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## Q1 2022 VNET Group Inc Earnings Call

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## PRESENTATION

**Operator**

Hello, ladies and gentlemen, thank you for standing by for the First Quarter 2022 Earnings Conference Call for VNET Group, Inc. (Operator Instructions). Participants from our management will include Mr. Samuel Shen, Chief Executive Officer and Executive Chairman of Retail IDC; Mr. Tim Chen, Chief Financial Officer; and Ms. Xinyuan Liu, Investor Relations Director of the company. Please note that today's conference call is being recorded.

I'd now like to turn the conference over to the first speaker today, Ms. Xinyuan Liu. Please go ahead.

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**Xinyuan Liu** ***VNET Group, Inc. - Investor Relations Director***

Thank you, operator. Hello, everyone, and welcome to our first quarter 2022 earnings conference call. Our earnings release was distributed earlier today, and you can find a copy on our IR website as well as on Newswire services.

Please note that the discussion today will contain forward-looking statements made under the Safe Harbor Provisions of the U.S. Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. For detailed discussions of these risks and uncertainties, please refer to our latest annual report and other documents filed with the SEC. VNET does not undertake any obligation to update any forward-looking statements, except as required under applicable laws.

Please also note that VNET's earnings press release and this conference call includes the disclosure of unaudited GAAP financial measures as well as unaudited non-GAAP financial measures. VNET's earnings press release contains a reconciliation of the unaudited non-GAAP financial measures to the unaudited GAAP measures. As a reminder, this conference is being recorded. In addition, a webcast of this conference call will also be available on our Investor Relations website at ir.vnet.com.

I will now turn the call over to our CEO, Samuel.

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**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

All right. Thank you, Xinyuan. Good morning, and good evening, everyone. Thank you for joining our first quarter 2022 earnings conference call. As we continue executing our dual-core growth strategy to grow our reach in retail and wholesale IDC market, we are pleased to report another solid quarter amid a complex macro environment. From a performance standpoint, we got off to a solid start in fiscal 2022, delivering healthy operational and financial growth in the first quarter.

Total cabinets under management increased to approximately 79,000 compared with approximately 56,000 at the end of first quarter of last year. Cabinets utilized by customers increased to approximately 43,000 compared with approximately 33,500 in the comparable period last year. Our retail MRR per cabinet grew to RMB 9,236 in the first quarter compared with RMB 9,144 in the same period of 2021.

For the first quarter, our revenue grew 18.6% year-over-year, and adjusted EBITDA grew 21.9% year-over-year, both in line with our expectations. The phenomenal rise of a digital economy and the favorable policy landscape as well as our proven ability to execute our strategy have all continued to bolster our business momentum across each of our business segments.

First of all, more supportive policy developments are paving the way for continued progress, reinforcing the positive outlook for the IDC sector and its role in China's digital transformation and technology development. At the most recent meeting of the Central Financial and Economic Affairs Commission held last month, China's central government extended the national initiative to further modernize infrastructure across information technology, logistics and other industries, aiming to deploy a considerable number of next-generation IT infra facilities, which include supercomputers, cloud, AI platforms, and broadband backbone networks. As one of the service providers to support this major initiative, we are well positioned to benefit from the fast-growing demand in a more favorable and healthier regulatory environment.

Additionally, as the significant national infrastructure advancement initiative, Eastern Data, Western Computing was released earlier this year to boost data center computing power across the nation, we continue to see the great potential for the expansion of our core business with even more efficient and effective approach.

Before I discuss our business segments in more detail, I'd like to speak about the COVID-19 resurgence in certain key locations and its impact on our operations. The lockdowns and related travel restrictions that were imposed in Shanghai, Beijing and several cities in Hebei province have impacted some of our customers' move-in rates and our progress with respect to the construction of some of our new projects in these areas. Our data centers in the affected areas have continued to operate uninterruptedly throughout the lockdowns, and we truly appreciate each of our on-site employees' efforts to keep things running smoothly. We will continue to closely monitor pandemic developments and together with our partners adopt measures to mitigate risk for our operations.

Now let's look at the first quarter performance and latest development of our wholesale business. As digitalization is taking place across sectors and geographies, more TMT customers, especially Internet players, cloud service providers, inevitably expand their efforts to enhance their data processing and storage capacities to keep up with frontier technology trends and gain competitive edges. Our compelling value proposition, rooted in extensive industry know-how, in-depth resource capabilities and well-seasoned operation teams continually enhance the appeal of our wholesale service offerings to leading technology players.

