21Vianet Group, Inc.
1Q17 Earnings Conference Call Script

Operator:

Good morning and good evening, ladies and gentleman. Thank you and welcome to 21Vianet Group's first quarter 2017 earnings conference call.

At this time all participants are in listen-only mode. We will be hosting a question and answer session after management's prepared remarks. Before we begin, I will read the safe harbor statement.

This call may contain forward-looking statements made pursuant to the safe harbor provisions for the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties, and other factors not under the company's control which may cause actual results, performance, or achievements of the company to be materially different from the results, performance, or expectations implied by these forward-looking statements. All forward-looking statements are expressly qualified in their entirety by the cautionary statements, risk factors, and details of the company's filings with the SEC. 21Vianet undertakes no duty to revise or update any forward-looking statements for selected events, or circumstances after the date of this conference call.

With us today are Mr. Steve Zhang, the Company's Chief Executive Officer and Mr. Terry Wang, the Company's Chief Financial Officer. At this time, I would now like to turn this conference call over to Mr. Steve Zhang. Please proceed.

Steve Zhang, CEO

Thank you, Operator. Good morning and good evening everyone. Thank you for joining us for the earnings call today.

We have started 2017 with solid execution upon our restructuring plans which are starting to bear fruit through improved financial and operating results. In particular, our hosting and related services business saw solid growth, as revenues grew close to 19% year over year. And while our managed network services business continued to face challenges because of increased competition and pricing pressure, we executed on our strategy to optimize this business through cost controls such as reducing excess headcount and contract re-negotiations, and we saw a noticeable improvement in our profitability in terms of EBITDA.

For our hosting and related services, including IDC, cloud and VPN services, we continued to witness strong growth momentum in the first quarter. For the core IDC business, we added 14 cabinets, and we ended the quarter with 26,394 cabinets under our management, while improving the utilization rate to 75.8%. We increased the number of self-built cabinets by 224 while reducing the number of partnered cabinets by 210, resulting in higher gross margins. Meanwhile, our hosting churn rate was lowered to 0.48% from 0.55% in the fourth quarter last year.

This past quarter, we were also able to expand capacity contracts with some of our large customers such as Didi, Momo, and Xiaomi. Furthermore, we were able to sign contracts with new customers such as Shenzhen Ping An Bank, Vipshop, Xueersi (TAL Education) and Cool Pad.

In terms of our partnership with Warburg Pincus, I would like to reiterate that it is a long-term partnership and everything is progressing on track so far. We are still planning to build a digital real estate platform which aims to add 80,000 to 100,000 cabinets within the next 5 to 7 years. This past quarter, we have already transferred one of the four high-quality data centers into the initial joint venture as part of the closing process, and are working on completing the remaining 3 asset injections. Furthermore, we are jointly exploring new data center project opportunities, and we look forward to seeing more encouraging results in the near future.

Moving on to cloud. We aim to provide more hybrid IT services that encompass all customer needs by leveraging our partnerships with public cloud providers and our strong expertise and technology advantages in cloud and data centers. The result is a complete package of interconnection and hybrid cloud services, which combines the scalability and cost efficiencies of the public cloud with the reliability and security of private cloud solutions.

In addition, we are glad to announce that we have partnered with Microsoft and Tencent to launch Microsoft Office Online, which offers Tencent Cloud users enhanced convenience of a mobile office anytime, anywhere as well as Microsoft office collaboration among multiple enterprise users. 21Vianet will provide enhanced operational and maintenance solutions to enable cross-platform technical support and streamlined use of Microsoft Office Online for Tencent Weiyun users. Leveraging Tencent Cloud's large user base, we believe that as the usage volume for Microsoft Office Online increases, we will provide additional technical service resources to support this initiative, which will drive more incremental cloud revenue down the road.

I would also like to mention that in late March of this year, 21Vianet was approved as a silver level partner for Akamai's NetAlliance Program. As a NetAlliance partner, we will be able to leverage the exceptional brand of Akamai, a global leader in CDN services, and profitably grow our own CDN business. Specifically, this is completed through the D2G, or domestic to global, program, which allows domestic Chinese customers that wish to expand globally to leverage Akamai's CDN services to increase data transmission speeds for applications and websites.

