THOMSON REUTERS STREETEVENTS

EDITED TRANSCRIPT

VNET - Q1 2015 21Vianet Group Inc Earnings Call

EVENT DATE/TIME: MAY 27, 2015 / 12:00AM GMT

THOMSON REUTERS

CORPORATE PARTICIPANTS

Josh Chen *21Vianet Group Inc - Chairman and CEO*

Shang Hsiao *21Vianet Group Inc - CFO*

Eric Chu *21Vianet Group Inc - VP, Capital Markets and Business Development*

CONFERENCE CALL PARTICIPANTS

Colin McCallum *Credit Suisse - Analyst*

Harsh Agarwal *Deutsche Bank - Analyst*

Cheng Cheng *Pacific Crest Securities - Analyst*

John Choi *Daiwa - Analyst*

Matthew Heinz *Stifel - Analyst*

Leping Huang *Nomura - Analyst*

Louie DiPalma *William Blair - Analyst*

PRESENTATION

Operator

Good morning, ladies and gentlemen. Thank you, everyone, and welcome to 21Vianet Group first quarter 2015 earnings conference call. (Operator Instructions).

Before we begin, I will read the Safe Harbor statement. This call may contain forward-looking statements, made pursuant to the Safe Harbor provisions for the Private Securities Litigation Reform Act of 1995.

These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties and other factors that are not under the Company's control, which may cause actual results, performance, or achievements of the Company to be materially different from the results, performance, or expectations implied by these forward-looking statements.

All forward-looking statements are expressly qualified in their entirety by the cautionary statements, risk factors, and details of the Company's filings with the SEC. 21Vianet undertakes no duty to revise or update any forward-looking statements for selected events or circumstances, after the date of this conference call.

With us today are Mr. Josh Chen, Chairman and Chief Executive Officer; Mr. Shang Hsiao, Chief Financial Officer and Mr. Eric Chu, Vice President of Capital Markets and Business Development. Following management's prepared remarks, we will conduct a Q&A.

At this time, I would now like to turn the conference call over to Mr. Josh Chen, 21Vianet's Chairman and Chief Executive Officer, for opening remarks.

Josh Chen - *21Vianet Group Inc - Chairman and CEO*

Good morning, and thank you for joining us today. Before going over operating details, I would like to first spend a few minutes to discuss current market dynamics, opportunities and challenges we face in China Internet infrastructure market.

First of all, we believe we have great opportunities in three key areas. One, developing ecosystems; two, improving operating efficiencies, and three, optimizing capital structures.

In terms of ecosystems, we are still at a very early stage in the China market, including verticals such as broadband ISPs, financial service, and cloud computing service providers, which proved to be strong growth engines for many of our peers in more advanced economies.

More specific in China is the broadband market. Government regulators are just starting to aggressively open up the market to private investment and more competition. For example, the central government has set clear goals to issue 100 broadband trial license and target RMB10b total investment by end -- by year end 2015. The trial city will be increased from 16 today to more than 30 by year end, and open up to nationwide, by 2017.

As this market is further deregulated, we believe these emerging broadband ISPs will create demand for interconnection and cross-connect services over time, which will offer attractive growth opportunities for our business.

In terms of operating efficiencies, we believe this is also a lot of room to make improvement, especially compared to some of our peers in the more advanced economies.

From the purchase of the resource, such as bandwidth and electricity, to operating expenses, such as sales, marketing, and overhead expenses, we -- to further optimize our business options -- operations, especially taking into account some of the changing market conditions. We have set up a special team to drive these initiatives, which work very closely with our product teams, key customer team, and regional teams.

In terms of capital structure, we believe there is also room for further improvement. As the Chinese government make regulatory change to encourage Internet infrastructure build-up, there are potential financing opportunities that could offer low-cost favorable capital that is supported by the government association financial institutions.

As a public listed company, we also continue to look for ways to further optimize our capital structure and support our datacenter expansion.

While we are very excited about these potential opportunities, we also recognize that we face some challenges in a very dynamic market.

For example, as cloud computing service become an increasingly viable options for small customers, we have to continue to look for ways and increase our value proposition to this type of customers.