During the first quarter, we signed 4 contracts generating a total of approximately 16 megawatts in capacity, including an extended pre-committed order of approximately 11 megawatts from a leading social platform operator and 3 orders under multiyear contracts with 2 existing customers and one state-owned cloud service providers in China's southwestern region. We continue to see the increasing demand from our wholesale business, and we're quite optimistic about our future prospects in this segment.

Moving on to our retail business. In the first quarter, our ongoing efforts to advance our value-added service offerings, fueled steady growth in orders from both existing and new customers, reaffirming the effectiveness of our strategy and the increasing efficiency of our execution. New customer expansion was primarily driven by growing demand from the financial services, e-commerce, automotive and energy sectors.

Also, as we continually enhance our service capabilities and enrich our one-stop service offerings, a large number of existing customers including Internet players, cloud service providers, cross-border e-commerce players, financial service providers and local service online marketplaces continue to extend or upgrade their contracts to procure additional value-added services, spanning a wide spectrum of areas from interconnectivity, bare metal services and hybrid multi-cloud solutions in addition to colocation services.

Technological innovation is a crucial driver for the business development of our digital services. We just launched a new in-house developed interconnectivity solution that aims to provide all-in-one enterprise connection services built on our innovative SD-WAN technology and backbone network. It also includes an array of cutting-edge features catering to different platforms and hybrid access networks to enable application-aware intelligent routing and network-wide visualization. In addition, we just rolled out NeoStack, a customer-oriented full-stack cloud-native services to empower corporate developers to build and run scalable applications in public, private and hybrid clouds facilitating digital transformation initiatives.

These new product launches also represent our powerful engineering capabilities to enrich our service portfolios, deliver additional values to customers and diversify our revenue streams. In addition to serving corporate customers across various verticals, we continue to explore opportunities to partner with more state-owned enterprises by leveraging our aptitude for technology and healthy government relationship.

Recently, we signed an exclusive partnership agreement with People Data, a subsidiary of People's Daily Online, an authoritative media platform in China. Under the agreement, as the exclusive partner, VNET will jointly build and operate People Cloud, the cloud platform of People Data to uphold its role in serving local government and SOE customers' needs for cloud computing. In this regard, we will provide all-around services, including colocation, interconnectivity, cloud platform, cloud native workloads and industry-specific cloud solutions.

On the Blue Cloud business front, we have been actively exploring business opportunities in different vertical industries leveraging our seasoned cloud service operation expertise and through decade long exclusive partnership with Microsoft. More encouragingly, in Q1 2022, we began to offer operations and maintenance services to support the digital business system of Huaneng Power, one of China's largest electric power companies. We will deliver first-class 24/7 O&M services across a wide array of core business systems, as well as secure a high availability architecture for relevant business continuity.

The initial feedback we have received from our customers has been remarkable. Our solutions and services not only enable customer systems to run trouble-free, but also optimize their efficiency and performance to better meet business needs, while effectively reducing their operating costs. As this system performance enhancement improve the overall operating efficiency, our customers' overall business management capabilities also grow stronger, which in turn, cements their competitive advantage. We expect to further expand our industry-specific solution for other sectors.

Last but not least, I'd like to reiterate that in a highly dynamic market in which we operate, upholding long-term commitments and responsibilities to our industry, environment and society is central to our ongoing success. As our industry shifts toward green data center operations and the world comes to embrace sustainable enterprise management, we are committed to building VNET as a positive force for the betterment of society.

For more than 2 decades, we have been committed to advancing a wide range of ESG initiatives within the stakeholder communities we serve. Our 2021 ESG report published in April showcases these initiatives and demonstrates our commitment to integrating sustainability into every aspect of our operations. Some highlights include our carbon neutrality target by 2030, lower than industry average PUE and the fact that we are the first data center service providers in China to disclose the third-party verification of our carbon inventory results. As a prominent domestic enterprise and a global industry player, we will continue to lead by example in this aspect.

Looking ahead, we will remain dedicated to utilizing our core strengths while continuing to focus on our dual-core growth strategy. We expect to capture greater opportunities and fulfill more growing digital demand across wide-ranging verticals as the digital transformation progresses.

Thank you, everyone. With that, I will now turn the call over to our CFO, Tim to discuss our financial performance for the quarter and our business outlook. Hi Tim?

