21Vianet Group, Inc.
2Q18 Earnings Conference Call Script

Operator:

Good morning and good evening, ladies and gentleman. Thank you and welcome to 21Vianet Group's second quarter 2018 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.

With us today are Mr. Alvin Wang, Chief Executive Officer and President, Ms. Sharon Liu, Chief Financial Officer, and Ms. Rene Jiang, Investor Relations Director, of the Company. I will now turn the call to Ms. Rene Jiang, IRD of 21Viane, please go ahead Ma'am.

Rene Jiang, IRD:

Hello, everyone. Welcome to our second quarter 2018 earnings call. Before we start, please note that 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.

I will now turn this call over to Mr. Alvin Wang, CEO and President of 21Vianet.

Alvin Shiqi Wang, CEO:

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

This is the third quarter since we completed the divestiture of our loss-making MNS business. Our strategy to focus entirely on our core hosting and related services business, including IDC, cloud and VPN services, has proven to be a key driver of our growth. During the last nine months, we saw continued improvements in both our financial and operational results. We are particularly pleased to achieve a 29% year-over-year growth of our Adjusted EBITDA this quarter, while expanding the Adjusted EBITDA margin to 26.7%, from 23% in the same period last year.

The healthy trajectory of our financial performance is fueled by our relentless efforts to optimize our operational efficiency. With our attention and resources fully focused on our core business, we were able to make marked improvements in the management of our cabinet capacity, power usage, and human resources. As a result, we significantly enhanced the efficiency of our cost and expenses structures, making our business leaner and stronger than ever before. Furthermore, in the first half of 2018, we introduced a series of incentives to our employees, called Performance Stock Units (or PSUs). We believe our incentive plans, based on very detailed KPIs, are well-designed to further motivate our team and boost their productivity. We will continue to implement this incentive program in the coming quarters.

Our improvements in operational efficiency builds upon our already robust capabilities in network reliability, service quality, and carrier- and cloud-neutrality, allowing us to capture new opportunities in the rapidly growing Chinese IDC market. During the quarter, we welcomed new clients in the Chinese Internet and financial services sectors, including MBCloud (a subsidiary of China Merchant Bank), Sinodata (an A-share listed service and solution provider for investment bank, fintech and other financial institutions), and Dingdang KuaiYao (an O2O pharmacy). In addition, as our existing clients expand their own businesses, they consequently increased their order size for our data center capacity. Examples of such requests came from companies including, Xiaomi, BMW China, and Zenlayer.

As our client base grows and their demand increases, we took measures to ensure that we have sufficient capacity to serve our clients, especially those in Tier-1 cities. We added around 300 cabinets to our self-built network in the second quarter, bringing the total number of our higher margin producing self-built cabinets to 24,167. The recent surge in customer demand has also prompted us to expand our capacity. We have reached an agreement to deliver an additional 1,000 cabinets in Shanghai in the second half this year. In addition, we recently signed a long-term lease agreement to obtain the rights to use over 20,000 square meter property in west Beijing. The new Beijing location is estimated to add another 3,000 to 4,000 cabinets to our datacenter network. We are now waiting for the electricity and fire appliance approvals from related authorities and we expect the first batch of cabinets to be delivered in the second half of 2019.

After conducting extensive market research on the wholesale data center market, we are convinced of the tremendous growth potential it offers. Consequently, we have decided to enter the wholesale market, albeit in a very disciplined manner. We have thoroughly examined potential property resources, negotiated with current and potential clients, and evaluated financial terms and return on our investments. We are confident that entering the wholesale market should lead us to sustainable growth and improving profitability for the long term.

Now, turning to our cloud business. As we recently announced, our wholly owned cloud business subsidiary, Shanghai Blue Cloud Technology, has entered into distribution partnership agreements with four world-class SAAS providers in July. We will be responsible for the localization, marketing, and distribution of our partners' cloud services in mainland China. This is an important milestone for our cloud business, as we have not only expanded our own service offerings but also established ourselves as a highly sought-after partner for international cloud solution providers seeking to commercialize their products safely and effectively in China.

Finally, I'd like to give an update on our VPN business. Our close communication with the relevant authorities regarding VPN compliance has resulted in important progresses. Our subsidiary DiYiXian has signed a cooperation agreement with China Mobile International (CMI), and submitted the agreement to the China Academy of Information and Communications Technology (CAICT) for regulatory review and approval. Once the agreement is approved, we will be among the first batch of companies that have become 100% compliant with the new regulations on VPN. We strongly believe that new regulations should raise industry standards, ensure service quality, and cultivate market growth in a healthy manner. We are also confident that our own commitment to network safety, availability, reliability, neutrality, and quality shall enable us to continuously gain market share and solidify our industry leadership.

