants Shenzhen Xunlei a non-exclusive and non-transferable right to use Giganology Shenzhen's proprietary technology. Shenzhen Xunlei can only use the proprietary technology to conduct business according to its authorized business scope. Giganology Shenzhen or its designated representative(s) owns the rights to any new technology developed due to implementation of this contract.

**Intellectual Properties Purchase Option Agreement** between Giganology Shenzhen and Shenzhen Xunlei. Giganology Shenzhen has an option to acquire Shenzhen Xunlei's intellectual properties at the lowest price permissible by the then-applicable PRC laws and regulation. The term of this contract will expire in 2022 and may be automatically extended for an additional 10 years at Giganology Shenzhen's discretion.

**Call Option Agreement** Giganology Shenzhen has an option to acquire all of the outstanding shares of Shenzhen Xunlei at a purchase price equal to RMB 1 or the lowest price permissible by the then-applicable PRC laws and regulation. The term of the agreement will expire in 2022 and may be extended at Giganology Shenzhen's discretion.

As a result of these agreements (collectively defined as Structured Service Contracts), Giganology Shenzhen can exercise effective control over Shenzhen Xunlei, receives all of the economic benefits and residual interest and absorbs all of the risks and expected losses from Shenzhen Xunlei as if it were the sole shareholder, and has an exclusive option to purchase all of the equity interest in Shenzhen Xunlei at a minimal price. Therefore, Giganology Shenzhen is considered the primary beneficiary of Shenzhen Xunlei and accordingly Shenzhen Xunlei's results of operations, assets and liabilities have been consolidated in the Company's financial statements.

On December 24, 2013, for purposes of developing the Group's computer software and information technology capability, Shenzhen Xunlei and Xunlei Computer entered into a technology development and software licenses framework agreement. The term of the agreement is two years from the date of its execution. Under this framework agreement, Xunlei Computer provides Shenzhen Xunlei with technology development services according to Shenzhen Xunlei's business needs. Any new intellectual property resulting from the technology development services is owned by Xunlei Computer, and cannot be substituted or sub-licensed to any third party by Shenzhen Xunlei without the prior written consent of Xunlei Computer. The framework agreement signed between Shenzhen Xunlei and Xunlei Computers does not have an impact on the Structured Services Contracts with Shenzhen Xunlei.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**1. Organization and nature of operations (Continued)**

**VIE-Related Risks**

It is possible that the Group's operation of certain of its operations and businesses through VIEs could be found by PRC authorities to be in violation of PRC law and regulations prohibiting or restricting foreign ownership of companies that engage in such operations and businesses. While the Group's management considers the possibility of such a finding by PRC regulatory authorities under current law and regulations to be remote, on January 19, 2015, the Ministry of Commerce of the PRC, or (the MOFCOM) released on its Website for public comment a proposed PRC law (the Draft FIE Law) that appears to include VIEs within the scope of entities that could be considered to be foreign invested enterprises (or FIEs) that would be subject to restrictions under existing PRC law on foreign investment in certain categories of industry. Specifically, the Draft FIE Law introduces the concept of actual control for determining whether an entity is considered to be an FIE. In addition to control through direct or indirect ownership or equity, the Draft FIE Law includes control through contractual arrangements within the definition of actual control. If the Draft FIE Law is passed by the People's Congress of the PRC and goes into effect in its current form, these provisions regarding control through contractual arrangements could be construed to reach the Group's VIE arrangements, and as a result the Group's VIEs could become explicitly subject to the current restrictions on foreign investment in certain categories of industry. The Draft FIE Law includes provisions that would exempt from the definition of foreign invested enterprises entities where the ultimate controlling shareholders are either entities organized under PRC law or individuals who are PRC citizens. The Draft FIE Law does not make clear how control would be determined for such purpose, and is silent as to what type of enforcement action might be taken against existing VIEs that operate in restricted industries and are not controlled by entities organized under PRC law or individuals who are PRC citizens. If a finding were made by PRC authorities, under existing law and regulations or under the Draft FIE Law if it becomes effective, that the Group's operation of certain of its operations and businesses through VIEs, regulatory authorities with jurisdiction over the licensing and operation of such operations and businesses would have broad discretion in dealing with such a violation, including levying fines, confiscating the Group's income, revoking the business or operating licenses of the affected businesses, requiring the Group to restructure its ownership structure or operations, or requiring the Group to discontinue all or any portion of its operations. Any of these actions could cause significant disruption to the Group's business operations, and have a severe adverse impact on the Group's cash flows, financial position and operating performance.

In addition, it is possible that the contracts among the Group, the Group's VIEs and shareholders of its VIEs would not be enforceable in China if PRC government authorities or courts were to find that such contracts contravene PRC law and regulations or are otherwise not enforceable for public policy reasons. In the event that the Group was unable to enforce these contractual arrangements, the Group would not be able to exert effective control over the affected VIEs. Consequently, such VIE's results of operations, assets and liabilities would not be included in the Group's consolidated financial statements. If such were the case, the Group's cash flows, financial position and operating performance would be severely adversely affected. The Group's contractual arrangements with respect to its consolidated VIEs are approved and in place. The Group's management believes that such contracts are enforceable, and considers the



possibility remote that PRC regulatory authorities with jurisdiction over the Group's operations and contractual relationships would find the contracts to be unenforceable.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**1. Organization and nature of operations (Continued)**

**Share split**

On January 21, 2011, the Company effected a 4 for 1 share split of all of its outstanding common shares and a proportional adjustment to the existing conversion ratios for preferred Series A, Series A-1 and Series B shares.

**Initial public offering**

The Company completed its initial public offering ( IPO ) on June 24, 2014 on the NASDAQ Global Market and the underwriters subsequently exercised their over-allotment option on June 27, 2014. The Company issued and sold a total of 8,412,250 American Depositary Shares ( ADSs ) pursuant to these transactions. Each ADS represents five common shares. The net proceeds received by the Company, after deducting commissions and offering expenses, amounted to approximately US\$ 89,665 thousand. Upon the completion of the IPO, all of the Company's outstanding preferred shares were converted into common shares immediately as of the same date.

**2. Summary of significant accounting policies**

**(a) Basis of presentation and use of estimates**

The accompanying consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( U.S. GAAP ). Significant accounting policies followed by the Group in the preparation of the accompanying consolidated financial statements are summarized below.

The Restructuring was accounted for at historical costs. The assets and liabilities of Shenzhen Xunlei are consolidated in the Company's financial statements at carryover basis.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying consolidated financial statements and related disclosures. Actual results could differ materially from these estimates. Significant accounting estimates reflected in the Group's consolidated financial statements mainly include the useful lives of property and equipment, allowance for doubtful accounts, valuation allowance of deferred tax assets, sales rebate to advertising agencies, amortization period of online game revenue, amortization of content copyrights, fair value of content copyrights exchange, impairment assessment of goodwill and impairment assessment of long-lived assets. In addition, the Group uses assumptions in a valuation model to estimate the fair value of share options granted, warrants issued and underlying common shares.

Management bases the estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results could differ from these estimates.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(b) Consolidation**

The consolidated financial statements include the financial statements of the Company, its subsidiaries, VIE for which the Company is the primary beneficiary and its subsidiaries. All significant transactions and balances among the Company, its subsidiaries, VIE and its subsidiaries have been eliminated upon consolidation.

A subsidiary is an entity in which the Company, directly or indirectly, controls more than one-half of the voting power, or has the power to appoint or remove the majority of the members of the board of directors to cast majority of votes at meetings of the board of directors or to govern the financial and operating policies of the investee under a statute or agreement among the shareholders or equity holders.

An entity is considered to be a VIE if the entity's equity holders do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

The Group consolidates entities for which the Company is the primary beneficiary if the entity's equity holders do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties.

In determining whether the Company or its subsidiary is the primary beneficiary of a VIE, the Company considered whether it has the power to direct activities that are significant to the VIE's economic performance, including the power to appoint senior management, right to direct company strategy, power to approve capital expenditure budgets, and power to establish and manage ordinary business operation procedures and internal regulations and systems.

Management has evaluated the contractual arrangements among Giganology Shenzhen, Shenzhen Xunlei and its shareholders and concluded that Giganology Shenzhen receives all of the economic benefits and absorbs all of the expected losses from Shenzhen Xunlei and has the power to direct the aforementioned activities that are significant to Shenzhen Xunlei's economic performance, and is the primary beneficiary of Shenzhen Xunlei. Therefore, Shenzhen Xunlei and its subsidiaries' results of operation, assets and liabilities have been included in the Group's consolidated financial statements. Management monitors the regulatory risk associated with these contractual arrangements. See Note 26 for further discussion.

Non-controlling interests represent the portion of the net assets of a subsidiary attributable to interests that are not owned by the Company. The non-controlling interests are presented in the consolidated balance sheets, separately from equity attributable to the shareholders of the Company. Non-controlling interests in the results of the Group is presented on the face of the consolidated statements of comprehensive income as an allocation of the total income or loss for the year/period between non-controlling shareholders and the shareholders of the Company.

**(c) Business combinations**

The Group accounts for acquisitions of entities that include inputs and processes and have the ability to generate economic benefit as business combinations. The Group allocates the purchase price of the acquisition to the tangible assets and identifiable intangible assets acquired based on their estimated fair values. The excess of the purchase price over those fair values is recorded as goodwill. Acquisition-related costs are expensed as incurred.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(d) Foreign currency translation**

The Company's reporting and functional currency is the United States Dollar ( USD ). Xunlei BVI and Xunlei HK's functional currency is the USD. The functional currency of other subsidiaries, VIE and its subsidiaries located in the PRC is the Renminbi ( RMB ), which is their respective local currency. Transactions denominated in foreign currencies are remeasured into the functional currency at the exchange rates prevailing on the transaction dates. Financial assets and liabilities denominated in foreign currencies are remeasured into the functional currency using the applicable exchange rates prevailing at the balance sheet date. The resulting exchange gains and losses from foreign currency transactions are included in other income (loss) within the consolidated statements of comprehensive income.

The Company uses the monthly average exchange rate for the year and the exchange rates at the balance sheet date to translate the operating results and financial position, respectively, of its subsidiaries whose functional currency is other than the USD. The resulting translation differences are recorded in cumulated translation adjustments, a component of shareholders' equity.

The exchange rate used is released by Chinese State Administration of Foreign Exchange.

**(e) Cash and cash equivalents**

Cash and cash equivalents include cash on hand, cash in bank and time deposits placed with banks or other financial institutions, which have original maturities of three months or less and are readily convertible to known amounts of cash.

**(f) Short-term investments**

Short-term investments include deposits placed with banks with original maturities of more than three months but less than one year and investments in financial instruments with a variable interest rate indexed to the performance of underlying assets. In accordance with *ASC 825 Financial Instruments*, for investments in financial instruments with a variable interest rate indexed to performance of underlying assets, the Group elected the fair value method at the date of initial recognition and carried these investments subsequently at fair value. Changes in the fair value are reflected in the consolidated statements of comprehensive income. Interest generated from short term investments are recorded when interest payments are received at the maturity date. It is recorded as other income on the statement of comprehensive income and measured based on the actual amount of interest the Group received.

**(g) Fair value of financial instruments**

The Group's financial instruments consist principally of cash and cash equivalents, short-term investments, accounts receivable, other receivables, amounts due from/(to) related parties, accounts payable, other payables and warrants liabilities. The carrying value of these balances, with the exception of short-term investments (see note 2 (e)), approximates their fair value due to the current and short term nature of these balances.

**(h) Accounts receivable, net**

Accounts receivable are presented net of allowance for doubtful accounts. The Group evaluates the creditworthiness of each customer at the time when services are rendered and continuously monitor the recoverability of the accounts receivable.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(h) Accounts receivable, net (Continued)**

The Group uses specific identification method in providing for bad debts when facts and circumstances indicate that collection is doubtful and a loss is probable and estimable. If the financial conditions of its customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances might be required. The allowance for doubtful accounts is based on the best facts available and is re-evaluated and adjusted on a regular basis as additional information is received.

Some of the factors that the Group considers in determining whether a bad debt allowance is recorded on an individual customer are:

- 1) the customer's past payment history and whether it fails to comply with its payment schedule;
- 2) whether the customer is in financial difficulty due to economic or legal factors;
- 3) a significant dispute with the customer has occurred;
- 4) the objective evidence which indicates non-collectability of the accounts receivable.

The allowances provided for Accounts Receivable as of December 31, 2013 and 2014 were USD12.1 million and USD9.4 million, respectively.

If the Group determines that an allowance is needed for a customer, the Group will discontinue business with them unless they start to resume payment. The accounts receivable is written-off when the Group ceases pursuing collection. Any changes in the estimates may cause the Group's operating results to fluctuate.

**(i) Long-term investments**

The Group holds investments in privately held companies. The Group accounts for these investments over which it has significant influence but does not own a majority equity interest or otherwise control using the equity method of accounting. For investments in an investee over which the Group does not have significant influence and of which the investee has no readily determinable fair value, the Group carries the investment using the cost method. Under the cost method, the investment is measured initially at cost. The investment carried at cost should recognize income when dividends are received from the distribution of the investee's earnings. The Group assesses its long-term investments for other-than-temporary impairment by considering factors including, but not limited to, current



economic and market conditions, operating performance of the companies, including current earnings trends and undiscounted cash flows, and other company-specific information. The fair value determination, particularly for investments in privately-held companies, requires significant judgment to determine appropriate estimates and assumptions. Changes in these estimates and assumptions could affect the calculation of the fair value of the investments and determination of whether any identified impairment is other-than-temporary. During the years ended December 31, 2012, 2013 and 2014, the Group did not impair any of its long-term investments.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****2. Summary of significant accounting policies (Continued)****(j) Property and equipment**

Property and equipment are stated at historical cost less accumulated depreciation and impairment loss, if any. Depreciation is calculated using the straight-line method over their estimated useful lives. Residual rate is determined based on the economic value of the asset at the end of the estimated useful life as a percentage of the original cost.

|  | <b>Estimated useful lives</b>    | <b>Residual rate</b> |
|--|----------------------------------|----------------------|
| Servers and network equipment            | 5 years                          | 5%                   |
| Computer equipment                       | 5 years                          | 5%                   |
| Furniture, fittings and office equipment | 5 years                          | 5%                   |
| Motor vehicles                           | 5 years                          | 5%                   |
| Leasehold improvements                   | shorter of lease term or 3 years |                      |

Repair and maintenance costs are expensed as incurred. Expenditures that substantially increase an asset's useful life are capitalized. Upon sale or disposition, gain or loss on the disposal of property and equipment is the difference between the net sales proceeds and the carrying amount of the relevant assets and is recognized in the consolidated statements of operations. The cost and related accumulated depreciation are removed from the financial statements.

**(k) Goodwill**

Goodwill represents the excess of the purchase price over the amounts assigned to the fair value of the assets acquired and the liabilities assumed of an acquired business.

**(l) Impairment of goodwill**

Impairment of goodwill assessment is performed on at least an annual basis on December 31 or whenever events or changes in circumstances indicate that the carrying value of the asset may not be recoverable. According to ASC 350-20-35, an entity may assess qualitative factors to determine whether it is more likely than not (that is, a likelihood of more than 50 percent) that the fair value of a reporting unit is less than its carrying amount, including goodwill. But the Group selects proceed directly to perform a two-step goodwill impairment test. The first step compares the fair values of a reporting unit to its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill is not considered impaired and the second step will not be required. If the carrying amount of a reporting unit exceeds its fair value, the second step compares the implied fair value of the affected reporting unit's goodwill to the carrying value of that goodwill. The implied fair value of goodwill is determined in a manner

similar to accounting for a business combination with the allocation of the assessed fair value determined in the first step to the assets and liabilities of the reporting unit. The excess of the fair value of the reporting unit over the amounts assigned to the assets and liabilities is the implied fair value of goodwill. This allocation process is only performed for purposes of evaluating goodwill impairment and does not result in an entry to adjust the value of any assets or liabilities. An impairment loss is recognized for any excess in the carrying value of goodwill over the implied fair value of goodwill. The judgment in estimating the fair value of a reporting unit includes estimating future cash flows, determining appropriate discount rates and making other assumptions. Changes in these estimates and assumptions could materially affect the determination of the fair value of a reporting unit.

No goodwill impairment losses were recognized for the year ended December 31, 2014.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(m) Intangible assets**

**1) Content copyrights**

Licensed copyrights of movies, TV series and variety shows (collectively Content Copyrights ) are capitalized when 1) the cost of the content is known 2) the content has been accepted by the Group in accordance with the conditions of the license agreement and 3) the content is available for its first showing on the Group's website. Content Copyrights are carried at cost less accumulated amortization and impairment loss, if any.

The Group has two types of Content Copyrights, 1) non-exclusive Content Copyrights and 2) exclusive Content Copyrights. With non-exclusive Content Copyrights, the Group has the right to broadcast the contents on its own websites. While, with exclusive Content Copyrights, besides the broadcasting right, the Group also has the right to sub-license these exclusive Content Copyrights to third parties.

For non-exclusive Content Copyrights, which only generates primarily indirect cash flows, the amortization method is based on the analysis of historical viewership consumption patterns. The Group determines consumption patterns by tracking the number of viewers watching the content throughout its life cycle. This information is then aggregated to come up with a viewership trend that can support an appropriate method to amortize non-exclusive Content Copyrights. The Group generally categorizes its contents in the Xunlei Kankan website into three broad categories, namely movies; TV series; and variety shows and others, which include reality shows, talent shows, talk shows and entertainment news. Prior to April 1, 2011, the Group concluded there was insufficient historical viewership data to support a demonstrative pattern in viewership of the Group's non-exclusive Content Copyrights. Therefore, the Group has determined that a straight line method of amortization over the estimated useful lives of the related non-exclusive Content Copyright provides the right level of expenses attribution. Effective April 1, 2011, based on an accumulation of data gathered on historical viewing patterns of the non-exclusive Content Copyrights, the Group revised the method to amortize new release of non-exclusive Content Copyrights over the shorter of estimated useful lives or their respective licensing periods using an accelerated method based on consumption patterns. Estimates of the consumption patterns for these non-exclusive Content Copyrights are reviewed periodically and revised, if necessary.

Exclusive Content Copyrights generate both direct and indirect cash flows. For the portion of exclusive Content Copyrights that generate indirect cash flows, the Group uses the amortization method based on the analysis of historical viewership consumption patterns, which is the same with that of non-exclusive Content Copyright as discussed above.

For the portion of exclusive Content Copyrights that generates direct cash flows, the Group amortizes the purchase costs using an individual-film-forecast-computation method, which amortizes such costs based on the ratio of sub-licensing revenue and barter transaction gain (details described in Note 2(r)) generated for the current period to

the total ultimate direct revenue estimated to be generated by the exclusive Content Copyrights for their whole license period or estimated useful lives. The Group revisits the forecast at each quarter or year end and makes adjustment, when appropriate.

II) Other intangible assets

Other intangible assets, which include computer software, internal use software development costs, online game licenses, domain names, land use right, trademarks, technology (including right-to-use) and non-compete agreement, are carried at cost less accumulated amortization and impairment loss, if any. Exclusive game licenses are amortized using the straight-line method over their licensing period of three years. Computer software, internal use software and domain name are amortized using the straight-line method over their estimated useful life of five years. Land use right is amortized using the straight-line method over their estimated useful life of thirty years.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(n) Impairment of long-lived assets**

The Group evaluates the program usefulness of non-exclusive Content Copyrights and exclusive Content Copyrights pursuant to the guidance in *ASC 920-350 Intangible Goodwill and Other: Recognition*, which provides that such rights be reported at the lower of unamortized cost or estimated net realizable value.

For non-exclusive Content Copyrights which only generate indirect cash flows, the Group evaluates the net realizable value of the content library by its three content categories (i.e. movies, TV series, variety shows and others). If management's expectations of programming usefulness, which represents the expected revenues and related net cash flows derived from the contents, are revised downward, they assess whether it is necessary to write down the unamortized costs to estimated net realizable value. The Group evaluates programming usefulness by category on an annual basis by comparing the unamortized cost to the estimated net realizable value. On a quarterly basis, the Group also monitors whether there are indicators of changes in their expected usage of program materials.

The Group estimates net realizable value using expected net cash flows of the content based on expected future levels of advertising revenues. Such estimates consider historical amounts and anticipated levels of demand. Expected future revenues are reduced by estimated direct costs to provide access to the website and generate the related revenue, including bandwidth costs and server costs. For purposes of estimating revenues for each category of content, the Group considers both expected future advertising revenues sold based on number of impressions delivered as well as advertising sold based on the period of time that it is displayed.

For exclusive Content Copyrights that generate both direct and indirect cash flows, the Group evaluates the net realizable value of the Group's licensed copyright on a content by content basis. Impairment is assessed on an annual basis by comparing the unamortized cost to the Group's estimated net realizable value. The Group estimates the net realizable value using expected net cash flows based on expected future levels of advertising and content sub-licensing revenues. For expected future levels of advertising revenue, the Group uses the same estimation methodology used for the impairment assessment of non-exclusive Content Copyrights.

For both exclusive and non-exclusive Content Copyrights, there were no impairments for the years ended December 31, 2012, 2013 and 2014 because a significant portion of the contents was related to movies and TV series, of which approximately 70% to 90% of the purchase costs of the Content Copyrights had already been amortized during the first year of the licensed period. As such, the unamortized carrying amounts were lower than the respective net realizable values when the impairment assessment was performed.

For other long-lived assets, the Group evaluates its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may no longer be recoverable. The Group assesses the recoverability of the long-lived assets by comparing the carrying value of the long-lived assets to the estimated undiscounted future cash flows expected to be received from use of the assets and their eventual disposition at the

lowest level of identifiable cash flows. Such assets are considered to be impaired if the sum of the expected undiscounted cash flows is less than the carrying amount of the assets. If the Group identifies an impairment, the carrying value of the asset will be reduced to its estimated fair value based on a discounted cash flow approach or, when available and appropriate, to comparable market values. The impairment of online game license were USD nil, USD 808 thousand and USD 808 thousand as of December 31, 2012, 2013 and 2014, respectively.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(o) Commitments and contingencies**

In the normal course of business, the Group is subject to contingencies, such as legal proceedings and claims arising out of its business, that cover a wide range of matters. Liabilities for such contingencies are recorded when it is probable that a liability has been incurred and the amount of the assessment can be reasonably estimated. In regards to legal cost, the Group recorded such costs as incurred.