As hybrid cloud service providers become a reality, we are evaluating different approaches in attracting and retaining medium and large customers, to addressing this change in the market.

Meanwhile, we also recognize that some of our domestic peers are equipped with the cheaper capital resources and might engage in less rational competition. Our management team is spending a lot of time with our operations, financial, and regional teams, in finding solution to address some of these changing market conditions.

Now, moving on to our operating results. We are off to a good start this year, as we witnessed continued growth in both our core IDC business and Microsoft cloud service business. This has led to a solid year over year growth in top-line revenues, profitability and scale of operation.

In addition, we are on track with the integration of the Aipu Group and the Dermot Entities, both of which we acquired in 2014.

As we mentioned last quarter, 2014 was focused on strategically repositioning our business platform to seize new opportunities, while 2015 will be a year of implementation and execution of our enhanced platform and well-crafted strategy.

Chief among our 2015 objectives, will be continued focus on our core IDC business. After adding close to 3,400 cabinets in the fourth quarter in [2015], we further increased our total cabinet count by another 500, in the first quarter of 2015, to over 22,000 cabinets. And now we're close to 68% in our self-built datacenters.

There are key opportunities for us, to serve not only retail co-location customers, but also an increasing number of VIP customers, such as Alibaba, Kingsoft and others. As we further expand our scales and operational capacities, our goal is to be the most recognized and trusted brand in China Internet infrastructure market.

Now let's look at our cloud-enabling business. We are very happy with the strong performance of our Microsoft cloud business, with revenue growing more than 200%, year over year. In this quarter, we also renewed the commercial operator agreement with Microsoft, for their public cloud service. The agreement was extended by four years, and will now be in effect until December 31, 2018.

This extension will allow us to build on the strong result that we saw from Microsoft Azure and Office 365 services, which now support over 85,000 enterprise customers, including both multinational corporations and an increasing number of domestic companies.

Finally, we are encouraged by the increased adoption of IT outsourcing by financial institutions. As these enterprise become more sophisticated, they increasingly look to the Internet infrastructure provider to manage their mission-critical applications in a cost-effective manner.

For example, we have already assisted Baoshang Bank in migrating their core production system to 21Vianet and expect other financial institutions to follow suit, as they gradually become more comfortable with the high level of security we can offer, and are able to reduce their own infrastructure cost.

Now I'd like to take a moment and talk about our MNS and CDN business. [This past quarter] we experienced some softness in both segments, which caused a larger than expected impact to our financial result.

For the MNS business, we have mentioned, in the past few quarters we have faced some headwinds in this space, mostly due to an industry-wide pricing decline and a greater competition. To that end, we have continued our network grooming process, and adapt our business model to the changing market dynamics.

For the CDN business, most of the softness can be attributed to a stronger than expected seasonality and to a lesser extent, the declining bandwidth prices. We are actively addressing these issues, by working closely with our customers and suppliers, as well as further optimizing our cost structure to ensure we get this business back on track.

With a stronger pipeline, and as well as we enter seasonality strong -- seasonally strong second half of the 2015, we are confident in our ability to continue executing on our strategies, and re-accelerate revenue growth.

To conclude, I want to thank all our colleagues and investors for your continued support. We are optimistic and excited about the Company's future and are confident we will continue to grow with the dynamic Internet landscape in China.

Now I would like to hand the call over to Shang, our CFO.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you, Josh. Good morning, everyone.

As Josh mentioned it, we had a solid quarter in our core IDC business. In particular, we sold a record number of cabinet in the quarter, supported by the significant capacity expansion in the last few quarters.

Our sales pipeline remains strong for the second half of 2015, as our year is typically back-end loaded. As our customer ramp up their resource usage of these new cabinet and as we lease up new datacenter location, we are confident that our IDC revenue growth can further accelerate in the coming quarters.

In the first quarter, we further improved our cost structure by more effectively managing our adjusted operating expenses. Our adjusted sales and marketing expenses, adjusted general and administrative expenses, and adjusted R&D expenses as a percentage of revenue all improved sequentially, from the fourth quarter of 2014.

