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VNET - Q3 2015 21Vianet Group Inc Earnings Call

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THOMSON REUTERS

## CORPORATE PARTICIPANTS

**Terry Wang** *21Vianet Group Inc - CFO*

## PRESENTATION

**Operator**

Good morning, ladies and gentlemen. Thank you everyone, and welcome to 21Vianet Group's third-quarter 2015 earnings conference call. (Operator Instructions). I would also like to mention that due to the pending going-private transaction, there will be no Q&A session at the end of the call.

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 the selected events or circumstances after the date of this conference call.

With us today is Mr. Terry Wang, 21Vianet's Chief Financial Officer. At this time, I would now like to hand the conference over to Mr. Terry Wang. Thank you. Please go ahead.

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**Terry Wang** - *21Vianet Group Inc - CFO*

Good day everyone, and thank you for joining us today. We are pleased to witness steady topline growth in the third quarter, with revenues increasing 19% year over year to RMB924m, which outperformed the mid-point of our revenue guidance. The increase was primarily driven by continued solid growth in our IDC business, elevated demand for the Company's cloud services, steady growth in our IPU business as well as additional contributions from Dermot Entities, which we acquired from DYXnet Group in August 2014.

The revenue growth was partially offset by the continued softening in managed network services, caused by ongoing slumps in bandwidth selling prices in the market.

EBIDTA came in softer than expected, primarily driven by the higher spending on telecommunication costs, and certain equipment sales to [our] broadband retail customers that generate lower margins.

Due to the changes in the competitive landscape in the marketplace, we have started in the third quarter to restructure our business. We have incurred certain restructuring charges which also impacted our EBITDA in the third quarter and likely in the next few quarters.

Looking at our overall business development and the challenges we currently face in the market, a key focus whilst going forward is to restructure our business into different business units in order to better serve the continuously-evolving, increasingly-specialized market segments. We are evaluating a new organizational structure that separates colocation, CDN, data center construction and development, enterprise network services and the consumer access network.

We believe this greater level of autonomy will allow the various units to specialize and optimize in a way to further improve scale, profitability and operating efficiencies. As we expand our data center footprint, we leverage our strong partnerships with global tech companies, we remain confident in our ability to scale our business both financially and operationally.

Now let's go over each of our core businesses in more detail. In our core IDC business, we increased our total cabinet capacity by nearly 600 in the third quarter. And we will accelerate deployment as we close out 2015 and move into 2016, especially in our Southern China data centers.

We continued to grow our billable cabinets at a rate faster than our total cabinet capacity, which further boosted our data center utilization rate in the third quarter from 67.5% to 71.8%. Our hosting churn rate also improved from 0.37% to 0.26% in the quarter.

Looking at the customer pipeline, we have secured a few leading domestic and international financial and enterprise customers, and are looking to working with others to further strengthen growth verticals.

Our cloud business also showed impressive progress, as demonstrated by the strengthening relationships with our global partners. In the third quarter of 2015, we signed a new agreement with UNIS and Microsoft to provide customized, hybrid cloud-computing solutions and related services to Chinese users. We look forward to further expanding our target customer base and the product offerings under this new agreement.

Furthermore, our partnership with IBM brought us another important project in recent quarters. In October 2014 we signed an agreement with IBM for BlueMix China landing project. Under the terms of the agreement, we will provide infrastructure support and operational services to IBM for BlueMix's entry into China market.

For our CDN business, we continue to execute on our growth strategy in catching up with the industry leaders. Given some of the recent changes in competitive landscape that could potentially benefit our CDN business, we're refining our going-market strategy in order to capture opportunities. Meanwhile it is important to point out that competition in the CDN market has also pressured our gross margins. And we expect this trend will likely continue in Q4. We are working diligently to optimize our cost structure in light of the continued decline in the bandwidth prices in the market.

Our VPN businesses, which primarily comprises of DYXnet Group that we acquired in 2014, continued to perform well. As the second-largest enterprise VPN service provider in the greater China region, DYXnet continues to attract customer demand as part of their overall IT spending. We are also working to leverage some of the potential cross-selling opportunities, now that DYXnet is part of the much larger platform.

Moving on to our MNS business, net revenue from managed network services came in soft, primarily due to the industry-wide decline of selling bandwidth prices and intensifying market competition. As we discussed in previous quarters, while IPU group continues to perform well, the organic MNS business remains one of the most challenging parts of the overall business.

