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VNET - Q3 2019 21Vianet Group Inc Earnings Call

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PRESENTATION

Operator

Ladies and gentlemen, thank you, and welcome to 21Vianet Group's Third Quarter 2019 Earnings Conference Call. (Operator Instructions) With us today are Mr. Alvin Wang, Chief Executive Officer and President; Ms. Sharon Liu, Chief Financial Officer; and Ms. Rene Jiang, Investor Relations Director of the company. I will now turn the call over to the first speaker today, Ms. Rene Jiang, IR Director of 21Vianet. Please go ahead, ma'am.

Rene Jiang - *21Vianet Group, Inc. - IR Director*

Hello, everyone. Welcome to our third quarter 2019 earnings call. Before we start, please note that 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 not under the management -- 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. Forward-looking statements are expressly qualified in their entirety by the cautionary statement, risk factors and details of the company's filing 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.

I will now turn the call over to Mr. Alvin Wang, CEO and President of 21Vianet.

Alvin Wang - *21Vianet Group, Inc. - CEO & President*

Thank you, Rene. Good morning, and good evening, everyone. Thank you for joining us on our earnings call today. In the third quarter of 2019, we grew our revenues to RMB 981 million and adjusted EBITDA to RMB 272.5 million, both of which exceeded the high end of our previous guidance range. Our adjusted EBITDA margin was 27.8% compared to 28.2% in the same period last year. This growth demonstrates both resilient customer demand and our progress in these 3 areas: Timely capture of the growing and changing market demand for IDC; continuous refinements of the product portfolio and the value propositions; prudent expansion of the capacity pipeline in anticipation of rising demands.

First, bucking the current macro headwind, the domestic IDC market is growing rapidly as a result of ongoing demand for hosting and cloud computing. In line with these trends, recent industry surveys by the IDCquan Research Center suggested that more than half of the companies surveyed consider IDC services a long-term investment priority, not subordinates to other cost control measures. Some findings validates our own experience in IDC industry as we have witnessed large-scale Internet and cloud enterprises accelerating their expansion of cabinet capacity to better accommodate their thriving Internet data traffic and the cloud computing needs. Meanwhile, recognizing the need to digitalize their operations, traditional companies are also increasing their demand for scalable and customized IT solutions.

To capture these growth trends and to attract more large-scale clients, we have deftly leveraged our industry leadership, technological know-how, domain expertise and the brand equity. Our partnership with Alibaba in October 2019 exemplifies our industry recognition and demonstrates our strong value proposition to industry giants. We plan to explore additional collaboration opportunities with Alibaba for its expansion. We also see potential for replicating such strategic partnership with other large-scale clients going forward.

In addition to obtain the wholesale clients, we are also refining our IDC offerings to increase our appeal to retail clients. As a result, during the third quarter, we were able to provide retail IDC solutions to a diverse group of clients such as COFCO, China Oil and Food Corporation, a nation-wide, state-owned enterprise; and Secoo, an online retailer traded on Nasdaq. As more clients adopt our innovative, scalable retail solutions, we have expanded our sales backlog to a record high of around 2,000 retail cabinets by the end of third quarter.

In conjunction with serving more wholesale and retail clients, we continued to expand our capacity pipeline in a prudent manner. Such pipeline expansion is in line with our previously announced 3-year growth plan. At the same time, we are maintaining regular dialogues with our clients to better understand their requirements for data centers, keep a close tab on the shifting market demands like solution adjustments in real time and secure additional orders for cabinets entering our pipeline. For example, we have received increasing interest from potential industry partners for our Jiangsu campus products, whose first batch of cabinets will be ready for wholesale customers order by the end of 2020. While we expand pipeline capacity and secure additional partnerships, we're also carefully monitoring our projects' progression and the delivery deadlines to ensure a healthy cabinet utilization rate. In addition, we continued to reduce the number of reserve partner cabinets and increase our self-base capacity.