I would also like to briefly highlight our working capital condition. As we mentioned during the past few quarter, we have been steadily improving our working capital situation. During the third quarter last year, our days sales outstanding, or DSO, was 92 and it decreased to 78 days in the fourth quarter.

In the first quarter of 2015, DSO has remained steady at 78 days, despite the usual challenge faced around the Chinese New Year. And it's still currently surpassing our midterm goal of 80 to 90 days. We are still striving to improve this important metrics in 2015.

Now moving on to our financial result. Before I begin, I would like to state that we will present non-GAAP measure today. Our non-GAAP excludes certain non-cash expenses, which are not a part of our core operations. The detail of these expenses may be found in the reconciliation table, included in our earlier release.

Also note that all the financial number we are presenting today are in RMB amounts, and percentage change is year over year, unless otherwise noted.

Our net revenue for the first quarter of 2015 increased by 46.8%, to RMB860.1m.

Net revenue from hosting and related service increased by 51.6%, to RMB613.2m, primarily due to a increase in total cabinet under management, increased demand for cloud service, as well as the contribution from the acquisition of cloud VPN service provider, Dermot Entities.

The MRR per cabinet was RMB10,031 in the first quarter of 2015, as compared to RMB10,400 in the fourth quarter of 2014. The sequential decline in MRR per cabinet was primarily due to record sale of new cabinet which use lower power and bandwidth during initial ramp up, and due to a higher contribution from cabinets outside of Beijing, which carry a relatively lower MRR.

Net revenue from managed network service increased by 35.9% to RMB246.9m. This increase was primarily because of contribution from the acquisition of the Aipu Group, which was partially offset by the continuing network grooming effort, due to an industry-wide decline in bandwidth price.

Adjusted gross profit increased by 59.4%, to RMB272.7m.

Adjusted gross margin was 31.7%, compared with 29.2% in the prior year and 34% in the fourth quarter of 2014. The year-over-year increase in adjusted gross margin was primarily due to a higher margin revenue contribution from acquisition and Microsoft cloud service.

The quarter-over-quarter decrease in adjusted gross margin was primarily due to the higher than expected seasonal fluctuation in CDN revenues continues -- and also continued softness in MNS business.

Adjusted operating expenses increased to RMB209.4m.

As a percentage of net revenue, adjusted operating expenses was 24.3%, compared with 18.8% in the prior year period and 27.5% in the fourth quarter of 2014.

More specifically, adjusted sales and marketing expenses increased to RMB85.1m, from RMB39m in the prior year period, due to the expansion of our sales and service personnel to support growth, and due to acquisition with higher sales and marketing expenses, partly benefited by the cost control initiatives.

Adjusted general and administrative increased to RMB91.7m, from RMB47.4m in the prior year period, primarily due to an increase in headcount, professional fees, and other expansion-related expenses, and due to acquisitions that have higher general and administrative expenses, partly benefited by the cost control initiatives.

Adjusted research and development expenses increased to RMB32.6m, from RMB23.6m, which reflected our effort to further strengthen our research and development capability, expand our cloud computing, and CDN service offering.

The difference between the adjusted operating expenses and our high GAAP total operating expenses amount is primarily due to change in the fair value of contingent purchase consideration payable, which was a loss of RMB20.9m, and share-based compensation expense of RMB44.2m.

The change in the fair value of contingent purchase consideration payable resulted from an increase in the present value of estimated cash and share consideration, as of March 31, 2015, associated with our Company past acquisition.

From a profitability perspective, adjusted EBITDA increased by 47.8%, to RMB166.9m, from RMB112.9m in the comparable period in 2014.

Adjusted EBITDA margin was 19.4%, compared to 19.3% in the prior year period and 18.8% in the fourth quarter of 2014.

Our adjusted net profit was RMB18.9m, compared to RMB33m in the prior year period.

Adjusted net profit margin was 2.2%, compared with 5.6% in the prior year period and 0.8% in the fourth quarter of the 2014.

Adjusted diluted earnings per share was RMB0.02 which represents an equivalent of RMB0.12 or $0.02 per ADS.