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**Tim Chen** ***VNET Group, Inc. - CFO***

Thank you very much, Samuel. Good morning, and good evening, everyone. Before we start the detailed discussion of our financials, 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 earnings press release. Please also note that unless otherwise stated, all the financials we present today are for the first quarter of 2022 in renminbi terms.

First, we're pleased to have achieved solid results on our top line and adjusted EBITDA in the first quarter, in line with our expectations. The sequential decrease in revenue was mainly due to seasonality given that the first quarter is typically not a strong period for our business because of Chinese New Year. In addition, our move-in rate was also impacted by lockdowns. Our robust financial performance against a backdrop of macro fluctuation reflects our continued efforts to further expand our service offerings, diversify our customer base and invest in our core capabilities.

Next, let me walk you through our first quarter financial results. Unless otherwise specified, the growth rates I will be reviewing are all on a year-over-year basis.

In the first quarter, our net revenue increased by 18.6% to RMB 1.65 billion from the same period last year, mainly due to the increased customer demand for our highly scalable carrier and cloud-neutral IDC solutions from both wholesale and retail IDC customers as well as the continued growth of our cloud business.

Gross profit was RMB 355.5 million in the first quarter of 2022 representing an increase of 10% from the same period of 2021. Gross margin was 21.6% in the first quarter of 2022 compared to 23.3% in the same period of 2021. Adjusted cash gross profit, which excludes depreciation, amortization and share-based compensation expenses, was RMB 684.8 million in the first quarter of 2022, an increase of 13.1% from the same period of 2021. Adjusted cash gross margin in the first quarter of 2022 was 41.6% as compared to 43.6% in the same period of 2021.

Adjusted operating expenses which exclude share-based compensation expenses and compensation for postcombination employment in an acquisition were RMB 200.8 million in the first quarter of 2022, representing a decrease of 5.5% from the same period of 2021. As a percentage of net revenues, adjusted operating expenses in the first quarter of 2022 were 12.2% compared to 15.3% in the same period of 2021. Adjusted EBITDA in the first quarter of 2022 was RMB 506.2 million representing an increase of 21.9% from the same period of 2021. Adjusted EBITDA in the first quarter of 2022 excluded share-based compensation expenses of RMB 43.2 million. Adjusted EBITDA margin in the first quarter of 2022 was 30.8% compared to 29.9% in the same period of 2021.

Our net profit attributable to ordinary shareholders in the first quarter of 2022 was RMB 90.7 million compared to a net loss of RMB 84.7 million in the same period of 2021. Basic and diluted profit was RMB 0.1 and RMB 0.03 per ordinary share, respectively, and RMB 0.6 and RMB 0.18 per ADS, respectively. Each ADS represents six Class A ordinary shares.

As for our balance sheet, the aggregate amount of the company's cash and cash equivalents, restricted cash and short-term investments as of March 31, 2022, was RMB 3.36 billion. Meanwhile, net cash generated from operating activities in the first quarter of 2022 was RMB 482.6 million compared to RMB 274.5 million in the same period of 2021. Our CapEx in the first quarter of 2022 was RMB 1 billion.

Looking ahead, we remain committed to investing in our core capabilities to advance our dual-core growth strategy, broaden the spectrum of our services, increase customer diversification and further tap into the long-term potential of digital economy development in China.

Moving to outlook. For the full year of 2022, our outlook remains unchanged from the previously provided estimates. We anticipate net revenues to be in the range of RMB 7,450 million to RMB 7,750 million and adjusted EBITDA to be in the range of RMB 1,975 million to RMB 2,125 million. This forecast reflects the company's current and preliminary views on the market and its operational conditions, which do not factor any potential future impacts caused by COVID-19 pandemic and are subject to change.

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

## QUESTIONS AND ANSWERS

**Operator**

(Operator Instructions) Our first question will come from Yang Liu at Morgan Stanley.

**Yang Liu** ***Morgan Stanley, Research Division - Equity Analyst***

Two major questions here. The first one is on the COVID impact. Could management update us in terms of what percentage of your data centers are undergoing the lockdown issue? And in terms of the second quarter move-in, should we expect even lower than first quarter, given both Shanghai and Beijing have some issue and maybe also Langfang as well? And also for the new capacity construction, whether the lockdown will delay the new capacity delivery, and of course, whether that will bring some CapEx savings this year. So that is the overall COVID-impact question.