Certain conditions may exist as of the date the financial statements are issued, which may result in a loss to the Group, but which will only be resolved when one or more future events occur or fail to occur. The Group's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Group or unasserted claims that may result in such proceedings, the Group, in consultation with its legal counsel, evaluates the perceived merits of any legal proceedings or unasserted claims as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Group's financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss, if determinable and material, would be disclosed.

**(p) Operating leases**

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating lease are charged to the statements of comprehensive income on a straight-line basis over the period of the lease.

**(q) Revenue recognition**

The Group generates revenues from various streams. The Group operates a prepaid virtual items system, under which, prepaid virtual items at fixed face value are sold to third parties. Virtual items purchased can be used to subscribe for membership or purchase of virtual items in online games, as discussed below. Virtual items sold but not yet consumed by the users are recorded as Receipts in advance from customers and upon consumption, they are recognized as membership subscription and online game revenue according to the respective prescribed revenue recognition policies addressed below.





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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(q) Revenue recognition (Continued)**

**I) Subscription revenues**

The Group operates a VIP membership program where VIP members can have access to high speed online acceleration services, online streaming and other access privileges. The membership fee is time-based and is collected up-front from subscribers except in the cases when they elect to pay via their mobile operators. The membership fee is collected when the subscribers pay for the monthly phone bills. The terms of time-based subscriptions range from one month to twelve months, with the subscribers having the option to renew the contract. The receipt of subscription fee is initially recorded as deferred revenue and revenue is recognized ratably over the period of subscription as services are rendered. Unrecognized portion beyond 12 months from balance sheet date is classified as a long-term liability. The Group evaluated the principal versus agent criteria and determined that the Group is the principal in the transaction and accordingly record revenue on a gross basis. In determining whether to report revenues gross for the amount of subscription revenue, the Group assesses whether it maintains the principal relationship with the VIP members, whether it bears the credit risk and whether it establishes prices for the end users. Service fees levied by online system, fixed phone line and mobile payment channels ( Payment Handling Fees ) are recorded as the cost of revenues in the same period as the revenue for the membership fee is recognized.

**II) Advertising revenues**

Advertising revenues are derived principally from arrangements where the customers pay to place their advertisements on the Group's platform in different formats over a particular period of time. Such formats generally includes but not limited to videos, banners, links, logos and buttons. Advertisements on the Group's platform are generally charged on the basis of duration, and advertising contracts are signed to establish the fixed price and the advertising services to be provided. The Group enters into advertising contracts with third party advertising agencies that represents advertisers, as well as directly with advertisers. A typical contract term would range from a few days to 3 months. Both third party advertising agencies and direct advertisers are generally billed at the end of the display period and payments are due usually within 3 months.

Where the Group's customers purchase multiple advertising spaces with different display periods in the same contract, the Group allocates the total consideration to the various advertising elements based on their relative fair values and recognizes revenue for the different elements over their respective display periods. The Group determines the fair values of different advertising elements based on the prices charged when these elements were sold on a standalone basis. The Group recognizes revenue on the elements delivered and defers the recognition of revenue for the fair value of the undelivered elements until the remaining obligations have been satisfied. Where all of the elements within an arrangement are delivered uniformly over the agreement period, the revenue is recognized on a straight line basis over

the contract period.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(q) Revenue recognition (Continued)**

**II) Advertising revenues (Continued)**

*Transactions with third party advertising agencies*

For contracts entered into with third party advertising agencies, the third party advertising agencies will in turn sell the advertising services to advertisers. Revenue is recognized ratably over the contract period of display based on the following criteria:

There is persuasive evidence that an arrangement exists the Group will enter into framework and execution agreements with the advertising agencies, specifying price, advertising content, format and timing

Price is fixed and determinable prices charged to the advertising agencies are specified in the agreements, including relevant discount and rebate rates

Services are rendered the Group recognizes revenue ratably over the contract period of display

Collectability is reasonably assured the Group assesses credit history of each advertising agency before entering into any framework and execution agreements. If the collectability from the agencies is assessed as not reasonably assured, the Group recognizes revenue only when the cash is received and all the other revenue criteria are met.

The Group provides sales incentives in the forms of discounts and rebates to third party advertising agencies based on purchase volume. As the advertising agencies are viewed as the customers in these transactions, revenue is recognized based on the price charged to the agencies, net of sales incentives provided to the agencies. Sales incentives are estimated and recorded at the time of revenue recognition based on the contracted rebate rates and estimated sales volume based on historical experience.

*Transactions with advertisers*

The Group also enters into advertisement contracts directly with advertisers. Under these contracts, similar to transactions with third party advertising agencies, the Group recognizes revenue ratably over the contract period of display. The terms and conditions, including price, are fixed according to the contract between the Group and the advertisers. The Group also performs credit assessment of all advertisers prior to entering into contracts. Revenue is recognized based on the amount charged to the advertisers, net of discounts.

The Group has estimated and recorded sales rebates provided to the agencies and advertisers of USD 7,414 thousand, USD 7,207 thousand and USD 5,005 thousand for the years ended December 31, 2012, 2013 and 2014, respectively.

### III) Other internet value-added services

#### i) Online game revenues

Users play games through the Group's platform free of charge and are charged for purchases of virtual items including consumable and perpetual items, which can be utilized in the online games to enhance their game-playing experience. Consumable items represent virtual items that can be consumed by a specific user within a specified period of time. Perpetual items represent virtual items that are accessible to the users' account over the life of the online game.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(q) Revenue recognition (Continued)**

III) Other internet value-added services (Continued)

i) Online game revenues (Continued)

Pursuant to contracts signed between the Group and game developers, revenue from the sale of virtual items are shared based on a pre-agreed ratio for each game. The Group enters into both non-exclusive and exclusive licensing contracts with game developers.

*Non-exclusive game licensed contracts*

The games under non-exclusive licensed contracts are maintained, hosted and updated by the game developers. The Group mainly provides access to the platform and limited after-sale services to the game players. The determination of whether to record these revenues using the gross or net method is based on an assessment of various factors; the primary factors are whether the Group acts as the principal in offering services to the game players or as agent in the transaction, and the specific requirements of each contract. The Group determined that for non-exclusive game licensed arrangements, the third party game developers are the principal given that the game developers design and develop the game services offered, have reasonable latitude to establish prices of game virtual items, and are responsible for maintaining and upgrading the game content and virtual items. Accordingly, the Group records online game revenue, net of the portion remitted to the game developers.

Given that online games are managed and administered by the game developers for non-exclusive licensed games, the Group does not have access to the data on the consumption details and the types of virtual items purchased by the game players. The Group has adopted a policy to recognize revenues relating to both consumable and perpetual items over the shorter of 1) estimated lives of the games and 2) the estimated lives of the user relationship with the Group, which were approximately two to six months for the periods presented.

Adjustments arising from the changes of estimated lives of virtual items are applied prospectively as such changes are resulted from new information indicating a change in the game player behavioral patterns.

*Exclusive licensing game contracts*

For exclusive licensing contracts with game developers, the games are maintained and hosted by the Group. Accordingly, the Group is determined to be the principal, the Group records online game revenue on a gross basis, with the amount remitted to the game developers reported as cost of revenue. Payment Handling Fees are recognized as cost of revenues when the related revenues are recognized.

For exclusive licensed games which are maintained on the Group's server, the Group has access to the data on the consumption details and types of virtual items purchased by the game players. The Group does not maintain information on consumption details of virtual items, and only have limited information related to the frequency of log-ons. Given that a substantial portion of the virtual items purchased by the game players in exclusive licensed games are perpetual items, management determined that it would be most appropriate to recognize revenue over the shorter of 1) estimated lives of the games and 2) the estimated lives of the user relationship with the Group, which were approximately one to three months for the periods presented. Revenues related to consumable items are recognized immediately upon consumption.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(q) Revenue recognition (Continued)**

III) Other internet value-added services (Continued)

i) Online game revenues (Continued)

*Exclusive licensing game contracts (Continued)*

Game players can purchase prepaid virtual items which can be used to purchase virtual items via online channels. The Group incurs service fees levied by those payment channels, and such payment expenses are recorded as the cost of revenues when the related revenues are recognized.

For both non-exclusive and exclusive licensed games, the Group estimates the life of virtual items to be the shorter of the estimated lives of the games and the estimated lives of the user relationship. The estimated user relationship period is based on data collected from those users who have purchased virtual items. To estimate the life of the user relationship, the Group maintains a software system that captures the following information for each user: the date of first log-in, the date of first purchase for a virtual item, the date of last purchase for a virtual item and the date the user ceases to play the game. The Group estimates the life of the user relationship to be the average period from the first purchase of a virtual item to the date the user ceases to play the game. The estimate of the life of the user relationship is based only on the data of those users who have purchased virtual items and is made on a game-by-game basis.

To estimate the life of the games, the Group considers both games that they operate as well as games in the market that are of a similar nature. The Group categorizes these games by their nature, such as simulation games, role playing games and others, which appeal to players belonging to different demographics. The Group estimates that the life of each group of the games to be the average period from the date of launch for such games to the date the games are expected to be removed from the website or terminated altogether. When the Group launches a new game, they estimate the life of the game and user relationship based on lives of other similar games in the market until the new game establishes its own history. The Group also considers the game's profile, attributes, target audience, and its appeal to players of different demographic groups in estimating the user relationship period.

The consideration of user relationship with each online game is based on the Group's best estimate that takes into account all known and relevant information at the time of assessment. Adjustments arising from the changes of



estimated lives of virtual items are applied prospectively as such changes are resulted from new information indicating a change in the game player behavioral patterns. Any changes in the estimates of lives of virtual items may result in the Group's revenues being recognized on a basis different from prior periods and may cause the Group's operating result to fluctuate. The Group periodically assesses the estimated lives of the virtual items and any changes from prior estimates are accounted for prospectively. Any adjustments arising from changes in user relationship as a result of new information will be accounted as a change in accounting estimate in accordance with *ASC 250 Accounting Changes and Error Corrections*.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(q) Revenue recognition (Continued)**

III) Other internet value-added services (Continued)

ii) Content sub-licensing revenue

With the exclusive Content Copyrights, the Group has the right to sub-license the broadcasting rights to third parties. The Group generates revenue from sub-licensing these broadcasting rights on a recurring basis to third party customers for cash, mainly video streaming internet platforms, for cash payments at a fixed rate for a fixed period of time that falls within the original exclusive license period. Revenue is recognized in full at the later of the delivery of the master copy of the content with acceptance acknowledged by the customers and the commencement of the license period, as the Group is not obliged to provide any other services. The Group performs credit assessment of its customers prior to entering into contracts to ensure that collection of the arrangement fee is reasonably assured. There is no ongoing obligation of the Group after delivery of the master copy of the content. The Group recognized content sub-licensing revenue of USD 15,234 thousand, USD 7,369 thousand and USD 9,218 thousand for the years ended December 31, 2012, 2013 and 2014, respectively.

iii) Pay per view subscription revenue

The Group operates a pay per view subscription program in which subscribers pay a monthly fee to watch and have access to a collection of movie contents. The subscription fee is time-based and is collected up-front from subscribers except in the cases where they elect to pay via their mobile operators. The subscription fee is collected when the subscribers pay for their monthly phone fees. The terms of time-based subscriptions range from one month to twelve months, with the subscribers having the option to renew the contract. The receipt of revenue is initially recorded as deferred revenue and revenue is recognized ratably over the period of subscription as services are rendered.

Viewers can also pay to watch individual movies for an unlimited number of times. Revenue is recognized when the movie is broadcasted to the viewer.

iv) Revenues from traffic referral programs

The Group enters into contracts with certain third party portals/websites to earn revenue by referencing online traffic to these third party portals/websites. On a monthly basis, the Group receives data on the user traffic and the related monthly revenue from these third party portals/ websites. Under these programs, the Group recognizes its share of

revenues based on contractual rates applied to user traffic referred to the advertisements of the third parties.

**(r) Barter transactions**

The Group also enters into agreements with third parties (mainly video streaming internet platform) to exchange content. The exchanged content provides rights for each respective party only to broadcast the content received on its own website; though, each party retains the right to continue broadcasting and or sub-license the rights to the content it surrendered in the exchange. These transactions are non-monetary transactions similar to barter transactions, and the Group follows ASC 845, Non-Monetary Transactions and ASC 360-10, Property, Plant, and Equipment.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(r) Barter transactions (Continued)**

Such barter transactions should be recorded at fair value of the surrendered assets in the transaction unless such fair value are not determinable within reasonable limits. The Group estimated the fair value of the content by gathering price reference of cash sub-licensing transactions of each exclusive content right and categorizing it into two buckets (1) cash transaction prices with established counterparties and (2) cash transaction prices with less established counterparties. With this information, the Group calculates an average cash transaction price for each category to be used as a reference for the non-monetary transaction. The attributable cost of the related exclusive Content Copyright surrendered is released and recorded as the cost of the barter transaction using the individual-film-forecast computation method. This method calculates such cost based on the ratio of the estimated fair value of the exchanged content over the aggregated estimated fair value to be generated by the exclusive Content Copyrights for their whole license period or estimate useful lives. The Group revisits the forecast at each quarter or year end and make adjustment, when appropriate.

The Group generated net gains amounted to USD1,556 thousand (2012:USD4,666 thousand, 2013: USD1,020 thousand) from barter transactions, which is the net amount of proceeds of USD4,428 thousand (2012:USD7,472 thousand, 2013: USD2,059 thousand), after deducting related allocation of cost of USD2,606 thousand (2012:USD2,380 thousand, 2013: USD915 thousand) and business tax and surcharge of USD266 thousand (2012:USD426 thousand, 2013: USD124 thousand).

**(s) Sales and marketing expenses**

Sales and marketing expenses comprise primarily of salary, commission and benefits of sales and marketing personnel and external advertising and market promotion expenses. The external advertising and market promotion expenses amounted to approximately USD 7,951 thousand, USD 12,247 thousand and USD 13,957 thousand for the years ended December 31, 2012, 2013 and 2014, respectively.

**(t) General and administrative expenses**

General and administrative expenses consist primarily of salary and benefits, professional service fees, legal expenses and other administrative expenses.

**(u) Research and development costs**

The Group incurred research and development costs to develop its downloading software. Costs incurred during the research phase are expensed as incurred. Costs incurred for the development of the downloading software prior to the establishment of technological feasibility, which is when a working model is available, are expensed when incurred. The development costs qualified for capitalization have been immaterial for the periods presented.

The Group also incurred development costs in connection with an internal-use ERP software to further enhance management to monitor the business. While internal and external costs incurred during the preliminary project stage are expensed as incurred, costs relating to activities during the application development stages have been capitalized. During each of the three years ended December 31, 2014, nil software development costs were capitalized as intangible assets, respectively.

In addition, the Group incurred other research and development costs in relation to software used to support its operations. Any development costs qualified for capitalization have been immaterial for the periods presented.

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****2. Summary of significant accounting policies (Continued)****(v) Taxation and uncertain tax positions**

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statements carrying amounts of existing assets and liabilities and their respective tax bases and tax loss carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which the difference is expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of operations in the period that includes the enactment date. A valuation allowance is provided to reduce the carrying amount of deferred tax assets if it is considered more likely than not that some portion, or all, of the deferred tax assets will not be realized. On January 1, 2007, the Group adopted the guidance regarding uncertain tax positions and evaluated its open tax positions that exist in each jurisdiction for each reporting period. If an uncertain tax position is taken or expected to be taken in a tax return, the tax benefit from that uncertain position is recognized in the Group's consolidated financial statements if it is more likely than not that the position is sustainable upon examination by the relevant taxing authority. The Group did not have any significant uncertain tax position and there was no effect on its financial condition or results of operations as a result of implementing the new guidance. The Group recognizes interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense, if any. Nevertheless, no significant interest and penalties were recorded in the years ended December 31, 2012, 2013 and 2014.

*Transition from PRC Business Tax to PRC Value Added Tax*

Effective September 1, 2012, the Chinese government has begun a pilot program (the Pilot Program) for transition from imposing business tax to imposing of value added tax (VAT) for revenues generated in certain industries. The Pilot Program has been expanded from Shanghai to eight other cities and provinces in China, including Beijing and Shenzhen. The Group's advertising and content sub-licensing revenues are subject to the Pilot Program since November 1, 2012, and its subscription revenue, online game revenue and pay per view subscription revenue are subject to the Pilot Program since June 1, 2014. Business Tax has been imposed primarily on revenues from the provision of taxable services, assignments of intangible assets and transfers of real estate. Prior to the implementation of the pilot program, the Group's Business Tax rate, which varies depending upon the nature of the revenues being taxed, generally ranged from 3% to 5%.

VAT payable on goods sold or taxable labor services provided by a general VAT taxpayer for a taxable period is the net balance of the output VAT for the period after crediting the input VAT for the period. Before the implementation of the Pilot Program, the Group was mainly subject to a small amount of VAT mainly for revenues of the sale of software. VAT has been imposed on those revenues at a rate of 17%. With the implementation of the Pilot Program, in addition to the revenues currently subject to VAT, the Group's advertising and content sub-licensing revenues, subscription revenue, online game revenue and pay per view subscription revenue are in the scope of the Pilot Program and are now subject to VAT at a rate of 6%.

**(w) Retirement benefits**

Full-time employees of the Company's subsidiaries, consolidated VIE and its subsidiaries in the PRC participate in a government mandated multi-employer defined contribution plan pursuant to which certain pension benefits, medical care, unemployment insurance, employee housing fund and other welfare benefits are provided to employees. Chinese labor regulations require that the subsidiaries and VIEs of the Company make contributions to the government for these benefits based on certain percentages of the employees' salaries. The Group has no legal obligation for the benefits beyond the contributions made. The total amounts for such employee benefits, which are expensed as incurred, were USD1,930 thousand, USD3,243 thousand and USD 3,818 thousand for the years ended December 31, 2012, 2013 and 2014, respectively.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****2. Summary of significant accounting policies (Continued)****(x) Share-based compensation**

The Group measures share-based compensation at the grant date based on the fair value of the award determined using the Black-Scholes option pricing model. As the Group has granted share options and restricted shares with service-only condition, the Group elected to recognize compensation costs net of estimated forfeitures on a straight line basis over the requisite service period, which is generally the same as the vesting period. The amount of compensation cost recognized at any date is at least equal to the portion of the grant-date value of the award that is vested at that date.

**(y) Government subsidies**

The Group receives subsidies from the local PRC government for general use or purchase of equipment. General-use subsidies which are not subject to any conditions or specific use requirements are recorded as subsidy income in the consolidated statements of operations. Subsidies for purchase of equipment are recorded as deferred government grant when received, and are recorded as other income over the expected useful life of the assets after the related equipment has been purchased.

**(z) Segment reporting**

The Group's Chief Executive Officer has been identified as the chief operating decision maker ( CODM ), who reviews consolidated operating results of the Group when making decisions about allocating resources and assessing performance of the Group as a whole. The Group has internal reporting of revenue, cost and expenses that does not distinguish between segments, and reports costs and expense by nature as a whole. The Group does not distinguish between markets or segments for the purpose of internal reporting. Management has determined that the Group operates and manages its business as a single segment which is the operation of its online media platform. All revenues of the Group are derived from mainland China.

An analysis of the different types of revenues for the years ended December 31, 2012, 2013 and 2014 are summarized as follows:

| <b>(In thousands)</b> | <b>Years ended December 31,</b> |             |             |
|-----------------------|---------------------------------|-------------|-------------|
|                       | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Subscription revenue  | 51,055                          | 86,733      | 98,189      |
| Advertising revenue   | 61,795                          | 48,028      | 38,378      |



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|  |         |         |         |
|--|---------|---------|---------|
| Other internet value-added services (note a) | 35,350  | 45,483  | 46,320  |
| Total  | 148,200 | 180,244 | 182,887 |

note a: Other internet value-added services mainly comprise online game revenue, content sub-licensing revenue, pay per view subscription revenue, revenue from traffic referral programs, technical services regarding online acceleration, online sales revenue, online game subscription revenue and sales of software licenses.

**(aa) Net income / (loss) per share**

Basic income / (loss) per share is computed by dividing net income / (loss) attributable to holders of common shares by the weighted-average number of common shares outstanding during the year using the two class method. Using the two class method, net income / (loss) is allocated between common shares and other participating securities based on their participating rights.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(aa) Net income / (loss) per share (Continued)**

Diluted income / (loss) per share is calculated by dividing net income / (loss) attributable to common shareholders as adjusted for the effect of dilutive common equivalent shares, if any, by the weighted-average number of common and dilutive common equivalents shares outstanding during the year. Dilutive equivalent shares are excluded from the computation of diluted income / (loss) per share if their effects would be anti-dilutive. Common share equivalents consist of the common shares issuable in connection with the Group's convertible non-redeemable and redeemable preferred shares using the if-converted method, and common shares issuable upon the conversion of the stock options, using the treasury stock method.

**(bb) Comprehensive income**

Comprehensive income is defined as the change in equity of a Group during the period from transactions and other events and circumstances excluding transactions resulting from investments from shareholders and distributions to shareholders. Accumulated other comprehensive income, as presented on the accompanying consolidated balance sheets, consists of cumulative translation adjustment.

**(cc) Profit appropriation and statutory reserves**

The Group's subsidiaries, consolidated VIE and its subsidiaries incorporated in the PRC are required on an annual basis to make appropriations of retained earnings set at certain percentage of after-tax profit determined in accordance with PRC accounting standards and regulations ( PRC GAAP ). Appropriation to the statutory general reserve should be at least 10% of the after-tax net income determined in accordance with the legal requirements in the PRC until the reserve is equal to 50% of the entities' registered capital. The Group is not required to make appropriation to other reserve funds and the Group does not have any intentions to make appropriations to any other reserve funds.