As of March 31, 2015, our cash and cash equivalents, and short-term investment was RMB2.02b, equivalent to $326.1m. Pro forma for the equity investment transaction with Kingsoft, Xiaomi, and Temasek for a total amount of $296m, the funds of which was received in early second quarter of 2015, our cash and cash equivalent, and short-term investment totally, approximately RMB3.2b or $516.2m.

Looking at our financial outlook, currently we expect second quarter 2015 net revenue to be in the range of RMB886m to RMB922m, which at the midpoint, represent growth of approximately 37%, from comparable period [in 2014].

Adjusted EBITDA is expected to be in the range of RMB152m to RMB172m, which at the midpoint, represents growth of approximately 23%, from the comparable period in 2014.

Net revenue for the full year of 2015 is expected to be in the range of RMB3.91b to RMB4.11b, which at the midpoint represents approximately 39% [growth over] 2014.

For the full year of 2015, adjusted EBITDA is expected to be in the range of RMB760m to RMB860m, which at the midpoint represents approximately 45% growth over 2014.

This forecast reflects the Company's current and preliminary view, which is subject to change.

This concludes our prepared remark for today. Operator, we are now ready to take some question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions). Colin McCallum, Credit Suisse.

Colin McCallum - *Credit Suisse - Analyst*

Morning. Thanks for the opportunity. A couple of questions from me.

First of all, can you tell us what was the cloud revenue in 1Q of 2015, both from Microsoft and IBM? And could you also confirm that you're putting that revenue into the hosting and related services line item? That's the first question.

Secondly, can you tell us what the revenue from the Aipu and Dermot business units were in the first Q of 2015? And can you also confirm that both of those are going into the managed network services line item? That would be great. Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you, Colin. This is starting from the Microsoft. In 1Q, Microsoft actually had a revenue around $10m. And here we reiterate, confirm the whole year, Microsoft revenue will be around $50m. So that's for Microsoft.

And for the IBM, the first quarter we have somewhere around RMB6m, so it's close to $1m revenue. So that's revenue we have right now.

For the Aipu and also VPN revenue that we're talking about a large number, also with inter-company elimination, etc. After the call we will provide all the details to you. Okay?

Colin McCallum - *Credit Suisse - Analyst*

Okay. And in terms of which line items they're going into, was what I suggested correct? So cloud revenue is going into --?

Shang Hsiao - *21Vianet Group Inc - CFO*

Yes.

Colin McCallum - *Credit Suisse - Analyst*

Okay. All right. Thank you.

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

Colin, this is Eric. Just wanted to clarify there really quick.

So if you look at the breakdown that we provided on our P&L, the hosting and related services items, that line item actually includes the Dermot Entities. So DYX, that's included in the hosting and related services. The Aipu Group, contributions from Aipu Group, that's included in MNS, managed network services.

Colin McCallum - *Credit Suisse - Analyst*

Got it. Okay. Thank you. And cloud is included in hosting, right? Cloud revenue (multiple speakers).

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

That is correct.

Colin McCallum - *Credit Suisse - Analyst*

All right. Okay.

Shang Hsiao - *21Vianet Group Inc - CFO*

It's under hosting revenue.

Colin McCallum - *Credit Suisse - Analyst*

Okay. All right. Thank you.

Operator

Harsh Agarwal, Deutsche Bank.

Harsh Agarwal - *Deutsche Bank - Analyst*

Hi. I had two questions actually.

One was you're sitting on a lot of cash balance. Can you give a sense of what is the Company's CapEx plans for this year and also if you're looking for any more acquisitions over the course of this year, given the high cash balance you're sitting on right now? That's my first question.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Yes, right now we have a higher level of the cash on hand. For this year, right now, current plan, our CapEx plan will be between RMB900m to RMB1b. But due to the, I have to say, strong demand from the market we may consider to adding the cabinets in the second half of the year. If we do that, we may increase the CapEx amount accordingly. This is number one question.

Number two is currently the Company has no plan to do any acquisition at this moment. Okay? Thank you.