And the second one is on the demand. We saw a new line in the disclosure that is utilized cabinet. And I think that is a pretty important metric the market is monitoring. Could management disclose what is the number at the end of last year? And what is the expected growth or expected increase for the full year 2022 based on current demand profile?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Thank you, Yang. This is Samuel. Let me take the first crack of the question that you have with regard to the lockdown impact. I think first of all, the lockdowns and also related travel restrictions that were imposed in Shanghai and recently in Beijing and also several cities in Hebei Province definitely impact some of our customers move-in rates and our progress with respect to the construction of some of the new projects. And separately, we're also seeing some of the industry like auto. Basically, they are slowing down their plant expansion due to their supply chain issues. That being said, we will continue to monitor the situation, working with the customers and partners and figure out a way appropriate measures to mitigate potential risk for the business operation.

And also based upon what we have seen so far and our assumption in a way to see different stages for cities to incrementally loosen restriction on business and individuals, like what we have seen in Shanghai, we hope to see in the coming months it's going to getting better. And so we expect our Q2 revenue probably going to grow mid-teens year-over-year and EBITDA and also to grow low single digits, maybe year-over-year. But having said that, we're going to do every single thing possible to accelerate once the situation is getting better. Tim, do you want to add on any comments you have?

**Tim Chen** ***VNET Group, Inc. - CFO***

Yes, sure. Let me also tackle the point about the whole capacity delivery. Actually, in our original plans, the deliveries were in the back end of the year. So I think that once the control measures are eased, we will do our very best to have the construction side catch up. And again, the original plan was to have it in the second half of the year back ended. So I think there is at least a greater chance for that to then take place for that.

The second, I guess, part of the question, Yang, you had questions about the number of cabinets. And so at the end of 2021, so fourth quarter, we were around just over 41,000 cabinets, actually 41,700 cabinets. And so you can sort of calculate obviously, the quarter-on-quarter increase in number of cabinets. As to the full year, we can sort of speak a little bit more, but at this point, as you can appreciate, we are still in the middle of the slow ramp up due to the COVID measures that Samuel was just talking about.

So at this moment, there are probably 3 or 4 different scenarios that are going through our heads in terms of when it eases. Obviously, there is going to be ramp-up demand but there's also then the physical constraint of how quickly people are going to ramp up. So I would say we remain sort of optimistic in terms of the full year ramp-up just on the basis that we've seen that when customers need to ramp up quickly, we're able to accommodate those requests and make sure that it can happen. So I think that it really now is a matter of a call on how long some of these measures will be in place in the Shanghai, Beijing area.

**Operator**

Our next question will come from Edison Lee at Jefferies.

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

I have 2 questions. Number one is more on the financial side. So why did the 1Q '22 revenue lower than 4Q '21? Because I imagine that it may have to do with the cloud business or the VPN business. Can you elaborate a little bit more on that? And then on 2Q because we are already at the end of May, right? So for 2Q, I think you commented that maybe it will be worse than 1Q. So does it mean that you remain very confident that second half you guys will be able to catch up? And whether that catch-up is realistic based on your assessment right now? And the last question is on the Hina Group's privatization offer because the company has not made any official comments on it. So is it possible for you to share some of the color and maybe what has been thinking about in terms of that privatization offer?

**Tim Chen** ***VNET Group, Inc. - CFO***

Sure thing. Let me take a first crack at it and I'll have Samuel add additional color as well. With regards to the revenue side, we do have a situation in fourth quarter compared to first quarter, where there is a one-off events in the fourth quarter. And typically, you have a lot of annual events on the e-commerce side that lead to an increased revenues from those customers and their requirements, and that doesn't repeat in first quarter. And so that is sort of the primary driver of that difference.

In terms of looking at second quarter and the ability for the customers to ramp up, I would say that the headwinds remain. But if you look at not just second quarter where we're 2/3 through the second quarter right now, you do see that their customers are ramping up still. And so we now also have a much better gauge obviously, as we go through the year, similar to what I was answering Yang earlier on which is that first half, we have good visibility, it really is going to be second half on how quickly the measures are eased so that this pent-up demand can take place.

Last question in terms of the offer. At the moment, again, we've told the market, we would have updates as and when it's appropriate. And right now, there has not been any decisions taken by the Board that we are able to disclose to the market. So we will provide updates as and when appropriate, but nothing further from what we've already released to the market. Samuel, anything else to add to that.

