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Q1 2024 VNET Group Inc Earnings Call

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PRESENTATION

Operator

Hello, ladies and gentlemen. Thank you for standing by for the First Quarter 2024 Earnings Conference Call for VNET Group, Inc. (Operator Instructions)

Our management today include Mr. Gavin Shen, rotating President; Mr. Qiyu Wang, Chief Financial Officer; Ms. Xinyuan Liu, Investor Relations Director of the company. Please note that today's conference call is being recorded.

I'll now turn the call over to first speaker today, Ms. Xinyuan Liu. Please go ahead.

Xinyuan Liu *VNET Group, Inc. - Director of IR*

Thank you, operator. Hello everyone and welcome to our first quarter 2024 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 today's call 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 obligations 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 include the disclosure of unaudited GAAP and non-GAAP financial measures. VNET's earnings press release contains a reconciliation of the unaudited non-GAAP 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 IR website at ir.vnet.com. Before we start today's presentation, let me briefly introduce Mr. Gavin Shen.

Beginning in May 2024, Gavin has undertaken the role of group's rotating president while also serving as the General Manager of the IDC Strategic Business Group. Gavin joined VNET as our vice president in 2017 and, in January 2020, became senior vice president, bringing nearly 20 years of business operations management experience in the IT strategic planning, cloud computing, and data centers.

I will now turn the call over to Gavin. Please go ahead.

Gavin Shen *VNET Group, Inc. - Rotating President*

Thank you, Xinyuan. Good morning and good evening, everyone. Thank you for joining our call today.

Before diving into our first quarter performance, I'd like to remind you of the disclosure refinement that we mentioned in our last call. To enhance information transparency and help the public better understand our business, starting from this quarter, we will report total revenues and operational metrics for our wholesale and the retail businesses separately. Our CFO, Qiyu, will go over the details.

Now let's move on to our first quarter initiatives and business progress. Solid first quarter results marked a good start for this year. We continued to execute our effective dual-core strategy while pursuing high-quality development. Our robust operating and financial results once again demonstrate our ability to grow our business by leveraging our core strengths to capture ever-evolving demand in the era of AI.

Macro-wise, supportive government policies and measures designed to foster our favorable market environment are creating more tailwinds for us and the IDC industry as a whole. Computing power is widely seen as the crucial components of China's high-quality development. Per the Government Work Report 2024, which calls for accelerating the formation of a nationwide computing power network, the telecom regulator MIIT has strengthened policy initiatives to further optimize computing power resources and infrastructure systems across the nation. We believe these initiatives will empower us to allocate and manage the data centers more efficiently and better meet the surging market demand for high-performance computing power.

Additionally, interest in "greener" computing solutions is on the rise. In April, we signed a strategic cooperation agreement with Ulanqab's local government and the Shandong High-Speed Holdings to build a green AI supercomputing data center cluster. The three parties will work together to promote the digitalization and green development of Ulanqab. We are confident our green data center business will resonate with customers and elevate our market competitiveness as these trends take hold.

While IDC development remains our primary focus, we are keenly aware of how AI-related demand for high-performance computing is reshaping the data center landscape. Our quality data centers and the high-density power capabilities enable us to tailor high-performance computing solutions to seamlessly meet customers' rapidly-growing AI needs. By the end of the first quarter, over 90% of our wholesale capacity in service is high-power density. Meanwhile, we continue to see increasing AI-driven demand from industries like chip design, autonomous driving, financial service, logistics and education.

As an industry pioneer, we are exploring AI data center(AIDC)development and actively upgrading our computing power infrastructure to capture market opportunities. AI workloads require massive computing power, enforcing a transition from CPU-based to GPU-based infrastructure. Apart from a few top Internet enterprises and AI technology enterprises with sufficient GPU resources of their own, most small and medium-sized enterprises will outsource this upgrade given the high costs, limited channels and other challenges in purchasing GPU infrastructure outright. AIDCs can meet enterprises' computing power needs while minimizing their capital investment, a significant advantage in the current environment.

