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PRESENTATION

Operator

Good morning ladies and gentlemen. Thank you everyone, and welcome to 21Vianet Group's second quarter 2016 earnings conference call. At this time all participants are in a listen only mode. We will be hosting a question and answer session towards the end of this conference call. We will begin -- before we begin I will read the safe harbor statement.

This call may contain forward looking statements, made pursuant to the Safe Harbor Provisions of 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 call this conference call over to Mr. Steve Zhang.

Steve Zhang - *21Vianet Group Inc - CEO*

Good morning and good evening everyone, and thank you for joining us. It's my pleasure to address you as the CEO of 21Vianet, and we look forward to your involvement with our Company.

As you are aware, 21Vianet has had an eventful past year. During this time we have strengthened and broadened our senior executive teams, restructured our corporate organization to enable each division to operate more independently, allowing them to adjust and grow with their respective markets more quickly and successfully. Additionally with strong strategic partnerships with several of China's leading tech and financial companies, enabling us to more comfortably fund our growth going forward.

These important actions help position us at the forefront of China's growing cloud adoption, and firmly at the center of China's internet infrastructure industry. The exponential growth in data traffic, driven by increasing mobile society, growing cloud computing demand, live broadcasting popularity, as well as future demand surrounding AR and the way our VR content will certainly continue to drive dramatic growth and demand our core IDC and the cloud computing capabilities. Our goal is to expand our leadership in this vitally important cross-section of China's dynamic internet market.

Another example of this strategy is that we were recently selected to participate in Tsinghua Holdings' Cornerstone Plan. The objective of this plan is to coordinate a portfolio of leading edge technology companies in economically vital areas, including telecommunication and renewable energy, and providing them with financial and government assistance in facilitating nationwide growth. By assisting us financially and with land bank reserves, the Plan is entrusting us to expand our data center portfolio, and develop hybrid cloud opportunities. The honor to participate in the program demonstrates our leadership in China's internet infrastructure sector.

Last month we also extended our strategic cooperation agreement with Kingsoft to 2021. This extension is a great recognition from our strategic partners for the high quality and value of our services, which remain the core competitive strengths of our business. Additionally, following the $388 million investment from Tus-Holdings, we have begun mutually sharing managerial expertise as well as resources, innovations, and R&D capabilities.

Now let me move to our second quarter highlights. Our topline growth remained steady, as our core hosting business helped to offset continued softness in the MNS business. Our core IDC business grew by 19% year-over-year, primarily driven by the steady growth in billable cabinets, and the improving utilization rate.

Growth for our cloud services remained strong, thanks to solid demand for Microsoft Azure and Office 365 services, and the contributions from the IBM cloud business. On the other hand our MNS business continued to face significant challenges, mainly due to the continuing weak bandwidth-pricing environment, and the carrier competition. Nonetheless, we expect this situation to stabilize in the second half of the year.

Now let's go over each of our core businesses in more detail. For core IDC business, after a soft first quarter, our cabinet capacity growth was back on track, where we added over 600 self-built cabinets in the second quarter. We see positive momentum in our self-built data centers, and are excited that another large Beijing-based data center is on track to begin operations during the third quarter.

The utilization rate of our data centers further improved to 76.2% in the second quarter, thanks to solid growth in billable cabinets which helped to drive the topline growth. Our churn rate slightly increased to over 1% during the quarter, however we believe churn rate at our data centers remains fairly low compared to other players in this industry.

Moving on to our cloud business, its momentum has maintained a healthy direction, and the business is progressing well with steady growth from our existing Microsoft cloud business, dominated by Azure and Office 365 users as well as new contributions from IBM cloud business.

It is worth noting that the recent commencement of IBM's Bluemix dedicated [area] in China marked an important step in our cooperation with IBM. Combining a comprehensive portfolio of services already in place and our brand as one of the most trustworthy providers of cloud computing and data center services in China, we believe we can further expand our customer base and enhance our product offerings to meet ever-growing customer demand.

Our enterprise VPN business is also doing well. We are pleased that it has gained increasing interest, not only among international customers, but also domestic markets, with increasing cross-selling opportunities among our existing customer base and other business units. We hope to further strengthen its position as the leading VPN service provider in the Greater China region.

