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PRESENTATION

Operator

Hello, ladies and gentlemen. Welcome, and thank you for standing by for the Fourth Quarter and Full Year 2023 Earnings Conference Call for VNET Group Inc. (Operator Instructions)

Our participants from our management team include: Mr. Jeff Dong, Chief Executive Officer; 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. And I will now turn the call over to the 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 Fourth Quarter and Full Year 2023 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. I will now turn the call over to our CEO, Jeff.

Jeff Dong ***VNET Group, Inc. - CEO***

Thank you, Xinyuan. Good morning and good evening, everyone. Thank you for joining our call today. I'd like to begin by providing an overview of our fourth quarter and full year 2023 performance. We ended 2023 on a solid note amid the steady economic recovery, demonstrating effective execution of our dual-core growth strategy. We meet our 2023 delivery target with 8,321 self-built cabinets delivered during the year. As of year-end 2023, we had grown our total cabinets under management to approximately 93,600 compared with approximately 87,300 one year ago. The number of utilized cabinets increased by 2,827 to 55,235 in the fourth quarter, driving our overall utilization rate to 59% compared with 55% one year ago. Our retail IDC MRR per cabinet remained stable in the fourth quarter at RMB 9,477. In terms of our financial performance, we continued to focus on high-quality revenue during the quarter, driving our net revenues to RMB 1.9 billion as well as a 3.8% year-over-year increase in our adjusted EBITDA to RMB 440.2 million.

Turning to our full year performance, our net revenues increased by 4.9% year over year to RMB 7.41 billion, and adjusted EBITDA grew by 8.9% year over year to RMB 2.04 billion. Our robust operational and financial performance reflects our effective strategy and strong execution, as well as our ability to grow our business by skillfully leveraging market trends and the supportive policy environment.

According to this year's Government Work Report, China is increasing its efforts to promote the innovative development of the digital economy. Specifically, the report called for policy support for the digital economy's, high-quality development and stated that China will step up the development and application of big data and artificial intelligence, launch an AI Plus initiative, and build world-class digital industry clusters. We believe these initiatives and goals will further drive market demand for high-quality data centers and premium IDC services. As a leading IDC service provider, VNET is strategically positioned to capitalize on these emerging opportunities through our comprehensive operational strengths across marketing and services as well as operations and maintenance.

Next, I'd like to share our fourth quarter business updates. We are excited to see AI-driven demand from our customers continuing to climb, especially computing power demand for training large language models. Among our wholesale customers, those in the short video industry are actively developing and integrating AI functions that require massive high-performance computing power to enhance their content creation capabilities and business operations. In our retail business, demand is also increasing steadily from customers in industries including autonomous driving, local services and virtual reality where large language models are widely deployed for business. Our high-performance data centers empower us to fulfill various AI-driven demands with innovative solutions.

Moving on to our wholesale business. We extended our impressive delivery track record to our wholesale customers with timely, high-quality deliveries of approximately 109 megawatts for the full year. These deliveries have not only solidified our reliability, but also boosted customer satisfaction. Of particular note is the rapid ramp-up period we have delivered to leading wholesale customers. For several of our projects, move-in periods were much faster than initially anticipated. Furthermore, we recently secured a new order from one of our existing customers, a leading cloud service provider in China. The new order is approximately 15 megawatts in one of our projects in the Yangtze River Delta region and is scheduled for completion in 2024. Once again, this new order showcases our long-term customer loyalty and our industry-leading service capabilities.

Our retail business remained resilient during the quarter, attracting new customers across mobility, cloud services, AI, and the IT services industry. We also extended contracts with loyal existing customers in finance, local services, autonomous driving, and gaming, where demand remains solid. On the value-added services front, our full stack, one-stop innovative Bare-Metal-As-a-Service solution based on AI technologies continued to win customers, including one of China's leading providers of energy-efficient computing solutions for smart mobility. This customer's demand for computing power is a surging rapidly due to growing adoption of advanced driver assistance systems and the autonomous driving technology in the mobility industry. Our innovative Bare-Metal-As-a-Service solution provides secure and flexible computing power resources to support the customer's intelligent, driving simulation training and LLM operation, empowering the customers' future growth.