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Probably only a few things to add on top of what Tim just mentioned about, because last year, we acquired a company call Tenxcloud, which is called native type of company providing the solution and platforms to the enterprise customers. Their business also have the seasonality. It tends to be the second half is more heavier to deliver. And so besides the one-off the projects due to the online retail type of business driven, we also have some of the business tend to be more bottom heavy. So that's additional color.

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

Okay. Can I quickly follow up on the privatization offer? So I understand the Board is still discussing that. So can you share a little bit more color as to what the Board is waiting for more information from the bidder or the Board is considering all the alternatives or the Board is actually discussing with the bidder? Is there any more color that you can share?

**Tim Chen** ***VNET Group, Inc. - CFO***

There's no additional color you can offer at this moment, Edison. But again, when there is something that we can disclose, we will do so to the market promptly.

**Operator**

Our next question comes from Hongjie Li from CICC.

**Hongjie Li** ***China International Capital Corporation Limited, Research Division - Associate***

I have two questions. The first one is about the People Cloud, because recently, the People Cloud launch VNET has also participated. So I was curious about what was strategically the company think on such business. And the second question is on the R&D expense ratio because in the first quarter it slightly increased to around 4%. So could management share your current R&D expenses?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Tim, how about I take the first one and then you can cover the second question that Hongjie has. In terms of the partnership with the People Cloud, it is true that we just signed an exclusive strategic partnership agreement with People Data. For those of you who probably know the People Daily better than the People Data. People Data is actually a subsidiary of People's Daily Online. People's Daily Online is an authoritative media platform in China. They're one of the leading authoritative media platforms.

So under the agreement as an exclusive partner VNET will jointly build and operate People Cloud. People Data is trying to targeting the

People Cloud as the cloud platform to uphold its role in serving local government and SOE customers need for their specific cloud computing. So in that regard, as I said earlier, we will provide the full-stack all around services all the way from the colocation, interconnectivity, bare metal services, cloud platforms called native workloads and some other industry-specific solutions on top of that because what happened is most of you probably know, that China is one of the latest countries to pass a new Omnibus Privacy Law, effectively from November 1 last year, the Personal Information Protection Law AKA PIPL is China's first comprehensive law designed to regulate online data and protect personal information.

And People Data has the agenda in a way to making sure they can provide a dedicated cloud platform in the way that to honor the PIPL and to serve the state-owned enterprise customers and so on and so forth. The partnership is still in the very early stage. So 2 parties are working together, figuring out the product road map and so on and so forth. That being said, I think it's a good indicator to demonstrate or to showcase our government relationship and our ability to partner with one of the leading state-owned enterprise. So hopefully, that gives some of the colors, but happy to report the progress when the time comes.

**Tim Chen** ***VNET Group, Inc. - CFO***

Okay. Thank you, Samuel. Let me take the question on the R&D costs. So I think you had sort of a question around what is the investment focused on or around, and this links back to what was in our press release but also what Samuel mentioned in his part of the presentation earlier on, which is about new products and new solutions. So the new SD-WAN interconnectivity solution would be one of them. And these are the products that we offer mainly through to our retail enterprise customers. Whether or not the R&D will stay at these levels, I would say, yes, but part of it is actually a recategorization. Some of the costs were in other departments, which we've now recategorized as R&D. So overall, costs are not going up, but rather a categorization in terms of what we are now looking at as R&D. So I think hopefully that answers the questions you had.

**Operator**

Our next question comes from Albert Hung at JPMorgan.

**Albert Hung** ***JPMorgan Chase & Co, Research Division - Analyst***

My first question is still about second half outlook. If I heard you right, your second quarter commentary suggest only 5% sequential growth. And if you want to achieve the full year guidance, you probably need more than 25% half-on-half growth in the second half. I understand there should be some seasonality in second half if I look at the historical trend, it's just like mid to high teens. So with all the macro headwinds and enterprise spending slowed down, may I ask why we are so bullish in the second half demand outlook? Is there any leading indicators such as new booking? Or could you share any feedback on your, say, discussion with the new customer? And my second question is you mentioned a lot of new wholesale customer wins in last quarter. And may I know how it's the move-in rate outlook for the new customer? And is there any pricing difference between the new orders and the existing one?

**Tim Chen** ***VNET Group, Inc. - CFO***

Albert, let me take the first part of that, and I guess, Samuel, if you want to jump in as well. In terms of the second half or actually second quarter and then leading into the second half, again, I think if you're looking for the leading indicators, I mean we do have feedback from our customers a desire to ramp up. And really, the constraint right now are the measures that have been put in place by the government, which don't allow them to actually ramp up and move into the data centers. So I think that pent-up demand, again, we've seen a number of our customers in a very, very short period of time ramp up to very high numbers.