Harsh Agarwal - *Deutsche Bank - Analyst*

Okay. Got it. Sorry, just one more housekeeping question was you said your cash balance at the end of March was about $326m. And then once you receive the $296m from the equity investors in the second quarter this year, your pro forma cash balance -- how do you get the number of $516m? I thought the pro forma cash, if I just add the numbers, should be more than $600m.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Yes, actually, the equity investment by Kingsoft, Xiaomi, and Temasek actually is a [cash in] under a two phase. The total amount is close to $300m, so in the first quarter $100m cash already in. And when we go into the beginning of the second quarter, actually in April, then the other $200m remitting to the Company. So it's $100m plus $200m. Okay?

Harsh Agarwal - *Deutsche Bank - Analyst*

Got it. Got it. Thanks. If I have more questions, I'll come back in the queue.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Thank you.

Operator

Cheng Cheng, Pacific Crest Securities.

Cheng Cheng - *Pacific Crest Securities - Analyst*

Hi. Thank you. A quick question on utilizations in Q1. It seems like that took a bit of a drop. I'm just wondering the rationale behind that and expectations around utilizations or maybe just of building cabinets for the rest of this year.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Thank you, Cheng Cheng. Yes, utilization actually has dropped according to (inaudible) consistent with our expectation, because in the last quarter of 2014, the Company totally deployed more than 3,000 cabinets, actually 3,400 cabinets. So those number of cabinets we need to enter into the sales process. But in the first quarter, actually you had Chinese New Year, etc., so the sales are actually a little bit slow. So that's why you see the 65% utilization rate.

But when we get into the second quarter, then we expect that utilization rate will be starting to climb. Maybe increase 2% to 3%, let's say, go to 67%, 68% in the Q2.

But when we enter the Q3, because currently we have more than 2,000 cabinets planned to be deployed in the second quarter, and that's another big amount of the cabinets to be deployed in the second quarter, so at the third quarter, you probably see the utilization maybe drop back to 65%. So that's the utilization rate rationale. That's all based on the number of the cabinets we deployed per quarter. Okay, Cheng Cheng?

Cheng Cheng - *Pacific Crest Securities - Analyst*

Yes, great. Thank you. And just a quick follow-up. Is there any update on any of the large cloud deployment bids that are currently going on? Is there any updates there? Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Yes. Actually, currently there are a couple of big projects. We are working on it. And it's a big one, the size is big. But once we sign the contract, we will let the market know. Okay?

THOMSON REUTERS

Cheng Cheng - *Pacific Crest Securities - Analyst*

Great. Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you.

Operator

John Choi, Daiwa.

John Choi - *Daiwa - Analyst*

Good morning, guys, and thanks for taking my question.

I have a quick question on the CDN and the MNS business. You did mention that it was weak due to seasonality. Can you elaborate a bit more on what kind of challenges that you guys are facing, particularly on the CDN and MNS? And what should we be expecting for in the second quarter and the second half? Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. I think from the business view, maybe Josh can say something, my CEO, and I can talk about financials later.

Josh Chen - *21Vianet Group Inc - Chairman and CEO*

I'll speak in Chinese and get Eric to make the translation. (Spoken in Chinese).

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

Yes. So in the -- the first thing that Josh mentioned is that right now we are going through really the early stage of the broadband market changes from a regulatory perspective and also driven by very rapidly increasing network traffic.

So the bandwidth -- as a result of those two factors, the bandwidth prices are declining and we are actually getting some outside impact from those changes. But at the same time we believe that we're going in the right direction, as the overall market is moving closer and closer to the more open, more developed economies.

Josh Chen - *21Vianet Group Inc - Chairman and CEO*

(Interpreted). So when I look at the US market, say, about 10 years ago, it was really the datacenter and the interconnection market started really after really the openness of the competitive local exchange carriers as enabled by the Telecom Act of 1996 back in the late 1990s.

And so in China we are about 10, 15 years behind the US, but we are literally just at a starting point of seeing more and more inter traffic -- Internet traffic being transmitted based on [peering], based on third connection rather than purely based on transit.

So during this transition we are seeing some impact, especially with our MNS business. But at the same time we are also working very diligently to take advantage and leverage the fact that we are in this market position and to capture the market opportunity in interconnection and cross-connect as that market develops.

