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Q1 2019 21Vianet Group Inc Earnings Call

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PRESENTATION

Operator

Good morning, and good evening, ladies and gentlemen. Thank you, and welcome to 21Vianet Group's First 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'll now turn the call over to the first speaker today, Ms. Rene Jiang, IRD of 21Vianet. Please go ahead.

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

Hello, everyone. Welcome to our First 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 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 statement, 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.

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

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

Thank you, Rene. Good morning, and good evening everyone. Thank you for joining us for our earnings call today. In line with our expectations, we achieved healthy growth and met our target in the first quarter. We recorded RMB 871.9 million in revenue, which represents an 8.9% year-on-year increase. Our adjusted EBITDA exceeded the high end of our guidance and delivered a 29.3% year-on-year increase to RMB 253.5 million. EBITDA margin expanded to 29.1% during the quarter. This steady growth is a result of our competitive advantage in scalable and customized solution for customers' data hosting and Internet infrastructure demands.

In order to satisfy our customers' continuous demand for increasingly complex hybrid IT solutions, customized space and value-added services, we have been enriching our service offerings since late 2017. By providing these services and solutions, we have formed a number of close relationships with corporate clients that are both large-scale and long-tail. Evidence of our success can be seen in our business relationships with large-scale brand name companies including Meituan, Beisen Cloud, Vivo and BaoZun as well as rising brands such as luckin coffee.

For our IDC business, we have bolstered our resources planning to expand our pipeline capacity and to better serve large-scale customers. In response to our customer desire for scalable cabinet capacity and customized data hosting solutions, we have increased our inventory of blank space. This type of IDC space is modular and can be tailored to support around 200 cabinets within a 3-month time span. Blank space provides customers with increased flexibility while allowing us to optimize our own resources and then receive valuable insights concerning sales commitments. We have also optimized our sales commission structure to promote this offering among a wider base of target customers.

As we implement this strategy in 2019 and beyond, we will continue to improve the scalability of our service offerings. Importantly, this scalability will be realized in both Tier 1 cities and satellite areas. Furthermore, we are pleased to announce an acquisition in the south of Beijing to support our expansion plan. This acquisition is targeted to deliver approximately 1,000 cabinets by the middle of the year and has the potential for further expansion.

Additionally, we have reserved campus sites that are suitable for hyper-scale data centers in both Jiangsu province near Shanghai and Hebei province near Beijing. These investments position us well to expand our business and customer base in a broader area.

Before I discuss our 3-year growth plan, I'd like to comment on the fluctuation in MRR and cabinet utilization in the first quarter. During the quarter, we closely monitored our cabinet utilization rate to guard against any risk from customer churn, which primarily occured due to business restructuring. As mentioned in the prior earnings call, one major customers started to move out of our data center and host its data under its new parent company. Additionally, another customer decided to utilize a self-built IDC to host data for some of its traditional business in a Tier 2 southwestern cities. This customer's revenue contribution in 2018 was less than 1% due to its low ARPU.

Undoubtedly, these terminations put negative pressure on our utilization rate and caused an inconsistent rise in our MRR. However, we expect these losses to be gradually offset as we implement our new resource allocation strategy over the next quarters, continue building our company brands and acquiring new large-scale corporate clients.

Now I would like to highlight on our 3-year growth plan. We have made this plan in response to growing demands for scalable customized IDC solutions expressed by our corporate clients in different industries. We made this plan after much consideration and thought, and it reflects our assessment of necessary balance between cabinet utilization and capacity expansion moving forward. This plan is based on our total cabinet expansion targets for both retail and wholesale customers, and reflects our growth target for both revenue and adjusted EBITDA.

In 2019, we renewed our plan to add 6,000 to 8,000 retail cabinets, including the recent acquisition in Beijing. In 2020 and in 2021, we aim to add approximately 15,000 cabinets each year, including cabinets for wholesale purpose.

For revenue growth, our current 2019 guidance midpoint indicates 12% annual growth. We aim to accelerate revenue growth in 2020 and 2021 to the range of 20% to 24% and 23% to 27%, respectively. We expect our adjusted EBITDA to continue to beat revenue growth. For 2019, our guidance midpoint indicates 14% annual growth while we aim to accelerate EBITDA growth in 2020 and 2021 to the range of 25% to 30% and 35% to 40%, respectively.

This plan gives us a clear focus for the coming years. In order to meet these goals, we must manage our resources appropriately, continuously engage in new business development efforts and ultimately serve more customers with quality, scalable services. In the long run all these components will come together to increase shareholder returns.

Now I would like to turn the call over to Sharon Liu, CFO of our company, to give you more details on our financial results.