The general reserve fund can only be used for specific purposes, such as setting off the accumulated losses, enterprise expansion or increasing the registered capital. Appropriations to the general reserve funds are classified in the consolidated balance sheets as statutory reserves.

There are no legal requirements in the PRC to fund these reserves by transfer of cash to restricted accounts, and the Group does not do so.

The following table presents the balances of registered capital, additional paid-in-capital and statutory reserves of entities within the Group incorporated in China as of December 31, 2013 and 2014 for the Group's reporting purpose in China as determined under generally accepted accounting principles in China:

| <b>(In thousands)</b>      | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|----------------------------|------------------------------|------------------------------|
| Registered capital         | 44,532                       | 54,467                       |
| Additional paid-in capital | 161                          | 161                          |
| Statutory reserves         | 4,478                        | 5,132                        |
| Total                      | 49,171                       | 59,760                       |

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(cc) Profit appropriation and statutory reserves (Continued)**

Relevant laws and regulations permit payments of dividends by the PRC subsidiaries and affiliated companies only out of their retained earnings, if any, as determined in accordance with respective accounting standards and regulations. Accordingly, the above balances are not allowed to be transferred to the Company in terms of cash dividends, loans or advances (See also Note 26).

**(dd) Dividends**

Dividends are recognized when declared. No dividends were declared for the years ended December 31, 2012, 2013 and 2014, respectively. The Group does not have any present plan to pay any dividends on common shares in the foreseeable future. The Group currently intends to retain the available funds and any future earnings to operate and expand its business.

**(ee) Recent accounting pronouncements**

In March 2013, the FASB issued guidance on Foreign Currency Matters, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity. The amendments clarify the applicable guidance for the de-recognition of all or a portion of a cumulative translation adjustment when an entity ceases to have a controlling financial interest in a subsidiary or group of assets that is a non-profit activity or a business (other than a sale of in substance real estate or conveyance of oil and gas mineral rights) within a foreign entity or when other changes stipulated occur and involve a foreign entity. The amendments are effective prospectively for fiscal years (and interim reporting periods within those years) beginning after December 15, 2013. The adoption of this Accounting Standard Update (ASU) did not have a material impact on the Company's consolidated financial statements.

In March 2013, the FASB also issued guidance on Income Taxes Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The amendments clarify that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss, similar tax loss, or tax credit carryforward, except as noted in the following sentence. To the extent a net operating loss, similar tax loss, or tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction to settle any additional income taxes that would result from the disallowance of a tax position or the tax law of the applicable jurisdiction does not require the entity to use, and the entity does not intend to use, the deferred tax asset for such a

purpose, then under this exception the unrecognized tax benefit is to be presented in the financial statements as a liability and should not be combined with (netted with) the deferred tax asset(s). The assessment of whether a deferred tax asset is available is based on the unrecognized tax benefit and deferred tax asset amounts that exist at the reporting date and should be made presuming disallowance of the tax position at the reporting date. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The adoption of this ASU did not have a material impact on the Company's consolidated financial statements.

In April 2014, the FASB issued Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, which changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal that represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results. The standard is required to be adopted by public business entities in annual periods beginning on or after December 15, 2014, and interim periods within those annual periods. Entities may early adopt the guidance for new disposals. The Company does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial statements.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**2. Summary of significant accounting policies (Continued)**

**(ee) Recent accounting pronouncements (Continued)**

On May 28, 2014, the FASB and IASB issued their long-awaited converged standard on the recognition of revenue from contracts with customers. The standard will improve the financial reporting of revenue and improve comparability of the top line in financial statements globally. The FASB is amending the FASB Accounting Standards Codification and creating a new Topic 606, Revenue from Contracts with Customers, to supersede the revenue recognition requirements in Topic 605, Revenue Recognition, and most industry-specific guidance throughout the Industry Topics of the Codification. Additionally, the amendments supersede some cost guidance included in Subtopic 605-35, Revenue Recognition Construction-Type and Production-Type Contracts. For a public entity, the amendments are effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early application is not permitted. The Company is currently evaluating the impact on its consolidated financial statements of adopting this guidance.

In June 2014, under ASC 718, Compensation Stock Compensation, the FASB issued Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period. These amendments apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. That is the case when an employee is eligible to retire or otherwise terminate employment before the end of the period in which a performance target could be achieved and still be eligible to vest in the award if and when the performance target is achieved. For all entities, the amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. The Company does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial statements.

In August 2014, the FASB issued Presentation of Financial Statements Going Concern. This standard requires management to evaluate for each annual and interim reporting period whether it is probable that the reporting entity will not be able to meet its obligations as they become due within one year after the date that the financial statements are issued. If the entity is in such a position, the standard provides for certain disclosures depending on whether or not the entity will be able to successfully mitigate its going concern status. This guidance is effective for annual periods ending after December 15, 2016 and interim periods within annual periods beginning after December 15, 2016. Early application is permitted. The Company does not expect the adoption of this pronouncement to have a significant impact on its consolidated financial statements.

On February 18, 2015, the FASB issued Accounting Standards Update 2015-02, Consolidation (Topic 810)

Amendments to the Consolidation Analysis. The new guidance applies to entities in all industries and provides a new scope exception to registered money market funds and similar unregistered money market funds. It provide new

guidance to companies in determining whether an entity is a variable interest entity (VIE), assessing fees paid to a decision maker or a service provider, and consideration of related parties in the economics test. The standard is effective for public business entities for annual periods beginning after December 15, 2015. The company is in the process of assessing the impact of this new guidance.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****3. Business combination**

In September 2014, the Group acquired assets relating to a personal cloud storage business from Kingsoft Corporation Limited, for cash consideration of USD 33 million plus the portion of the fair value of replacement share-based awards allocated to consideration for the acquisition of USD 0.3 million. As a result of the acquisition, the Group obtained the key intellectual property to develop and expand the personal cloud storage business. The assets acquired constitute a business and the acquisition was recorded as a business combination. The allocation of the purchase price at the date of acquisition is as follows:

| <b>(In thousands)</b>               |        |
|-------------------------------------|--------|
| Property and equipment              | 255    |
| Intangible assets                   |        |
| Trademarks                          | 6,120  |
| Technology (including right-to-use) | 2,381  |
| Non-compete agreement               | 1,490  |
| Goodwill                            | 23,057 |
|                                     | 33,303 |

The business combination was completed on 5 September 2014 and the company has finalised the purchase price allocation. The excess of purchase price over tangible assets and identifiable intangible assets acquired was recorded as goodwill. There was no liability assumed arising from the acquisition. In connection with this acquisition, the Group is obligated to issue share options to replace the unvested awards owned by the employees who are transferred to the Group, the portion of the fair-value-based measure of the replacement award attribute to pre-combination service of USD 303 thousand was allocated to the consideration, while the portion attribute to post-combination service of USD44 thousand was recorded to as share based compensation expense over the remaining vesting period. The acquired goodwill is not deductible for tax purposes. Acquisition related costs were immaterial and were included in general and administrative expenses for the year ended December 31, 2014.

Pro forma revenue data was not disclosed because the impact was immaterial. Pro forma earnings data was not disclosed because the personal cloud storage business was previously operated by the seller as an integral part of its cloud storage business, and it was impracticable to determine the expenses attributable to the personal cloud storage business.



**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****4. Cash and cash equivalents**

Cash and cash equivalents represent cash on hand, cash held at bank, and time deposits placed with banks or other financial institutions, which have original maturities of three months or less. Cash on hand and cash held at bank balance as of December 31, 2013 and 2014 primarily consist of the following currencies:

| <b>(In thousands)</b> | <b>December 31, 2013</b> |                       | <b>December 31, 2014</b> |                       |
|-----------------------|--------------------------|-----------------------|--------------------------|-----------------------|
|                       | <b>Amount</b>            | <b>USD equivalent</b> | <b>Amount</b>            | <b>USD equivalent</b> |
| RMB                   | 499,034                  | 81,851                | 674,001                  | 110,149               |
| USD                   | 11,959                   | 11,959                | 294,036                  | 294,036               |
| HKD                   | 749                      | 96                    | 697                      | 90                    |
| Total                 |                          | 93,906                |                          | 404,275               |

Time deposits with original maturities of three months or less as of December 31, 2013 and 2014 primarily consist of the following currencies:

| <b>(In thousands)</b> | <b>December 31, 2013</b> |                       | <b>December 31, 2014</b> |                       |
|-----------------------|--------------------------|-----------------------|--------------------------|-----------------------|
|                       | <b>Amount</b>            | <b>USD equivalent</b> | <b>Amount</b>            | <b>USD equivalent</b> |
| RMB                   | 157,860                  | 25,892                | 156,749                  | 25,617                |
| USD                   | 5,000                    | 5,000                 | 5,500                    | 5,500                 |
| Total                 |                          | 30,892                |                          | 31,117                |

**5. Short-term investments**

| <b>(In thousands)</b>                       | <b>December 31, 2013</b> | <b>December 31, 2014</b> |
|---|--------------------------|--------------------------|
| Time deposits                               | 9,695                    |                          |
| Investments in financial instruments (note) | 31,298                   | 29,427                   |
| Total                                       | 40,993                   | 29,427                   |

Note: the investments were issued by commercial banks in China with a variable interest rate indexed to performance of underlying assets. Since these investments' maturity dates are within one year, they are classified as short-term investments.

Time deposits and investments in financial instruments are stated on the balance sheet at the principal amount plus accrued interest. Interest income is recorded in other income in the statement of comprehensive income.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****6. Accounts receivable, net**

| <b>(In thousands)</b>                 | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---------------------------------------|------------------------------|------------------------------|
| Accounts receivable                   | 47,386                       | 38,273                       |
| Less: Allowance for doubtful accounts | (12,111)                     | (9,352)                      |
| <b>Accounts receivable, net</b>       | <b>35,275</b>                | <b>28,921</b>                |

The accounts receivable that was fully reserved as of December 31, 2013 and 2014 was USD 10.9 million and USD 8.9 million, respectively.

The following table presents movement in the allowance for doubtful accounts:

| <b>(In thousands)</b>             | <b>December 31,<br/>2012</b> | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|-----------------------------------|------------------------------|------------------------------|------------------------------|
| Balance at beginning of the year  | 4,150                        | 7,875                        | 12,111                       |
| Additions                         | 3,840                        | 4,308                        | 2,633                        |
| Reversals                         | (140)                        | (373)                        | (1,176)                      |
| Write-off                         |                              |                              | (4,161)                      |
| Exchange difference               | 25                           | 301                          | (55)                         |
| <b>Balance at end of the year</b> | <b>7,875</b>                 | <b>12,111</b>                | <b>9,352</b>                 |

The top 10 customers accounted for about 40% and 37% of accounts receivable as of December 31, 2013 and 2014, respectively.

**7. Prepayments and other assets**

| <b>(In thousands)</b>                     | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---|------------------------------|------------------------------|
| <b>Current portion:</b>                   |                              |                              |
| Advance to suppliers                      | 717                          | 520                          |
| Interest-free loans to employees (note a) | 3,578                        | 3,998                        |

|   |              |               |
|---|--------------|---------------|
| Low-interest loans to employees, current portion (note c)     |              | 64            |
| Advance to employees for business purposes                    | 316          | 585           |
| Content copyrights prepaid assets (note b)                    | 830          | 297           |
| Interest receivable   | 118          | 5,380         |
| Rental and other deposits                                     | 596          | 774           |
| Prepayment for share repurchase plan (note d)                 |              | 1,000         |
| Prepaid game sharing costs                                    |              | 458           |
| Prepaid professional fees                                     |              | 900           |
| Prepaid management insurance                                  |              | 179           |
| Others  | 164          | 405           |
| <b>Total of prepayments and other current assets</b>          | <b>6,319</b> | <b>14,560</b> |
| <b>Non-current portion:</b>                                   |              |               |
| Prepayments for content copyrights                            | 3,149        | 1,988         |
| Prepayments for online game licenses                          | 2,358        | 5,346         |
| Deferred initial public offering costs                        | 374          |               |
| Low-interest loans to employees, non-current portion (note c) | 196          | 506           |
| <b>Total of long-term prepayments and other assets</b>        | <b>6,077</b> | <b>7,840</b>  |

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****7. Prepayments and other assets (Continued)**

Note a: The Group had entered into loan contracts with certain employees as at December 31, 2013 and 2014, under which the Group provided interest-free loans to these employees. The loan amounts vary amongst different employees and are repayable on demand.

Note b: Content copyrights prepaid assets represent content copyright that the Group has yet to receive from the counterparty under a barter transaction but the counterparty has already received the content copyrights from the Group.

Note c: The Group had entered into loan contracts with certain employees as at December 31, 2013 and 2014, under which the Group provided low-interest loans to these employees. The loan amounts vary amongst different employees and are repayable in equal instalments on a monthly basis over the term of 10 years.

Note d: In December 2014, the Company announced a share repurchase program to purchase up to USD 20 million shares and prepaid USD 1 million to a security broker for this program.

**8. Property and equipment**

Property and equipment consist of the following:

| <b>(In thousands)</b>                    | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|--|------------------------------|------------------------------|
| Servers and network equipment            | 32,108                       | 35,256                       |
| Computer equipment                       | 2,097                        | 2,123                        |
| Furniture, fixtures and office equipment | 889                          | 903                          |
| Motor vehicles                           | 340                          | 339                          |
| Leasehold improvements                   | 2,177                        | 2,169                        |
| <br>                                     |                              |                              |
| Total original costs                     | 37,611                       | 40,790                       |
| Less: Accumulated depreciation           | (17,403)                     | (23,271)                     |
|  | 20,208                       | 17,519                       |

Depreciation expense recognized for the years ended December 31, 2012, 2013 and 2014 are summarized as follows:

| <b>(In thousands)</b> | <b>Years ended December 31</b> |             |             |
|-----------------------|--------------------------------|-------------|-------------|
|                       | <b>2012</b>                    | <b>2013</b> | <b>2014</b> |

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|                                     |              |              |              |
|-------------------------------------|--------------|--------------|--------------|
| Cost of revenues                    | 3,271        | 4,317        | 5,652        |
| General and administrative expenses | 594          | 690          | 715          |
| Sales and marketing expenses        | 129          | 105          | 133          |
| <b>Total</b>                        | <b>3,994</b> | <b>5,112</b> | <b>6,500</b> |

No impairment loss had been recognized for the years ended December 31, 2012, 2013 and 2014.

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****9. Intangible assets, net**

The following table presents the movement in intangible assets:

| (In thousands)                                  | December 31, 2013 |              |                                 | December 31, 2014 |              |            |                   |          |
|---|-------------------|--------------|---------------------------------|-------------------|--------------|------------|-------------------|----------|
|   | Cost              | Amortization | Impairment<br>Net book<br>value | Cost              | Amortization | Impairment | Net book<br>value |          |
| Content copyrights                              | 110,346           | (89,396)     | 20,950                          | 137,470           | (116,511)    |            | 20,959            |          |
| Exclusive                                       | 84,313            | (67,487)     | 16,826                          | 106,942           | (93,172)     |            | 13,770            |          |
| Non-exclusive<br>(note a)                       | 26,033            | (21,909)     | 4,124                           | 30,528            | (23,339)     |            | 7,189             |          |
| Land use rights                                 | 5,298             | (78)         | 5,220                           | 5,279             | (253)        |            | 5,026             |          |
| Trademarks                                      |                   |              |                                 | 6,168             | (167)        |            | 6,001             |          |
| Non-compete<br>agreement                        |                   |              |                                 | 1,502             | (252)        |            | 1,250             |          |
| Technology<br>(including<br>right-to-use)       |                   |              |                                 | 2,399             | (100)        |            | 2,299             |          |
| Acquired computer<br>software                   | 1,284             | (1,061)      | 223                             | 1,468             | (1,141)      |            | 327               |          |
| Internal use software<br>development costs      | 718               | (395)        | 323                             | 716               | (537)        |            | 179               |          |
| Online game licenses<br>(note b)                | 5,321             | (3,343)      | (808)                           | 1,170             | (4,478)      | (808)      | 18                |          |
| Domain name                                     | 200               | (110)        | 90                              | 200               | (149)        |            | 51                |          |
|   | 123,167           | (94,383)     | (808)                           | 27,976            | 160,506      | (123,588)  | (808)             | 36,110   |
| Less: Content<br>copyrights, current<br>portion |                   |              |                                 |                   |              |            |                   | (16,018) |
|   |                   |              |                                 |                   |              |            |                   | 11,958   |
|   |                   |              |                                 |                   |              |            |                   | 20,097   |

Note a: Included in non-exclusive content copyrights are net book values of USD 1,987 thousand and USD 1,401 thousand of rights that were acquired from barter transactions as of December 31, 2013 and 2014, respectively. These assets were initially recorded at their respective fair values determined at the time of exchange.

Note b: In 2013, indicator of possible impairment triggered the Group to perform an impairment test for one online game license. The impairment test was triggered by the significant decline in the revenue generated by the one online game. For the quarter ended December 31, 2013, this online game only generated revenue amounted to USD 27 thousand as compared to USD 303 thousand for the quarter ended September 30, 2013, which was significantly lower than the Group's expectation. The impairment test was performed using a discounted cash flow analysis that requires certain assumptions and estimates regarding economics and future profitability. As of December 31, 2014, full provision for impairment has been provided for this online game license.

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****9. Intangible assets, net (Continued)**

Amortization expense recognized for the years ended December 31, 2012, 2013 and 2014 are summarized as follows:

| <b>(In thousands)</b>                   | <b>Years ended December 31</b> |               |               |
|---|--------------------------------|---------------|---------------|
|   | <b>2012</b>                    | <b>2013</b>   | <b>2014</b>   |
| Cost of revenues                        | 47,810                         | 36,980        | 35,181        |
| Cost of barter transactions (note 2(r)) | 2,380                          | 916           | 2,606         |
| General and administrative expenses     | 388                            | 418           | 412           |
| Research and development expenses       |                                |               | 542           |
| <b>Total</b>                            | <b>50,578</b>                  | <b>38,314</b> | <b>38,741</b> |

The estimated aggregate amortization expense for each of the next five years as of December 31, 2014 is:

| <b>(In thousands)</b> | <b>Content</b>    |               |
|-----------------------|-------------------|---------------|
|                       | <b>Copyrights</b> | <b>Others</b> |
| 2015                  | 15,780            | 2,052         |
| 2016                  | 4,421             | 1,897         |
| 2017                  | 758               | 1,815         |
| 2018                  |                   | 1,614         |
| 2019 and thereafter   |                   | 7,773         |

The weighted average amortization periods of intangible assets as at December 31, 2013 and 2014 are as below:

| <b>(In year)</b>                        | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---|------------------------------|------------------------------|
| Copyrights related to content           | 2.83                         | 2.78                         |
| Land use right                          | 30                           | 30                           |
| Trademarks                              |                              | 7                            |
| Non-compete agreement                   |                              | 4                            |
| Technology (including right-to-use)     |                              | 8                            |
| Acquired computer software              | 5                            | 5                            |
| Internal use software development costs | 5                            | 5                            |

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|                      |      |      |
|----------------------|------|------|
| Online game licenses | 3    | 3    |
| Domain name          | 5    | 5    |
| <b>Total</b>         | 4.04 | 3.97 |

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Table of Contents**Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****10. Long-term investments**

| <b>(In thousands)</b>   | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---|------------------------------|------------------------------|
| <b>Equity method investments:</b>                                     |                              |                              |
| Balance at beginning of the year                                      | 1,488                        | 2,785                        |
| Additions   | 1,214                        |                              |
| Share of income / (loss) from equity investees                        | 25                           | (259)                        |
| Dilution gains arising from deemed disposal of investments (ii) (iii) |                              | 449                          |
| Exchange differences  | 58                           | (10)                         |
| <b>Balance at end of the year</b>                                     | <b>2,785</b>                 | <b>2,965</b>                 |
| <b>Cost method investments:</b>                                       |                              |                              |
| Balance at beginning of the year                                      |                              | 164                          |
| Additions (i)   | 162                          | 2,359                        |
| Exchange difference   | 2                            | 10                           |
| <b>Balance at end of the year</b>                                     | <b>164</b>                   | <b>2,533</b>                 |
| <b>Total long-term investments</b>                                    | <b>2,949</b>                 | <b>5,498</b>                 |

Details of the Group's ownership are as follows:

| <b>Investee</b>  | <b>Percentage of ownership of shares<br/>as of December 31,</b> |             |
|--|---|-------------|
|  | <b>2013</b>   | <b>2014</b> |
| <b>Equity method investments:</b>  |   |             |
| Zhuhai Qianyou Technology, Co., Ltd. ( Zhuhai Qianyou ),                     | 19%   | 19%         |
| Guangzhou Yuechuan Network Technology, Co., Ltd. ( Guangzhou Yuechuan ) (ii) | 23.44%  | 19.13%      |
| Chengdu Diting Technology, Co., Ltd. ( Chengdu Diting ) (iii)                | 19.9%   | 16.58%      |
| <b>Cost method investments:</b>  |   |             |

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|  |     |        |
|--|-----|--------|
| Shenzhen Kushiduo Network Science and Technology Co., Ltd. ( Shenzhen Kushiduo ) | 10% | 10%    |
| Shanghai Guozhi Electronic Technology Co., Ltd. ( Shanghai Guozhi ) (i)          |     | 21%    |
| Guangzhou Wucan Information Technology Co., Ltd. ( Guangzhou Wucan ) (i)         |     | 10%    |
| Guangzhou Hongsan Network Technology Co., Ltd. ( Guangzhou Hongsan ) (i)         |     | 19.9%  |
| Tianjin Kunzhiyi Network Technology Co., Ltd. ( Tianjin Kunzhiyi ) (i)           |     | 19.99% |

- (i) In 2014, the Group made equity investments in four unrelated privately-held companies. The shares held by the Group are not in-substance common stock and therefore the Group accounted for these investments according to ASC 320 as equity activities using the cost method.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****10. Long-term investments (Continued)**

(ii) In April of 2014, Guangzhou Yuechuan, an equity method investee held by the Group, issued new shares to a number of third parties for a total consideration of RMB 18 million (USD 2,928 thousand). As a result of the transaction, the Group's ownership interest in Guangzhou Yuechuan was diluted from 23.44% to 19.13%. The Group recorded a dilution gain of RMB 1.8 million (USD 298 thousand) arising from the sale of shares by the investee to third parties at a price in excess of the per share carrying value of the shares owned by the Group in 2014. The Group continued to classify Guangzhou Yuechuan as an equity method investment because it retained significant influence through its one out of four seats on the board of directors.