More specifically for our CDN business, because of the relatively easiness, easier to change from carrier to carrier, we do have a higher fluctuation as compared to our core co-location business. And in the first quarter more specifically, especially around Chinese New Year, there was some expected revenues that we had expected to be coming in, but did not come in, in reality, which impacted our overall financial conditions. Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

This is Shang. Okay. We talk about CDN and MNS. From the financial side, for the MNS business, this year we expect that the revenue from the MNS will be flat, no growth. But we already see the revenue [pressure] and right now we are in the [pattern]. So the revenue we expected no growth.

But for the CDN business, you guys can recall three years ago we acquired Fastweb. Since the acquisition, Fastweb actually [earned the] [annual] more than 50% growth year over year already for two years. This year again we expect our CDN revenue will have a growth more than 50%.

So seasonality impacts our Q1 revenue. But based on the sales of our pipeline, etc. we do expect very strong second half of this year to see the CDN revenue growth. Okay? Thank you.

Operator

Matthew Heinz, Stifel.

Matthew Heinz - *Stifel - Analyst*

Hi. Thanks for taking the questions. Just wondering just in terms of the cloud business and the $50m guidance you have out there for Microsoft, does that include -- does that assume bookings of the few large customers that have been discussed late last year and I think that slipped into this year? And you alluded to a large deal in the pipeline as well. Does the guidance include the onboarding of those customers?

Shang Hsiao - *21Vianet Group Inc - CFO*

Matthew, the answer will be yes. So that's -- we have a contract with Microsoft. So when you mentioned about a couple of big contracts, that's -- we mentioned that and those contracts continue. We are working on it. When we're booking the $50m revenue we did -- actually, that should include certain projects that we are working on it. Okay?

Matthew Heinz - *Stifel - Analyst*

Okay. Thanks. And then maybe secondly just an update on the regulatory front. Have the conversations changed or evolved at all with respect to the basic broadband license? What kind of visibility do you have around that at this point, particularly as the government assesses the shift in Internet infrastructure towards the peering model?

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Yes, we talked about the broadband license. Actually, during the last month, the central government, through the MIIT, they issued a circular to talk about they will open the broadband license in certain cities. Actually, right now the cities they plan to open is somewhere around 16 cities, but they also -- later on they say they will increase the cities to be opened from 16 to 31. My CEO already mentioned about it.

But the broadband license right now they try to open including, number one, the last mile. The second one, it's including the, we call, metropolitan area network [transit] (inaudible). So right now they plan to open this. And for the timing, we believe the timing should be around the middle of this year.

But the key message over here the central government, the MIIT, they won't issue a nationwide license to a particular company, etc. Actually, that will be a MI -- each local city, MIIT they will issue the local license. They say if you plan to operate the 10 cities, then you are supposed to get 10 licenses from each local MIIT. That's the current plan by the government.

Matthew Heinz - *Stifel - Analyst*

Okay. Thank you very much.

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

This is Eric. Matt, this is Eric. I just wanted to add a couple of things really quick there.

So in addition to the licenses that we need to receive from the regulators, we are also working on a couple of other fronts. One is the ecosystem, because license is one thing and in order to really capture the market opportunity you really do need to have a ecosystem, be it financial services or ISPs or cloud computing services providers. So that's something that we are working on currently right now.

The other thing is we also need to educate some of our customers, because in China a lot of customers, even though they are becoming increasingly sophisticated, some of the customers, frankly speaking, just don't know the benefits or the possibility of the benefits that can be provided by interconnection and cross-connect services. So that's another factor that we also have to work on.

Matthew Heinz - *Stifel - Analyst*

Okay. Thank you.

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

Thank you.

Operator

Leping Huang, Nomura.

Leping Huang - *Nomura - Analyst*

Thank you for taking my question.

So my question follow -- it's also about the MNS business. So the State Council now recently pushed operators to increase the network speed and lower the tariff. And also we see a lot of negative media reports about the, how to say -- China -- I think, in my knowledge, China Mobile buy a lot of bandwidth through the independent companies, [China Unicom, Telecom and these]. I'm not sure whether this is related to MNS service, but this seems to be -- there is negative news report about this one.