Now let me go through some updates on the IDC front. We continued to win new orders for both wholesale and retail business during the quarter. On the wholesale side, as we mentioned on our last call, we secured a new order from one of our esteemed existing clients for approximately 15 megawatts, scheduled to be completed within 2024. We also won an order of approximately 2.5 megawatts in our data center in the Yangtze River Delta region from a new customer, one of China's largest restaurant companies.

On the retail side, we continue to attract new customers in financial services, local services, and manufacturing and deepen existing relationships. Notably, we won a new order of approximately 1.5 megawatts in our data center in the Greater Beijing Area from an existing customer, a leading player in local service sector.

Moving to our non-IDC business, we also made progress with our VPN service. Our wholly-owned subsidiary, DYXnet, has successfully expanded its global network coverage with a new Point-of-Presence established in Dubai in the first quarter and in South Korea and Mexico more recently. The new PoPs broaden our VPN service's global network coverage of our VPN service and the new PoPs will provide enterprise customers with comprehensive and integrated "Network, Cloud, Security" services, enabling them to capitalize on emerging markets and global expansion opportunities.

Turning now to our ESG performance. In April, we issued our fourth annual ESG report detailing the Company's 2023 endeavors and progress in sustainability, including verified carbon inventory results. During 2023, we continued to execute our "SHIELD" sustainability system and achieved various performances across employee diversity and equality, green power engagement and efficient energy consumption. We also highlighted achievements such as our average annual power usage efficiency of 1.29, a total green power

purchase of about 56.9 million kilowatt-hours during the year, and an increase in our percentage of female employees in our management positions to 31%.

Moving forward, we will remain dedicated to integrating ESG best practices company-wide, advancing the coordinated development of green economy and the digital economy, driving sustainability and creating value for our stakeholders and our society.

To conclude, our solid first quarter performance underscores our core strengths: a broad and growing array of innovative IDC services, outstanding high-power density deployment capabilities and a loyal and expanding customer base. Looking ahead, we will continue to drive our dual-core business strategy and pursue high-quality growth while advancing the development of China's digital economy. Thank you, everyone.

I will now turn the call over to Qiyu to discuss more about our operating and financial performance.

Qiyu Wang VNET Group, Inc. - CFO

Thank you, Gavin. Good morning and good evening, everyone. Before we start the detailed discussion of our first quarter performance, please note that, as Gavin just mentioned, we have enhanced our disclosures with more detailed operational and financial metrics starting this quarter. We believe these new metrics will provide shareholders with greater insight into our business.

Specifically, beginning in the first quarter of 2024, our IDC business was subdivided into wholesale IDC business and retail IDC business based on the nature and scale of our data center projects. Prior to 2024, the subdivision was based on the types of customer contracts. You may find a detailed list of all wholesale projects in our IR presentation for this quarter.

Accordingly, for operating metrics, we have presented them by retail and wholesale separately. For the wholesale business, the metrics are measured in terms of power capacity instead of cabinets, which we believe will more meaningfully reflect our business development. In addition, our wholesale capacity is presented across 3 different stages, including in service, under construction, and held for future development, which we believe will provide a clearer and more comprehensive picture of our wholesale capacity, boosting the high-growth potential of our wholesale business.

For financial metrics, we have subdivided our net revenue into revenues from IDC business, which includes retail revenues and wholesale revenues and revenues from non-IDC business, which consist of our Cloud and VPN business.

Now let's move on to our first quarter results. Please also note that, unless otherwise stated, all the financials we present today are for the first quarter of 2024 and are in Renminbi terms. Furthermore, all the growth rates I am reviewing are on a year-over-year basis. We kick off 2024 with solid operating and financial results.

Our wholesale IDC business continued to gain momentum, driven by rapid customer move-ins. Capacity in service was 332 megawatts as of the end of the first quarter. Capacity utilized by customers increased by 17 megawatts to 236 megawatts in the first quarter, primarily driven by increasing demand from the customers in N-OR06, N-HB03 and E-JS03 data centers.

As a result, the utilization rate of wholesale capacity improved to 71%, with the utilization rate for mature capacity reaching around 95% and the ramp-up capacity reaching around 34%. In addition, the capacity under construction was 139 megawatts with pre-commitment rate of around 75% and the capacity held for future development was 557 megawatts.