Turning now to our recent ESG performance. Our commitment to sustainability once again won recognition from global leading ESG rating agencies in 2023earning VNET an "A" rating from MSCI for the second consecutive year. This represents the highest ranking awarded to date in China's Internet Service & Infrastructure industry, distinguishing us among our peers. In addition, our company scored 53 in the 2023 S&P Global Corporate Sustainability Assessment, ranking the highest among China's IT Services industry and in the top 11% in the industry globally. Looking ahead, we will remain steadfast in our pursuit of ESG excellence, embracing and promoting a green future industry-wide.

Before I conclude, I'd like to share some meaningful progress we made on our refinancing projects. In late December 2023, We completed the USD 299 million strategic investment from Shandong Hi-Speed Holdings Group to further strengthen our balance sheet. We have also established a partnership with Shandong Hi-Speed Holdings to cooperatively explore new opportunities in renewable energies. Amid the booming computing power demand driven by AI development, we believe our core businesses will enjoy great synergies with Shandong Hi-Speed Holdings' resources and expertise in traditional infrastructure fields. We look forward to collaborating with Shandong Hi-Speed Holdings on an array of green energy initiatives to jointly advance toward our carbon neutrality targets while meeting society's surging demand for digital transformation.

Also, on 1st February of this year, we successfully completed the repurchase payment relating to our Convertible Senior Notes due in

2026, in aggregate principal amount of USD 600 million. Amid the capital market, this stands as another testament to our resilient business fundamentals as well as our commitment to long-term sustainable development.

In conclusion, strong execution of our dual-core strategy for high-quality growth drove our solid performance in 2023, while laying a firm foundation for 2024. Harnessing the booming AI trend, we grew our business alongside the macro environment's steady recovery. We will continue to build on our core capabilities as we head into 2024, fulfilling market demand for secure and premium IDC services and facilitating digital transformation across a wider spectrum of verticals.

Our unwavering commitment to our shareholders is to fuel sustainable growth and generate long-term value. Before I share our delivery projection for 2024, I want to highlight that going forward, these projections will be expressed in terms of power capacity instead of number of cabinets. We believe power capacity will more meaningfully reflect our business development given our data centers' increasing power density amid the growing AI trend. That said, we expect to deliver 100 to 120 megawatts during 2024.

Thank you, everyone. I will now turn the call to Qiyu to discuss our financial performance for the quarter.

Qiyu Wang ***VNET Group, Inc. - CFO***

Thank you, Jeff. 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 fourth quarter and full year of 2023, and in Renminbi terms.

Now, let me walk you through our fourth quarter and full year of 2023 financial results. Unless otherwise specified, the growth rates I will be reviewing are all on a year-over-year basis. We concluded 2023 with solid financial and operating performance, both in line with our guidance. More encouragingly, our wholesale business continued strong growth momentum. During the year of 2023, we added 109 megawatts of capacity to our wholesale business, driving a year-over-year increase of around 70% in our wholesale revenue. In the fourth quarter, our net revenues increased by 0.9% to RMB 1.9 billion from the same period last year, mainly driven by the continued growth of our core businesses.

Gross profit was RMB 290.9 million in the fourth quarter of 2023, representing a decrease of 11.4% from the same period of 2022. Gross margin was 15.3% in the fourth quarter of 2023, compared to 17.5% in the same period of 2022. The year-over-year decrease was primarily attributable to an increase in depreciation and amortization expenses as additional data centers were put into service during the past quarters. Adjusted cash gross profit, which excludes depreciation, amortization, and share-based compensation expenses, was RMB 741.7 million in the fourth quarter of 2023, an increase of 0.2% from the same period of 2022. Adjusted cash gross margin in the fourth quarter of 2023 was 39.1%, compared to 39.4% in the same period of 2022. Adjusted operating expenses, which exclude share-based compensation expenses, compensation for postcombination employment in an acquisition, allowance of loan receivables, impairment of long-lived assets, and impairment of goodwill, were RMB 334.2 million in the fourth quarter of 2023, compared to RMB 355.4 million in the same period of 2022. As a percentage of net revenues, adjusted operating expenses in the fourth quarter of 2023 were 17.6%, compared to 18.9% in the same period of 2022.

