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PRESENTATION

Operator

Good morning and good evening, ladies and gentlemen. Thank you, and welcome to 21Vianet Group's Fourth Quarter 2019 Earnings Conference Call. (Operator Instructions) 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'll now turn the call over to the first speaker today, Ms. Rene Jiang, IR Director of 21Vianet. Please go ahead, ma'am.

Rene Jiang ***21Vianet Group, Inc. - IR Director***

Hello, everyone. Welcome to our fourth quarter and full year 2019 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 the call over to Mr. Alvin Wang, CEO and President of 21Vianet.

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

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

In the fourth quarter of 2019, we grew our revenues to RMB 1.05 billion and adjusted EBITDA to RMB 263.8 million, meeting both of our previous guidance ranges. Notably, our prudent cabinet management and increasingly diverse suite of IDC solutions helped to drive growth in the quarter.

First, we continue to expand our cabinet capacity in anticipation of growing demand for carrier- and cloud-neutral IDC solutions. As such, we grew our total cabinet capacity, reaching a total of 36,291 cabinets by the end of the quarter. Moreover, in line with the market's steady growth trend, we delivered over 6,000 self-built cabinets in the full year 2019, demonstrating our team's strong execution capabilities and achieving a record high for the past few years.

In 2019, we established a dual-core strategy to address both wholesale and scale retail IDC market opportunities. In accordance with this plan, we have adapted our cabinet delivery and allocation practices to better suit different customer needs. Importantly, we experienced some early success on both wholesale and retail fronts with the strategy in the year. On the wholesale front, our competitive advantage in hyper-scale IDC services and carrier-neutral connectivity bolstered our capability to secure contracts with large-scale enterprise, such as Alibaba. Notably, as we continued to deliver high-quality and reliable services to these wholesale clients, they have expressed strong levels of satisfaction and an increasing desire to explore additional collaboration opportunities in 2020 and beyond.

On the retail front, we continued to grow our client base. During 2019, for example, we provided retail IDC services in Tier-1 cities to a leading online streaming company as well as to a top smartphone manufacturer. At the beginning of 2020, we won a bid to provide and operate a mission-critical production data center for China Everbright Bank. We believe that these kinds of customers are crucial for us to accelerate the growth of our retail IDC business and reach the next level of development. In addition, we were pleased to see that value of our interconnectivity products and turn-key hybrid cloud solutions were recognized by more customers such as CNS News, COFCO and Lenovo. Going forward, we intend to upsell more tailored solutions to these types of key customers in order to penetrate a broader range of industry verticals.

Let's now turn to our non-IDC business. During the year, we cultivated more cloud services business partnerships to enrich the cloud ecosystem with our operating Azure platform in the domestic market, including both local and global SaaS solutions landing in China. We are increasingly optimistic about our cloud services business' growth potential in 2020 with the increasing demand of digital transformation among our enterprise customers. We aim to be our customers' best cloud partner through developing and delivering more solutions to support their digital transformation journey, such as simplifying IT management, optimizing operations, meeting regulatory requirement and empowering them to engage with their employees and customers effectively.

In summary, we concluded the first year of our 3-year growth plan with fruitful results. In 2020. We plan to accelerate our cabinet expansion and prudently increase our pipeline capacity in Tier-1 and satellite cities. As such, we are reaffirming our original target for a capacity delivery of 15,000 cabinets and a revenue growth exceeding 20% year-over-year in 2020.

Now before ending my part, I'd like to take a moment to discuss the impact of COVID-19 on our business. In response to the epidemic, we have implemented a number of initiatives to protect the wellbeing of our employees and clients. Such measures include utilizing remote working systems, providing our clients with remote assistance and tools to better facilitate their operations during this period, as well as ensuring sufficient medical masks and disinfection measures at IDCs. In addition, we have donated over 70,000 medical supply items, including medical masks, to hospitals and other public institutions in Hubei province. We expect the epidemic to have a mixed impact on customer demand in the near term. It may cause a surge in demand for the services of certain industries, such as online education and online entertainment, while dampening the demand for other industries, such as retail, transport and hospitality.