Moving on to our MNS business, net revenue from managed network services again were weak during the second quarter, and the main reason was the declining bandwidth pricing for the whole industry, which we have talked about for multiple quarters.

However we estimate the trend will gradually stabilize in the second half on pricing. To offset this trend, we have focused our efforts here on improving the cost optimization strength. Additionally, the restructuring effort within the Aipu business also negatively impacted both the revenues and the margins this quarter. We are actively managing this optimization process within the Aipu business unit to address some of the challenges in the last-mile access market, and enforce stabilization later this year.

To summarize, we are redoubling our efforts to reaccelerate growth in our core business, and will continue to invest in these growth areas, including our internet data centers, core offerings, cross-connection capabilities, and the enterprise VPN services, as we see great potential ahead, and believe they will be the key drivers for our Company's continued growth.

Our vision is beyond these short-term challenges, as we will continue expanding our data center footprint and working closely with our partners in order to deliver first-class internet infrastructure services in China to all of our existing and future clients. We remain fully committed to our cloud-neutral, carrier-neutral and customer-focused value proposition, and are confident in our growth potential and the leading position as an internet infrastructure service provider in China.

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

Terry Wang - *21Vianet Group Inc - CFO*

Thanks Steve. Let me start with the second quarter of 2016 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 operation. The details of these expenses may be found in reconciliation tables included in our press release. Also note that all the financial numbers we are presenting today are in RMB, and our percentage change is year-over-year unless otherwise stated.

Our revenues for the second quarter of 2016 increased by 51% to RMB911 million. Net revenues from hosting and the related services increased by 19.3% to RMB768 million from RMB644 million in the comparative period of 2015, primarily due to our year-over-year increase in the total number of billable cabinets, improved utilization rate, as well as solid growth from cloud and VPN services.

Monthly recurring revenues for cabinets was RMB8793 in the second quarter of 2016, compared with RMB9115 in the first quarter of 2016. The decrease in the MRR was due to the continual bandwidth pricing pressure, as well as a higher percentage of billable cabinets in lower MRR markets, which is expected to be temporary.

Net revenues for managed network services were RMB143 million in the second quarter of 2016, compared with RMB223 million in the comparative period in 2015. The decrease was mainly due to the continual industry-wide decline in bandwidth pricing as well as lower revenue contribution from Aipu.

Adjusted growth profit was RMB201 million, compared with RMB246 million in the comparative period in 2015. Adjusted gross margin was 22% compared with 28.3% a year ago, and 24.5% in the first quarter of 2016. The decrease in the gross margin was primarily due to the continual softness in the Company's MNS business.

Adjusted operating expenses increased to RMB313 million from RMB209 million in the comparative period in 2015. As a percentage of net revenues, adjusted operating expenses were 34.4%, compared with 24.2% a year ago, and 25.2% in the first quarter of 2016. More specifically, sales and marketing expenses increased by 7% to RMB83 million from RMB78 million in the comparative period in 2015, partially due to increased staff costs, including cash settlement of staff based compensation expenses.

General and administrative expenses increased by 19.5% to RMB199 million from RMB167 million in the comparative period in 2015, primarily due to one-time bad debt provision, of which mostly were investment related, and an increase in depreciation expenses. Research and development expenses increased by 2.9% to RMB33 million from RMB32 million in the comparative period in 2015, as we continue to invest in our strategic growth areas. Changes in the fair value of contingent purchase consideration payable was a gain of RMB15 million in the second quarter of 2016, compared with a loss of RMB17 million in the comparative period in 2015.

From a profitability perspective, our adjusted EBITDA for the second quarter of 2016 was RMB15 million, compared with RMB149 million in the comparative period in 2015. The decrease in adjusted EBITDA was primarily due to a combination of lower gross profit and an aggregated one-time expense of RMB69.9 million, which included a change of bonus policy and accrual of bad debt provision. Adjusted EBITDA margin for the quarter was 1.7% compared with 17.2% a year ago, and 12.6% in the first quarter of 2016.

Under the terms and conditions governing our 6.875% bonds due 2017, we are required to maintain a ratio of adjusted EBITDA to consolidated interest expense of 2.75:1 or higher for the six month period ending June 30, 2016. As a result of the decrease in just the EBITDA, we were not able to meet this requirement. However as mentioned above, the decrease in adjusted EBITDA was primarily attributable to non-recurring factors and one-time expenses, the effect of which we believe to be temporary.