And so we are quite confident that if and when these measures are eased that these customers will be able to ramp up quite quickly and perhaps even ahead of what we had sort of predicted. This happened last year as well. But again, it will depend on these measures. Now look, if these measures continue on indefinitely, then obviously, we'll look to see what that means in terms of third quarter, fourth quarter and obviously then the full year.

Your second question, I guess, was on the new MOUs? Sorry, you're asking what was the progress or?

**Albert Hung** ***JPMorgan Chase & Co, Research Division - Analyst***

Is there any pricing difference or move-in rate difference between the new orders and the existing ones.

**Tim Chen** ***VNET Group, Inc. - CFO***

No. They are actually more mirrored to our existing contracts with these customers. So no slower and then pricing is generally the same.

**Albert Hung** ***JPMorgan Chase & Co, Research Division - Analyst***

Understood. And another follow-up question on the move-in rate. I understand there are probably some constraint in Shanghai, Beijing area. But did you see any separation in move-in rate in other regions because customers may be afraid of potential lockdown?

**Tim Chen** ***VNET Group, Inc. - CFO***

Samuel, do you have any color on that?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Yes. If I look back, I would say the Shanghai region lockdown, it does impact the customers move-in rates. That being said, as I have stated earlier, the lockdown and travel restriction do create some of the impact, I would say, negative impact. But that's not going to be a long term. Today, when we look at the West region, the data center that we have, for example, Chongqing and Xi'an areas, we're not seeing that type of impact. As a matter of fact, while the COVID-19 created a lot of headwinds, from a customer point of view, their digital transformation has been accelerated, and so that's the reason we are cautiously, I would say, optimistic.

If the whole country, having the dynamic COVID zero policy, and then want to make sure the major city to keep a societal zero COVID, I think the situation will be getting better probably going to be impacted about a month and 2 months, but right after that is going to be accelerated. And even though people in Beijing are working from home, but I do have a regular conversation with the customers, the key customers. And based upon the conversation I have with the customers, and also the impact coming from our sales channel, customers do want to accelerate once the lockdown is over. So I would say, first of all, keep the country's agenda at the top priority. But nothing is going to change after that. So it's going to be an impact. It's going to be like a hiccup for a given period of time. But overall, still put it positive in my opinion.

**Operator**

Our next question comes from Clive Cheung at Credit Suisse.

**Clive Cheung** ***Credit Suisse AG, Research Division - Associate***

My first question is on wholesale demand, I guess a follow-up question. As we are seeing some slowdown in the cloud business, in traditional wholesale customers, say, VAT one who recently reported, so my question is how should we expect this to impact our kind of wholesale outlook, particularly in the second half post the COVID impact? That's my number one question. My second question is on the potential pricing or margin impact as we have seen over the last 2 quarters, we have SOE orders or government-related customers as new take on. And so would this impact any of our margin profile at all?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Okay. This is Samuel. I'm happy to take on your questions and welcome Tim to chime in with additional color. I think from a wholesale segment point of view, in the past, we tend to focus on cloud service providers, big name Internet companies, especially for those video type of Internet giants requires the data center to store the data so on and so forth. So a lot of times, the analysts might be worried about is government really support of the Internet sectors.

So let me kind of do a very quick spin on that one. I think in general, the Chinese government is very supportive of the Internet sectors. Given the fact that the sector's innovation that has contributed to the growth of country's economy in the past 20 years, yet it is equally important to know the regulatory risk does step up recently, probably in the past 12 months for some of the Internet verticals.

As you can see, some of the antitrust law, online gaming impact, live streaming impact, social media services or even for the profit-making in off-campus tutoring. Therefore, we have to stay agile to cope with the government policy while partnering with our customers to plan for their business growth accordingly. There are definitely some headwinds but also tailwinds.

In terms of the pricing or pricing pressure, pricing competition that you asked about, we're not seeing a material difference from what we have seen in the past quarter. That being said, because the COVID-19 or the pandemic outbreak, that's the impact to most of the verticals: local life, entertainment or even for the online retail. Therefore, it is prudent to assume customers would be more cost sensitive moving forward given the market conditions. So that being said, in short, we're not seeing a material impact, but we have the empathy to understand the customers could be cost-sensitive. So hopefully, that address your question. I'm not sure whether Tim, you have additional color you want to add?