Additionally, due to the extended holiday period and the government's strict implementation of measures for epidemic containment, we are currently facing the challenge of maintaining our original cabinet construction schedule. Going forward, while we take measures to try and accelerate our construction schedule to make up for the lost time during the 6- to 9-month construction period, we will also continue to closely monitor the epidemic development and make adjustments to our construction timetable as necessary. Despite the short-term uncertainties, we are positive that we will benefit from the continuing and even accelerated trend of digital transition in the long run.

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

Xiao Liu ***21Vianet Group, Inc. - CFO***

Thank you, Alvin, and hello, everyone. Before we start our detailed financial discussion, please note that we will present non-GAAP measures today. Our non-GAAP results exclude certain non-cash expenses, which are not 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 RMB terms and that percentage changes are on a year-over-year basis unless otherwise stated.

Our performance in 2019 was characterized by the expansion of our sales pipeline in key markets, improved operational efficiency and the consistent delivery of cabinet capacity, which proceeded according to schedule. For the fourth quarter of 2019, both of our revenue and adjusted EBITDA were within our previous guidance range. Revenue in the fourth quarter increased by 16.2% to CNY 1.05 billion from CNY 901.9 million in the same period of 2018. Such growth was mainly driven by retail customers' increasing demand for scalable space and cutting-edge IT solutions as a result of the increase in digitalization of corporations across China.

Hosting MRR per cabinet during the fourth quarter improved to CNY 8,822 from CNY 8,457 in the same period of 2018. As of December

31, 2019, we operated and managed 36,291 cabinets, which included 32,047 self-built cabinets and 4,244 partnered cabinets. Overall, utilization rate in the fourth quarter was 65.6%. If we exclude the impact from the cabinet added in 2019, our utilization rate for those cabinet delivered before 2019 was 71.8%. Going forward, in order to keep investors informed of our cabinet delivery progress as we ramp up deliveries in 2020, we plan to discuss our utilization rates for both existing cabinets and newly built cabinets separately.

Adjusted cash gross profit in the fourth quarter, which excludes depreciation, amortization and share-based compensation expenses, was CNY 425.9 million compared to CNY 409.2 million in the same period of 2018. Adjusted cash gross margin was 40.6% compared to 45.4% in the same period of 2018. The decline in margin on a yearly basis was due to the delivery of additional pipeline capacity. As we continue to expand our sales pipelines and optimize our product offers, we are confident that our adjusted cash gross margin will return to a healthier level in 2020.

Adjusted operating expenses in the fourth quarter, which excludes share-based compensation expenses, changes in the fair value of contingent purchase consideration payables and the impairment of receivables from equity investees, increased to CNY 184.2 million from CNY 172.4 million in the same period of 2018. As a percentage of net revenue, adjusted operating expenses decreased to 17.6% from 19.1% in the same period of 2018.

Adjusted EBITDA in the fourth quarter grew by 3.3% to CNY 263.8 million from CNY 255.3 million in the same period of 2018. Adjusted EBITDA margin decreased to 25.2% from 28.3% in the same period of 2018 due to the delivery of additional capacity. Net loss attributable to ordinary shares in the fourth quarter was CNY 16.4 million. Basic and diluted loss were CNY 0.02 per ordinary share and CNY 0.12 per ADS, respectively. Each ADS represents 6 ordinary shares.

Moving on to our balance sheet and liquidity. At the end of fourth quarter, our debt to asset ratio was 63.3% and our debt to adjusted EBITDA ratio was 3.2. Net cash generated from operating activities was CNY 444.8 million in the fourth quarter. As of December 31, 2019, we recorded a cash position of CNY 2.72 billion. Going forward, we plan to maintain a healthy balance sheet as a means of maximizing our ability to capture potential growth opportunities and in the future expand our services in key markets.