In summary, we expanded our data center capacity, achieved new client wins, and improved our operating efficiency during the second quarter of 2018. We have also expanded our business scope to the wholesale data center market, and laid a solid foundation for accelerating and sustaining our growth. We are confident that we will further strengthen our market leadership in one of the fastest growing IDC markets in the world.

Now I would like to turn the call to Sharon Liu, CFO of our Company, to give you more details of our financial results.

Sharon Xiao Liu, CFO:

Thank you and hello, everyone. As Alvin mentioned earlier, we divested MNS business by the end of the third quarter of 2017. Since then all of our revenues and expenses are entirely generated by our core hosting and related services. To make our year-over-year comparisons relevant and meaningful, in the following remarks, we have excluded all revenues and expenses related to the MNS business from our second quarter of 2017 results. We believe this would offer better clarity and insight into the true performance of our core business.

Please also note 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. Please note that all of the financial numbers we are presenting today are in Renminbi terms and that percentage changes are on a year-over-year basis, unless otherwise stated.

During the quarter, we remained focused on enhancing the efficiency and effectiveness of our operations while sustaining our strong top- and bottom-line growth momentum. Our net revenues in the second quarter increased by 11.4% year over year to 828.3 million, driven by the rising customer demand for more cabinet capacity.

Hosting MRR per cabinet for the second quarter was 8,271 compared to 7,697 in the same period of last year and 7,905 in the first quarter of 2018. The increase in MRR was mainly due to an increased amount of Hybrid IT services and value-added services that our customers purchased during the quarter.

Our adjusted cash gross profit, which excludes depreciation, amortization, and share-based compensation expenses, increased to 364.0 million this quarter, representing an increase of 14.4% from 318.2 million in the prior year period. Adjusted cash gross margin further expanded to 43.9% from 42.8% in the prior year period. The improvement in adjusted cash gross margin was mainly due to our solid revenue growth and a series of efficiency enhancement initiatives that we implemented.

Adjusted operating expenses were 161.9 million, a slight increase of 1.2% from 160.0 million in the prior year period. As a percentage of net revenues, adjusted operating expenses reduced to 19.5% from 21.5% in the prior year period, driven by our ongoing effort in optimizing our cost and expense structures.

As our economy of scale improves, our Adjusted EBITDA increased by 29.1% to 221.1 million from 171.3 million in the prior year period. Adjusted EBITDA margin expanded to 26.7% from 23.0% in the prior year period.

Our net loss was 95.5 million, compared to 119.3 million in the same period of 2017. Our net loss in the second quarter included a 73.4 million foreign exchange loss due to depreciation of RMB, which was unrealized non-cash in nature.

Basic and diluted loss per share was RMB 14 cents in second quarter of 2018, which represents the equivalent of RMB 84 cents per (“ADS”). Each ADS represents six ordinary shares.

Turning to our cash flow and balance sheet. We generated 111.4 million of positive cash flow from operating activities during the second quarter. In addition, our cash and cash equivalents, restricted cash and short-term investment were 2,657.5 million at the end of June 2018. With our solid cash position and our strong cash generation capability, we are well positioned to capitalize on new market opportunities in the blooming IDC industry in China.

Before I give you our forward-looking guidance, it is important to note that we have been able to achieve or exceed our own guidance three quarters in a row. As a company, we have always been prudent in managing our financial budget and conservative in giving our growth forecast. We also go great length to maintain stringent internal control and ensure full disclosure of accurate information.

Now, for the third quarter of 2018, we expect net revenues to be in the range of 840 to 860 million. Adjusted EBITDA is expected to be in the range of 230 to 250 million. The midpoint of the guidance range indicates year-over-year increase of 12% in revenue and 36% in adjusted EBITDA.

Based on solid first half 2018 results, we are raising our full year 2018 guidance for both net revenues and adjusted EBITDA. For the full year, we now expect net revenues to be in the range of RMB3.28 billion to RMB3.38 billion, 30 million above the original guidance range. Adjusted EBITDA for the full year is now expected to be in the range of RMB800 million to RMB880 million, 50 million above the original guidance range. The midpoint of the guidance range indicates year-over-year increase of 12% in revenue and 25% in adjusted EBITDA.

This forecast reflects our current and preliminary views on the market and operational conditions, which are subject to change.

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