THOMSON REUTERS

EDITED TRANSCRIPT

Q1 2018 21Vianet Group Inc Earnings Call

EVENT DATE/TIME: MAY 18, 2018 / 12:00AM GMT

CORPORATE PARTICIPANTS

Rene Jiang
Shiqi Wang *21Vianet Group, Inc. - Co-CEO & President*
Xiao Liu *21Vianet Group, Inc. - CFO*

CONFERENCE CALL PARTICIPANTS

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

PRESENTATION

Operator

Good morning, and good evening, ladies and gentlemen. Thank you, and welcome to 21Vianet Group's First Quarter 2018 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 will now turn the call to Ms. Rene Jiang, IRD of 21Vianet, to read the safe harbor statement.

Rene Jiang

Hello, everyone. Welcome to our first quarter 2018 earnings call. This call may concern 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. Please.

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

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

We started 2018 with outstanding financial and operating performance in the first quarter. Our net revenue for our hosting and related services carried through a strong momentum this quarter and achieved a 13.3% year-over-year growth. More importantly, since we completed the divestiture of our MNS business in 2017, our profitability has been improving steadily.

During the quarter, we generated an operating income of RMB 56.4 million. Our adjusted EBITDA also increased by 95.5% year-over-year to RMB 196 million. This is a testament to how effective we are in executing our growth plans and in improving our operational efficiencies.

During this quarter, we continued to experience growing demands for more cabinet spaces from our existing customers, including Xiaomi, Momo, [China Bank Payments] and Weibo. More importantly, utilizing our industry-leading service quality and our competitive advantages in carrier utility, we have win new customers this quarter, including Central Bank, [eWill] (inaudible) and [ECCP].

As we previously announced in the fourth quarter of 2017, we have entered into an agreement with Tus-Holdings for a land parcel in Songjiang, Shanghai to construct 2 buildings for data center use. The construction is currently on track. This will significantly increase our hosting capacity. It will also allow us to better serve our ever-expanding customer base and our growing demand, especially in Tier 1 cities. In addition, the expansion of our data center network will lay a solid foundation for us to pursue future opportunities in wholesale business.

On the cloud side, we continue to provide world-class public cloud services to Chinese customers. In March 2018, we extended our long-term partnership agreements with Microsoft for Asia and Office 365 cloud service in China. With our track record of providing those services in China in the past 4 years, we have established ourselves as industry-leading, uniquely qualified and highly reliable AliCloud service provider. Furthermore, working with Microsoft, we also launched a new partnership with Adobe in April 2018. Collaborating with both Microsoft and Adobe, we will deliver the world-class cloud solutions with localized and customized user experiences to our Chinese customers going forward.

As we extend and strengthen our partnerships with world's most renowned technology leaders, we will continue to invest more resources into expanding our data center capacity, optimizing our daily operations and providing high-quality cloud service to our customers in China.

To further strengthen our corporate governance, the board has appointed Dr. Li Yao as independent director and a member of the company's Compensation Committee. Dr. Li Yao will act as Chairman of the company's Strategic Advisory Board. Dr. Li has over 23 years' experience in finance and investments industry and currently serves as Chief Investment Officer of Asia for the International Finance Corporation, IFC, of the World Bank Group. Prior to that, he served as Chief Executive Officer of China-ASEAN Capital Advisory Company. His rich experience and connections in global finance and Internet infrastructure industry will further strengthen our capabilities to address high-growth wholesale segments of data center markets.

Overall, we are pleased with the progress that we have made in the first quarter. Moreover, we are likely to see the reacceleration in revenue growth and the profitability improvement as a result of our restructuring in 2017. As we continue to expand our data center network, establish new global partnerships and improve our operational efficiency, we are confident that we will further strengthen our position as industry's leading carrier and cloud-neutral service provider in China.

Now I'd like to turn the call to Sharon Liu, CFO of our company, to give you more details of our financial details.

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

Thank you, Alvin, and hello, everyone. Before I begin, I would like to state that we will present non-GAAP measures today. Our non-GAAP results exclude certain noncash expenses, which are not a part of our core operation. The details of these expenses may be found in the reconciliation table included in our press release. Please note that all the financial numbers we are presenting today are in renminbi, and, thus, percent changes are over year -- are year-over-year, unless otherwise stated.

In addition, as we divested our loss-making MNS business by the end of the third quarter 2017, all of revenues and expenses are now entirely generated by our core hosting and related services. For the purpose of providing an apple-to-apple comparison, in the following remarks, we have excluded all revenues and expenses related to the MNS business from our first quarter of 2017 results. We believe this would offer better clarity and insight into the strong performance of our core business.

As Alvin mentioned in his remarks, we are focused on improving our operational efficiency while maintaining our strong growing momentum in the first quarter of 2018. Net revenues from this quarter were CNY 800.8 million, an increase of 13.3% compared to CNY 706.7 million in the prior year period. The increase was mainly due to the increased amount for more cabinet capacity and hybrid IT services from the company's new and existing customers.

Hosting MRR per cabinet for the first quarter was CNY 7,905 compared to CNY 7,598 in the same period of last year and CNY 7,766 in the first quarter of 2017.