In order to support the company's organic growth and meet its delivery target of 15,000 cabinets, we are planning for CapEx to be between RMB 2.4 billion to RMB 2.8 billion in 2020, which is in line with our 3-year growth plan. In February 2020, the company announced that it had entered into purchase agreements with a group of investors led by Goldman Sachs for a total of USD 200 million in convertible notes. The proceeds of this deal will provide the necessary support for our capacity expansion plans this year while also potentially enabling us to secure additional resources for continuing growth. Importantly, we have been seeing an increasing favorable banking environment over the past few months as IDCs were listed as a key component of the Internet infrastructure industry and our resources pipeline gradually became stronger through an increasing quantity of long-term contracts with well-known customers.

Speaking from a financial perspective, we are confident that we will be able to secure a more diversified range of financing resources to support the efficient growth of our business over the long term. Looking ahead, we expect net revenue for the first quarter of 2020 to be in the range of CNY 1.07 billion to CNY 1.09 billion and adjusted EBITDA to be in the range of RMB 245 million to RMB 265 million. For the full year of 2020, we now expect net revenue to be in the range of CNY 4.6 billion to CNY 4.8 billion and adjusted EBITDA to be in the range of CNY 1.25 billion to CNY 1.35 billion. This forecast reflects our current and preliminary views on the market and operational conditions which are subject to change and do not factor in any of the potential impact that could be caused by the COVID-19 epidemic in the future.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Yang Liu from Morgan Stanley.

Yang Liu ***Morgan Stanley, Research Division - Research Associate***

Three questions from me. The first one is we saw that the Chinese government or political bureau announced yesterday that they will encourage the -- or accelerate the construction of data centers. Could you please share about your understanding or your view on this kind of tone from the central government? And what kind of policy are you expecting to see in the future? And what will change in term of the future competitive dynamics or return profile? That's the first question on the policy front.

The second one is the COVID-19 impact. When do you expect your construction site or the pipeline under construction to resume working? And whether this kind of a construction delay will bring some negative impact because I think the wholesale customer will have very -- stringent the requirement on the delivery date. And the third question is related with CapEx. I think that 2.6 to -- CNY 2.4 billion to CNY 2.8 billion CapEx, could you please provide a breakdown? What percentage of the CapEx will be for the 2020 capacity delivery? And what will be for the 2021 preparation or land bank reserve, et cetera?

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

Liu Yang, this is Alvin. Let me -- to address your questions. Your first question regarding the central government's very strong support to build more capacity for data center from the top leaders. For sure, as we see, it's a very positive policy to encourage and even support the growth of data center and big data cloud computing nationwide going forward. At the same time, we see that still -- from the local -- from the Tier 1 cities, the local government still have their very established policy on the quota of new data center capacity. And going forward, we will see that most likely that these Tier 1 cities will allocate slightly more quota for data center going forward. At the same time, we still see very limited supply of land and property and also with the power supply to meet very high standard, high requirements from the top Internet and other data center customers. But we do see -- do foresee that for the Tier 2 and Tier 3 cities, it might be -- there's more data center capacity in the coming years. But still, we see in our IDC industry, there is very high entry barrier. And also, there's very big, very strong requirements on the economy of scale. So as a leading supplier -- player in this domain, we remain our confidence going forward.

Regarding the effect from -- impact from the COVID-19, as we said in our prepared remarks that it will be a mixed impact on our short-term -- near-term business but there will be very clear impact -- negative impact on our construction projects. As today, we already resumed all the constructions outside of Beijing even though that we see -- feel this delay compared to our original plan. And also, we are working very closely with the local authority to resume our construction in Beijing as well. So for the third question, I will turn to our CFO to give you more detail.

Xiao Liu ***21Vianet Group, Inc. - CFO***

Liu Yang, regarding to your question on the CapEx plan, our CapEx guidance in 2020 will be in the range of CNY 2.4 billion to CNY 2.8 billion. And among that, around CNY 2.1 billion to CNY 2.2 billion is for the 15,000 cabinets we will deliver this year, and the rest RMB 300 million to RMB 600 million will be for the preparation for the construction for the projects we will deliver next year.

Operator

Our next question comes from Jonathan Atkin from RBC Capital Markets.

Bora Lee ***RBC Capital Markets, Research Division - Assistant VP***

This is Bora Lee on behalf of Jonathan Atkin. First, in the wholesale segment, have customer move-ins or decision cycles been delayed? And then secondly, for the overall market, how do you view longer-term trends for retail and wholesale growth?