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

Thank you, and hello everyone. Before we start our detailed financial discussion, please note that we will present non-GAAP measures today. Our non-GAAP result excludes certain noncash expenses, which are not part of our core operations. The details of these expenses may be found in the reconciliation table 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.

We started 2019 with solid first quarter results, which were marked by steady revenue growth, profitability improvements, positive cash flow and an overall strong balance sheet. For the first quarter, we grew our revenue by 8.9% year-over-year to RMB 871.9 million, close to the high end of our guidance range. This growth was mainly driven by gradually increasing demand for the cabinet storage capacity and value-added services, partially offset by the churn of a major customer.

For operating metrics, hosting MRR per cabinet rose to 8,788 in the first quarter of 2019. Total cabinet under management adjusted to

30,578 as of March 31, 2019. Among the total, 84.1% are self-built and 15.9% are partnered. Utilization rate in the first quarter fell to 66.2% caused by the restructuring of 2 customer businesses.

Adjusted cash gross profit, which excludes depreciation, amortization and share-based compensation expenses, increased by 17% to RMB 406.7 million from RMB 347.5 million in the same period of 2018. Adjusted cash gross margin expanded by 3.2 percentage points to 46.6% from 43.4% in the same period of 2018. This was mainly due to the increasing number of high-margin self-built cabinets in our sales mix and the greater economies of scale.

Adjusted operating expenses, which excludes share-based compensation expenses and changes in the fair value of contingent purchase consideration payable, increased by 2.5% to RMB 171.3 million from RMB 167.2 million in the same period of 2018. As a percentage of net revenues, adjusted operating expenses decreased to 19.6% from 20.9% in the same period of 2018.

Adjusted EBITDA grew by 29.3% year-on-year to RMB 253.5 million, also exceeding the high end of our previous guidance range. Adjusted EBITDA margin increased by 4.6 percentage points to 29.1% from 24.5% in the first quarter of 2018.

Net profit attributable to ordinary shareholders was RMB 5.6 million. Basic and diluted profit was RMB 0.01 per ordinary share and RMB 0.06 per ADS, respectively. Each ADS represents 6 ordinary shares.

Moving on to our balance sheet and the liquidity. At the end of the first quarter, our debt-to-asset ratio was 55.2% and our debt-to-adjusted EBITDA ratio was 3.8. We generated a positive net operating cash flow of RMB 32.4 million during the first quarter. As of March 31, 2019, we maintained a sizable cash position of RMB 2.54 billion. Moreover, in April, we further improved our liquidity by issuing USD 300 million senior notes due in 2021. This is our first offering with independent ratings. The offer was well received from high-quality investors in Asia and Europe. We believe this is a testament of investor confidence in the company's solid growth and the booming IDC industry in China.

With the healthy cash flow and the improved approach to financing, we are well positioned to expand our business and sustain profitable growth going forward. In the meantime, we will monitor our financial leverage to maintain and improve our ratings in order to keep funding channels [open] and gradually lower funding costs.

Looking forward to the remainder of the year, we are optimistic about the IDC market growth outlook. As corporate clients continue to grow in size, their demand for flexible data hosting solutions and quality value-added services increases in turn. Under the 3-year vision plan that Alvin mentioned, we expect net revenues for the second quarter of 2019 to be in the range of RMB 880 million to RMB 900 million and adjusted the EBITDA to be in the range of RMB 250 million to RMB 270 million. For the full year of 2019, we reiterate our previous guidance for the net revenue to be in the range of RMB 3.76 billion to RMB 3.86 billion and adjusted EBITDA to be in the range of RMB 1 billion to RMB 1.1 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 today comes from the line of Yang Liu from Morgan Stanley.

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

In Page 23 of the presentation elaborating the 3-year plan, I found a lot of new capacity pipeline for the next 3 years. I would like to ask, could you please elaborate more in terms of the Jiangsu, Hebei campus? How is the customer -- the early look at the customer demand, et cetera? And how big of the 15,000 next year and 2021 will go to wholesale customers? That's my first question. The second one is the wholesale -- the progress. I think the very aggressive expansion plan definitely includes some contribution from wholesale customers. What about the timetable in terms of a contract and the next stage moving, et cetera? And the third question is the CapEx plan to support the aggressive expansion plan? This year, we have a clear CapEx guidance. But how about 2020 and 2021 in terms of the total CapEx? And also if there's any further plan to borrow or leverage?