For our retail business, capacity in service was around 52,000 cabinets remaining flat compared to last quarter, with utilization rate stable at 64%, with the utilization rate for mature capacity reaching around 73%. MRR per retail cabinet was CNY 8,742 in the first quarter, compared to CNY 8,759 for last quarter and CNY 8,874 for the same period last year.

Moving on our financial performance. We remained focused on high-quality revenue businesses and our efforts continued to generate positive outcomes. Our net revenues increased by 5.1% to CNY 1.9 billion, mainly driven by the continued growth of our core businesses.

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To highlight, our wholesale revenues increased by 59.1% to CNY 361 million, mainly contributed by E-JS Campus 01 Phase 1, and E-JS Campus 02 A, E-JS Campus 02 B, N-HB03 and E-JS03 data centers. On the other hand, retail revenues decreased by 7.1% to CNY 923.7 million, mainly due to our consolidation and redevelopment of several data centers since the second quarter of 2023. Adjusted EBITDA was CNY 539.8 million with adjusted EBITDA margin of 28.4%. Net loss attributable to VNET was CNY 187 million.

Turning to our balance sheet. As of the end of first quarter, the total amount of the Company's cash and cash equivalents, restricted cash was CNY 2.1 billion. Meanwhile, net cash generated from operating was CNY 267.6 million. Our CapEx was CNY 971.3 million.

For updates on our financings, as we mentioned last quarter, on February 1, 2024, we completed the repurchase payment relating to our Convertible Senior Notes due 2026 in the total principal amount of USD 600 million. In the current capital market environment, this strategic move reflects our resilient business fundamentals and our commitment to long-term sustainable development.

Now moving to our full year guidance for 2024, we expect net revenues to be in the range of CNY 7.8 billion to CNY 8 billion, representing a year-over-year increase of 5.2% to 7.9% and adjusted EBITDA to be in the range of CNY 2.22 billion to CNY 2.28 billion, representing a year-over-year increase of 8.9% to 11.8%. This is unchanged from our previous guidance.

Given the latest market conditions, we have increased our delivery plan to 100 to 140 megawatts from previously stated 100 to 120 megawatts.

CapEx is expected to be in the range of CNY 3.7 billion to CNY 4.2 billion. This is unchanged from our previous guidance and may further increase according to market conditions.

Looking ahead, our focus will remain on high-quality growth, we will continue to execute our effective dual-core strategy and further enhance our core capabilities to capture market opportunities driven by the AI boom.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) The first question comes from Edison Lee from Jefferies.

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

Thank you management for the presentation and a very good disclosure. I have 3 questions. Number one is about the definition of retail and wholesale. I think a lot of investors would like to know what exactly the definition is, because the retail MRR that you are presenting today for historical numbers are actually lower than previously disclosed. So that's why I would like to get a clarification on the definition.

Number two is on operating cash flow. Can you comment why 1Q '24 operating cash flow is so much lower than 1Q '23?

And number three is on your retail cabinet redevelopment. Can you tell us how many cabinets are actually being affected by the redevelopment? And what will be the outcome of the redevelopment? Does it mean that these cabinets will actually become wholesale or they will also be still for retail and with much higher power? So can you explain that?

So let me repeat in Chinese. (foreign language)

Qiyu Wang *VNET Group, Inc. - CFO*

Okay. Thank you, Edison. I'll answer the question in Mandarin and let the translator help me to translate to English. (foreign language)

Unidentified Participant

[Interpreted] Thank you for the question, and we want to share with you more information to boost up the information transparency of the company as well as for the purpose of letting capital market have a better understanding of our business development. Starting from quarter 1 of 2024, we began to add new disclosure metrics. [For the revenue we have divided into wholesale, retail and non-IDC. At the same time, we've also added operational metrics for the wholesale business, including capacity in-service, capacity under construction and capacity held for future development] (corrected by company after the call).