Adjusted EBITDA in the fourth quarter of 2023 was 440.2 million, representing an increase of 3.8% from the same period of 2022. Adjusted EBITDA margin was 23.2% in the fourth quarter of 2023, compared to 22.6% in the same period of 2022. Our net loss attributable to VNET Group, Inc. in the fourth quarter of 2023 was RMB 2.4 billion, compared to a net loss of RMB 64.2 million in the same period of 2022. Basic and diluted loss were both RMB 2.65 per ordinary share and both RMB 15.88 per ADS. Each ADS represents six Class A ordinary shares.

Turning to our balance sheet. As of December 31, 2023, the aggregate amount of the Company's cash and cash equivalents, restricted cash and short-term investments were RMB 5.46 billion. Meanwhile, net cash generated from operating activities in the fourth quarter of 2023 was RMB 730.7 million, compared to RMB 407.5 million in the same period of 2022. Our capital expenditure in the fourth quarter of 2023 was RMB 1.6 billion and the total CapEx for full year 2023 was RMB 3.58 billion.

Now moving to our outlook. We expect net revenues for the full year of 2024 to be in the range of RMB 7.8 billion to RMB 8 billion, representing a year-over-year increase of 5.2% to 7.9%, and adjusted EBITDA to be in the range of RMB 2.22 billion to RMB 2.28 billion, representing a year-over-year increase of 8.9% to 11.8%. The forecast reflects the Company's current and preliminary views on the market and its operational conditions, and is subject to change.

Looking into 2024, we will continue to execute our effective dual-core strategy, driving high-quality business growth. We believe our solid fundamentals and core strengths position us to capture market opportunities, especially AI-driven demand. As always, we remain dedicated to creating sustainable value for all our stakeholders.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Yang Liu of Morgan Stanley.

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

I have 2 questions. The first one, can management update us in terms of the cooperation with the strategic shareholder, Shandong Hi-Speed? What kind of a pipeline are you talking about? Or what should be the timeline that we can see the 2 parties will do something together with either revenue synergy or cost synergy in the coming year?

And the second question is that, can management update us in terms of the 2024 CapEx guidance? And what will be the key investment area? What type of customers or what kind of a region in the company is investing?

Qiyu Wang ***VNET Group, Inc. - CFO***

Thank you, Yang Liu. Let me answer the 2 questions. For the Shandong Hi-Speed synergy, as a strategic investor, Shandong Hi-Speed Holdings will play a positive role in providing support and guidance to the executive team of our company at the Board level. We remain committed to operating in accordance with market standards with existing executive team responsible for the day-to-day operations. Being a Fortune 500 enterprise, Shandong Hi-Speed Holdings has the rich financial resources, they bring variable support to our onshore financing effort.

Also, just like Jeff said, the strong synergy between their green energy business and our IDC wholesale business in the new infrastructure projects present significant opportunities. Also recently, the company signed a strategic collaboration agreement with Inner Mongolia Ulanqab government and with Shandong Hi-Speed Holdings to construct green computing projects together. The cost efficiency in the onshore financing efforts will show some number in this year balance sheet. Also, I think the green energy opportunity cooperation also will start from this year.