In May of 2014, Chengdu Diting, an equity method investee held by the Group, issued new shares to a third party for a total consideration of RMB 10 million (USD 1,627 thousand). As a result of the transaction, the Group's ownership interest in Chengdu Diting decreased from 19.9% to 16.58%. The Group recorded a dilution gain of RMB 0.9 million (USD 151 thousand) arising from the sale of shares by the investee to third parties at a price in excess of the per share carrying value of the shares owned by the Group in 2014.

(iii) As of December 31, 2013, the investment in Chengdu Diting was accounted for under the cost method due to the fact that the Group did not have significant influence in this company. In May of 2014, the Group obtained the right to appoint a director to Chengdu Diting and thus had one out of five seats on the board of directors of this investee. Given the existence of significant influence; the Group started to apply equity method in May 2014. The investment, results of operations (current and prior periods presented), and retained earnings of the Group have been adjusted retroactively on a step-by-step basis as if the equity method had been in effect during all previous periods in which the investment was held.

**11. Deferred revenue and income**

| <b>(In thousands)</b>                 | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|---------------------------------------|------------------------------|------------------------------|
| <b>Deferred revenue</b>               |                              |                              |
| Membership subscription revenues      | 30,051                       | 27,543                       |
| Online game revenues                  | 1,650                        | 1,111                        |
| Pay per view subscription revenues    | 261                          | 550                          |
| <b>Deferred income</b>                |                              |                              |
| Government grants                     | 6,580                        | 5,331                        |
| Reimbursement from the depository (i) |                              | 1,053                        |

|   |         |         |
|---|---------|---------|
| <b>Total</b>  | 38,542  | 35,588  |
| Less: non-current portion (ii)                      | (9,190) | (7,294) |
| <b>Deferred revenue and income, current portion</b> | 29,352  | 28,294  |

- (i) In December of 2014, the Company received from its depository a reimbursement of USD 1.2 million, net of withholding tax of USD0.3 million. This reimbursement was recognized as deferred income and amortized over the depository service period of 5 years.
- (ii) As of December 31, 2014, the non-current portion included Membership subscription revenues of USD 1,121 thousand (2013: USD 2,610 thousand), Government grants of USD 5,331 thousand (2013: USD 6,580 thousand), and Reimbursement from the depository of USD 842 thousand (2013: nil).

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****12. Accrued liabilities and other payables**

| <b>(In thousands)</b>                                      | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|--|------------------------------|------------------------------|
| Payroll and welfare  | 8,784                        | 12,260                       |
| Agency commissions and rebates online advertising          | 9,745                        | 8,017                        |
| Payables for advertisement on exclusive online games       | 2,797                        | 2,515                        |
| Receipts in advance from customers                         | 2,211                        | 1,133                        |
| Tax levies   | 1,198                        | 556                          |
| Payables for purchase of equipment                         | 4,157                        | 240                          |
| Legal and litigation related expenses (Note 25)            | 288                          | 451                          |
| Professional fees  | 574                          | 2,460                        |
| Staff reimbursements                                       | 1,228                        | 440                          |
| Content copyrights deposits (note a)                       | 1,555                        | 622                          |
| Rental expense   | 70                           | 382                          |
| Payables for proceeds from selling exercised stock options |                              | 872                          |
| Advance for exercise of stock options                      |                              | 356                          |
| Others   | 800                          | 1,111                        |
| <b>Total</b>   | <b>33,407</b>                | <b>31,415</b>                |

Note a: Content copyrights deposits are recognized under a barter transaction when the Group has yet to provide the content copyrights to the counterparty while the Group has received the content copyrights from the counterparty.

**13. Cost of revenues**

| <b>(In thousands)</b>                 | <b>Years ended December 31,</b> |             |             |
|---------------------------------------|---------------------------------|-------------|-------------|
|                                       | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Bandwidth costs                       | 22,211                          | 35,454      | 40,373      |
| Content costs, including amortization | 46,671                          | 35,964      | 34,671      |
| Payment handling fees                 | 8,505                           | 12,401      | 11,961      |

|   |               |               |               |
|---|---------------|---------------|---------------|
| Depreciation of servers and other equipment | 3,271         | 4,317         | 5,652         |
| Games revenue sharing costs and others      | 3,354         | 5,124         | 5,802         |
| <b>Total</b>                                | <b>84,012</b> | <b>93,260</b> | <b>98,459</b> |

#### **14. Redeemable convertible preferred shares**

##### *Series D convertible redeemable preferred shares*

On January 31, 2012, the Company entered into an agreement to issue Series D preferred shares and warrants to a third-party investor for a total consideration of USD37,500 thousand. Pursuant to the agreement, the company issued 10,580,397 series D preferred shares at USD 3.544 per share; and warrants to purchase 2,218,935 Series D preferred shares at USD 3.38 per share at the option of the holders. In addition, the third-party investor also purchased a total of 5,036,367 existing shares directly from other then existing shareholders and they were entitled to the same rights as attached to the respective classes of existing shares.



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**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**14. Redeemable convertible preferred shares (Continued)**

*Series D convertible redeemable preferred shares (Continued)*

The key terms of the Series D preferred shares were as follows:

*Dividend rights*

The holders of the Series D preferred shares were entitled to participate in any dividend pari passu with common shareholders of the Company on an as-converted basis.

*Liquidation preferences*

Amount shall be paid to Series D holders before any distribution or payment shall be made to the holders of Series A, Series A-1, Series B and C Preferred Shares. If asset for distribution is insufficient to pay off Series D holders, the assets shall be distributed among the holders of Series D in proportion to the full amounts to which they would otherwise be respectively entitled thereon on an as-converted basis.

Upon issuance of Series E preferred shares, the liquidation preference of Series D preferred shares was amended. Before any distribution or payment shall be made to the Series A, A-1, B and C shareholders (for the purpose of this clause, such holders did not include Skyline Global Company Holdings Limited ( Skyline Holdings ), or Series D Investor ), the Series D holder, who also held any Series A, A-1, B and any other Junior Securities) an amount shall be paid with respect to each share held by Skyline Holdings equal to original issue price.

*Voting rights*

The holders of the Series D preferred shares shall be entitled to such number of votes equal to the whole number of common shares into which such Series D preferred shares are convertible.

*Conversion rights*

Each share of the Series D preferred shares was convertible at the option of the holder, at any time after the issuance of such shares, and each share can be converted into one common share of the Company. The conversion was subject to adjustments for certain events, including but not limited to additional equity securities issuance, reorganization, mergers, share dividends, distribution, subdivisions, redemptions, combinations, or consolidation of common shares. The conversion price was also subject to adjustment in the event the Company issues additional common shares at a price per share that is less than such conversion price. In such case, the conversion price shall be reduced to adjust for

dilution on a weighted average basis.

In addition, each share of the Series D preferred shares would automatically be converted into common shares of the Company (i) upon the closing of an initial public offering of the Company's shares or (ii) upon written notice to convert given to the Company by the holders of a majority of Series D preferred shareholders.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**14. Redeemable convertible preferred shares (Continued)**

*Series D convertible redeemable preferred shares (Continued)*

*Redemption Right*

The Series D preferred shares were redeemable at any time after the 4<sup>th</sup> anniversary of the initial closing of February 6, 2012 to request the Company to purchase all Series D preferred shares and shares issuable upon the conversion or exercise of the Series D warrants if an initial public offering is not consummated. This redemption right expires after the 5<sup>th</sup> anniversary of the initial closing of the transaction. The redemption price shall be equal to the aggregate amount of price paid at USD3.544, plus all declared but unpaid dividends up to the date of redemption plus interest of 8% per annum compounded annually from the closing of the Series D preferred shares investment( Initial Closing ) up to and including the date of redemption.

The Company had determined that the Series D preferred shares should be classified as mezzanine equity. The Series D warrant is initially measured at its fair value and the initial carrying value for Series D preference shares is allocated on a residual basis as it was liability classified. The initial carrying value for Series D preference shares was USD 32,481 thousand, and the related capitalized expense was USD2,012 thousand. There were no beneficial conversion features for the Series D preferred shares.

The carrying value of the preferred shares was accreted from its carrying value on the date of issuance to the redemption value using effective interest method from date of issuance to the earliest redemption date. The accretion was recorded against retained earnings, or in the absence of retained earnings, by charging against additional paid-in capital. Once additional paid-in capital had been exhausted, additional charges were recorded by increasing the accumulated deficit. The Company had determined that conversion and redemption features embedded in the Series D convertible redeemable preferred shares were not required to be bifurcated and accounted for as a derivative.

*Series D Warrants*

The holder of Series D warrants had the right to exercise the warrants at the earlier of (i) 24 months from date of Initial Closing or (ii) automatically exercised immediately prior to the closing of the following transactions: (a) mergers or consolidation of the Company, b) initial public offering, c) transaction in which in excess of 50% of the Company's equity is transferred to any person, d) sale, transfer, lease, assignment conveyance, exchange, mortgage, or other disposition of all or substantially all of the assets of the Company. The warrants were not entitled to dividend rights nor to vote until the warrants were exercised and shares became issuable. Series D warrants was classified as a liability and initially measured at their fair value at USD 3,007 thousand. As of December 31, 2013, the fair value of Series D warrants was USD 2,186 thousand. For the year ended on December 31, 2012 and 2013, the fair value (loss)

/ gain recorded were USD 710 thousand and USD 1,531 thousand, respectively.

*Exchange of Series D warrants and the issuance of Series E warrants*

The warrants to purchase 1,952,663 and 266,272 Series D preferred shares at USD3.38 per share expired on February 6, 2014 and March 1, 2014, respectively. On the date of the expiration, the warrant was measured at a fair value of USD2,414 thousand. It was agreed that upon issuance of the Series E preferred shares on March 5, 2014, the Company would issue to the Series D investor warrants to purchase 3,406,824 Series E preferred shares with an exercise price of USD2.82. These warrants are exercisable at the option of the holder, at any time, no later than the earlier of (1) the pricing date of the initial public offering of the Company or (2) March 1, 2015. As the warrants were exercised into mezzanine equity, the warrants are classified as a liability and were initially measured at a fair value of USD2,819 thousand.

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The exchange of the Series D warrants and the issuance of the Series E warrants were considered to be a related transaction and are accounted for as a single transaction because the holder was willing to allow the Series D warrants to expire in contemplation that they would be issued Series E warrants. A loss of USD405 thousand, which was the difference in value of the Series D warrants on the expiration date and the value of the Series E warrants on the issuance date was charged to the income statement in quarter one of 2014.

The fair value of the Series D warrants and the Series E warrants was estimated by the Company with the assistance of an independent valuation firm based on the Company's estimates and assumptions. The valuation report provided the Group with guidelines in determining the fair value, but the determination was made by the Group. The Group applied the Black-Scholes Option Pricing Model to calculate the fair value of the Series D warrant on the valuation date.

The major assumptions used in calculating the fair value of the Series D warrants include:

|  | <b>December 31,<br/>2013</b> | <b>February 6,<br/>2014</b> |
|--|------------------------------|-----------------------------|
| Spot price <sup>(1)</sup>              | 4.36                         | 4.47                        |
| Risk-free interest rate <sup>(2)</sup> | 0.05%                        | 0%*                         |
| Volatility rate <sup>(3)</sup>         | 30.33%                       | 0%*                         |
| Dividend yield <sup>(4)</sup>          |                              |                             |

\* Given that the maturity date of Series D warrant was February 6, 2014, the volatility rate and risk-free interest rate did not affect the valuation of the warrant on February 6, 2014.

The major assumptions used in calculating the fair value of the Series E warrants include:

|  | <b>March 5, 2014</b> |
|--|----------------------|
| Spot price <sup>(1)</sup>              | 3.31 - 4.65          |
| Risk-free interest rate <sup>(2)</sup> | 0.04% - 0.12%        |
| Volatility rate <sup>(3)</sup>         | 38.39% - 38.81%      |
| Dividend yield <sup>(4)</sup>          |                      |

- (1) Spot price based on the fair value of 100 percent equity interest of the Company which was allocated to preferred shares and common shares of the Company as at the valuation date under different scenarios. For the valuation on March 5, 2014 and March 31, 2014, the probability of the occurrence of an IPO is assumed to be 80%, the probability of the occurrence of a liquidation event is assumed to be 10% and the probability of the occurrence of a redemption event is assumed to be 10%
- (2) Risk-free interest rate based on the US Treasury Bond & Notes BFV curve from Bloomberg as at the valuation date.
- (3) Volatility based on the average historical volatility of the comparable companies from Bloomberg as at the valuation date.
- (4) The Company has no history or expectation of paying dividends on its common shares.

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**14. Redeemable convertible preferred shares (Continued)**

*Series D convertible redeemable preferred shares (Continued)*

*Exchange of Series D warrants and the issuance of Series E warrants (Continued)*

*Triggering of the anti-dilution clause*

Upon issuance of Series E preferred shares in March and April 2014, the Company adjusted the Series D conversion price from USD3.5 to USD2.86 per share for 6,771,454 Series D preferred shares held by the Series D Investor. The Company concluded that the downward conversion price adjustment is in accordance with the anti-dilution clause in the original Series D financing agreement. As a result of this anti-dilution, the Company would issue a total of 8,391,850 common shares on a fully-converted basis of the original 6,771,454 Series D preferred shares when the conversion right is exercised by the holder. The downward adjustment of the conversion price did not contain a contingent beneficial conversion feature.

For the remaining 3,808,943 Series D preferred shares held by the Series D Investor, the Series D investor agreed to waive the anti-dilution clause as the Series D Investor has planned to sell these shares to the Company upon the issuance of Series E preferred shares in March 2014. The waiver of this anti-dilution clause was accounted for as a modification of the terms of the Series D preferred shares. However, it was determined that the incremental value contributed by the Series D Investor was deemed to be a transfer of value between the preferred shareholders because 1) the change in value of the common shares before and after the modification was deemed to be negligible and 2) the modification of the Series D preferred shares were also made concurrent with the sale of the Series E preferred shares. The Company concluded that this was evidence to suggest that most of the value was transferred from the Series D preferred shareholder to the other existing preferred shareholders. Therefore, no accounting charge was recorded.

Upon the completion of the IPO on 24 June 2014, the Company adjusted the Series D conversion price from USD2.86 to USD2.27 per share relating to 6,771,454 Series D preferred shares held by the Series D Investor. The Company concluded that the downward conversion price adjustment is in accordance with the anti-dilution clause in the latest shareholders agreement. As a result of this anti-dilution, the Company would issue a total of 10,581,726 common shares on a fully-converted basis of the original 6,771,454 Series D preferred shares when the conversion right is exercised by the holder. At the time of this anti-dilution, the Series D preferred shares anti-diluted contained a beneficial conversion feature of USD4,008 thousand as a deemed dividend to Series D Investor and charged against retained earnings, and in the absence of retained earnings, a charge to additional paid-in capital.

*Modification of redemption rights*

Upon issuance of the Series E preferred shares in March 2014, the Company amended the redemption rights of 6,771,454 Series D preferred shares. The Series D investor shall have the right to request the Company to purchase its shares after February 28, 2017 but no later than February 28, 2018. Prior to the modification, the holder had the right to request the Company to purchase its shares after February 6, 2016 but no later than February 6, 2017. The amendment of the redemption date was accounted for as modification of the terms of Series D preferred shares. The incremental value received by the Series D preferred shareholder amounted to USD279 thousand and was deemed to be a transfer of value between the preferred shareholder and common shareholders and the amount was charged to retained earnings.

In determining the accounting for the modification of the Series D preferred shares, the Company estimated the valuation of the Series D preferred shares with the assistance of an independent valuation firm based on the Company's estimates and assumptions. Option-pricing method was used to allocate enterprise value to preferred and ordinary shares, taking into account the guidance prescribed by the AICPA Audit and Accounting Practice Aid, Valuation of Privately-Held Company Equity Securities Issued as Compensation. The method treats common stock and preferred stock as call options on the enterprise's value, with exercise prices determined based on the liquidation preference of the preferred stock. The option-pricing method involves making estimates of the anticipated timing of a potential liquidity event, such as a sale of the Company or an initial public offering, and estimates of the volatility of the Company's equity securities.



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**14. Redeemable convertible preferred shares (Continued)**

*Series D convertible redeemable preferred shares (Continued)*

*Modification of redemption rights (Continued)*

The anticipated timing was based on the plans of management. Estimating the volatility of the share price of a privately held company was complex because there is no readily available market for the shares. The Company estimated the volatility of its shares to range from 38.39% to 43.40% based on the historical volatility of comparable publicly traded shares of companies engaged in similar lines of business.

*Modification of liquidation rights*

Upon issuance of the Series E preferred shares, the Company amended the liquidation rights of Skyline Holdings common shares, Series A preferred shares, Series A-1 preferred shares, and Series B preferred shares (collectively, the Series D Investor Shares ). As a result of this amendment, the Series D Investor Shares had priority to receive proceeds from the Company upon liquidation over the common shares, Series A preferred shares, Series A-1 preferred shares, Series B preferred shares and Series C preferred shares held by other investors. This right given to the Skyline Holdings was non-transferable to a third party. The amendment of the liquidation rights was accounted for as modification of the terms of Series D Investor Shares. However, the incremental value received by Skyline Holdings is deemed to be negligible. No accounting charge was recorded by the Company. Similar to the modification of the Series D preferred shares as stated above, the fair value of the Series D preferred shares was estimated by the Company with the assistance of an independent valuation firm based on the Company's estimates and assumptions. The Option-pricing method as described above, was also used to account for this modification. The Company estimated the volatility of its shares to range from 38.39% to 43.40% based on the historical volatility of comparable publicly traded shares of companies engaged in similar lines of business.

The Group had determined that there was no beneficial conversion feature attributable to the Series D preferred shares because the initial and adjusted effective conversion prices of these preferred shares were higher than the fair value of the Company's common shares determined by the Group with the assistance from an independent valuation firm.

*Initial public offering*

Upon the completion of the IPO on 24 June 2014, the Series D Investor did not exercise Series E warrants, and the fair value of Series E warrants was nil. The fair value gain of USD2,922 thousand was recorded for the year ended

December 31, 2014 as other income. As a result, 10,581,726 common shares were issued, and the balance of Series D preferred shares was transferred to common shares and additional paid-in capital on that date.

| <b>(In thousands)</b>   | <b>Years ended December 31,</b> |             |
|---|---------------------------------|-------------|
|   | <b>2013</b>                     | <b>2014</b> |
| Beginning balance   | 35,990                          | 40,290      |
| Deemed dividend to Series D shareholder from its modification                     |                                 | 279         |
| Accretion of Series D to convertible redeemable preferred shares redemption value | 4,300                           | 1,870       |
| Repurchase of preferred shares  |                                 | (15,003)    |
| Deemed dividend to preferred shareholders upon IPO                                |                                 | 4,008       |
| Converted to common shares upon IPO   |                                 | (31,444)    |
| <b>Ending balance</b>   | <b>40,290</b>                   |             |

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**14. Redeemable convertible preferred shares (Continued)**

*Series E convertible redeemable preferred shares*

On March 5, 2014, the Company entered into an agreement to issue Series E preferred shares (the Series E Tranche 1 Preferred Shares ) and warrants to a third-party investor ( Series E Tranche 1 Investor ) for a total consideration of USD 200 million. Pursuant to the agreement, the Company issued 70,975,491 Series E Tranche 1 Preferred Shares at USD 2.82 per share; and warrants to purchase 17,743,873 Series E preferred shares at USD 2.82 per share at the option of the holders. In addition, within 3 months after the closing, the Series E Tranche 1 Investor shall have the right ( Subscription Rights ) to purchase, or designate any other person/party to purchase from the Company an additional 35,487,746 Series E preferred shares, at a price equal to USD 2.82 per share.

The key terms of the Series E preferred shares were as follows:

*Dividend rights*

The holders of the Series E preferred shares were entitled to participate in any dividend pari passu with common shareholders of the Company on an as-converted basis.

*Liquidation preferences*

Before any distribution or payment shall be made to the holders of Series A, Series A-1, Series B, Series C and D preferred shares, an amount shall be paid to Series E holders with respect to each Series E preferred share held by the Series E holder equal to 100% of the applicable original issue price.

*Voting rights*

The holders of the Series E preferred shares shall be entitled to such number of votes equal to the whole number of common shares into which such Series E preferred shares are convertible.

*Conversion rights*

Each of the Series E preferred shares was convertible at the option of the holder, at any time after the issuance of such shares, and each share could be converted into one common share of the Company. The conversion was subject to adjustments for certain events, including but not limited to additional equity securities issuance, reorganization, mergers, share dividends, distribution, subdivisions, redemptions, combinations, or consolidation of common shares. The conversion price was also subject to adjustment in the event the Company issues additional common shares at a price per share that was less than such conversion price. In such case, the conversion price shall be reduced to adjust for dilution on a weighted average basis.

In addition, each of the Series E preferred shares would automatically be converted into common shares of the Company (i) upon the closing of an initial public offering of the Company's shares or (ii) upon written notice to convert given to the Company by the holders of a majority of Series E preferred shareholders.

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**14. Redeemable convertible preferred shares (Continued)**

*Series E convertible redeemable preferred shares (Continued)*

*Redemption right*

The Series E preferred shares were redeemable at the option of the investor any time after March 1, 2018 but not later than March 1, 2019.