Notwithstanding the above, we intend to amend our offer to purchase announced on August 1, 2016 to include a consent solicitation for a waiver from the requirement to meet certain financial ratios under the bonds for the period ended June 30, 2016. We intend to fund the repurchase of the bond and the consent fee, if any, with cash on hand. We currently have sufficient cash to repurchase or redeem outstanding bonds. Details of our amended offer to purchase and consent solicitation will be announced at a later date.

Adjusted net loss for the second quarter was RMB109 million, compared with adjusted net loss of RMB16 million in the comparative period in 2015. Adjusted net margin was negative 12%, compared with negative 1.8% a year ago, and negative 8.6% in the first quarter of 2016. Adjusted diluted loss per share for the second quarter of 2016 was RMB0.19, which represents the equivalent of RMB1.14 per ADS.

As of June 30, 2016, our cash and cash equivalents and short-term investments were RMB3.57 billion, equivalent to $537.2 million, which includes recent developments by Tus-Holdings.

Our third quarter guidance, we expect the net revenues to be in the range of RMB900 million to RMB940 million. Adjusted EBITDA expected to be in the range of RMB40 million to RMB60 million. For the full year of 2016, the Company now expects our net revenue to be in the range of RMB3.62 billion to RMB3.66 billion. Adjusted EBITDA for the full year of 2016 is expected to be in the range of RMB240 million to RMB260 million. This forecast reflects the Company's current and preliminary review, which may be subject to change.

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

QUESTIONS AND ANSWERS

Operator

Certainly. Ladies and gentlemen, we will now begin the question and answer session. (Operator instructions.) Our first question comes from the line of Matthew Heinz from Stifel. Please go ahead.

Matthew Heinz - *Stifel Financial Corp - Analyst*

Thank you. Thanks for taking the questions. I was hoping you could just elaborate a bit more on the demand trends you're seeing across the cloud business with the existing base of Microsoft Azure and 365 customers, as well as the IBM private cloud business. What kind of growth rates are you seeing in those businesses currently? Is that something that you expect to accelerate or be sustained from these levels into next year?

Steve Zhang - *21Vianet Group Inc - CEO*

For our cloud business -- our Microsoft Azure and Office 365 business, we see continued strengths with the popularity of cloud as a new infrastructure choice for our customers. We see both strong growth in the Azure business as well as Office 365 business, and there are a lot of SME customers in this segment. For the IBM Bluemix services, it was just recently -- became generally available in the Chinese market in June, and we are already seeing a lot of the multinational customers was referred to us by IBM, which globally they were deploying their IT infrastructure on IBM cloud, and now they are looking to move it and copy that to the Chinese market.

Matthew Heinz - *Stifel Financial Corp - Analyst*

Okay, thank you. Then just a couple of follow-ups if I may. First on the IDC business, should we expect the majority of the cabinet adds that you articulated for the rest of the year to be self-built, and if so, should we expect some sort of pick-up -- uptick in the MRR per cab going through the second half of the year? Then secondly I just wanted to get an update on your buyback. It is a fairly substantial chunk of your current market cap, and I'm just wondering how that's progressing. Have you already begun the buyback? When do you expect to have the financing in place for the duration of those purchases?

Steve Zhang - *21Vianet Group Inc - CEO*

I will cover the first question. Terry will address the buyback issue. For your first question, the new cabinet expansion, it's our focus and strategy going forward that we'll mostly focus on our self-built cabinets. In the third quarter we have a large data center that will be ready, and will start offering to our customers in Beijing in the third quarter.

We've got another expansion for our Shanghai data center hopefully to be done in the fourth quarter. Right now we have a large pipeline of projects concurrently going on for our self-built data centers in both Beijing for next year, and as well as Guangzhou for our first quarter next year.

Terry Wang - *21Vianet Group Inc - CFO*

This is Terry. Regarding your question about the buyback, you're talking about the equity and stock repurchase program, which we announced the last couple of months, about next 12 months and we are willing to contribute $200 million to do stock purchase program.