For the CapEx side, our full year CapEx should be around RMB 3.7 billion to RMB 4.2 billion for this year, driven by the strong demand from our wholesale customers. Around 70% the CapEx on the wholesale business. Compared about RMB 3.6 billion CapEx in 2023, the estimated CapEx for this year is expected to increase about around 10%. For the financial side, after the company repaid the USD 600 million convertible bonds in early this year, the company's credit status remains solid, considered a more favorable domestic financing elements in terms of cost efficient need. We plan to primarily fulfill this year CapEx demand through onshore financing. Thanks for Shandong Hi-Speed Holdings support, we will be able to obtain onshore financing approval more efficiently. Excluding the series and the asset disposals, we plan to raise fund through credit-based, project-based, and existing asset-based financing in onshore financing market with the financing cost expected to around the LPR. We plan to raise around RMB 5 billion in financing in this year. This amount of financing with 60% already secured and about 40% under negotiation.

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

Sure, management can provide more color that will be better.

Operator

Our next question comes from Edison Lee of Jefferies Hong Kong Limited.

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

I have 2 questions. Number one is, I'm looking at your debt breakdown on Page 20 of your PPT. And assumes that by the end of this year you have RMB 4.25 billion of convertible promissory notes that will come to you. So is that, how much of that is U.S. dollar? And how are you going to cover that? So that's question number one.

Number two is that, can you talk about the write-down on your long-lived assets that you took in the fourth quarter of this year because in your earnings announcement you said that this is related to some plan to consolidate your data centers or certain data centers. So I wonder if you can elaborate on that.

And then number three, on the CapEx guidance that you just gave, RMB 3.7 billion to RMB 4.2 billion, so would that totally support the 119 megawatts projects under construction? And also maybe a little bit aside follow-up on that, how much of that 119 megawatts is wholesale? And how much is retail? Because you said 70% of the CapEx will go to wholesale.

Qiyu Wang ***VNET Group, Inc. - CFO***

Let me first answer the second and third question. For the loss in the fourth quarter of 2023, the company conducts impairment testing on goodwill and long-lived assets, in accordance with the U.S. GAAP. The result shows that the fair value of the reporting unit and certain asset groups were lower than their carrying amounts. As a result, a one-off impairment of goodwill and long-lived assets was recognized. Excluding the one-off impact, the net loss, it's same as 2022. The increasing number of data center puts into operation in recent years has resulted in a significant increase in the company's depreciation and amortization expense, which has negatively impacted gross profit and net profit.

Due to change in both internal and external environment, the company recently conduct reassessment of the useful lives and its fixed assets. Actually, we will also conduct and will be informed the actual useful life of certain machinery and equipment exist to provide estimates of 8 to 10 years. As a result, the company plans to make accounting estimate change in 2024 and extend the depreciation period for certain machinery and equipment. After the adjustment, the average useful life of the company's fixed assets will be extended to about 14 years, aligning with the industry average. This adjustment is expected to have a positive impact on gross profit and net profit in this year. Excluding uncertain factors such as foreign exchange gain or loss and fair value change, the company expects achieving breakeven by this year. So also, the third question for the CapEx. Most of the CapEx for the wholesale business, around 80% for the wholesale business. Sorry, what is the first question? Could you please repeat it?

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

Just on the CapEx, can I clarify that if 80% of the CapEx is going to wholesale, does it mean that 80% of that 119 megawatts project is wholesale?

Qiyu Wang ***VNET Group, Inc. - CFO***

Yes.

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

Okay. My first question is about the debt breakdown by maturity on Page 20 of your PPT, right? So you saw that in 2024, you have RMB 4.25 billion of convertible debt deal. So I want to know how much of that is U.S. dollar and what is your plan to cover that?

Qiyu Wang ***VNET Group, Inc. - CFO***

It's the USD 600 million, which we already have completely repayment in February.

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

All right. So that has been taken care of.

Operator

Our next question comes from Timothy Zhao of Goldman Sachs.

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

Also 2 questions here. One is regarding your guidance for 2024 regarding the top line as well as EBITDA. Could management share what is the underlying assumption for the high-end and low-end? And any color on the, for example, the MRR, the utilization rate and also the revenue growth between your IDC and non-IDC business, wholesale versus retailI think any color on that would be quite helpful.