The redemption price shall be equal to the aggregate amount of price paid per such share pursuant to the share purchase agreement (i.e. USD 2.82), plus interest on the original issue price applicable to each Series E convertible redeemable preferred share at a rate of 15% per annum compounded annually from the issuance date up to and including the date of redemption, plus all declared but unpaid dividends and distributions on any such Shares; If the Company did not have sufficient funds to redeem all of the redeemable shares, the Company shall redeem a pro rata portion of each holder's redeemable shares out of funds legally available; and redeem the remaining shares as soon as practically after the Company had funds legally available therefor.

The Company had determined that the Series E preferred shares should be classified as mezzanine equity in the unaudited condensed consolidated balance sheets because the preferred shares are only contingently redeemable by the holder four years after the issuance date. The carrying value of the preferred shares is accreted from its carrying value on the date of issuance to the redemption value using the effective interest method from date of issuance to the earliest redemption date. The accretion was recorded against retained earnings, or in the absence of retained earnings, by charging against additional paid-in capital. Once additional paid-in capital has been exhausted, additional charges should be recorded by increasing the accumulated deficit.

The Company assessed beneficial conversion feature attributable to the Series E Tranche 1 Preferred Shares and determined that there was a beneficial conversion feature with an amount of USD52,377 thousand, which was bifurcated from the carrying value of Series E Tranche 1 Preferred Shares as a contribution to additional paid-in capital upon issuance of Series E Tranche 1 Preferred Shares. The discount of USD52,377 thousand resulting from the recognition of the beneficial conversion feature were amortized from the date of the issuance to the first redemption date of the Series E Tranche 1 Preferred Shares as a deemed dividend to preferred shareholders and charged against retained earnings, and in the absence of retained earnings, a charge to additional paid-in capital. The beneficial conversion feature is calculated based on the difference between an adjusted conversion price of USD2.31 and the Company's common share fair value of USD3.05 multiplied by the number of shares into which the preferred shares are convertible into. The conversion price was adjusted from USD2.82 to USD2.31 principally because liability classified instruments, such as the warrants and the subscription rights (see below for further information) were issued with the Series E Tranche 1 Preferred Shares. Since the warrants and the subscription rights are classified as liability,

the sales proceeds are first allocated to the warrants and the subscription rights full fair value (not relative fair value) and the residual amount of the sales process is allocated to the Series E Tranche 1 Preferred Shares to calculate the beneficial conversion feature.

| <b>(In thousands)</b>   | <b>December 31,<br/>2014</b> |
|---|------------------------------|
| Beginning balance   |                              |
| Addition  | 275,314                      |
| Exercise of Series E subsequent sale rights                                       | 28,568                       |
| BCF upon Series E   | (53,486)                     |
| Amortisation of BCF of Series E   | 4,139                        |
| Accretion of Series E to convertible redeemable preferred shares redemption value | 12,754                       |
| Acceleration of amortization of BCF of Series E upon IPO                          | 49,346                       |
| Deemed dividend to preferred shareholders upon IPO                                | 27,396                       |
| Converted to common shares upon IPO   | (344,031)                    |
| <b>Ending balance</b>   |                              |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****14. Redeemable convertible preferred shares (Continued)***Series E convertible redeemable preferred shares (Continued)**Exchange of Series E Tranche 1 Investor options for transfer restrictions*

As part of the issuance of the Series E Tranche 1 Preferred Shares, the Series E Tranche 1 Investor and the Company's founders (who are also employees) and two employees (collectively the Grantees) of the Company agreed that (i) Series E Tranche 1 Investor will grant to the Grantees the right to purchase certain number of restricted shares of the Series E Tranche 1 Investor's own shares with a total subscription consideration of not more than USD20 million at a subscription price per share that reflects the valuation of the Series E Tranche 1 Investor being USD10 billion (the Series E Tranche 1 Investor Options); and (ii) the Grantees agreed to impose a transfer restriction (the Transfer Restrictions) on 39,934,162 common shares, 3,394,564 unvested restricted shares, 180,000 unvested options and 180,000 vested options (the Shares) owned by the Grantees. The Transfer Restrictions prohibit the Grantees from transferring their shares to another person/party until April 24, 2018 or April 24, 2019 as appropriate without the prior written consent of the holders of at least 75% of the Series E Tranche 1 Preferred Shares holders. The Series E Tranche 1 Investor Options and the Transfer Restrictions are not tied to the Grantees' future employment with the Company.

The value of the Transfer Restrictions was determined to be significantly greater than the value of Series E Tranche 1 Investor Options. In determining the value of the Transfer Restrictions, the Company was assisted by an independent valuation firm based on data provided by the Company. The valuation of the Transfer Restrictions is estimated to be USD43.3 million (refer to the valuation methodology below). For the valuation of the Series E Tranche 1 Investor Options, the Company was only able to obtain limited financial information from the Series E Tranche 1 Investor, a private company, to perform a valuation analysis. This information includes high level 2013 revenue data and information of a third party investment transaction that valued the Series E Tranche 1 Investor at USD10 billion in August of 2013. Given the lack of financial information, the Company is unable to determine a more precise estimate of the fair value of the Series E Tranche 1 Investor Options on the exchange date. If the fair value of the Series E Tranche 1 Investor Options were worth USD43.3 million, the estimated value of the Transfer Restrictions, the Series E Tranche 1 Investor itself would need to be estimated at a valuation in excess of USD30 billion on March 5, 2014. The Company does not expect the valuation of the Series E Tranche 1 Investor to increase by 200% from USD 10 billion in August 2013 to USD 30 billion in March 2014. Hence, no incremental benefit was given to the Grantees and no compensation expense was recognized.

To determine the fair value of the Transfer Restrictions, the Company valued the common shares with the Transfer Restrictions and compared this value to the value of the common shares without the restriction. The difference was determined to be the value of the Transfer Restrictions. A put option pricing model was used to determine the discount

to be applied to the common shares to arrive at the value of common shares with the Transfer Restrictions. Pursuant to that model, the Company used the cost of a put option, which can be used to hedge the price change before a share subject to transfer restriction can be sold, as the basis to determine the discount for transfer restrictions. A put option was used because it incorporates certain company-specific factors, including timing of the expected initial public offering or duration of the Transfer Restriction and the volatility of the share price companies engaged in the same industry.

*Series E Warrants*

The Series E warrants ( Series E warrants ) granted to the Series E Tranche 1 Investor is exercisable at the option of the Series E Tranche 1 Investor, at any time, on or after January 1, 2015 and no later than March 1, 2015. The warrants are not exercisable if the Company has completed the initial public offering in the United States by December 31, 2014. The exercise price shall be adjusted from time to time as provided below: proportionate adjustment for issuance of additional common shares, share split and combination, dividend and distributions, reclassification, reorganization, merger, and consolidations.



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The warrants are not entitled to dividend rights nor to vote until the warrants are exercised and shares become issuable. The Series E warrants are initially measured at its fair value and the initial carrying value for Series E Tranche 1 Preferred Shares is allocated on a residual basis as the warrant is liability classified. The Series E warrants are initially measured at their fair value of USD 6,477 thousand.

The fair value of the Series E warrants were estimated by the Company with the assistance from an independent valuation firm based on data provided by the Company. The valuation report provided by the Company with guidelines in determining the fair value, but the determination was made by the Company. The Company applied the Black-Scholes Option Pricing Model to calculate the fair value of the Series E warrants on the valuation date.

The major assumptions used in calculating the fair value of the Series E warrants include:

|  | <b>March 5,<br/>2014</b> |
|--|--------------------------|
| Spot price <sup>(1)</sup>              | 4.50 - 4.65              |
| Risk-free interest rate <sup>(2)</sup> | 0.12%                    |
| Volatility rate <sup>(3)</sup>         | 38.81%                   |
| Dividend yield <sup>(4)</sup>          |                          |

(1) Spot price based on the fair value of 100 percent equity interest of the Company which is allocated to preferred shares and common shares of the Company as at the valuation date under different scenarios. The probability of the occurrence of an IPO is assumed to be 80%, the probability of the occurrence of a liquidation event is assumed to be 10% and the probability of the occurrence of a redemption event is assumed to be 10%.

(2) Risk-free interest rate based on the US Treasury Bond & Notes BFV curve from Bloomberg as at the valuation date.

(3)

Volatility based on the average historical volatility of the comparable companies from Bloomberg as at the valuation date.

(4) The Company has no history or expectation of paying dividends on its common shares.

*Subscription Rights*

Within 3 months after March 5, 2014, the Series E Tranche 1 Investor shall have Subscription Rights to purchase, or designate any other person/party to purchase from the Company an additional number of 35,487,746 Series E preferred shares, at a price equal to the purchase price per share (USD 2.82) of the Series E issuance. The exercise price shall be adjusted from time to time as provided below: proportionate adjustment for issuance of additional common shares, share split and combination, dividend and distributions, reclassification, reorganization, merger, and consolidations. The Subscription Rights are not entitled to dividend rights nor to vote until the Subscription Rights have been exercised and shares are issuable.

On April 24, 2014, two of the three Series E Tranche 2 Investors exercised the Subscription Rights assigned to them by the Series E Tranche 1 Investor to purchase USD100 million while the third Series E Tranche 2 investor purchased the remaining USD10 million. Upon the exercise of the Subscription Rights, the fair value of the warrant liability of USD 29,223 thousand was derecognized and credited to carrying amount of the Series E Tranche 2 Preferred Shares.

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The fair value of the Subscription Rights was estimated by the Company with the assistance from an independent valuation firm based on data provided by the Company. The valuation report provided by the Company with guidelines in determining the fair value, but the determination was made by the Company. The Company applied the Black-Scholes Option Pricing Model to calculate the fair value of the Subscription Rights on the valuation date. The Subscription Rights are initially measured at their fair value of USD 28,208 thousand. As of April 24, 2014, the fair value of Subscription Rights was USD 29,223 thousand.

The major assumptions used in calculating the fair value of the Subscription Rights include:

|  | <b>March 5,<br/>2014</b> | <b>April 24,<br/>2014</b> |
|--|--------------------------|---------------------------|
| Spot price <sup>(1)</sup>              | 3.31 - 4.65              | 3.39 - 4.64               |
| Risk-free interest rate <sup>(2)</sup> | 0.04%                    | 0.02%                     |
| Volatility rate <sup>(3)</sup>         | 38.12%                   | 42.74%                    |
| Dividend yield <sup>(4)</sup>          |                          |                           |

- (1) Spot price based on the fair value of 100 percent equity interest of the Company which is allocated to preferred shares and common shares of the Company as at the valuation date under different scenarios. The probability of the occurrence of an IPO is assumed to be 80%, the probability of the occurrence of a liquidation event is assumed to be 10% and the probability of the occurrence of a redemption event is assumed to be 10%.
- (2) Risk-free interest rate based on the US Treasury Bond & Notes BFV curve from Bloomberg as at the valuation date.
- (3) Volatility based on the average historical volatility of the comparable companies from Bloomberg as at the valuation date.
- (4) The Company has no history or expectation of paying dividends on its common shares.

*Issuance of Series E Tranche 2 Preferred Shares*

On April 24, 2014, the Company issued Series E convertible redeemable preferred shares (the Series E Tranche 2 Preferred Shares ) to three investors (the Series E Tranche 2 Investors ) to subscribe 39,037,382 Series E Tranche 2 Preferred Shares for a total consideration of USD110 million.

The Company assessed the beneficial conversion feature attributable to the Series E Tranche 2 Preferred Shares and determined that there was a beneficial conversion feature with an amount of USD1,109 thousand for the Series E Tranche 2 Preferred Shares of USD10 million issued to one investor. For the remaining Series E Tranche 2 Preferred Shares of USD100 million issued to another two investors, there was no beneficial conversion feature attributable to them.

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**14. Redeemable convertible preferred shares (Continued)**

*Series E convertible redeemable preferred shares (Continued)*

*Initial public offering*

Upon the completion of the IPO on 24 June 2014, the Company adjusted the Series E conversion price from USD2.82 to USD2.4 per share relating to 110,014,440 Series E preferred shares held by the Series E investors. The Company concluded that the downward conversion price adjustment is in accordance with the anti-dilution clause in the latest shareholders agreement. As a result of this anti-dilution, the Company issued a total of 129,166,667 common shares on a fully-converted basis when the conversion right is exercised by the Series E shareholders. The triggering of the anti-dilution clause resulted in a beneficial conversion feature amounted to USD 27,396 thousand which was charged to retained earnings in 2014 as a deemed dividend to Series E shareholders. And the unamortized beneficial conversion features of Series E preferred shares of USD49,346 thousand were recognized upon the completion of the IPO as a deemed dividend to Series E investors and charged against retained earnings, and in the absence of retained earnings, a charge to additional paid-in capital.

Upon the completion of the IPO on 24 June 2014, the Series E warrants are not exercisable in future. As a result, the fair value of Series E warrants liability of USD6,381 thousand was derecognized and the related fair value gain was recognized as other income.

**15. Convertible preferred shares**

The key terms of the Series A, Series A-1, Series B and Series C preferred shares are as follows:

*Dividend rights*

The holders of the Series A, Series A-1, Series B and Series C preferred shares are entitled to participate in any dividend pari passu with common shareholders of the Company on an as-converted basis.

*Liquidation preferences*

In the event of a liquidation, dissolution or winding up of the Company, available assets and funds of the Company are distributed to the holders of the preferred shares in order of 1) Series C and Series B which are grouped as one class for the purpose of liquidation preference, 2) Series A-1 and then 3) Series A, at their respective original issuance price per share plus any declared but unpaid dividends adjusted for share splits, share dividends, recapitalizations, and

other adjustments. In the event that available assets and funds are insufficient to permit payment to the holders of the less senior class of preferred shares, the assets and funds will be distributed ratably to that class of preferred shareholders based on their proportional share ownership. After the distribution to the holders of Series C and Series B, Series A-1, Series A preferred shares and common shares are made, any remaining legally available assets and funds shall be distributed to the holders of common shares and Series C and Series B, Series A-1 and Series A preferred shares pro rata on an as-converted basis.

In addition, the following events are deemed liquidation events in which case any proceeds derived from such deemed liquidation events will be distributed in the order discussed above. If no proceeds are derived from such deemed liquidation events, the Series B preferred shareholders shall have the right to require the Company to repurchase all or any of the outstanding Series B preferred shares at the original issue price.

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**(Amounts in US dollars unless otherwise stated)**

**15. Convertible preferred shares (Continued)**

*Liquidation preferences (Continued)*

- 1) Any consolidation or merger of the Company or other corporate reorganization, in which the shareholders of Company own less than a majority of the voting power of the Company or surviving company, after such consolidation, merger or reorganization
  
- 2) A sale of other disposition of all or substantially all of the assets of the Company or the Group
  
- 3) A transfer or an exclusive licensing of all or substantially all of the intellectual property of the Company. However, all liquidation events or deemed liquidation event have to be approved by a special resolution passed by a duly convened general meeting of the Company, which require presence of a representative from the common shareholders, a representative from Series A-1 preferred shareholders and a representative from Series B preferred shareholders. Accordingly, the Company determined that the deemed liquidation events are within the control of the Company and the Series B preferred shareholders do not have control of the Company. Therefore, the deemed liquidation events do not preclude the Series B preferred shares from being classified within permanent equity.

*Voting rights*

The holders of the Series A, Series A-1, Series B and Series C preferred shares shall be entitled to such number of votes equal to the whole number of common shares into which such Series A, Series A-1, Series B and Series C preferred shares are convertible.

*Conversion rights*

Each share of the Series A, Series A-1, Series B and Series C preferred shares is convertible at the option of the holder, at any time after the issuance of such shares, and each share can be converted into one common share of the Company. In addition, each share of the Series A, Series A-1, Series B and Series C preferred shares would automatically be converted into common shares of the Company upon (i) an underwritten public offering of the company's shares on major stock exchanges, including Nasdaq Global Market that results in proceeds to the Company of at least USD 50 million ( QIPO ) or (ii) upon written notice to convert given to the Company by the holders of a majority of such class or series of preferred shares in issue, in each case voting as a separate class on an as converted basis, as applicable.

At the time of issuance, the Series A preferred shares issued to one of the shareholders in 2005 contained a beneficial conversion feature of USD 54 thousand and the amount was charged to retained earnings in 2005 as a deemed dividend.

At the time of anti-dilution, the Series C preferred shares anti-diluted in 2012 contained a beneficial conversion feature of USD 286 thousand and the amount was charged to retained earnings in 2012 as a deemed dividend. There were no beneficial conversion features for the other issuance.

In April, 2011, the Company removed the USD 50 million threshold from the definition of QIPO. The removal of the threshold is not expected to have a significant impact to the financial statements of the Company.

None of the preferred shares are redeemable at the holders' option.



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**15. Convertible preferred shares (Continued)**

*Modification in 2012*

Upon issuance of Series D preferred shares in January 2012 as discussed in note 13, the Company adjusted the Series C conversion price from USD5.24 to USD4.14 per share; and obtained an exclusive option to purchase at any time within 12 months after the date of the conversion for all, but not less than all, of Series C preferred shares at the purchase price of USD4.607 per common share. The Series C conversion price could be adjusted for any share dividends, sub-division and consolidation, and unpaid dividend. As a result of this modification, the Company would issue a total of 7,248,293 common shares on a fully-converted basis of the original 5,728,264 Series C preferred shares when the conversion right is exercised by the holder. Other terms of the Series C preferred shares including the original liquidation rights remained unchanged.

The Company concluded that the downward conversion price adjustment from USD 5.24 to USD 5.13 is in accordance with the anti-dilution clause in the original Series C financing agreement. The incremental downward price adjustment from USD 5.13 to USD 4.14 and the right to an exclusive purchase option are accounted for as modifications of the terms of Series C preferred shares. The incremental value contributed by the Series C preferred shareholder amounted to USD 2,905 thousand and was deemed to be a wealth transfer between the preferred shareholder and common shareholders and the amount was charged to additional paid-in capital.

In determining the accounting for the modification of the Series C preferred shares, the Group also relied on, in part, a valuation report retrospectively prepared by an independent valuer based on data provided by the Group. The valuation report provided the Group with guidelines in determining the fair value, but the determination was made by the Group. Option-pricing method was used to allocate enterprise value to preferred and ordinary shares, taking into account the guidance prescribed by the AICPA Audit and Accounting Practice Aid, Valuation of Privately-Held Company Equity Securities Issued as Compensation . The method treats common stock and preferred stock as call options on the enterprise's value, with exercise prices determined based on the liquidation preference of the preferred stock.

The option-pricing method involves making estimates of the anticipated timing of a potential liquidity event, such as a sale of the Company or an initial public offering, and estimates of the volatility of the Group's equity securities. The anticipated timing is based on the plans of management. Estimating the volatility of the share price of a privately held company is complex because there is no readily available market for the shares. The Group estimated the volatility of its shares to range from 55.36% to 59.91% based on the historical volatility of comparable publicly traded shares of companies engaged in similar lines of business.

*Modification in 2014*

In January of 2014, the Company modified the anti-dilution terms relating to 5,613,699 Series C preferred shares held by one investor ( Series C Investor 1 ). The modification effectively amended the anti-dilution triggering price from USD4.14 to USD2.81 per share. The incremental downward trigger price adjustment from USD 4.14 to USD 2.81 is accounted for as modifications of the terms of Series C preferred shares. The incremental value contributed by the Series C preferred shareholder was deemed to be a transfer of value between the preferred shareholders because the change in the value of the common shares before and after the modification was deemed to be negligible. The Company concluded that this was evidence to suggest that most of the value was transferred from this Series C preferred shareholder to the other existing preferred shareholders. No accounting charge was recorded by the Company.

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**15. Convertible preferred shares (Continued)**

*Triggering of the anti-dilution clause*

Upon issuance of Series E preferred shares in March and April 2014, the Company adjusted the Series C conversion price from USD4.14 to USD3.64 and from USD3.64 to USD3.63 per share relating to 114,565 Series C preferred shares held by one investor ( Series C Investor 2 ), respectively. The Company concluded that the downward conversion price adjustment is in accordance with the anti-dilution clause in the original Series C financing agreement. As a result of this anti-dilution, the Company would issue a total of 165,236 common shares on a fully-converted basis of the original 114,565 Series C preferred shares when the conversion right is exercised by the holder. At the time of this anti-dilution, the Series C preferred shares anti-diluted in 2014 contained a beneficial conversion feature of USD 58 thousand and the amount was charged to retained earnings in 2014 as a deemed dividend. The issuance of the Series E Tranche 1 Preferred Shares did not triggered the anti-dilution term of Series C Investor 1 as their shares were modified as described above.

Upon the completion of the IPO on 24 June 2014, the Company adjusted the Series C conversion price from USD4.14 to USD3.89 and from USD3.63 to USD3.45 per share relating to 5,613,699 Series C preferred shares held by Series C Investor 1 and 114,565 Series C preferred shares held by Series C Investor 2, respectively. The Company concluded that the downward conversion price adjustment is in accordance with the anti-dilution clause in the latest shareholders agreement. As a result of this anti-dilution, the Company issued a total of 7,724,419 common shares on a fully-converted basis when the conversion right is exercised by the Series C shareholders. The triggering of the anti-dilution clause resulted in a beneficial conversion feature amounted to USD 1,403 thousand as a deemed dividend to Series C shareholders and charged against retained earnings, and in the absence of retained earnings, a charge to additional paid-in capital.

As a result, 96,024,567 common shares were issued, and the balance of Series A, Series A-1, Series B and Series C preferred shares was transferred to common shares and additional paid-in capital on the same date.

**16. Common shares**

The Company's Memorandum and Articles of Association authorizes the Company to issue 1,000,000,000 shares of USD0.00025 par value per common share as of December 31, 2014. Each common share is entitled to one vote. The holders of common shares are also entitled to receive dividends whenever funds are legally available and when declared by the Board of Directors, which is subject to the approval by the holders of the common shares representing a majority of the aggregate voting power of all outstanding shares. As of December 31, 2013 and 2014, there were 61,447,372 and 327,611,487 common shares outstanding, respectively. In November 2013 and April 2014, 9,073,732 shares and 14,195,412 shares of USD0.00025 par value per common share were issued to Leading Advice Holdings Limited, a BVI Company owned by the Group's chairman and chief executive officer for no consideration,

respectively. While the common shares have been legally issued, the common shares issued to Leading Advice do not have the attributes of unrestricted, issued and outstanding shares. Therefore, these shares issued to Leading Advice are accounted as treasury shares.