So we, right now, and given this period of time and the future growth potential, and I think that our stock prices right now, we believe, add value for to look at the next few quarters as we move, and business can continue per se. So we will do some purchase on the stock side and we have money on hand already.

You might have noted that we have $388 million at Tus-Holdings company as the largest shareholders investment in June. And also we generate our operating cash from our business side and also project manage to get the finance back to give us support of business. So that, end of the day, then we have the cash enough to be able to support a purchase program.

Steve Zhang - *21Vianet Group Inc - CEO*

I want to add one more point. We haven't really start the repurchase program yet because the trading window was not open yet.

Matthew Heinz - *Stifel Financial Corp - Analyst*

Okay, thank you very much for taking the questions.

Operator

The next question comes from the line of Colin McCallum from Credit Suisse, please go ahead.

Steve Zhang - *21Vianet Group Inc - CEO*

Hi.

Colin McCallum - *Credit Suisse - Analyst*

Yes, thanks for the opportunity, just three questions from me. First of all, is it possible for you to give us the magnitude of cloud revenue in second quarter, if possible split between Microsoft and IBM? Secondly, can you just reiterate how many cabinets you expect to be in place by the end of the year?

Then thirdly, obviously the EBITDA margin has come down even more, compared with the first quarter. When do you think your adjusted EBITDA margin can get back up to the 19% type level? Is that a 2017 type expectation? Or has something structurally changed in your business that you don't think that that sort of EBITDA margin that you used to achieve will be achievable again? Thank you.

Steve Zhang - *21Vianet Group Inc - CEO*

Okay, I will address the cloud business questions and probably Terry can address the EBITDA margin question later on. When we report our revenue, we don't report the gross revenue generated by both IBM cloud business and the Microsoft cloud business. We only include the net portion where we can book our revenue. Because it's more like a revenue sharing or a technical service agreement with both IBM and Microsoft.

Colin McCallum - *Credit Suisse - Analyst*

Sure, no it was the net revenue number I was looking for actually, that's no problem.

Steve Zhang - *21Vianet Group Inc - CEO*

Yes, right now it's roughly close to 10% of our total revenue.

Terry Wang - *21Vianet Group Inc - CFO*

Also, I want to add that you have year-over-year growth rates related to Microsoft's cloud business, and we see the trend is about approximately 20% growth year-over-year. So that trend is continuing, we will see it.

Speaking of the EBITDA and answer the question you raised in two. One is why the second quarter drop, versus the first quarter. I mean we mentioned the two reasons. One is our operation, in terms of the pricing, continued to fall because of the bandwidth pricing pressure. So that our gross margin gets squeezed, compared to the first quarter and last year as well.

The other thing is that a one-time provision related to a couple of investments and the money and productivity, that's the issue that we set up provision for that. The other one also, the change of bonus policy from the -- to get the cash based, that's added temporarily one time on the quarter. So that have impact approximately about RMB70 million on EBITDA for the quarter.

Things that we were looking for is the gross margin area, that's back to the last question mentioned, is when we're going to come back to 19% or 18% EBITDA, as we used to be. I think that environment right now in China is very competitive and bandwidth pricing and continued pressure on everybody has been because as a result of competition.

And we see the bandwidth pricing continue to fall, but at same time internal we made some efforts on this cost control and cost reduction area. So we believe next couple of quarters, our gross margin will go up. But you can see when we will reach 19% or 18% EBITDA, I think that will be, in my view, next year some time.

Colin McCallum - *Credit Suisse - Analyst*

Great, thanks a lot.

Terry Wang - *21Vianet Group Inc - CFO*

Thank you.

Operator

The next question comes from the line of Yang Liu from Morgan Stanley, please go ahead.

Yang Liu - *Morgan Stanley - Analyst*

Hello, thanks for the opportunity to ask questions. I have two questions here. First, could management share with us the cabinet number to be deployed in second half? What is the size of your Beijing unit and what is the size of the one in Shanghai? I think the third quarter has already passed almost half, could you please update about the progress in Beijing?

The second question is around competitive landscape in cloud computing. We notice that recently iCloud booked very strong year-on-year revenue growth and also Amazon formerly launched in AWS in China. So I would like to hear management's understanding about the competitive landscape in the cloud computing in China and what's the Microsoft advantage and position with competitive environment, thanks.