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

Regarding your first question, we do -- from our wholesale business, we do see even stronger demand from our major customers, especially the cloud -- public cloud players during this period. We see very strong demand especially from the online entertainment, video conference, et cetera, and also a lot of collaboration applications as well. And at the same time, we do see some industries, especially the online education, online entertainment, this -- in these sectors, we do see very strong customer demand during this period and we foresee strong growth afterwards as well. And also, we foresee it will be a very big kind of driver for all the industries to accelerate their digital transformation.

Xiao Liu ***21Vianet Group, Inc. - CFO***

Our long-term trends, as we mentioned, for the IDC future growth was driven by the wholesale business as well as the large-scale retail business. And from 2020, we'll start to recognize revenue and EBITDA for the wholesale customers. And from 2020, we expect the incremental revenue from wholesale business will contribute to around 40% of our total incremental revenue as company expect to sign more MOUs with wholesale customers this year.

Operator

Our next question comes from Edison Lee from Jefferies.

Edison Lee ***Jefferies LLC, Research Division - Equity Analyst***

I have 3. Number one is that you said that you signed an MOU with a wholesale customer in the fourth quarter. Can you give us a little bit more color on what the MOU means? And when do you think that MOU will start producing revenue? And what are the potential customers in the pipeline on the wholesale front? That's question number one. Number two is can you talk a little bit about this impairment of receivables from an equity investee in the fourth quarter. What nature is that? And why did that happen? And question number three is on your retail growth, I know that you mentioned some major customers that you have signed up. Are the terms of service for these major customers, such as China Everbright Bank, any different from the other retail customers in terms of the contract length and also in terms of the services that you provide?

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

Thank you, Edison, for your questions. Let me take your first and third question. Regarding the MOU with the leading customer we signed Q4 last year, this is a very strategic agreement between us and our customer. It will be a very big data center campus in central part of China, and there will be 2 phases. The Phase 1 has already started, and we expect -- we can see the revenue contribution to start the first half of this year. And also the second -- Phase 2 has also started construction. So we will see that the full projects ready for launch by the end of this year. And also that this -- we -- at the same time, we have very strong engagements with all the leading customers across China. So we foresee that this year, we will have more wholesale projects compared to last year and going forward. Thank you.

For your third question that said our services to retail customers. We do see a lot of new, large-scale retail customers' demand especially from a field where we -- strong sectors like fintech, like artificial intelligence, like the new retail customers. And for this kind of customers, first, we will provide a very -- a big capacity compared to the past, our smaller customers. And also, we'll provide very quick delivery of the capacity and also a different kind of services like hybrid cloud and also some connectivity services and also including bare metal server -- services as well.

Xiao Liu ***21Vianet Group, Inc. - CFO***

Edison, regarding to your question on the impairment of the receivables, it was one-off and non operating-related expenses. Therefore, we made the adjustment into adjusted EBITDA.

Operator

(Operator Instructions) Our next question comes from Arthur Lai from Citi.

Arthur Lai ***Citigroup Inc, Research Division - Director & Analyst***

I have the 2 questions. Number one, we understand that right now is a special period of time of the virus outbreak and a lot of student majorly study at home. So can you elaborate a little bit on the impact to your kind and also your demand? And then also, my investor management are more confident about -- after summer when lots of student may go back to school and what happened in this part of the mix? That was the first question.

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

Actually, as you mentioned, we do see a very strong impact from the coronavirus to the education system, especially the students in high school and middle school and even from the universities. So we do see a lot of very strong requirements from some of our major customers from online education, like Xueersi (TAL) and Yuanfudao and others. We do provide very quick expansion support for them.

And also, we foresee this kind of demands will remain in the coming probably weeks or months. And in the long run, we will see even -- we will see more demands from the online education customers compared to the past years.

Arthur Lai ***Citigroup Inc, Research Division - Director & Analyst***

Yes. And second thing is that we see that MRR actually increased year-over-year. Can you share a little bit more what component drives this MRR increase?