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**17. Repurchase of shares**

On April 15, 2014, the Company repurchased from Skyline 469,225 common shares, 27,180 Series A preferred shares, 591,451 Series A-1 preferred shares, 725,237 Series B preferred shares and 3,808,943 Series D convertible redeemable preferred shares at a consideration of approximately USD24,276 thousand.

On April 24, 2014, the Company repurchased from a number of existing shareholders the following common and preferred shares for a total consideration of USD49,809 thousand. The Company repurchased the following common and preferred shares at a per share price of USD2.82, equal to the issuance price of the Series E preferred shares:

10,334,679 common shares from Vantage Point Global Limited (Founder's company) for USD29,121 thousand;

3,860,733 common shares from Aiden & Jasmine Limited (Co founder's company) for USD10,879 thousand;

450,000 Series A preferred shares from Bright Access International Limited for USD1,268 thousand;

2,921,868 Series B preferred shares from Fidelity Asia Ventures Fund L.P. for USD8,233 thousand;

108,960 Series B preferred shares from Fidelity Asia Principals Fund L.P. for USD308 thousand;

For accounting purposes, the Company determined the per share fair value of the common shares, Series A preferred shares, and Series B preferred shares to be USD3.13, USD3.13, and USD3.19, respectively, on April 24, 2014, the date of repurchase. The repurchase price of USD2.82 was mutually negotiated at the time of the repurchase transactions. There were no other arrangements with the selling shareholders other than the exchange of Xiaomi options for transfer restrictions as described above. The selling shareholders were willing to sell its common and preferred shares at the USD2.82 per share price as it would provide them with as a form of liquidity. For the common shares repurchased, the Company charged the excess of the purchased price over the par value to additional paid in capital. For the preferred shares repurchased, the Company charged the excess of the purchase price over the carrying value to retained earnings or to additional paid in capital if retained earnings is zero.

On the same day, April 24, 2014, the Company transferred a total of 14,195,412 repurchased common shares to Leading Advice for future issuance of restricted shares under the Company's 2014 Plan and cancelled the remaining repurchased shares. While the common shares have been transferred to Leading Advice, the common shares issued to Leading Advice do not have the attributes of unrestricted, issued and outstanding shares. Therefore, these shares issued to Leading Advice are accounted as treasury shares.

According to the repurchase contract, the Company was entitled to an amount (the Withheld Price ) to withhold any taxes with respect to this repurchase as required under the applicable laws. If the Seller has not been specifically required by the applicable governmental or regulatory authority to pay any taxes as required under the applicable laws in connection with the repurchase, after the fifth anniversary of the Closing Date, the Company will pay to the Seller the Withheld Price with a simple interest thereon at the rate of five percent (5%) per annum (the repayment price ) from the Closing Date. Therefore, the Withheld Price was recognized as long-term payable of USD4,782 thousand including due to related parties, non-current portion in the financial statements.

#### **18. Non-controlling interest**

Non-controlling interest includes the interest owned by a shareholder of the Company in a subsidiary of the consolidated VIE.

In February 2010, Shenzhen Xunlei set up a new subsidiary named Xunlei Games Development (Shenzhen) Co., Ltd ( Xunlei Games ) and holds 70% of its equity interest. A shareholder of the Company contributed RMB 3,000 thousand (equivalent to USD439 thousand) and holds 30% equity interest in Xunlei Games, which was accounted for as a non-controlling interest of the Group.

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**19. Share-based compensation**

*2010 share incentive plan*

During the years presented, the Company granted share options to employees, officers and directors of the Group. There were no options granted to non-employees as of December 31, 2012, 2013 and 2014.

These options were granted with exercise prices denominated in the USD, which is the functional currency of the Company. The maximum term of any issued stock option is seven or ten years from the grant date. Stock options granted to employees and officers vest over a four-year schedule as stated below:

- (1) One-fourth of the options shall be vested upon the first anniversary of the grant date;
  - (2) The remaining three quarters of the options shall be vested on monthly basis over the next thirty-six months.  
( $\frac{1}{48}$  of options shall be vested per month subsequently)
- Stock options granted to directors were subject to a vesting schedule of approximately 32 months.

All share-based payments to employees are measured based on their grant-date fair values. Compensation expense is recognized on a straight-line basis over the requisite service period.

In December 2010, the Group adopted a share incentive plan, which is referred to as the 2010 Share Option Plan ( the 2010 Plan ). The purpose of the plan is to attract and retain the best available personnel by linking the personal interests of the members of the board, employees, and consultants to the success of the Group s business and by providing such individuals with an incentive for outstanding performance to generate superior returns for our shareholders. Under the 2010 Plan, the maximum number of shares in respect of which options, restricted shares, or restricted share units may be granted is 26,822,828 shares (excluding the share options previously granted to the directors who are the founders of the Company). The amount of shares available for such grants as of December 31, 2014 is 8,043,115.

On June 11, 2014, board of directors of the Group decided to extended the contractual life for certain vested share options to June 11, 2015, because the maturity date of these options was from June to December in 2014, whereas, the lock-up period for the shares was 6 months from the IPO closing date, i.e. June 24, 2014, which would result in the expiration of these options before the exercise. The incremental share-based compensation of USD768 is recognized at the time of modification.

In the business combination of personal cloud storage business completed on September 5, 2014, the Group granted share options under the 2010 Plan to replace the unvested awards owned by the employees who are transferred to the Group, the portion of the fair-value-based measure of the replacement award attribute to pre-combination service of

USD 303 thousand was allocated to the consideration, while the portion attribute to post-combination service of USD44 thousand was recorded as share based compensation expense over the remaining vesting period (See Note 3).

On December 1, 2014, board of directors of the Group approved the conversion of certain vested and unvested share options with relatively high exercise price into restricted shares. In this conversion, 3,776,711 share options were cancelled and 1,505,787 restricted shares were granted. The incremental share-based compensation of USD 2,214 thousand is recorded over the remaining vesting period of 2 to 4.5 years.

In November 2014, the Company issued to a depositary bank for American Depositary Shares, 10,000,000 common shares, which were reserved for the future exercise of share options or vesting of restricted shares.



**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****19. Share-based compensation (Continued)***2010 share incentive plan (Continued)*

The following table summarizes the share option activity for the years ended December 31, 2012, 2013 and 2014:

|   | <b>Number of<br/>share options</b> | <b>Weighted<br/>average<br/>exercise<br/>price (USD)</b> | <b>Weighted-<br/>average<br/>grant-date<br/>fair<br/>value (USD)</b> | <b>Weighted<br/>average<br/>remaining<br/>contractual<br/>life<br/>(years)</b> | <b>Aggregate<br/>intrinsic<br/>value (in<br/>thousands)</b> |
|---|------------------------------------|--|--|--|---|
| Outstanding, December 31, 2011                      | 20,891,782                         | 1.30   |  | 3.87   | 43,068  |
| Granted   | 320,000                            | 2.73   | 1.59   |  |   |
| Forfeited   | (989,120)                          | 1.72   |  |  |   |
| Outstanding, December 31, 2012                      | 20,222,662                         | 1.30   |  | 2.82   | 40,788  |
| Granted   | 1,076,761                          | 3.33   | 1.27   |  |   |
| Forfeited   | (326,647)                          | 3.32   |  |  |   |
| Outstanding, December 31, 2013                      | 20,972,776                         | 1.37   |  | 2.03   | 39,420  |
| Vested and expected to vest at<br>December 31, 2013 | 20,701,286                         | 1.32   | 0.40   | 1.89   | 41,014  |
| Exercisable at December 31, 2013                    | 19,382,156                         | 1.17   | 0.31   | 1.67   | 40,771  |
| Granted   | 1,566,381                          | 3.23   | 1.01   |  |   |
| Forfeited   | (371,989)                          | 3.96   |  |  |   |
| Expired   | (1,116,531)                        | 0.26   |  |  |   |
| Converted to restricted shares                      | (3,776,711)                        | 3.14   |  |  |   |
| Exercised (note a)                                  | (7,333,641)                        | 0.18   |  |  |   |
| Outstanding, December 31, 2014                      | 9,940,285                          | 1.88   |  | 1.95   | 3,067   |
| Vested and expected to vest at<br>December 31, 2014 | 9,642,307                          | 1.86   | 0.49   | 1.87   | 3,057   |

|                                  |           |      |      |      |       |
|----------------------------------|-----------|------|------|------|-------|
| Exercisable at December 31, 2014 | 9,129,958 | 1.81 | 0.41 | 1.49 | 3,042 |
|----------------------------------|-----------|------|------|------|-------|

Note a: Of which 1,431,320 shares had been settled as of December 31, 2014.

A summary of the restricted shares activities under the 2010 Plan for the years ended December 31, 2014 is presented below:

|   | <b>Number of<br/>restricted<br/>shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair<br/>Value</b> |
|---|--|---|
| Unvested at January 1, 2014:                        |  |   |
| Converted from share options                        | 1,505,787                                  | 1.71  |
| Vested  |  |   |
| Forfeited   |  |   |
| Unvested at December 31, 2014                       | 1,505,787                                  |   |
| Vested and expected to vest at December 31,<br>2014 | 1,279,919                                  |   |

Forfeitures are estimated at the time of grant. If necessary, forfeitures are revised in subsequent periods if actual forfeitures differ from those estimates. Based upon the Company's historical and expected forfeitures for stock options granted, the directors of the Company estimated that its future forfeiture rate would be 20% for employees and nil for directors and advisors.

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The aggregate intrinsic value in the table above represents the difference between the estimated fair value of the Company's common shares as of December 31, 2013 and 2014 and the exercise price.

Total fair values of share options vested as of December 31, 2013 and 2014 were USD 6,271 thousand and USD 7,923 thousand, respectively.

As of December 31, 2013 and 2014, there were USD 2,803 thousand and USD 1,462 thousand of unrecognized share-based compensation costs related to share options, which were expected to be recognized over a weighted-average vesting period of 2.66 and 2.84 years, respectively. To the extent the actual forfeiture rate is different from the Company's estimate, the actual share-based compensation related to these awards may be different from the expectation.

The Black-Scholes option pricing model is used to determine the fair value of the stock options granted to employees. The fair values of stock options granted during the years ended December 31, 2012, 2013 and 2014 were estimated using the following assumptions:

Options granted to employees

| <b>Years ended December 31,</b>         | <b>2012</b>    | <b>2013</b>    | <b>2014</b>     |
|---|----------------|----------------|-----------------|
| Risk-free interest rate <sup>(1)</sup>  | 0.67% to 0.92% | 0.77% to 1.76% | 0.77% to 1.76%  |
| Dividend yield <sup>(2)</sup>           |                |                |                 |
| Volatility rate <sup>(3)</sup>          | 53.9% to 54.5% | 43.8% to 51.3% | 40.07% to 43.3% |
| Expected term (in years) <sup>(4)</sup> | 4.58           | 4.58           | 4.13 to 4.58    |

(1) The risk-free interest rate of periods within the contractual life of the share option is based on the USD denominated China Government Bond yield as at the valuation dates.

(2) The Company has no history or expectation of paying dividends on its common shares.

(3) Expected volatility is estimated based on the average of historical volatilities of the comparable companies in the same industry as at the valuation dates.

(4)

The expected term is developed by assuming the share options will be exercised in the middle point between the vesting dates and maturity dates.

*2013 share incentive plan*

In November 2013, the Group adopted a share incentive plan, which is referred to as the 2013 Share Incentive Plan ( the 2013 Plan ). The purpose of the plan is to motivate, attract and retain the best available personnel by linking the personal interests of senior management to the success of the Group s business. The group appointed Leading Advice Holdings Limited ( Leading Advice ), a BVI company owned by the Group s chairman and chief executive officer for no consideration, to administer the plan and is the Administrator. Leading Advice has no activities other than administering the plan and does not have employees. The Group has considered whether Leading Advice is a variable interest entity and, if so, whether the Group is the primary beneficiary. The Group concluded that it is not the primary beneficial of Leading Advice.

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**19. Share-based compensation (Continued)**

*2013 share incentive plan (Continued)*

On behalf of the Group, the Administrator has the authority to select the eligible participants to whom awards will be granted; determine the types of awards and the number of shares covered; establish the terms, conditions and provisions of such awards; cancel or suspend awards; and, under certain conditions to accelerate the exercisability of awards. The Administrator is authorized to interpret the 2013 Plan; to establish, amend, and rescind any rules and regulations relating to the 2013 Plan; to determine the terms of agreements entered into with recipients under the 2013 Plan; and, to make all other determinations that may be necessary or advisable for the administration of the 2013 Plan. In the event of any disagreement between the Group and Leading Advice, the Group's decision shall be final and binding.

In November 2013, the Company issued 9,073,732 common shares to Leading Advice. Although the shares were legally issued to Leading Advice, Leading Advice does not have any of the rights of a typical common share holder. Leading Advice 1) is not entitled to dividends 2) does not have the right to vote prior to vesting and 3) does not have the right to sell the unvested portion of the awards or awards that have not been granted. In addition, upon 1) the liquidation of Leading Advice 2) the dissolution of Leading Advice and 3) the expiration of the 2013 Plan, common shares not granted as awards shall be transferred back to the Group at no consideration. Given the structure of this arrangement, while the common shares have been legally issued, the common shares issued to Leading Advice do not have the attributes of unrestricted, issued and outstanding shares. Therefore, the 9,073,732 common shares issued to Leading Advice are accounted as treasury shares until these common shares are earned by the senior management or employees for service provided to the Group.

For the awards that have been granted and become vested, Leading Advice held shares for the grantees' benefit and exercise the voting rights on their behalf. The grantees will be entitled to dividends and have the right to request Leading Advice to transfer vested award to a transferee designated by the grantees. Shares that have been granted and vested continued to be held by and voting rights exercised by Leading Advice on behalf of the grantee at the closing of a QIPO.

Before the closing of a QIPO, the Company would have a right of first refusal with respect to any proposed transfer of vested restricted shares. After the closing of a QIPO, vested restricted shares may not be sold or transferred for a period of six months or a period of time determined by the underwriter (the lock up period). If the grantee terminates its employment prior to the closing date of a QIPO and a trade sale, the Group would have the right to acquire the vested restricted shares from the senior officer at a market price as determined by third-party valuation experts.

Upon the closing of IPO, the administrator of the 2013 Plan was changed from Leading Advice to the Company's compensation committee.

Under the 2013 Plan, the maximum number of restricted shares that may be granted is 9,073,732 shares.

As of December 31, 2014, 8,764,000 restricted shares were granted to a few senior officers.

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**19. Share-based compensation (Continued)**

*2013 share incentive plan (Continued)*

- (1) 6,285,737 of these restricted shares will vest over a four-year schedule in which one-fourth of the restricted shares shall be vested upon the first, second, third, and fourth anniversary of the grant date, respectively.
- (2) 1,383,858 of these restricted shares will vest over a five-year schedule in which one-fifth of the restricted shares shall be vested upon the first, second, third, fourth and fifth anniversary of the grant date, respectively.
- (3) 60,000 of these restricted shares will vest over one year schedule in which one-fourth of the restricted shares shall be vested upon the end of each quarter since the grant date.
- (4) 180,000 of these restricted shares will vest in one month since the grant date.
- (5) The remaining 854,405 restricted shares granted will vest over a four-year schedule as stated below:
  - (i) One-fourth of the restricted shares shall vest on the earlier of: (i) the first anniversary of the grant date, or (ii) upon a QIPO; and
  - (ii) The remainder three quarters of the restricted shares shall vest in equal instalments on a monthly basis over a thirty-six month vesting period afterwards.

A summary of the restricted shares activities under the 2013 Plan for the years ended December 31, 2012, 2013 and 2014 is presented below:

| <b>Number of<br/>restricted<br/>shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair<br/>Value</b> |
|--|---|
|--|---|

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|  |             |      |
|--|-------------|------|
| Unvested at January 1, 2013:                     |             |      |
| Granted  | 8,095,238   | 3.15 |
| Unvested at December 31, 2013                    |             |      |
| Granted  | 4,233,558   | 2.89 |
| Vested   | (1,563,222) |      |
| Forfeited  | (3,564,796) |      |
| Unvested at December 31, 2014                    |             |      |
|  | 7,200,778   |      |
| Vested and expected to vest at December 31, 2014 | 7,683,884   |      |

Forfeitures are estimated at the time of grant. If necessary, forfeitures are revised in subsequent periods if actual forfeitures differ from those estimates.

All restricted shares granted to senior officers are measured based on their grant-date fair values. Compensation expense is recognized on a straight-line basis over the requisite service period. As of December 31, 2014, total unrecognized compensation expense relating to the restricted shares was USD 20,058 thousand. No restricted shares were issued to non-employees.



**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****19. Share-based compensation (Continued)***2014 share incentive plan*

In April 2014, the Group adopted a share incentive plan, which is referred to as the 2014 Share Incentive Plan (the 2014 Plan). The purpose of the plan is to motivate, attract and retain the best available personnel by linking the personal interests of senior management to the success of the Group's business. Under the 2014 Plan, the maximum number of restricted shares that may be granted is 14,195,412 shares to certain officers, directors or employees of, or advisors or consultants to the Company and its subsidiaries and consolidated affiliated entities. The company issued 14,195,412 common shares to Leading Advice, a company owned by the Group's chairman and chief executive officer. The issuance of common shares was to facilitate the administration of the 2014 plan. The 2014 Plan was administered by the Company's compensation committee.

As of December 31, 2014, 3,896,500 restricted shares were granted to certain officers and employees of the Group:

- (1) 2,096,500 of these restricted shares will vest over a five-year schedule in which one-fifth of the restricted shares shall be vested upon the first, second, third, fourth and fifth anniversary of the grant date, respectively.
- (2) The remaining 1,800,000 restricted shares will vest over a four-year schedule in which one-fourth of the restricted shares shall be vested upon the first, second, third and fourth anniversary of the grant date, respectively.

A summary of the restricted shares activities under the 2014 Plan for the years ended December 31, 2014 is presented below:

|  | <b>Number of<br/>restricted<br/>shares</b> | <b>Weighted-Average<br/>Grant-Date<br/>Fair<br/>Value</b> |
|--|--|---|
| Unvested at January 1, 2014                      |  |   |
| Granted  | 3,896,500                                  | 1.77  |
| Unvested at December 31, 2014                    | 3,896,500                                  |   |
| Vested and expected to vest at December 31, 2014 | 3,312,025                                  |   |

Forfeitures are estimated at the time of grant. If necessary, forfeitures are revised in subsequent periods if actual forfeitures differ from those estimates.

All restricted shares granted are measured based on their grant-date fair values. Compensation expense is recognized on a straight-line basis over the requisite service period. As of December 31, 2014, total unrecognized compensation expense relating to the restricted shares was USD 6,713 thousand. No restricted shares were issued to non-employees.

Total compensation costs recognized for the years ended December 31, 2012, 2013 and 2014 are as follows:

| <b>(In thousands)</b>               | <b>Years ended December 31,</b> |             |             |
|-------------------------------------|---------------------------------|-------------|-------------|
|                                     | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Sales and marketing expenses        | 46                              | 43          | 66          |
| General and administrative expenses | 1,102                           | 1,080       | 6,407       |
| Research and development expenses   | 1,085                           | 973         | 1,171       |
| Total                               | 2,233                           | 2,096       | 7,644       |

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****20. Basic and diluted net (loss) / income per share**

Basic and diluted net (loss) / income per share for the years ended December 31, 2012, 2013 and 2014 are calculated as follows:

| <b>(Amounts expressed in thousands of United States dollars ( USD ), except for number of shares and per share data)</b> | <b>Years ended December 31,</b> |             |               |
|--|---------------------------------|-------------|---------------|
|  | <b>2012</b>                     | <b>2013</b> | <b>2014</b>   |
| <b>Numerator:</b>  |                                 |             |               |
| Net (loss) / income attributable to Xunlei Limited   | 503                             | 10,662      | 10,812        |
| Beneficial Conversion Feature of Series C convertible preferred shares from their modifications                          | (286)                           |             |               |
| Deemed contribution from Series C preferred shareholders   | 2,979                           |             |               |
| Accretion of Series D to convertible redeemable preferred shares redemption value  | (3,509)                         | (4,300)     | (1,870)       |
| Contingent beneficial conversion feature of series C to one Series C shareholder   |                                 |             | (57)          |
| Deemed dividend to Series D shareholder from its modification  |                                 |             | (279)         |
| Accretion of Series E to convertible redeemable preferred shares redemption value  |                                 |             | (12,754)      |
| Amortization of beneficial conversion feature of Series E  |                                 |             | (4,139)       |
| Deemed dividend to certain shareholders from repurchase of shares  |                                 |             | (14,926)      |
| Acceleration of amortization of beneficial conversion feature of Series E upon initial public offering                   |                                 |             | (49,346)      |
| Deemed dividend to preferred shareholders upon IPO   |                                 |             | (32,807)      |
| Allocation of net income to participating preferred shareholders   |                                 | (4,094)     |               |
| Numerator of basic net (loss) / income per share   | (313)                           | 2,268       | (105,366)     |
| Dilutive effect of warrant   |                                 | (1,531)     |               |
| Numerator for diluted (loss) / income per share  | (313)                           | 737         | (105,366)     |
| <b>Denominator:</b>  |                                 |             |               |
| Denominator for basic net (loss) / income per share-weighted average shares outstanding                                  | 61,447,372                      | 61,447,372  | 194,711,227   |
| Dilutive effect of warrants  |                                 | 2,218,935   |               |
| Dilutive effect of share options and restricted shares   |                                 | 12,399,591  |               |
| Denominator for diluted net (loss) / income per share  | 61,447,372                      | 76,065,898  | 194,711,227   |
| <b>Basic net (loss) / income per share</b>   | <b>(0.01)</b>                   | <b>0.04</b> | <b>(0.54)</b> |
| <b>Diluted net (loss) / income per share</b>   | <b>(0.01)</b>                   | <b>0.01</b> | <b>(0.54)</b> |



**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****20. Basic and diluted net (loss) / income per share (Continued)**

The following common shares equivalent were excluded from the computation of diluted net income per common share for the periods presented because including them would have had an anti-dilutive effect:

|  | <b>Years ended December 31,</b> |             |             |
|--|---------------------------------|-------------|-------------|
|  | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Preferred shares weighted average                    | 110,083,912                     | 110,953,534 | 93,213,683  |
| Share options and restricted shares weighted average | 2,240,681                       | 2,513,017   | 9,041,434   |

**21. Related party transactions**

The table below sets forth the related parties and their relationships with the Group:

| <b>Related Party</b>                                  | <b>Relationship with the Group</b>                         |
|---|--|
| Zhuhai Qianyou  | Equity investment of the Group                             |
| Hao Cheng   | Co-founder and shareholder of the Group                    |
| Chuan Wang  | Director of the Company                                    |
| Shenglong Zou   | Co-founder and shareholder of the Group                    |
| Beijing Millet technology Co., LTD ( Beijing Xiaomi ) | Company owned by a shareholder of the Group                |
| Leading Advice Holdings Limited                       | Company owned by a Co-founder and shareholder of the Group |
| Vantage Point Global Limited                          | Shareholder of the Company                                 |
| Aiden & Lasmine Limited                               | Shareholder of the Company                                 |
| Kingsoft Corporation Limited                          | Shareholder of the Company                                 |

During the years ended December 31, 2012, 2013 and 2014, significant related party transactions were as follows:

| <b>(In thousands)</b>  | <b>Years ended December 31,</b> |             |             |
|--|---------------------------------|-------------|-------------|
|  | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Game sharing costs paid and payable to Zhuhai Qianyou (note a) | 1,041                           | 1,760       | 402         |
| Advance to Hao Cheng   |                                 | 85          |             |
| Repayment from Hao Cheng                                       |                                 |             | 85          |

|  |     |
|--|-----|
| Technology service revenue from Beijing Xiaomi | 303 |
| Advertisement revenue from Beijing Xiaomi      | 871 |
| Advance to Shenglong Zou                       | 10  |
| Advance to Chuan Wang                          | 7   |

note a The Company obtained an exclusive game operation right from Zhuhai Qianyou, which is specialized in developing online games. According to the agreement, the Company will share revenues derived by the licensed games with Zhuhai Qianyou.