For our non-IDC business, we've also made solid progress in further developing our products and enhancing our operational capability during the quarter. Due to our service products adjustment, our VPN business experienced a revival.

In summary, we delivered a strong third quarter performance as we captured the growing market demand for IDC solutions, refined our product offerings and expanded our capacity pipeline in sync with our 3-year growth plan.

Moving forward, we shall continue to elevate our value propositions, establish additional partnership in a broad range of sectors, and strike a balance between the pace and the utilization rates of our capacity expansion. We are convinced that we are in the right markets at the right time with the right solutions. We have the industry leadership, the experienced team and the domain expertise. We are optimistic about our future, and we are confident that we can generate superior sustainable shareholder value consistently going forward.

Now I would like to turn the call over to Sharon, our CFO, for more financial details.

Sharon Liu - *21Vianet Group, Inc. - CFO*

Thank you, Alvin, and hello, everyone. Before we start our detailed financial discussion, please note that we will present non-GAAP measures today. Our non-GAAP results exclude certain noncash expenses, which are not part of our core operations. The details of these expenses may be found in the reconciliation tables included in our press release. Please note that all of the financial numbers we are presenting today are in RMB terms and that percentage changes are on a year-over-year basis, unless otherwise stated.

During the third quarter, we ramped up our cabinet delivers fulfilled more client orders, made meaningful progress in several projects and expanded our sales pipeline. As a result, both our revenue and adjusted EBITDA grew year-over-year, and our balance sheet strengthened at the same time.

During the third quarter, our revenue increased by 12.7% to CNY 981 million, exceeding our guidance. Such growth was driven by the expanding scope of corporate digitalization across China. As a result, client demand for high-quality and scalable IDC service, such as ours, has received a significant boost.

During the third quarter of 2019, our hosting MRR per cabinet improved to CNY 8,711. As of September 30, 2019, we operated and managed a total of 32,116 of cabinets, which included 27,267 self-built and 4,849 partnered cabinets. Our utilization rate in the third quarter was 66.2%.

Adjusted cash gross profit which excludes depreciation, amortization and share-based compensation expenses, was CNY 396.7 million in the third quarter of 2019 compared to CNY 391.9 million in the same period last year. Our adjusted cash gross margin was 40.4% compared to 45% in the third quarter of 2018. The year-over-year decline in margin was due to the introduction of certain lower-margin product offerings, higher rent and utility costs, as well as the delivery of additional pipeline capacity.

Adjusted operating expenses, which exclude share-based compensation expenses and changes in the fair value of contingent purchase consideration payable, decreased to CNY 146.2 million from CNY 162.9 million in the same period of 2018. As a percentage of net revenues, adjusted operating expenses decreased to 14.9% from 18.7% in the same period of 2018.

Adjusted EBITDA grew by 11.1% to CNY 272.5 million, exceeding our previous guidance range. Adjusted EBITDA margin decreased slightly to 27.8% from 28.2% in the same period of 2018 due to the delivery of additional capacity.

Net loss attributable to ordinary shareholders was CNY 69.5 million. Basic and diluted profit were CNY 0.10 per ordinary share and CNY 0.60 per ADS, respectively. Each ADS represents 6 ordinary shares.

Moving on to our balance sheet and liquidity. At the end of the third quarter, our debt to asset ratio was 61.2% and our debt to adjusted EBITDA ratio was 3.1. Our net cash generated from operating activities was CNY 103 million during the third quarter. As of September 30, 2019, we maintained an abundant cash position of CNY 2.94 billion, which services as a solid foundation for us to capture additional growth opportunities and expand our client base to a broader range of industry.