To that end we will continue our network grooming business process, and are restructuring our business to suit the changing market dynamics. In the meantime, we are reviewing our customers' credit against our accounting policies to assess the account receivables collections.

Now I want to discuss our third-quarter financial results. Before I begin, I would 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 detail of these expenses may be found in the reconciliation tables included in our earlier release. Also note that all financial numbers we're presenting today are RMB amounts and percentage change is year over year, unless otherwise noted.

Our net revenues for the third quarter of 2015 increased by 19% to RMB924m.

Net revenues from hosting and related services increased by 36% to RMB696m from RMB513m in the comparable period of 2014, primarily due to the increase in the total number of billable cabinets under management.

MRR per cabinet was RMB9,900 in the third quarter of 2015 compared to RMB9,872 in the second quarter of 2015.

Net revenues from managed network services were RMB228m in the third quarter of 2015 as compared to RMB265m in the comparable period of 2014. The decrease was primarily due to the continued decline of bandwidth pricing.

Adjusted gross profit was RMB214m -- RMB240m compared with RMB265m in the comparable period in 2014.

Adjusted gross margin was 26% compared to 34% in the comparable period in 2014 and 28.3% in the second quarter of 2015. The decrease in gross margin was primarily due to a higher spending on telecommunication services, lower spending -- lower selling bandwidth prices, and some lower-margin equipment sales to IPU customers.

Adjusted operating expenses increased to RMB230m from RMB198m in the comparable period in 2014. As a percentage of net revenue, adjusted operating expenses were 25% compared to 25.5% in the prior-year period and 24.2% in the second quarter of 2015.

More specifically, sales and marketing expenses increased by 4% to RMB89m from RMB86m in the comparable period in 2014, primarily due to higher services fee, which were more than offset by lower labor costs as we outsourced some functions to more cost-effective service providers.

General and administrative expenses increased by 54% to RMB139m from RMB90m in the comparable period in 2014, primarily due to expenses associated with previously-issued employee stock options, and increased headcounts associated with the growth in our overall business.

Research and development expenses increased by 12% to RMB35m from RMB31m in the comparable period in 2014, which reflected our efforts to further strengthen our research and development capabilities and expand our cloud computing and CDN service offerings.

Change in fair value of contingent purchase consideration payable was a loss of RMB0.4m (sic - see press release "RMB0.7m") in the third quarter of 2015 compared with a gain of RMB65m in the comparable period in 2014.

From a profitability perspective, our adjusted EBITDA for the third quarter of 2015 was RMB122m compared with RMB154m in the comparable period in 2014.

Adjusted EBITDA margin for the quarter was 13.2% compared with 19.8% in the comparable period in 2014, and 17.2% in the second quarter of 2015.

Adjusted net profit for the third quarter was RMB15m compared with RMB16m in the comparable period in 2014.

Adjusted net margin was 1.7% compared with 2.1% in the comparable period in 2014, and negative 1.8% in the second quarter of 2015.

Adjusted diluted earnings per share for the third quarter of 2015 was RMB0.02 which represents the equivalent of RMB0.12 per ADS.

As of September 30, 2015, our cash and cash equivalents and the short-term investments were RMB1.88b (sic - see press release "RMB1.9m") equivalent to 298 -- $296m.

Now turning to our financial outlook, for the fourth quarter of 2015, the Company expects net revenues to be in the range of RMB960m to RMB1b, representing approximately 15% year-over-year growth at the mid-point.

Adjusted EBITDA is expected to be in the range of RMB100m to RMB120m, representing approximately 31% year-over-year decline at the mid-point. The year-over-year decline reflects expected one-time charges in the fourth quarter related to accounts receivable write-off of approximately RMB30m.

For the full year 2015, the Company now expect the net revenue to be in the range of RMB3.61b to RMB3.65b, revised from prior guidance of RMB3.58b to RMB3.68b. At the mid-point, this represents approximately 26% topline growth over 2014.

Adjusted EBITDA for the full year 2015 is expected to be in the range of RMB538m to RMB558m, revised from prior guidance of RMB620m to RMB660m.

This represents approximately 2% decline over 2014 at mid-point.

These forecasts reflect the Company's current and preliminary view, which is subject to change.

This concludes our prepared remarks. Thank you for joining our call today. And now we would like to conclude the call. Thanks.

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**Operator**

Ladies and gentlemen, that does conclude our conference today. Thank you for all participating. You may all disconnect. Thank you.

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