In April 2014, the company issued 14,195,412 common shares to Leading Advice, a company owned by the Group's chairman and chief executive officer. The issuance of common shares was to facilitate the administration of the 2014 plan.

As mentioned in note 3, the Group acquired assets relating to a personal cloud storage business from certain PRC subsidiaries of Kingsoft Corporation Limited for an aggregate cash consideration of USD33 million. Kingsoft Corporation Limited, through its wholly owned subsidiary King Venture Holdings Limited, owned approximately 11.4% of our outstanding shares as of the closing of the transaction.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****21. Related party transactions (Continued)**

As of December 31, 2012, 2013 and 2014, the amounts due to / from related parties were as follows:

| (In thousands)  | December 31,<br>2012 | December 31,<br>2013 | December 31,<br>2014 |
|---|----------------------|----------------------|----------------------|
| <b>Amounts due to related parties</b>                       |                      |                      |                      |
| Accounts payable to Zhuhai Qianyou                          | 313                  | 225                  | 84                   |
| Long-term payable to Aiden & Lasmine Limited (note 17)      |                      |                      | 1,125                |
| Long-term payable to Vantage Point Global Limited (note 17) |                      |                      | 3,012                |
|   | December 31,<br>2012 | December 31,<br>2013 | December 31,<br>2014 |
| <b>Amounts due from related parties</b>                     |                      |                      |                      |
| Accounts receivable from Beijing Xiaomi                     |                      |                      | 5                    |
| Other receivable from Hao Cheng                             |                      | 85                   |                      |
| Other receivable from Shenglong Zou                         |                      |                      | 10                   |
| Other receivable from Chuan Wang                            |                      |                      | 7                    |

**22. Taxation****(i) Cayman Islands**

Under the current laws of the Cayman Islands, the Company is not subject to tax on income or capital gains. Additionally, upon payment of dividends by the Company to its shareholders, no Cayman Islands withholding tax will be imposed.

**(ii) PRC Enterprise Income Tax ( EIT )**

Giganology Shenzhen, the VIE and its subsidiaries which were established in the Shenzhen Special Economic Zone of the PRC were all subject to EIT at a rate of 15% before 2008. On March 16, 2007, the PRC National People's Congress promulgated the New Enterprise Income Tax Law (the New EIT Law), which became effective on January 1, 2008, adopting a unified EIT rate of 25%. In addition, the New EIT Law also provides a five-year

transitional period starting from its effective date for those enterprises that were established before the date of promulgation of the New EIT Law and that were entitled to preferential income tax rates under the then effective tax laws or regulations. On December 26, 2007, the State Council issued the Circular to Implementation of the Transitional Preferential Policies for the Enterprise Income Tax . Pursuant to this Circular, the transitional income tax rates for enterprises established in the Shenzhen Special Economic Zone before March 16, 2007 were 18%, 20%, 22%, 24% and 25% for 2008, 2009, 2010, 2011 and 2012, respectively. Thus, the applicable EIT rate for Giganology Shenzhen, the VIE and its subsidiaries, which were established in the Shenzhen Special Economic Zone before March 16, 2007, was 25%, 25% and 25% for the years 2012, 2013 and 2014, respectively.

As approved by the local tax authority, Giganology Shenzhen was further exempt from EIT for two years commencing from its first year of profitable operation after offsetting prior years tax losses, followed by a 50% reduction for the next three years ( 2-year Exemption and 3-year 50% Reduction ) as a software enterprise. The first year of profit operation of Giganology Shenzhen was 2006. According to new EIT Law, Giganology Shenzhen could still enjoy the tax holidays which were grandfathered by the New EIT Law.



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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**22. Taxation (Continued)**

(ii) PRC Enterprise Income Tax ( EIT ) (Continued)

Accordingly, the applicable EIT rates for Giganology Shenzhen were 25%, 25% and 25% for the years ended December 31, 2012, 2013 and 2014, respectively.

On April 14, 2008, relevant governmental regulatory authorities released further qualification criteria, application procedures and assessment processes for meeting the High and New Technology Enterprise ( HNTE ) status under the New EIT Law which would entitle qualified and approved entities to a favorable statutory tax rate of 15%.

In April 2009, the State Administration for Taxation ( SAT ) issued Circular Guoshuihan [2009] No. 203 ( Circular 203 ) stipulating that entities which qualified for the HNTE status should apply with in-charge tax authorities to enjoy the reduced EIT rate of 15% provided under the New EIT Law starting from the year when the new HNTE certificate becomes effective. In addition, an entity which qualified for the HNTE status can continue to enjoy its remaining tax holiday from January 1, 2008 provided that it has obtained the HNTE certificate according to the new recognition criteria set by the New EIT Law and the relevant regulations.

In February 2011, Shenzhen Xunlei obtained the HNTE certificate with effect from January 1, 2011.

According to a policy promulgated by the State tax bureau of the PRC and effective from 2008 onwards, enterprises engage in research and development activities are entitled to claim 150% of the research and development expenses so incurred in a year as tax deductible expenses in determining its tax assessable profits for that year ( Super Deduction ). Shenzhen Xunlei has been claiming such Super Deduction in ascertaining its tax assessable profits from 2009 onwards. In addition, approved by the relevant local tax authority in July 2010, Shenzhen Xunlei was recognized as an enterprise engaged in software development activities, accordingly, it is entitled to a tax holiday of 2-year Exemption and 3-year 50% Reduction from 2010 onwards.

In December 2013, Shenzhen Xunlei obtained the certificate of Key Software Enterprise for the years ended December 31, 2013 and 2014, which enabled Shenzhen Xunlei to enjoy the preferential tax rate of 10% for the year 2013. As a result, the applicable tax rate of Shenzhen Xunlei for the years ended December 31, 2012, 2013 and 2014 were 12.5%, 10% and 10% respectively.

The subsidiaries and VIE s subsidiaries, which were established after January 1, 2008, were subject to EIT at a rate of 25%.

Xunlei Computer was established in 2011 in the Shenzhen Special Economic Zone, the PRC. As approved by the relevant tax authority in June 2013, Xunlei Computer was further exempt from EIT for two years commencing from

its first year of profitable operation after offsetting prior years' tax losses, followed by a 50% reduction for the next three years ( 2-year Exemption and 3-year 50% Reduction ). The first year of profit operation of Xunlei Computer is 2013.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****22. Taxation (Continued)****(ii) PRC Enterprise Income Tax ( EIT ) (Continued)**

Dividends paid by the PRC subsidiaries of the Group out of the profits earned after December 31, 2007 to non-PRC tax resident investors are subject to PRC withholding tax. The withholding tax ( WHT ) on dividends is 10%, unless a foreign investor's tax jurisdiction has a tax treaty with the PRC that provides for a lower withholding tax rate and the foreign investor is recognized as the beneficial owner of the income under the relevant tax rules. The 10% WHT is applicable to any dividends to be distributed from Giganology Shenzhen and Xunlei Computer to the Company out of any profits of these two companies derived after January 1, 2008. Up to December 31, 2014, both Giganology Shenzhen and Xunlei Computer did not declare any dividend to the parent company and have determined that it has no present plan to declare and pay any dividends. The Group currently plans to continue to reinvest its subsidiaries undistributed earnings, if any, in its operations in China indefinitely. Accordingly, no withholding income tax was accrued or required to be accrued as of December 31, 2013 and 2014. The undistributed earnings from the Group's PRC entities as of December 31, 2013 and 2014 amounted to USD 31,385 thousand and USD 38,393 thousand, respectively. An estimated foreign withholding taxes of USD 3,138 thousand and USD 3,839 thousand would be due if these earnings were remitted as dividends as of December 31, 2013 and 2014, respectively.

Moreover, the current EIT Law treats enterprises established outside of China with effective management and control located in the PRC as PRC resident enterprises for tax purposes. The term effective management and control is generally defined as exercising overall management and control over the business, personnel, accounting, properties, etc. of an enterprise. The Company, if considered a PRC resident enterprise for tax purposes, would be subject to the PRC Enterprise Income Tax at the rate of 25% on its worldwide income for the period after January 1, 2008. As of December 31, 2014, the Company has not accrued for PRC tax on such basis. The Company will continue to monitor its tax status.

The current and deferred portions of income tax expense included in the consolidated statements of operations are as follows:

| <b>(In thousands)</b>        | <b>Years ended</b>  |              |                |
|------------------------------|---------------------|--------------|----------------|
|                              | <b>December 31,</b> |              |                |
|                              | <b>2012</b>         | <b>2013</b>  | <b>2014</b>    |
| Current income tax expenses  | 2,362               | 175          | 397            |
| Deferred income tax benefits | (123)               | (822)        | (1,856)        |
| <b>Taxation for the year</b> | <b>2,239</b>        | <b>(647)</b> | <b>(1,459)</b> |

The aggregate amount and per share effect of the tax holiday are as follows:

|   | <b>Years ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Aggregate dollar effect ( <b>in thousands</b> ) | 2,073                           | 4,638       | 2,784       |
| Per share effect basic                          | 0.03                            | 0.08        | 0.01        |
| Per share effect diluted                        | 0.03                            | 0.06        | 0.01        |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****22. Taxation (Continued)****(ii) PRC Enterprise Income Tax ( EIT ) (Continued)**

The reconciliation of total tax (benefit) / expense computed by applying the respective statutory income tax rates to pre-tax (loss) / income is as follows:

| <b>(In thousands)</b>   | <b>Years ended December 31,</b> |              |                |
|---|---------------------------------|--------------|----------------|
|   | <b>2012</b>                     | <b>2013</b>  | <b>2014</b>    |
| Income tax (benefit) / expense at PRC statutory rate (based on statutory tax rate applicable to enterprises in Shenzhen, China) | 655                             | 2,433        | 2,129          |
| Effects of differences in tax rates in different jurisdictions applicable to entities of the Group outside of the PRC           | 2,074                           | 667          | (838)          |
| Non-deductible expenses   | 53                              | 102          | 714            |
| Effect of Super Deduction available to Shenzhen Xunlei  | (2,274)                         | (1,763)      | (1,365)        |
| Effect of tax holiday   | (2,073)                         | (4,638)      | (2,784)        |
| Change in valuation allowance of deferred tax assets  | 6                               |              | 291            |
| Effect on deferred tax assets due to change in tax rates  | (437)                           | 1,764        | (103)          |
| Outside basis difference arising from VIE and its subsidiaries in the PRC   | 4,217                           | 713          | 478            |
| Expiration of tax loss  |                                 | 31           | 51             |
| Others  | 18                              | 44           | (32)           |
| <b>Income tax expense / (benefit)</b>   | <b>2,239</b>                    | <b>(647)</b> | <b>(1,459)</b> |

The tax effects of temporary differences that give rise to the deferred tax asset and liability balances at December 31, 2013 and 2014 are as follows:

| <b>(In thousands)</b>                       | <b>December 31,</b> | <b>December 31,</b> |
|---|---------------------|---------------------|
|   | <b>2013</b>         | <b>2014</b>         |
| Deferred tax assets, current portion:       |                     |                     |
| Net operating loss carried forward (Note a) | 50                  | 315                 |
|   | 69                  | 69                  |

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|   |         |         |
|---|---------|---------|
| Amortization of intangible assets arising from intragroup transactions (Note b) |         |         |
| Amortization of content copyrights (Note c)                                     | 1,033   | 1,675   |
| Impairment of online game licenses  | 33      | 32      |
| Deferred tax assets, current portion, net                                       | 1,185   | 2,091   |
| Deferred tax assets, non-current portion:                                       |         |         |
| Net operating loss carried forward (Note a)                                     | 3,676   | 6,103   |
| Allowance for doubtful accounts   | 1,311   | 796     |
| Amortization of intangible assets arising from intragroup transactions (Note b) | 175     | 105     |
| Impairment of online game licenses  | 49      | 16      |
| Amortization of Content Copyrights (Note c)                                     | 4,219   | 4,133   |
| Valuation allowance   |         | (291)   |
| Deferred tax assets, non-current portion, net                                   | 9,430   | 10,862  |
| Deferred tax liability, non-current portion:                                    |         |         |
| Outside basis difference (Note d)   | (8,074) | (8,552) |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****22. Taxation (Continued)****(ii) PRC Enterprise Income Tax ( EIT ) (Continued)**

Note a: As of December 31, 2014, the Group had tax loss carryforwards of USD 24,509 thousand, which can be carried forward to offset future taxable income. The net operating tax loss carryforwards will begin to expire as follows:

| <b>(In thousands)</b> |        |
|-----------------------|--------|
| 2015                  | 1,259  |
| 2016                  | 1,784  |
| 2017                  | 1,971  |
| 2018                  | 9,638  |
| 2019 and thereafter   | 9,857  |
|                       | 24,509 |

Note b: Before 2008, Giganology Shenzhen sold several self-developed software at a market valuation of approximately RMB42 million to Shenzhen Xunlei. Shenzhen Xunlei was entitled to capitalize the amounts as intangible assets for tax purposes and the respective amortization charges could be entitled to claim tax deduction. As a result, this transaction had created a temporary difference between the accounting base (on a group basis) and the tax base (on Shenzhen Xunlei standalone basis) and led to origination of a deferred tax asset.

Note c: As mentioned in Note 2(m), the Group adopts certain accelerated amortization methods for amortization of certain Content Copyrights for accounting purposes, while straight-line method is adopted for PRC tax reporting. Accordingly, the differences have led to origination of temporary differences.

Note d: The deferred tax liabilities arising from the aggregate retained earnings and reserves of the VIE and its subsidiaries that are expected to be recovered by Giganology Shenzhen and other affiliates of the Group in the future periods, amounted to USD 32,296 thousand and USD 34,210 thousand as of December 31, 2013 and 2014, respectively.

Movement of valuation allowance is as follows:

**Years ended December 31,**

| <b>(In thousands)</b> | <b>2012</b> | <b>2013</b> | <b>2014</b> |
|-----------------------|-------------|-------------|-------------|
| Beginning balance     | (37)        | (43)        |             |
| Additions             | (6)         |             | (291)       |
| Write-off             |             | 43          |             |
| Ending balance        | (43)        |             | (291)       |

Valuation allowances had been provided against the net deferred tax assets because it is more likely than not that all of the deferred tax asset will not be realized. In 2013, valuation allowance was written off due to the termination of the business of Xunlei Nanjing. In 2014, valuation allowance was provided for net operating loss carry forward of Wangxin because it was more likely than not that such deferred tax assets will not be realized based on the Group's estimate of Wangxin's future taxable income.



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**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**22. Taxation (Continued)**

(ii) PRC Enterprise Income Tax ( EIT ) (Continued)

As of December 31, 2014, the tax returns of the Group's subsidiaries, VIE and its subsidiaries since their respective dates of incorporation are still open to examination.

**23. Fair value measurements**

Effective January 1, 2008, the Group adopted ASC 820-10, Fair Value Measurements and Disclosures, which defines fair value, establishes a framework for measuring fair value and expands financial statement disclosures about fair value measurements. Although adoption did not impact the Group's consolidated financial statements, ASC 820-10 requires additional disclosures to be provided on fair value measurements.

ASC 820-10 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level 1 Observable inputs that reflect quoted prices (unadjusted) for identical assets or liabilities in active markets

Level 2 Include other inputs that are directly or indirectly observable in the marketplace or based on quoted price in markets that are not active

Level 3 Unobservable inputs which are supported by little or no market activity and are significant to the overall fair value measurement

ASC 820-10 describes three main approaches to measuring the fair value of assets and liabilities: (1) market approach; (2) income approach and (3) cost approach. The market approach uses prices and other relevant information generated from market transactions involving identical or comparable assets or liabilities. The income approach uses valuation techniques to convert future amounts to a single present value amount. The measurement is based on the value indicated by current market expectations about those future amounts. The cost approach is based on the amount that would currently be required to replace an asset.

**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****23. Fair value measurements (Continued)**

The following table sets forth the financial instruments, measured at fair value, by level within the fair value hierarchy as of December 31, 2013 and 2014.

| <b>Fair value measurements as at December 31, 2013</b>                         |              |   |  |  |
|--|--------------|---|--|--|
| <b>(In thousands)</b>  | <b>Total</b> | <b>Quoted prices</b>                                    |  |  |
|  |              | <b>in active market for indentical assets (Level 1)</b> | <b>Significant other observable inputs (Level 2)</b> | <b>Significant observable inputs (Level 3)</b> |
| Cash equivalent: time deposits with original maturities less than three months | 30,892       |   | 30,892   |  |
| Short term investments:  |              |   |  |  |
| Time deposits  | 9,695        |   | 9,695  |  |
| Investments in financial instruments   | 31,298       |   | 31,298   |  |
| Warrant liabilities  | (2,186)      |   | (2,186)  |  |
|  | 69,699       |   | 69,699   |  |

| <b>Fair value measurements as at December 31, 2014</b>                         |              |   |  |  |
|--|--------------|---|--|--|
| <b>(In thousands)</b>  | <b>Total</b> | <b>Quoted prices</b>                                    |  |  |
|  |              | <b>in active market for indentical assets (Level 1)</b> | <b>Significant other observable inputs (Level 2)</b> | <b>Significant observable inputs (Level 3)</b> |
| Cash equivalent: time deposits with original maturities less than three months | 31,117       |   | 31,117   |  |
| Short term investments:  |              |   |  |  |
| Investments in financial instruments   | 29,426       |   | 29,426   |  |
|  | 60,543       |   | 60,543   |  |

**24. Other income, net**

| <b>(In thousands)</b>   | <b>Years ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Subsidy income  | 1,621                           | 1,393       | 2,236       |
| Fair value changes of warrants liabilities (note 14)                | (710)                           | 1,531       | 8,054       |
| Investment income from short-term investments                       | 2                               | 1,847       | 3,471       |
| Dilution gains arising from deemed disposal of investment (Note 10) |                                 |             | 449         |
| Exchange losses   | (351)                           | (252)       | (176)       |
| Others  | 2                               | 160         | (68)        |
|   | 564                             | 4,679       | 13,966      |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****25. Commitments and contingencies*****Rental commitments***

The Group leases facilities in the PRC under non-cancellable operating leases expiring on different dates. Payments under operating leases are expensed on a straight-line basis over the periods of the respective leases, including any free rental periods.

Total office rental expenses under all operating leases were USD 2,390 thousand, USD 2,786 thousand and USD 3,068 thousand for the years ended December 31, 2012, 2013 and 2014, respectively.

Future minimum payments under non-cancellable operating leases of office rental consist of the following as of December 31, 2014:

| <b>(In thousands)</b> |       |
|-----------------------|-------|
| 2015                  | 2,203 |
| 2016                  | 1,329 |
| 2017                  | 6     |
|                       | 3,538 |

***Bandwidth lease commitments***

The Group leases bandwidth in the PRC under non-cancellable operating leases expiring on different dates. Payments under bandwidth leases are expensed on a straight-line basis over the duration of the respective lease periods, including any lease free periods.

Total bandwidth leasing costs under all operating leases were USD 22,211 thousand, USD 35,454 thousand and USD 40,373 thousand for the years ended December 31, 2012, 2013 and 2014.

Future minimum payments under non-cancellable bandwidth leases consist of the following as of December 31, 2014:

| <b>(In thousands)</b> |        |
|-----------------------|--------|
| 2015                  | 15,053 |
| 2016                  | 608    |
|                       | 15,661 |

***Capital commitments***

As at December 31, 2014, the Group had irrevocable purchase obligations for certain copyrights and online game licenses that had not been recognized in the amount of USD 5,789,600 and USD nil, respectively.