So do you think that this government push on the lower tariff will affect -- mainly affect your MNS service -- the tariff or it will also negatively affect your volume or what do you see? Or do you think, if you look at the organic growth of the MNS business, if you take out the acquisition, the Fastweb acquisition, do you see long-term this will -- it will [expand] or it will decline? Thank you.

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Leping, okay. It's like this, MNS actually is a

volume business. In fact, our volume sale to our customers continued to increase, but the pricing decreased a lot.

We monitor the pricing. I can give you an example of the pricing. Actually, in the same quarter of the last year, the pricing at that time probably is three times, four times of the current price. What that means is that the pricing has declined by more than 60%, 70% year over year. So we face pressure. We face pressure, but our customers continued to increase.

But I have to say that the traffic from those MNS revenues, they are very, very important for us. Even this business without the revenue growth, but our traffic amount continued to increase. We do have our network strategy and plan, so we already [explained] to the market. The revenue of the MNS this year will remain stable as well as the margin, actually, will remain stable. So that's on the current situation.

But you also need to consider, because China is going to open the broadband license in a very short period of time, [accumulate] of the traffic from the last mile, from the metropolitan network as well as the traffic from backbone are also very, very important for us. Not because of revenue, but somehow that's very important to our network cost structure. Okay? Thank you.

Leping Huang - *Nomura - Analyst*

Yes. Thank you.

Operator

Louie DiPalma, William Blair.

Louie DiPalma - *William Blair - Analyst*

Thanks for taking the question. A quick one. When do you forecast that utilization will return to 70%?

Shang Hsiao - *21Vianet Group Inc - CFO*

How many percent? I'm sorry. Seven --?

Louie DiPalma - *William Blair - Analyst*

70%.

Shang Hsiao - *21Vianet Group Inc - CFO*

70%? Okay. Well, the 70%, that's for the first -- that's for the Q4 number. Right? And for the 70%, I think if we look at maybe in the Q4 this year maybe we can see the 70%, if I answer your question?

Louie DiPalma - *William Blair - Analyst*

Yes. And just a follow-up. Can you remind me how many cabinets or capacity you expect to add in total for 2015?

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. Our guidance right now is between 7,000 to 9000, with a midpoint 8,000. And I can reaffirm that guidance. So if you want to do your model, so it's 8,000 cabinets deployment for this year, with second quarter somewhere more than 2,000 cabinets in -- again more than 2,000 cabinets in Q3 and more than 2,000 cabinets in Q4. In total, more than 8,000 cabinets.

Louie DiPalma - *William Blair - Analyst*

Great. That's all that I had. Thanks for taking the questions.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you.

Operator

(Operator Instructions). Harsh Agarwal, Deutsche Bank.

Harsh Agarwal - *Deutsche Bank - Analyst*

Hi. Do you mind just reminding us again what has been the change in the VAT system that you talk about in the results?

Eric Chu - *21Vianet Group Inc - VP, Capital Markets and Business Development*

I'm sorry, Harsh. Could you repeat your question?

Harsh Agarwal - *Deutsche Bank - Analyst*

What has been the change in the VAT system that you mention in the results that has impacted your revenues?

Shang Hsiao - *21Vianet Group Inc - CFO*

Okay. So VAT, actually it's a Company impact. Let me summarize like this. So right now, the Company use VAT tax system, because we have been required to do that after the June of the last year. And in the beginning [we take the] VAT invoice, because the local tax bureau, they did not give us enough VAT. But up to the and close to the end of the last year, we've received the sufficient VAT invoice. And evident by, everybody can see our DSO right now is quite stable, around 78 days. So that one right now is not an issue anymore. Okay?

Harsh Agarwal - *Deutsche Bank - Analyst*

Yes. Thanks.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you.

Operator

Thank you. Ladies and gentlemen, we have no further questions from the phone line. I would like to hand the call back to the management for closing remarks.

Shang Hsiao - *21Vianet Group Inc - CFO*

Thank you, everyone.

Operator

Ladies and gentlemen, that concludes the conference for today. Thank you for your participating. You may now disconnect the line.

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.