Looking forward, we expect net revenue for the fourth quarter of 2019 to be in the range of CNY 1.03 billion to CNY 1.05 billion and adjusted EBITDA range of CNY 245 million to CNY 265 million. For the full year of 2019, we now expect the net revenue to be in the range of CNY 3.771 billion to CNY 3.791 billion and adjusted EBITDA to be in the range of CNY 1.033 billion to CNY 1.053 billion. This forecast reflects our current and preliminary views on the market and operational conditions, which 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) Your first question comes from the line of Rex Wu from Jefferies.

Rex Wu - *Jefferies LLC, Research Division - Equity Analyst*

So I'll ask 3 first. So number one, it's -- we see this quarter, we added 1,500 new cabinets, self-built cabinets. And you mentioned about 2,000 backlog. So based on the guidance of 6,000 new cabinets for the full year, we still need to deliver about like 4,500 new cabinets. So do -- are you still reiterating the new cabinets target? And second is, the utilization is still maintained at 66%. So in which region is below the average? And how do you plan to improve? And number three is, can you talk more about the upcoming wholesale pipeline for 2020?

Alvin Wang - *21Vianet Group, Inc. - CEO & President*

This is Alvin. Thank you, Rex, for your questions. Your first question is regarding the capacity in the -- new added capacity in 2019. Actually, in the fourth quarter this year, so we will deliver another 4,000 plus new cabinets. So we are confident to deliver the capacity according to our guidance for this year's new capacity expansion target. And secondly, it's regarding the utilization rates. We are currently see -- we'll see strong demand from our customers across the regions. But still that -- we see that in some regions, especially tier 2 cities, we see the customer demands are lower than average. So that's the current situation. But still that we see in the Tier 1 cities, we will see very strong demand. That's why we -- as we said before, that we have 2,000 cabinets backlog, so mainly in Tier 1 cities.

And for 2020, wholesale types, we are now -- have very strong engagements with all the top public cloud players across China. So we are confident to secure further projects in addition to current 2 deals with 2 major public cloud players this year.

Operator

Your next question comes from the line of Camille Xu from Morgan Stanley.

Camille Xu - *Morgan Stanley, Research Division - Research Associate*

Congratulations on the good result. I have only one question about the financials. I see the G&A expenses decline accelerated to about 25% year-on-year this quarter, which I think is a good signal for efficiency improvement. So I just would like to know, is there any more fat to cut here? And what is the expected run rate for the G&A expense going forward?

Sharon Liu - *21Vianet Group, Inc. - CFO*

Thank you, Camille. This is Sharon. I will answer your question regarding to our G&A and operating expenses. You're right. If you are looking at our financial statements, you can see a decline of the operating -- adjusted operating expenses, especially the G&A. That was because of our operating efficiency and leverage as well as the capitalization of certain expenses because we spent more expenditures on the resources finding as well as the construction and all the costs was capitalized under construction. Yes, it is hard for the company to make the adjusted operating expenses to further decline to below 15%, so we expect in Q4, the adjusted [operating margin] (corrected by company after the call) was still about 15%.

And regarding to our EBITDA margin in Q4. If you are looking at our guidance, the EBITDA margin will stay challenged because of the concentrated delivery of the new capacity during this quarter. Thank you.

Operator

(Operator Instructions) Your next question comes from the line of Stella Li from Citigroup.

Stella Li - *Citigroup Inc, Research Division - Analyst*

I have 3 questions. First, I noticed that the operating cash flow of third quarter is weaker compared to second quarter or compared to last year. So I'm wondering what's the major reason? And what's our expectation for the operating cash flow in fourth quarter? The second question is, given that we still need to deliver pretty big size of cabinets in the fourth quarter and also that we revised our CapEx guidance, that means the investing CapEx will be pretty big in fourth quarter. Do we have any other fund raising plans? That's the second question. The third question is in the cash flow statement. I noticed there are a few -- several hundred million outflow of investments. I want to know what is that?