Steve Zhang - *21Vianet Group Inc - CEO*

For cabinet growth in the third quarter, the one in Beijing is very healthy and we see roughly will add 2100 cabinets in the third quarter. And with our Shanghai data center expansion, probably in the fourth quarter with a few hundred cabinets.

I think on the cloud front, the cloud adoption is accelerating. And recently we noticed Alibaba report a very strong growth and we are also seeing pretty healthy growth in the demand from our customers for Microsoft cloud, as well as IBM cloud business.

Yang Liu - *Morgan Stanley - Analyst*

Okay, thank you.

Operator

We have a follow-up question from the line of Matthew Heinz from Stifel, please go ahead.

Matthew Heinz - *Stifel Financial Corp - Analyst*

thanks for coming back around. Just following up on the color you gave around EBITDA margins for the balance of the year. So if I look at your second quarter adjusted number, adding back the RMB70 million of one-time charges, that approximates to a margin of about 9.5%, and the guidance mid-point for 3Q seems to correlate to about a 5% EBITDA margin. I'm just wondering how to square that up with the comments around gross margin improving in the back half and why you see EBITDA margins continuing to decline on a sequential basis in 3Q?

Terry Wang - *21Vianet Group Inc - CFO*

Okay, good question. You know operation-wise, we have a different business unit in combined. And just frankly speaking, one of the business units we think is still deteriorating, which is Aipu. And the second half we don't -- we see that, even we make some efforts on now and so, but because of the landscape change from the carriers that we have some sort of bandwidth and some restrictions from the access to the customers' connection.

So that our pricing and per user basis has dropped dramatically from last year and in the quarter-over-quarter. So the second half of that trend we see is continue, [daily] they are our margin, gross margin and margin, so we will suffer loss and continuously until throughout the year. So that's why we give them a little cushion on that.

Even we have some measures taken, we do see some of the results, but from conservative point of view, I think that we will take those risk out and that we try to commit our guidance to the investors as much as we can. I think this is -- we will take this guidance that we would think is reliable to the capital market.

Matthew Heinz - *Stifel Financial Corp - Analyst*

Okay, thank you.

Terry Wang - *21Vianet Group Inc - CFO*

Thank you.

Operator

There are no questions in the queue. (Operator Instructions). If there are no further -- looks like we have a question from the line of Tina Hu from Goldman Sachs, please go ahead.

Tina Hu - *Goldman Sachs - Analyst*

Hi management, thank you very much for your time. Just one very quick question, you mentioned the bandwidth pricing as declining every year, just wondering how much is it declining at?

Terry Wang - *21Vianet Group Inc - CFO*

Okay, you know for bandwidth we have different BTP and different bandwidth in the different category. On average, if we look at the number of beginning of last year and this year, and pricing dropped approximately 45% already. That trend we do see stabilized throughout the year but will still trend downwards, we could see another 10% to 15% fall. So that's on a [friend] of the sales area.

But in the past, the couple of quarters our margin gets squeezed is our cost area, we need to work on that. So second half we will put a lot of efforts to continue to cost reduction associated with this procurement on this bandwidth area, so that we can expand our gross margin as much as we can.

So that [internets] as Steve mentioned, that we have restructuring our Company unit and to centralize our procurement capability, to be able to use our bandwidth capacities in a mostly optimized way, so that they save in our cost side. So that we can get our margin up next couple of quarters.

Tina Hu - *Goldman Sachs - Analyst*

Okay, thank you. I just want to quickly confirm, you said it was 4% to 5% decline this year or 45%?

Terry Wang - *21Vianet Group Inc - CFO*

45% from beginning of last year, up to this point.

Tina Hu - *Goldman Sachs - Analyst*

Okay, 45%, okay. And you see another 10% to 15% this year, for the remaining of this year?

Terry Wang - *21Vianet Group Inc - CFO*

Yes.

Tina Hu - *Goldman Sachs - Analyst*

Okay, thank you.

Operator

Thank you. Ladies and gentlemen, as there are no further questions, that will conclude today's conference call. Thank you all very much for your attendance, you may all disconnect.

Terry Wang - *21Vianet Group Inc - CFO*

Thank you.