***Litigation***

The Group is involved in a number of cases pending in various courts. These cases are substantially related to alleged copyright infringement as well as routine and incidental matters to its business, among others. Adverse results in these lawsuits may include awards of damages and may also result in, or even compel, a change in the Group's business practices, which could impact the Group's future financial results. The Group had incurred USD 760 thousand, USD 263 thousand and USD 1,073 thousand legal and litigation related expenses for the years ended December 31, 2012, 2013 and 2014, respectively.

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**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**25. Commitments and contingencies (Continued)**

*Litigation (Continued)*

Up to April 20, 2015, which is the date when the consolidated financial statements were issued, the Group had 24 lawsuits pending against the Group with an aggregate amount of claimed damages of approximately RMB 1.88 million (USD 0.31 million) which occurred before December 31, 2014. Of the 24 pending lawsuits, 22 lawsuits were relating to the alleged copyright infringement in the PRC and the remaining 2 were relating to the Xunlei Kankan and online game business which is not related with copyright infringement. The Group had accrued for USD 451 thousand litigation related expenses in *Accrued expenses and other liabilities* in the consolidated balance sheet as of December 31, 2014.

Out of the 22 lawsuits for the alleged copyright infringement, 12 lawsuits involved Xunlei Kankan, an online video website owned by the Group. The remaining 10 lawsuits were relating to online services the Group provided on the Xunlei download accelerator tool, cloud subscription and Gougou, a digital media content search engine previously owned by the Group.

The Group estimated the litigation compensation based on judgments handed down by the court, out-of-court settlements of similar cases as well as advices from the Group's legal counsel. The Group is in the process of appealing certain judgments for which the losses had been accrued. Although the results of unsettled litigation and claims cannot be predicted with certainty, the Group does not expect that the outcome of the 24 lawsuits will result in the amounts accrued materially different from the range of reasonably possible losses.

In May 2014, the Group entered into a content protection agreement with the Motion Picture Association of America, Inc., or MPAA, and six major U.S. entertainment content providers, which are the members of MPAA. In January 2015, a number of MPAA member studios filed copyright infringement lawsuits against the Group with an aggregate amount of claimed damages of RMB 8.40 million (USD 1.37 million), and the cases are awaiting trial as of April 20, 2015. As the litigations remain in their preliminary stages, the Group is unable to express any opinion on the likelihood of an unfavorable outcome or any estimate of the amount or range of any potential loss. Further, subsequent to December 31, 2014, there were additional claims mainly with an aggregate amount of claimed damages of approximately RMB 2.17 million (USD 0.35 million) related to alleged copyright infringement made in the ordinary course of business against the Group. The Group has assessed that none of these claims that occurred between January 1, 2015 to April 20, 2015 will result in the amount accrued materially different from the range of reasonably possible losses in the consolidated financial statements of the Group.



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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**26. Certain risks and concentration**

**PRC regulations**

Current PRC laws and regulations place certain restrictions on foreign ownership of companies that engage in internet businesses, including the provision of online video and online advertising services. Specifically, foreign ownership in an internet content provider or other value-added telecommunication service providers may not exceed 50%. The Group conducts its operations in China principally through contractual arrangements among Giganology Shenzhen, its wholly-owned PRC subsidiary, and Shenzhen Xunlei and its shareholders. Shenzhen Xunlei holds the licenses and permits necessary to conduct its resource discovery network, online video, online advertising, online games and related businesses in China and hold various operating subsidiaries that conduct a majority of its operations in China. The Company conducts all of its operations in China through, Shenzhen Xunlei, a variable interest entity, which it consolidates as a result of a series contractual arrangements enacted. If the Company had direct ownership of Shenzhen Xunlei, it would be able to exercise its rights as a shareholder to effect changes in the board of directors of Shenzhen Xunlei, which in turn could effect changes at the management level, subject to any applicable fiduciary obligations. However, under the current contractual arrangements, it relies on Shenzhen Xunlei and its shareholders performance of their contractual obligations to exercise effective control. In addition, its operating contract with Shenzhen Xunlei has a term of ten years, which is subject to Giganology Shenzhen's unilateral termination right. None of Shenzhen Xunlei or its shareholders may terminate the contracts prior to the expiration date.

Further, the Group believes that the contractual arrangements among Giganology Shenzhen, Shenzhen Xunlei and its shareholders are in compliance with PRC law and are legally enforceable. However, the Chinese government may issue from time to time new laws or new interpretations on existing laws to regulate this industry. Regulatory risk also encompasses the interpretation by the tax authorities of current tax laws, and the Group's legal structure and scope of operations in the PRC, which could be subject to further restrictions resulting in limitations on the Company's ability to conduct business in the PRC. The PRC government may also require the Company to restructure the Group's operations entirely if it finds that its contractual arrangements do not comply with applicable laws and regulations. Furthermore, it could revoke the Group's business and operating licenses, require it to discontinue or restrict its operations, restrict its right to collect revenues, block its website, require it to restructure its operations, impose additional conditions or requirements with which the Group may not be able to comply, or take other regulatory or enforcement actions against the Group that could be harmful to its business. The imposition of any of these penalties may result in a material and adverse effect on the Group's ability to conduct the Group's business. In addition, if the imposition of any of these penalties causes the Group to lose the rights to direct the activities of the VIE and its subsidiaries or the right to receive their economic benefits, the Group would no longer be able to consolidate the VIE. The Group does not believe that any penalties imposed or actions taken by the PRC Government would result in the liquidation of the Company, Giganology Shenzhen or Shenzhen Xunlei.

As of December 31, 2014, the aggregate retained earnings and distributable reserves of VIE and VIE's subsidiaries amounted to approximately USD 34,210 thousand (2013: USD 32,296 thousand), which has been included in the consolidated financial statements.



As stated above, Shenzhen Xunlei holds assets that are important to the operation of the Group's business, including patents for proprietary technology, related domain names and trademarks. If Shenzhen Xunlei or its subsidiaries falls into bankruptcy and all or part of its assets become subject to liens or rights of third-party creditors, the Group may be unable to conduct its business activities in China, which could have a material adverse effect on the Group's future financial position, results of operations or cash flows. However, the Group believes this is a normal business risk many companies face. The Group will continue to closely monitor the financial conditions of Shenzhen Xunlei and its subsidiaries.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**26. Certain risks and concentration (Continued)**

**PRC regulations (Continued)**

Shenzhen Xunlei and its subsidiaries' assets comprise both recognized and unrecognized revenue-producing assets. The recognized revenue-producing assets include intangible assets, purchased property and equipment. The balances of these assets held by the VIE and its subsidiaries are included in copyrights related to content, current portion of property and equipment, net and intangible assets, net in the consolidated balance sheet and specifically in the VIE table on the following page. The unrecognized revenue-producing assets mainly consist of license, patents, trademarks, and domain names which are not recorded in the financial statement as they didn't meet the recognition criteria set in ASC 350-30-25. The licenses stated above primarily consist of licenses that grant the VIE and its subsidiaries the right to produce and broadcast internet, radio, and television programs. One of them is the ICP licenses as described in note 1.

As of December 31, 2014, Shenzhen Xunlei and its subsidiaries held patents granted in the PRC and in the United States. Presently, patent applications are being examined by the State Intellectual Property Office of the PRC and also patent application is being reviewed by the United States Patent and Trademark Office.

As of December 31, 2014, Shenzhen Xunlei and its subsidiaries have applied to register trademarks, of which the Company has received registered trademarks in different applicable trademark categories including trademark registered with the United States Patent and Trademark Office and trademark registered with World Intellectual Property Organization.

As of December 31, 2014, Shenzhen Xunlei held one domain name that was recognized as an intangible asset and other domain names that are not recorded in the financial statements.

Table of Contents**Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****26. Certain risks and concentration (Continued)****PRC regulations (Continued)**

The following consolidated financial information of the Group's VIE and its subsidiaries was included in the accompanying consolidated financial statements as of and for the years ended:

| <b>(In thousands)</b>                          | <b>As of December 31,</b> |                |
|--|---------------------------|----------------|
|  | <b>2013</b>               | <b>2014</b>    |
| <b>Current assets:</b>                         |                           |                |
| Cash and cash equivalents                      | 50,663                    | 43,849         |
| Short-term investments                         | 31,298                    | 28,575         |
| Accounts receivable, net                       | 35,592                    | 29,248         |
| Due from related parties                       | 85                        | 6              |
| Deferred tax assets                            | 750                       | 1,358          |
| Prepayments and other current assets           | 11,403                    | 10,819         |
| Copyrights related to content, current portion | 14,230                    | 15,333         |
| <b>Total current assets</b>                    | <b>144,021</b>            | <b>129,188</b> |
| <b>Non-current assets:</b>                     |                           |                |
| Equity method investments                      | 2,949                     | 5,498          |
| Deferred tax assets                            | 6,756                     | 8,262          |
| Property and equipment, net                    | 20,116                    | 17,481         |
| Intangible assets, net                         | 13,083                    | 21,632         |
| Goodwill                                       |                           | 23,237         |
| Prepayments for content copyrights             | 2,483                     | 1,694          |
| Other long-term prepayments                    | 2,554                     | 5,852          |
| <b>Total non-current assets</b>                | <b>47,941</b>             | <b>83,656</b>  |
| <b>Total assets</b>                            | <b>191,962</b>            | <b>212,844</b> |
| <b>Current liabilities:</b>                    |                           |                |
| Accounts payables                              | 62,603                    | 49,771         |
| Due to a related party                         | 225                       | 84             |
| Deferred revenue and income, current portion   | 29,352                    | 28,083         |

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|  |                |                |
|--|----------------|----------------|
| Income tax payable                               | 2,581          | 2,554          |
| Accrued liabilities and other payables           | 49,265         | 86,323         |
| <b>Total current liabilities</b>                 | <b>144,026</b> | <b>166,815</b> |
| <b>Non-current liabilities:</b>                  |                |                |
| Deferred revenue and income, non-current portion | 9,190          | 6,452          |
| <b>Total non-current liabilities</b>             | <b>9,190</b>   | <b>6,452</b>   |
| <b>Total liabilities</b>                         | <b>153,216</b> | <b>173,267</b> |

| (In thousands)                                     | Years ended December 31, |         |         |
|--|--------------------------|---------|---------|
|  | 2012                     | 2013    | 2014    |
| Net revenue  | 140,532                  | 174,594 | 179,590 |
| Net income / (loss) attributable to Xunlei Limited | 14,637                   | 1,368   | (5,730) |

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**Table of Contents****Xunlei Limited****Notes to consolidated financial statements****(Amounts in US dollars unless otherwise stated)****26. Certain risks and concentration (Continued)****PRC regulations (Continued)**

| <b>(In thousands)</b>                                 | <b>Years ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Net cash provided by operating activities             | 59,379                          | 92,580      | 70,822      |
| Net cash used in investing activities                 | (33,675)                        | (66,243)    | (78,335)    |
| Net cash (used in) / provided by financing activities | (20,632)                        | 2,487       | 856         |
|   | 5,072                           | 28,824      | (6,657)     |

**Foreign exchange risk**

The Group's financing activities are denominated mainly in the USD. The RMB is not freely convertible into foreign currencies. Remittances of foreign currencies into the PRC and exchange of foreign currencies into the RMB require approval by foreign exchange administrative authorities and certain supporting documentation. The State Administration for Foreign Exchange, under the authority of the People's Bank of China, controls the conversion of the RMB into other currencies. The revenues and expenses of the Company's subsidiaries, consolidated VIE and its subsidiaries are generally denominated in the RMB and their assets and liabilities are denominated in the RMB.

**Concentration of customer risk**

The top 10 customers accounted for 20%, 14% and 16% of the net revenues for the years ended December 31, 2012, 2013 and 2014, respectively. Prior to entering into sales agreements, the Group performs credit assessments of its customers to assess the credit history of its customers. Further, the Group has not experienced any significant bad debts with respect to its accounts receivable.

**Credit risk**

As of December 31, 2013 and 2014, substantially all of the Group's cash and cash equivalents were held at reputable financial institutions in the jurisdictions where the Group and its subsidiaries are located. The Group believes that it is not exposed to unusual risks as these financial institutions have high credit quality. The Group has not experienced any losses on its deposits of cash and cash equivalents.

Prior to entering into sales agreements, the Group performs credit assessments of its customers to assess the credit history of its customers. Further, the Group has not experienced any significant bad debts with respect to its accounts

receivable.

**27. Subsequent events**

*Restricted shares grant*

In March 2015, 1,769,000 restricted shares had been granted to certain executive officers or employees of the Group.

*Issuance of common shares*

In January 2015, the Company issued to a depository bank for American Depositary Shares, 10,991,120 common shares, which were reserved for the future exercise of share options or vesting of restricted shares.

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**Xunlei Limited**

**Notes to consolidated financial statements**

**(Amounts in US dollars unless otherwise stated)**

**27. Subsequent events (Continued)**

*Investments*

In January 2015, the Group paid USD 1 million as the consideration to acquire 2.24% equity interests in 11.2 Capital I, L.P., a limited partnership which makes venture capital investments, principally by investing in and holding equity and equity-oriented securities of privately held companies, with a focus on companies that are primarily focused on enterprise technologies, next generation hardware and related technologies. This acquisition was closed on January 15, 2015.

In February 2015, the Group paid USD 647 thousand as the consideration to acquire 19.9% equity interests in Suzhou Heidisi Network Technology Co., Ltd., a company which develops and operates mobile game in the PRC. This acquisition was closed on March 11, 2015.

In March 2015, the Group paid USD 1.2 million as part of the consideration (total consideration was 2 million) for acquiring 15% equity interests in Xiamen Diensi Network Technology Co., Ltd., a company which provides domain name analysis services in the PRC. This acquisition was still in the process as of April 20, 2015.

*Proposed disposal of business and assets in relation to Xunlei Kankan*

On March 31, 2015, the Group entered into a legally binding framework agreement with Beijing Nesound International Media Corp., Ltd. (Nesound), an independent third party, to sell the Group's online video streaming platform, Xunlei Kankan. Pursuant to the framework agreement, the Group agreed to dispose and Nesound agreed to acquire the business and assets in relation to Xunlei Kankan, together with 100% of equity interest of Shenzhen Xunlei Kankan Information Technologies Co., Ltd, for an aggregate cash consideration of RMB 130 million. Nesound has paid a deposit of RMB26 million as of the date of April 20, 2015. The completion of the transaction is subject to the signing of a definitive purchase agreement and fulfilling closing conditions contained therein, which may include the completion of a specific research and development project, the transfer of domain name, other assets and certain liabilities and businesses of Xunlei Kankan, and the application for the transfer of permits and licenses required for Xunlei Kankan's operations. If the transaction fails to close due to the fault of either Xunlei or Nesound, including the failure to meet closing conditions, the responsible party shall be liable to pay a penalty of RMB52 million in addition to returning the deposit of RMB26 million.

**28. Restricted net assets**

Relevant PRC laws and regulations permit payments of dividends by the Company's subsidiaries, VIE and VIE's subsidiaries in China only out of their retained earnings, if any, as determined in accordance with PRC accounting standards and regulations. In addition, the Company's subsidiaries, VIE and VIE's subsidiaries in China are required to

make certain appropriation of net after-tax profits or increase in net assets to the statutory surplus fund (see Note 2(cc)) prior to payment of any dividends. As a result of these and other restrictions under PRC laws and regulations, the Company's subsidiaries, VIE and VIE's subsidiaries in China are restricted in their ability to transfer their net assets to the Company in terms of cash dividends, loans or advances, which restricted portion amounted to USD 49,171 thousand and USD 59,760 thousand as of December 31, 2013 and 2014, respectively. Even though the Company currently does not require any such dividends, loans or advances from the PRC subsidiaries, VIE and VIE's subsidiaries for working capital and other funding purposes, the Company may in the future require additional cash resources from the Company's subsidiaries, VIE and a VIE's subsidiaries in China due to changes in business conditions, to fund future acquisitions and development, or merely to declare and pay dividends to make distributions to shareholders.



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**29. Additional information: condensed financial statements of the Company**

Regulation S-X require condensed financial information as to financial position, changes in financial position and results of operations of a parent company as of the same dates and for the same periods for which audited consolidated financial statements have been presented when the restricted net assets of consolidated and unconsolidated subsidiaries together exceed 25 percent of consolidated net assets as of the end of the most recently completed fiscal year.

The Company records its investment in its subsidiaries, VIE and VIE s subsidiaries under the equity method of accounting.

Such investments are presented on the separate condensed balance sheets of the Company as Long-term investments .

The subsidiaries did not pay any dividends to the Company for the periods presented. Certain information and footnote disclosures generally included in financial statements prepared in accordance with U.S. GAAP have been condensed and omitted. The footnote disclosures represent supplemental information relating to the operations of the Company, as such, these statements should be read in conjunction with the notes to the consolidated financial statements of the Group.

The Company did not have significant other commitments, long-term obligations, or guarantees as of December 31, 2014.

**Table of Contents****Condensed balance sheets**

| <b>(In thousands)</b>  | <b>December 31,<br/>2013</b> | <b>December 31,<br/>2014</b> |
|--|------------------------------|------------------------------|
| <b>Assets</b>  |                              |                              |
| Current assets:  |                              |                              |
| Cash and cash equivalents  | 28,863                       | 309,457                      |
| Due from subsidiaries and consolidated VIEs  | 25,859                       | 67,397                       |
| Prepayments and other current assets   | 653                          | 6,709                        |
| Total current assets   | 55,375                       | 383,563                      |
| Non-current assets:  |                              |                              |
| Intangible assets, net   | 1,017                        | 394                          |
| Investments in subsidiaries and consolidated VIEs                                    | 67,009                       | 82,360                       |
| Total assets   | 123,401                      | 466,317                      |
| <b>Liabilities</b>   |                              |                              |
| Current liabilities:   |                              |                              |
| Accounts payable   | 807                          | 101                          |
| Deferred revenue and income, current portion   |                              | 211                          |
| Accrued liabilities and other payables   | 924                          | 2,328                        |
| Total current liabilities  | 1,731                        | 2,640                        |
| Non-current liabilities:   |                              |                              |
| Deferred revenue and income, non-current   |                              | 842                          |
| Warrants liabilities   | 2,186                        |                              |
| Due to related parties, non-current portion  |                              | 4,137                        |
| Other long-term payable  |                              | 807                          |
| Total liabilities  | 3,917                        | 8,426                        |
| Commitments and contingencies  |                              |                              |
| Mezzanine equity   | 40,290                       |                              |
| <b>Shareholders equity</b>   |                              |                              |
| Series C convertible non-redeemable preferred shares                                 | 1                            |                              |
| Series B convertible non-redeemable preferred shares                                 | 8                            |                              |
| Series A-1 convertible non-redeemable preferred shares                               | 9                            |                              |
| Series A convertible non-redeemable preferred shares                                 | 7                            |                              |
| Common shares  | 15                           | 82                           |
| Treasury shares 9,073,732 shares as at December 31, 2013 and 30,274,602 shares as at |                              |                              |
| December 31, 2014  | 2                            | 7                            |
| Other shareholders equity  | 79,152                       | 457,802                      |

|  |         |         |
|--|---------|---------|
| Total Xunlei Limited's shareholders' equity                  | 79,194  | 457,891 |
| Total liabilities, mezzanine equity and shareholders' equity | 123,401 | 466,317 |

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**Table of Contents****Condensed statements of operations**

| <b>(In thousands)</b>  | <b>Years ended December 31,</b> |             |             |
|--|---------------------------------|-------------|-------------|
|  | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| Revenues   |                                 |             |             |
| Cost of revenues   | (3,075)                         | (2,264)     | (1,673)     |
| Gross profit   | (3,075)                         | (2,264)     | (1,673)     |
| <b>Operating expenses</b>  |                                 |             |             |
| Research and development expenses                                      | (1,369)                         |             |             |
| Sales and marketing expenses   | (489)                           | (241)       |             |
| General and administrative expenses                                    | (1,315)                         | (972)       | (996)       |
| <b>Total operating expenses</b>  | (3,173)                         | (1,213)     | (996)       |
| <b>Operating loss</b>  | (6,248)                         | (3,477)     | (2,669)     |
| Interest income  | 1,089                           | 706         | 6,171       |
| Interest expense   |                                 |             | (163)       |
| Other (loss) / income, net   | (885)                           | 1,651       | 7,602       |
| Income from subsidiaries and consolidated VIEs                         | 6,547                           | 11,782      | (129)       |
| <b>Income before income tax</b>  | 503                             | 10,662      | 10,812      |
| Income tax   |                                 |             |             |
| <b>Net income</b>  | 503                             | 10,662      | 10,812      |
| Net income attributable to the non-controlling interest                |                                 |             |             |
| <b>Net income attributable to Xunlei Limited's common shareholders</b> | 503                             | 10,662      | 10,812      |

**Condensed statement of cash flows**

| <b>(In thousands)</b>   | <b>Years ended December 31,</b> |             |             |
|---|---------------------------------|-------------|-------------|
|   | <b>2012</b>                     | <b>2013</b> | <b>2014</b> |
| <b>Cash flows from operating activities</b>                   |                                 |             |             |
| Net cash generated from / (used in) operating activities      | 695                             | 4,708       | (41,485)    |
| <b>Cash flows from investing activities</b>                   |                                 |             |             |
| Net cash used in investing activities                         | (37,302)                        | (3,843)     | (10,333)    |
| <b>Cash flows from financing activities</b>                   |                                 |             |             |
| Net cash generated from / (used in) financing activities      | 35,488                          | (2,242)     | 332,412     |
| <b>Net (decrease) / increase in cash and cash equivalents</b> | (1,119)                         | (1,377)     | 280,594     |

|   |               |               |                |
|---|---------------|---------------|----------------|
| Cash and cash equivalents at beginning of year        | 31,359        | 30,240        | 28,863         |
| Effect of exchange rates on cash and cash equivalents |               |               |                |
| <b>Cash and cash equivalents at end of year</b>       | <b>30,240</b> | <b>28,863</b> | <b>309,457</b> |

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