Overall, we are pleased to see a robust improvement this quarter. Going forward, we will further strengthen our restructuring efforts by focusing on expanding our core retail colocation business and cloud-neutral platform, optimizing our managed network services business, shifting towards an asset-light business model, and capitalizing on new growth opportunities in the market such as wholesale data center services and hybrid IT solutions. We remain confident in our ability to fortify our leading position as an internet infrastructure services provider and generate incremental value for our shareholders.

With that, I would like to turn the call over to Terry, our CFO, to go through our financial results.

Terry Wang, CFO

Thanks Steve.

First of all, we are delighted to report that our topline revenues of 862 million outperformed the mid-point of our guidance for the first quarter of 2017.

Secondly, I would like to talk about the profitability side of our business. In the first quarter, we witnessed positive signs from our efforts to control costs and improve our operational leverage. As a result, our adjusted EBITDA was 100 million, exceeding the high-end of our guidance of 85 million by 18%, and our net loss narrowed by 23% year over year from 151 million to 117 million.

As we move forward with our business restructuring, we remain committed to further driving topline growth, improving our operating leverage and enhancing our profitability.

Now let's take a closer look at our first quarter 2017 financial results. Before I begin, I'd like to state that we will present non-GAAP measures today. Our non-GAAP results exclude certain non-cash expenses which are not a part of our core operations. The details of these expenses may be found in the reconciliation tables included in our press release. Also note that all the financial numbers we are presenting today are in Renminbi and percentage change is year-over-year, unless otherwise stated.

Our net revenues were 862 million, compared with 862 million in the prior year period and 901 million in the fourth quarter of 2016. Net revenues remained flat year-over-year due to the increase in revenues from hosting and related services being offset by the decrease in revenues from managed network services.

Net revenues from hosting and related services were 707 million, compared with 597 million in the prior year period and 703 million in the fourth quarter of 2016. The increase year-over-year was primarily due to the increase in total number of billable cabinets as a result of increased demand from fast-growth customers, and increased utilization rate.

Our monthly recurring revenue per cabinet for the first quarter was RMB 8,363, compared with RMB 8,490 in the fourth quarter of 2016. The decrease in monthly recurring revenue per cabinet was mainly attributable to lower bandwidth pricing.

Net revenues from managed network services were 156 million compared with 266 million in the prior year period and 197 million in the fourth quarter of 2016. The decrease year-over-year was primarily due to continued increased competition and pricing pressure.

Adjusted gross profit increased was 212 million, compared with 211 million in the prior year period. Adjusted gross margin was 24.5% compared with 24.5% in the prior year period.

Adjusted operating expenses were 251 million, compared with 220 million in the prior year period. As a percentage of net revenues, adjusted operating expenses were 29.1%, compared with 25.5% in the prior year period.

Sales and marketing expenses were 66 million, compared with 77 million in the prior year period. The decrease was primarily driven by reduced agency fees.

General and administrative expenses were 136 million, compared with 134 million in the prior year period.

Research and development expenses were 38 million in the first quarter of 2017, as compared with 42 million in the comparative period in 2016. The decrease was primarily due to execution of our business restructuring.

Our Adjusted EBITDA was 100 million compared with 109 million in the prior year period and 52 million in the fourth quarter of 2016. Adjusted EBITDA margin was 11.6% compared with 12.6% in the prior year period and 5.8% in the fourth quarter of 2016.

Adjusted EBITDA for hosting and related services was 153 million compared with 94 million in the prior year period and 130 million in the fourth quarter of 2016.

Adjusted EBITDA for managed network services was negative 52 million compared with positive 15 million in the prior year period and negative 78 million in the fourth quarter of 2016.

Adjusted net loss was 84 million compared with 74 million in the prior year period. Adjusted net margin in the first quarter of 2017 was negative 9.7%, compared with negative 8.6% in the prior year period.

Adjusted diluted loss per share for the first quarter of 2017 was RMB 12 cents, which represents the equivalent of RMB 72 cents per ADS.

As of March 31, 2017, our cash and cash equivalents and short-term investment were 1.26 billion, equivalent to USD 184 million.

Now, let me provide you with our guidance. For the second quarter of 2017, we expect net revenues to be in the range of 870 million to 910 million, compared with 911 million in the prior year period. Adjusted EBITDA is expected to be in the range of 100 million to 120 million, compared with 16 million in the prior year period.

This concludes our prepared remarks for today. Operator, we are now ready to take questions.