And secondly, I think back to your CapEx plan for 2024, just wondering, I think in your prepared remarks you mentioned something about the AI-related demand. Just wondering any color on what percentage or what proportion of that wholesale CapEx is related to the CapEx to meet the demand for the higher power density cabinets? And how do you think about the overall environment in China for the IDC market?

Qiyu Wang ***VNET Group, Inc. - CFO***

Let me answer the first question and Jeff will answer the second. For the year 2023, our retail IDC business and non-IDC business is quite stable. With the wholesale business, it's a growth rapidly. By the end of 2023, our wholesale companies represent over 30% of our total cabinets and contributed around 20% of our total IDC revenue. Our wholesale revenue grew 70% year-to-year in 2023. The assumption of our 2024 guidance range is mainly based on our stable retail IDC business and non-IDC business. And the mainly the reason is the utilization rate of our wholesale IDC business. So we expect to provide more color on wholesale, retail and non-IDC starting from the first quarter of this year. So maybe in next quarter earnings, we will show more number about our wholesale and the retail and the non-IDC business.

Jeff Dong ***VNET Group, Inc. - CEO***

Yes, in terms of AIGC demand, we have seen actually a rapid growth in China and AI-driven demand from our customer side continue to climb, especially computing power demand for training LLM. And those models are dominated by the Internet giants, which the vertical models are led by the leading players in specific industries. As I mentioned, some tech startups aside from the Internet giants. For our business, for the wholesale, AI-driven demands are mainly surged by Internet giant customers, especially like short video and e-commerce business. As I mentioned on the call, we can see short video customers are ramping up very fast than we expect, which is highly contributed by the strong AI-driven demand.

In terms of retail side, we are receiving increasing demand from retail customers across various industries like the autonomous driving, local services and virtual reality and so on. In 2024, we will explore into further demand from that side. And also, we have the value-added service part, can also provide solid support to the AI demand.

And as you mentioned, in terms of the CapEx side, to category into the AI driven, as of 2023, around 20% of our self-built cabinets are high-power density, and especially for the cabinets new delivered during 2023, the large majority is high power density cabinets, which are all for wholesale customers. For cabinets to be delivered during 2024, it will be 100% is high power density cabinets, which are all for wholesale customers. So come back to the current CapEx side, majority of the CapEx will go to the high-power density wholesale customers.

Operator

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

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

I also have 2 questions. Firstly, regarding our guidance. We guided like adjusted EBITDA growth for this year is to have higher growth on the top line. So what would be the key drivers for the margin you mentioned. For the second question is about the new capacity expansion. And for the 100 to 120 megawatts of this capacity, what's the delivery timetable for this year will be majority in the second half or like 4Q or some will be in first half of this year.

Qiyu Wang ***VNET Group, Inc. - CFO***

Thank you. Let me answer the first question about guidance. The main reason for the company's EBITDA growth higher than the revenue growth in this year's guidance as follows. There are 3 reasons. The first one, the expected growth in this year is primarily driven by the wholesale business. Considering the nature of the wholesale business, we do not include the electricity revenue in income. The wholesale business EBITDA margin is higher than the retail. So the growth of the wholesale business in this year is to contribute more EBITDA for the company.

The second is that we plan to update and improve certain retail data center with a lower EBITDA margin. This aims to enhance our operating efficiency and increase their contribution to the EBITDA. Third, further cost control measures will be deployed to improve the company's operating efficiency, which will positively impact EBITDA growth.

Jeff Dong ***VNET Group, Inc. - CEO***

In terms of the 100 to 120 megawatts we will deliver in 2024, the pace will be similar to our previous years. So the majority of our deliveries will be happened in the second half of this year.

Operator

Thank you. This concludes today's conference call. Thank you all for participating. You may now disconnect. Have a great day, everyone. Thank you very much.