Qiyu Wang VNET Group, Inc. - CFO

(foreign language)

Unidentified Participant

[Interpreted] For the first question of the definition of the wholesale and retail, as you have noticed that we have already redefined the wholesale and retail. Before, [it was based on customer contract types.

Right now, in terms of the wholesale, it refers to projects with the capacity of more than 40 megawatts. For those projects, they have the potential to expand their capacities in the long run in terms of the land as well as power supply. In most of the cases, those wholesale projects are targeting the major clients and customers, which is consistent with our previous range of wholesale business. However, we are also selling a small proportion of them to the middle-sized clients. And on the other side, the retail projects, which are located mainly in the top tier cities and surroundings.

Generally speaking, the total size of retail projects usually is smaller than 40 megawatts without much potential for capacity expanding. And for most of the cases, those projects are targeting the small and medium-sized enterprises. But, we are also offering part of the retail projects to the major clients to satisfy the needs for low latency.

Around 10% of the our cabinets have been reclassified. As a small proportion of the retail projects are offering to the large clients, and the MRR of large clients are lower than that of small customers, since the large clients use less of our value-added services. That is why you are seeing the decrease in retail MRR] (corrected by company after the call).

Qiyu Wang VNET Group, Inc. - CFO

(foreign language)

Unidentified Participant

[Interpreted] And for the question two, for why in 2024 Q1, the [operating cash flow] was smaller than that of in 2023. So in Q1 of 2024, the company observed a stable and normal cash flow. However, back in 2023 Q1, there were some one-off [items], such as the government grants as well as certain [tax rebates]. Those 2 items did not happen in Q1 2024 (corrected by company after the call).

Qiyu Wang VNET Group, Inc. - CFO

(foreign language)

Gavin Shen VNET Group, Inc. - Rotating President

(foreign language)

Unidentified Participant

[Interpreted] For the third question, the question will be answered by Gavin.

In Q1 2024, the retail [business is operating stably, and we have already observed certain changes of the demands for AI inference. So we actively improve the power density of the. In that sense, the total number of cabinets is on the decline. This is for the purpose of better utilizing the resources to maximize our capacity to meet the market demands.

And according to demand of market, we will redevelop the reserved cabinets to better meet the market demand] (corrected by company after the call).

Operator

Our next question comes from Yang Liu from Morgan Stanley.

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

Thanks for the opportunity and great thanks for the more disclosure, which is very helpful to us. I have two questions. The first one is regarding the 3 business growth outlook. I think, clearly, the wholesale will be a key driver and the retail looks like a dragger. Management quantify the growth rate of the 3 business or what is behind the current guidance of around 5% to 8% of full year growth in the 3 business lines? That's my first question.

The second question is G&A expense, we saw is a pretty big increase year-over-year. What is behind that and whether that is a one-off or sustainable?

(foreign language)

Qiyu Wang *VNET Group, Inc. - CFO*

(foreign language)

Unidentified Participant

[Interpreted] Thank you for the question, [yes, the main source of revenue growth comes from wholesale business. And I will give you more information about different lines on the revenue side. In light of the wholesale, we will maintain about 45% growth. Our retail business should remain stable compared to last year. For the non-IDC business, which has been relatively stable over the past few years, with an annual growth rate of about 5%] (correct by company after the call).

Qiyu Wang *VNET Group, Inc. - CFO*

(foreign language)

Unidentified Participant

[Interpreted] And I want to give you more information about the EBITDA. [As we continuing focus on cost control and optimization measures, which is driving the company's EBITDA growth to be higher than the revenue growth. For instance, despite that the retail revenue remains flat, but we are expecting to see a slight increase in the EBITDA this year] (corrected by company after the call).

Qiyu Wang *VNET Group, Inc. - CFO*

(foreign language)

Unidentified Participant

[Interpreted] And for the [increase in G&A, it is primarily due to two main events. At the beginning of this year, in 2024, the company has repaid a large amount of the debt, which incurred some intermediary fees associated with the debt repayment process. The second reason was that we issued some share based compensation to employees in the first quarter] (corrected by company after the call).

Operator

Our next question comes from the line of Daley Li of Bank of America Securities.