Our adjusted cash gross profit, which excludes depreciation, amortization and share-based compensation expenses, increased by 18.1% to CNY 347.5 million from CNY 294.3 million in the prior year period. Adjust

(technical difficulty)

[0.6%] in the prior year period. The expansion in adjusted cash gross margin was mainly due to the company's relation and successful exclusion of its efficiency improvement.

Adjusted operating expenses were CNY 167.2 million, an increase

(technical difficulty)

[5%] from CNY 154.1 million in the prior year period. As a percentage of the net revenue, adjusted operating expenses were reduced to 20.9% from control measures that we implemented.

As a result of our improved operational efficiencies, our adjusted EBITDA increased by 28.3% to CNY 196 million from CNY 152.7 million in the prior year period. Adjusted EBITDA margin increased to 24.5% compared to 21.6% in the prior year period.

Our net profits have increased to CNY 34.7 million compared to a net loss of CNY 116.8 million in the same period of 2017.

Diluted profit per share was CNY 0.05 in the first quarter of 2018, which represents the equivalent of CNY 0.30 per ADS. Each ADS represents 6 ordinary shares.

Turning to other cash flow and the balance sheet. We generated CNY 95.9 million of positive cash flow from operating activities during the first quarter. In addition, our cash and cash equivalents and short-term investments were CNY 2.38 billion at the end of March 2018. We are confident that our healthy cash provision will support our accelerated organic growth and enable us to take new initiatives and seize market opportunities as they appear.

Now let me provide you with our guidance. For the second quarter of 2018, we expected net revenues to be in the range of CNY 810 million to CNY 830 million. Adjusted EBITDA is expected to be in the range of CNY 200 million to CNY 220 million.

Finally, we reiterate our full year guidance. We are confident that we will be able to further improve our top line performance and operational efficiency to meet the growing market demand in the quarters ahead.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Yang Liu from Morgan Stanley.

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

I have 3 questions here. The first one, I think, 21Vianet, it appears, have some new retail data center supply in the past 6 months. Could management talk about the demand for the new capacity so far and the pricing trend? The second question is, what is the utilization for self-built data centers and the partnered data centers? We understand that the self-built data center needs some time to ramp up utilization, but how about the situation for the partnered cabinets? The third question is, among the expense items, we see R&D has some Q-on-Q decline compared with stable SG&A. What is your outlook for your R&D expense going forward?

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

Thank you, Yang. I'll answer your question related to our price, which is hosting MRR. Right, our hosting MRR increased by 139 compared with last quarter. However, we believe that our MRR is quite stable. This is a blended rate, which includes different products and the customer mix, as we have different products such as the colocation, high-density cabinets as well as our hybrid IT services, which will command different MRRs. In the foreseeable future, we estimate the MRR trend will remain stable. It will be in the range of CNY 7,700 to CNY 7,900, with little fluctuations. And for your question 2 is the -- is related to the utilization rate. In this quarter, our utilization rate is 70%. And the partnered data centers utilization rate will be higher, around 80%, while the self-built data center utilization rate is below 70% as we delivered 2 data centers by the end of last year. And for the R&D decline, it is kind of related to the spin-off with the MNS service we restructured and (inaudible) headcounts for certain engineers. But as a percentage of revenue, our R&D expenses will be stable in the future.

Operator

(Operator Instructions) Your next question comes from the line of [Hans Huang from QS Optimal Selection].

Unidentified Analyst

I have 2 questions. One is related to your previously announced management incentive plan. Are we still on track on that? Can you share some light on the progress? Secondly, I would like to ask about your wholesale data center incentives. Given that you have some cash on your balance sheet, I'm just wondering if you could maybe share the wholesale data center-related CapEx trends with us.

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

It's Alvin here. Thank you for your question, [Hans]. Let me address your question regarding the incentive plan. As we previously communicated, the company has approved the so-called performance-based stock units plan to cover the management team and the key talents in the company. And currently, this plan is -- it's on track. Actually, we already identified the key personnels covered in the first batch of this plan. And within the quarter, we will communicate with each individual and finalize the other process regarding that process. Regarding your second question, for wholesale, for sure, the wholesale in the data center business is quite -- is growing quite faster and even higher -- the growth rate is higher than retail. And since 21Vianet has limited resources in the past 2 to 3 years, so it takes time to have all the projects ready for our retail customers -- for our wholesale customers. So we are still in the process regarding the project preparation, and also, we have a commercial negotiation with one of our leading customers here in China. So we -- in the foreseeable future, we expect we will have some projects landed, but it's -- the time wise that we cannot give the detailed information. And regarding CapEx, since wholesale projects are very big for each individual project, so it will -- we will have a project-by-project business plan and CapEx plan. So as of this moment, I can't give you a detailed plan regarding our CapEx for wholesale projects.

Operator

(Operator Instructions) There are no further questions at this time. I would now like to hand the conference back to management. Please continue.

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

Thank you all once again for joining the call today. If you have any further questions, please contact our Investor Relations at IR@21Vianet.com. Thank you.

Operator

Ladies and gentlemen, we have reached the end of our conference call. Thank you all for joining us today. You may now disconnect.