**Tim Chen** ***VNET Group, Inc. - CFO***

Not for that part. But the second question, you had a question about margin impact on -- was the state-owned cloud?

**Clive Cheung** ***Credit Suisse AG, Research Division - Associate***

Yes, that's correct. Just wondering if in terms of contract terms compared to, say, private wholesale kind of orders, would that be meaningfully different? And how would that potentially impact our long term?

**Tim Chen** ***VNET Group, Inc. - CFO***

I think it's probably still early. I mean we're just getting our first orders now to sort of see if there's an overall trend. But as Samuel was explaining earlier on about the partnership that we have with Peoples Cloud. These customers are likely going to engage us across a range of the services that we offer or the products. So I don't expect at the moment for there to be a sort of material margin impact. I think they are like other customers, they have requirements. And those requirements will be priced accordingly. I hope that helps.

**Operator**

Our next question will come from Sara Wang at UBS.

**Sara Wang** ***UBS Investment Bank, Research Division - Analyst***

So I have two questions. First is still on demand. Just a quick follow-up on the previous question on demand. So is it right to say that on the wholesale side, we are still seeing orders from the Internet sector? And then how about the retail side? Do we see any change in the verticals of our customer mix, say certain industries might grow faster than the other, et cetera, when we talk about new orders? And then second question is on the People Cloud. So why People Data choose VNET over other third-party IDC providers or SOE Telco IDC services?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Okay. Thank you, Sara, for the questions. So first of all, from the retail momentum, if you look at the first quarter this year, our top 5 verticals remain the same, still going to be IT services, financial services, carriers, local life, entertainment, and so on and so forth. So nothing particularly changed. And also from a momentum point of view, we've seen a pretty strong year-over-year double digits, that's for sure whether or not we have the appropriate resources to meet the customers' demand. That's one question.

The second thing is we're seeing more and more customers looking for the full stack services. So other than the colocation, that's a very typical enterprise, I would say, mentality. They want to find a single throat to choke. So making sure they can partner with a credible partner who is a long-term player, has the credential and be able to support their needs.

I think the recent lockdown it's a very good showcase because even though we were impacted by the city lockdown in Shanghai area, we're talking about 2 months. And our engineers, for example, O&M services are pretty much locked in the data center for a little over 2 months, and we're making sure nothing stopped our services and support. And from a customer point of view, we even receive customers' feedback and appreciation and so on and so forth. So I think that's a great testimonial, a reason for that. So from a retail point of view, I think that's a very good thing, a good momentum. We're supposed to kind of keep it up.

Your second question is about the People's Data. We've been telling the industry that in China, probably unlikely in the rest of the world, well dedicated cloud probably going to be the mainstream. The reason has been because from a public cloud point of view or from a private cloud point of view, they have their advantages but also disadvantages. Public cloud players, the typical disadvantages will be the dynamic cost. Customers have less technical control, the customers can only have limited customization. From a private cloud point of view, the customer tend to have very obvious disadvantages, such as higher cost, limited access for their mobile users. They can't keep up with the unpredictable demand and so on and so forth.

In China, what happened is because it's a highly regulated economy, and so there's new policy, new regulation. And today, people even pay extra attention on the data sovereignty and data privacy. Therefore, that's what we believe because given the track record, given the full stack services capabilities, People's Data, they went through their study due diligence, and finally picked up VNET as their exclusive partners. So for that, we're pretty honored to have the opportunity to partner with them. But that being said, it is still early stage. And then so hopefully, we'll see some great progress. And then at that point in time, happy to share with all the public.

**Operator**

Our next question comes from Ethan Zhang at Nomura.

**Ethan Zhang** ***Nomura Securities Co. Ltd., Research Division - Analyst***

I have two questions. The first one is regarding the margin trend. I saw that the first quarter adjusted EBITDA margin was improved by around 4% compared to 4Q. Just wonder what's the main driver behind this and what's the margin trend in second quarter and second half considering the current COVID-19 lockdown in China? And second one, a follow-on question on the People Cloud. So just wonder, I understand that what we provide could be the private or hybrid cloud to the SOE customers. So what's the comparison between our People Cloud and our previous retail and wholesale customers? For example, the contract size, the prices level as well as margin?