Xiao Liu ***21Vianet Group, Inc. - CFO***

Okay. Arthur, I will answer your question regarding to our MRR. Our Q4 MRR increased a little bit due to -- we delivered more value-added service to our retail customers. Generally, the retail MRR per cabinet will be stable in 2020.

Operator

Our next question comes from STEVEN ZHANG from Huizhi Asset.

STEVEN ZHANG ***HUIZHI Asset - Analyst***

Actually, I have one question regarding the USD 200 million private placement. I'm just wondering are these 2 placement be completely finished that the note has been issued. So what's the current status?

Xiao Liu ***21Vianet Group, Inc. - CFO***

Okay. Thank you for your question. In February, the company announced the private placements with a group of investors, and the deal is worth amounting to USD 200 million and subject to the closing conditions. And the company will receive the capital -- majority of the capital in March and the rest in April. That was the status.

Operator

Our next question comes from Edison Lee from Jefferies.

Edison Lee ***Jefferies LLC, Research Division - Equity Analyst***

I have 2 follow-ups. Number one is that as 30% of your incremental revenue will come from wholesale in 2020, what do you think will be the impact on your adjusted EBITDA margin? And I assume that your 1Q guidance does not include a lot of wholesale revenue if my understanding is correct. Number two is on your CB, can you tell us what the conversion price is going to be and what the expiry date is going to be?

Xiao Liu ***21Vianet Group, Inc. - CFO***

Thank you, Edison. I will answer your questions. Regarding your question -- regarding your first question, our wholesale incremental revenue, we will start to recognize the revenue for the wholesale project in Jiangsu. In the first few months, there will be a ramp-up period. So the wholesale product will not contribute so much on our Q1 adjusted EBITDA. And for the CB, the conversion price was based on the 60-day VWAP before we send the NPAs and with around 26% premium.

Edison Lee ***Jefferies LLC, Research Division - Equity Analyst***

Okay. Sorry -- Sharon, sorry. I just want to clarify maybe for the first question. Other than 1Q, for the full year 2020, what do you think will be the impact on the adjusted EBITDA margin as a result of the growth in the wholesale business?

Xiao Liu ***21Vianet Group, Inc. - CFO***

Okay. Actually, for the -- we signed MOUs with the wholesale customers. And if the ramp-up ended for the material wholesale business, the adjusted EBITDA will -- above 70%. But in 2020, it's still in the ramp-up period. So the adjusted EBITDA margin, that's in line with our average EBITDA margin.

Operator

Our final question comes from Stella Li from Citigroup.

Stella Li ***Citigroup Inc, Research Division - Analyst***

I have a few questions. The first one is regarding the 15,000 cabinet delivery guidance. Roughly how much will be delivered in, say, first half and how many in the second half? Is there any delivery time line guidance? And the second question is noticing your financial statement, there is a loss from equity method investment of CNY 20 million. So I just wonder what is this one. And also a follow-up question on the impairment of the receivable. Do we expect that there will be some more in this year? Three questions.

Shiqi Wang ***21Vianet Group, Inc. - CEO & President***

Okay. Let me -- thank you for your questions, Stella. Let me address your first question. That's based on the latest situation as we spare no effort to accelerate our construction. So currently, we foresee that at least 40% of our total capacity delivery plan will be delivered in the first half of this year and the rest of it will be at the second half.

Xiao Liu ***21Vianet Group, Inc. - CFO***

Stella, regarding your questions on our increase of the long-term investment, it was because the acquisition for the Jiangsu project. [the loss from equity method investment was resulted from the Warburg Pincus joint venture restructure] (added by company after the call). And for your question regarding to the impairment, as I just mentioned before, it's -- one-off expenses will be -- no such amount will be occurred in 2020.

Operator

Thank you. That was our final question. So I'll pass back to management for closing comments.

Rene Jiang ***21Vianet Group, Inc. - IR Director***

Thank you again for joining us. If you have further questions, please feel free to contact IR. Have a good day. Bye-bye.

Operator

Thank you very much. Ladies and gentlemen, that does conclude the call. Thank you so much for your attendance. You may now disconnect.