Daley Li *BofA Securities, Research Division - China Software Analyst*

Firstly, it's great to see more disclosure about the segment breakdown. I have 2 questions. The first one is about the overall demand for China IDC data center market. How the management see the overall demand outlook for this year compared to last? And what kind of clients we have seen could have better demand? And could management could give more color?

My second question about the wholesale business. Management earlier discussed the expansion plan for this year. And could management update us the moving progress from the clients in the following quarters and for the total expansion target we have. Maybe let me have a quick translation. (foreign language)

Gavin Shen VNET Group, Inc. - Rotating President

(foreign language)

Unidentified Participant

[Interpreted] For the first question, [regarding the IDC market condition, and we have seen a steady growing demand from our customers' traditional business. For most of them, they have demonstrated a strong demand for their AI applications] (corrected by company after the call).

Gavin Shen VNET Group, Inc. - Rotating President

(foreign language)

Unidentified Participant

[Interpreted] At the end of the first quarter of 2024, almost [90% of our in service wholesale capacities are the high power density cabinets, This corroborates what I mentioned earlier about the strong demand for customer's AI applications. Secondly from an industry perspective, this strong demand comes from the chip design side, the autonomous driving, the financial service, logistic as well as education sectors. They have increasingly demand on LLM training and LLM inference] (corrected by company after the call).

Gavin Shen VNET Group, Inc. - Rotating President

(foreign language)

Unidentified Participant

[Interpreted] [Regarding our expanded delivery plan this year, we are currently seeing that customers may have higher delivery expectations. Additionally numbers of our potential projects are also under discussion with customers, which could lead us to further increase our delivery targets this year. At this moment, our overall CapEx plan remains unchanged. However, due to some potential projects that are currently underway, subsequent customer orders may further increase our Capex investments] (corrected by company after the call).

Gavin Shen VNET Group, Inc. - Rotating President

(foreign language)

Unidentified Participant

[Interpreted] And you also asked questions about the wholesale clients' [move-in timeline. As a standard market practice, we typically start to charging our wholesale customer based on the contracted guaranteed rate after a 2-3yr of grace period. However, for certain newly signed customers, we have observed an accelerated ramp-up, where they were able to reach mature utilization levels within the span of just half a year] (corrected by company after the call).

Operator

Our next question comes from the line of Timothy Zhao from Goldman Sachs.

Timothy Zhao Goldman Sachs Group, Inc., Research Division - Research Analyst

Great. And also thank you for the more transparent this quarter, which is quite helpful. I have 2 questions here. One is on the, I think, on your full year guidance, I think compared to the first quarter results, I was wondering I think, especially on the top line, I think we are assuming an acceleration in terms of revenue growth for the rest of this year. Just wondering if management can elaborate on what is the key driver and just the breakdown between wholesale, retail IDC and also non-IDC segment, which line could be growing faster in the coming quarters?

And secondly, I think given the more transparent this quarter, I think a follow-up question is wondering if management has any target or

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like a goal in terms of the wholesale versus retail capacity or revenue breakdown by year-end or in the mid-term? And that would be very helpful. Let me quickly translate myself. (foreign language)

Qiyu Wang VNET Group, Inc. - CFO

(foreign language)

Unidentified Participant

[Interpreted] The answer is as follows: The wholesale business is [the main driver of revenues growth. The retail business slightly declined on a year-over-year basis. However, as we all see that starting from last year Q3, we began the redevelopment of several retail data centers to deploy more high power density. And by the end of this Q2 and Q3, the completion of the redevelopment will pick up our retail revenue growth on year-over-year basis] (corrected by company after the call).

Qiyu Wang VNET Group, Inc. - CFO

(foreign language)

Unidentified Participant

[Interpreted] In light of the [revenue contribution, the retail against the wholesale is standing at 2:1. Still, the revenue from the retail is taking the major proportion. In terms of the capacity by cabinets the retail and wholesale is approximately standing at 5:3] (corrected by company after the call).

Operator

Seeing no more questions, ladies and gentlemen, that concludes our conference for today. Thank you for participating. You may now disconnect your lines.

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