**Tim Chen** ***VNET Group, Inc. - CFO***

Let me take the first question and see if Samuel has any follow-on answers to the People's Cloud question. In terms of the first quarter margins, if you look at the breakdowns that we provided in the press release or earnings release, mainly, it's driven by cost control as well as obviously, the top line was not as high. And so those 2 things combined resulted in a higher margin. Going forward or looking at the full year, I would say that we're still looking at the full year margins that we had expected.

There will be some costs as you've sort of pointed out in relation to the lockdown plus some incremental costs that were unexpected to be factored in. But also, we would expect, again, the top line, the revenues to also then start to ramp up once the customers are actually into the data centers. So it will be a combination of both. But yes, I would say that the margins are probably a little bit higher just driven by those 2 factors, what you talked about earlier on. Samuel, you want to see if there's any other color you want to give in terms of the People's Cloud?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Sure. So Ethan, other than what I stated earlier, I think two other key points I could possibly reiterate. Number one is think about hybrid multi-cloud is a new norm in China, unlike the rest of the world, I think that's one of the key messages. The second one would be -- it's a great endorsement for a dedicated cloud. I just mentioned earlier -- addressed the previous question regarding the advantages and disadvantages if you have to compare among the public cloud, private cloud and also dedicated cloud. I think the partnership that we have with People's Data is a great endorsement for the dedicated clouds importance here in China.

**Operator**

Our next question comes from Guohan Wang at Daiwa.

**Guohan Wang** ***Daiwa Securities Co. Ltd., Research Division - Research Analyst***

It's Guohan from Daiwa Capital Markets. So my first question is regarding your pipeline. I think there is no material change in our current pipeline compared to last quarter. But we also create a low end of the rent, which is more approximately 13,000. So depending on your current market demand dynamics, do we have any KPI such as pre-commitment rate in deciding what's the capacity we need to inject depending on the real situation in the second half? So that's my first question.

And the second one is our customer diversification. So you are talking about two questions regarding the People Data, which is a subsidiary of People's Daily. So I think we have achieved a certain progress in non-Internet and finance sector. We are talking about a lot about the new energy and other sectors. Could you share with us more color about further penetration strategy into SOEs and other sectors in the future to offset the negative impact from Internet sectors in the near term?

**Tim Chen** ***VNET Group, Inc. - CFO***

Samuel, let me take a crack at the pipeline question and then leave the second customer one to you, Samuel. Guohan, in terms of the first question on pipeline, I guess you're looking at the sort of the pipeline saying there's been no changes. Again, we've talked about the sort of construction progress of these projects. They are back ended in our original plan. There are delays. So we'll have to see how much the engineering teams can catch up. But as of now, we're still being told that they will be able to complete as per plan within this year. And so that's the reason for the number.

There is a range that we've provided, and that range is really twofold. One is dependent on the construction progress but also there are projects where given customer feedback on when they can ramp up and on the demand side, those are some of the projects where we may actually push into 2023. And so that's why you have that range in the first place. So we will continue to closely monitor. And as we progress into each quarter, we will update when we have more visibility on whether or not things well from a construction point of view or from a customer demand point of view, shift into '23 or not. Samuel?

**Samuel Shen** ***VNET Group, Inc. - CEO & Executive Chairman of Retail IDC Business Group***

Okay. The second question Guohan, you asked about the People's Data, and you also talked about the state-owned enterprise. So if I understand your question correctly, what happened in the past, I would say, 80-20, 80% of VNET's revenue coming from the key sectors like IT services, financial services, carrier, local life, entertainment, this type of industry, of course, including the traditional enterprises as well. What happened in the past, the government institution SOE was not on top of our list. That being said, last year, we acquired Tenxcloud, one of the leading cloud-native platform here in China. And then it created a lot of synergies because Tenxcloud major customers happen to be the financial services industry. They also provide technical support for some of the state-owned enterprise. So the partnership that we have with People's Data, which is one of the subsidiary of People's Daily Online, their major customers happen to be the state-owned enterprise.

And so it's a great leverage over there. I mean from a customer point of view, and also a good synergy from a technical stack point of view because what happened in the past, if you look at all the public cloud services providers, their offerings tend to be generic. But for certain verticals, their services and workloads and scenarios tend to be laser beam focused which is a great workload on top of the cloud native platforms. So I think from a customer touch point and also from a technical synergy point of view, it is a great partnership. We're definitely looking forward to having some of the positive impact moving down the road. Like I said before, I'm happy to update once we have a good progress in hitting the milestones.

**Operator**

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