Sharon Liu - *21Vianet Group, Inc. - CFO*

Thank you, Stella, for your questions. Regarding to our net operating cash flow, yes, the net operating cash flow will come in lower than last year due to our higher rent expenses, the higher interest payment because we raised new debt financing in the first half of this year and the lower tax refund compared to 2018. And for full year 2019, we expect the net operating cash flow between CNY 500 million to CNY 600 million. And your second question is about our future financing plans, and our financing -- our long-term financing strategy is to maintain diversified funding portfolios to balance the liquidity and optimize the cost and to support the expansion of our cabinet capacity. So our future plan is based on our capacity plan. And currently, company cannot provide any specific plans on our future financing plans. And your third question is regarding to our cash out of the...

Stella Li - *Citigroup Inc, Research Division - Analyst*

There is a payment for investments. Yes, there's CNY 320 million outflow of payments for investments. What is that?

Sharon Liu - *21Vianet Group, Inc. - CFO*

Yes, yes. It's because we buy some time deposit.

Stella Li - *Citigroup Inc, Research Division - Analyst*

Okay.

Sharon Liu - *21Vianet Group, Inc. - CFO*

For the U.S. dollars offshore.

Stella Li - *Citigroup Inc, Research Division - Analyst*

Sure. Can I have a follow-up question. Regarding funding plan, let me rephrase the question. Do we have any new bank credit lines or any other source of funding in addition to our existing channel?

Sharon Liu - *21Vianet Group, Inc. - CFO*

Yes, of course. From this year, the debt capital market environment in domestic market is, for IDC industry, is getting better. We have been discussing with local banks and finance lease institutions for project financing, with longer maturity profile and favorable interest rate. And currently, we have just confirmed with one local bank for project financing for a data center in Shanghai areas. And we will sign the final project financing contracts with the bank in the coming months.

Operator

Your next question comes from the line of Shiwen Li from CICC.

Shiwen Li - *CICC - Analyst*

I have 2 questions. First, I'm hoping that you could add more color on your cooperation with Alibaba. Like, how many cabinets will they take in Phase 1? And when do you expect to have a Phase 2 plan announced? And my second question is that I've seen your MRR per cabinet is stable this quarter. I want to know whether you take any measures to prevent MRR from falling quickly after you entering the wholesale market?

Alvin Wang - *21Vianet Group, Inc. - CEO & President*

Thank you for your question. This is Alvin. I will take your questions. The first one is regarding the cooperation with Alibaba Group, at least Alibaba Cloud. So we already signed long-term strategic agreements with AliCloud in one of their database campus in central part of China. And in Phase

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1, we are planning to deliver around more than 20 -- actually, 2,000 high-power density cabinets. And actually, it's in the first phase. And the first phase, we'll formally deliver first half next year. And the second phase already started. We have very close cooperation with our customers and also our partners, so we will see the projects formally kick off and all the companies work started very soon. And regarding the wholesale MRR, for sure, that's -- currently, we have no very significant contribution from the wholesale to our top line and the bottom line yet. So after we see the quite significant contribution from the wholesale project, we will consider to separate the report, especially consider MRR and other financial figures as well. Thank you.

Operator

(Operator Instructions) Your next question is a follow-up question from Rex Wu from Jefferies.

Rex Wu - *Jefferies LLC, Research Division - Equity Analyst*

Thank you, Alvin and Sharon. So I'd just follow-up. Alvin just mentioned, the Phase 2 already started. Is this like in the same campus and for the same customer? And how much -- like how many cabinets approximately will it have?

Alvin Wang - *21Vianet Group, Inc. - CEO & President*

Okay. Rex, thank you for your question. It's Alvin, again. That Phase 2 project is in the same campus for the same customer. The capacity will be higher than the Phase 1. Thank you.

Operator

There are no further questions at this time. I would now like to hand the conference back to the management. Please continue.

Rene Jiang - *21Vianet Group, Inc. - IR Director*

Thank you, once again, for joining the call today. If you have any further questions, please feel to contact our IR. Thank you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may all disconnect.