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

This is Alvin. First of all, thank you also for Liu Yang's questions. Let me try to address the 3-year plan first. Actually -- as we all know that we adjust our strategy and spinoff the unprofitable businesses since end of Q3 2017. So the main focus in 2018 was to improve operational efficiency, and so we see that we have very clear progress since then. And from the beginning of 2019 and beyond, we are fully focused on how to adjust the growth opportunities going forward. That's why that with a lot of efforts from the entire organization, we developed this 3-year growth plan. And so based on this growth plan, we have reserved enough capital and also enough pipeline projects to serve top customers, especially the public clouds, top Internet players and also our financial customers as well. So the team is now very excited and also very passionate and confident to address all the potential growth opportunity and fulfill our growth ambition going forward. So based on the current plan we disclosed, we already secured all the major projects within 2019 and the majority of the pipeline projects in 2020 and 2021. And I'll especially address the campus project -- campus site projects in Jiangsu and Hebei. So these 2 projects are basically very close to the Tier 1 cities, which are Beijing and Shanghai, and we see very strong demand from the customer there. And also the space on all these 2 campus, we can provide very high-capacity, high-powered density and also customized solution to customers to serve their very strong demand. And also, all these 2 projects, we already have necessary approval for the Phase 1 and also for the following phases, especially with very strong support from the local partners and, of course, the local governments as well. So that's why we have extremely strong confidence at least today that look at our growth opportunities going forward.

And back to the wholesale projects this year, we are very confident to close at least one deal within the calendar year. And at the same time, we do have very strong engagements with several top customers, namely the top public cloud players and other top Internet players as well. So I'd like to reiterate our current plan at least to close one deal within this calendar year, and also we will have much more wholesale opportunities from 2020 and 2021. And regarding the CapEx plan, I'd like to refer to our CFO to give you more explanation.

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

Okay. Yang, I will take your question related to the CapEx regarding to our 3-year growth plan. As you all know, our CapEx for cabinet is in the range of 100,000 to 120,000, in that range, and in the next 2 years, we'll deliver at least 15,000 cabinets, so you can easily calculate our CapEx. While if we provide more high-density cabinets to our customers in the wholesale market, the related CapEx for cabinet will increase accordingly.

Operator

(Operator Instructions) Your next question today comes from the line of Rex Wu from Jefferies.

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

So congratulations on another beaten race and also giving investors more clear outlook for the 3-year plan. So I actually also got 3 questions. So my first question is, you mentioned about another retail client moving to their self-built capacity. So I'm wondering if we have to like run through our client list, see any other potential like churn of customers. And my second question is, you seem to have a pretty aggressive new cabinet addition plan for 2020 and 2021. So can you give us more color about the utilization rate you target? And my third question is on M&A. So the future with your M&A what's in your mind and what are the -- do you have more to come in the next 2 quarters?

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

Okay. Thank you, Rex, for your questions. Your first one, that's related to our churn rate. At this moment, we don't see any additional major churn rate for Q2 and for the remaining period of this year. And your second question is related to the utilization rate. In the utilization rate will be -- the utilization rate will be in the range of 60% to 70% for our next 3 years. And for the M&A we disclosed this quarter, actually, that's related to 1,000 cabinets in south Beijing. And we consider that the valuation is very reasonable, and it will attribute revenue and EBITDA, especially for 2020 and 2021. And currently, we still have some M&A pipelines. We will closely discuss with the potential cooperators to settle some good ones. And in our 3-year plan, we have not included any M&A projects. Thank you.

Operator

(Operator Instructions) Your next question comes from the line of Yang Liu from Morgan Stanley.

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

Sorry, I have one more question here. In terms of the vacant capacity or the inventory left when the customer moved out. How about -- in the progress of reselling this capacity to new customers? I think one of your churn customer, previously, used a lot of capacity in Beijing and Shanghai. I guess the demand should be good, but how about the progress in terms of reselling?

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

Thank you, Yang, for that question. This is Alvin. So we -- as you mentioned, we have very strong customer demand especially in Tier 1 cities, Beijing, Shanghai and Guangzhou and Shenzhen. So that's why we have strong confidence to refill the vacant capacity in these Tier 1 cities. So going forward, especially in the rest of the year, we have confidence to get the very strong customer demand. Actually, we already have very strong customer demand in our pipeline, so we still remain confident to maintain and increase the utilization rate in these Tier 1 cities.

Operator

Your next question comes from the line of Rex Wu from Jefferies.

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

So I have a follow-up question. Actually, you mentioned -- and I remember in the past quarters you mentioned that the government has tightened their approval --- data center approval in Tier 1 cities. So how do you see for 2019 what's like in the first 5 months and remaining? So do you see any potential of more approvals coming from the government?

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

Actually -- Rex, thank you also for your question. So we do see that the government has a very strong and very strict rules to approve especially new capacity in Tier 1 cities. And during the first quarter 2019 and also looking ahead, we don't foresee any kind of relief or kind of comment how they may weaken their rules and approval procedure. So at the same time, we do reserve very good resource pool, especially in the centralized areas, to fulfill very big customer demands from Tier 1 cities. And at the same time, as we disclosed in our 3-year plan, we already reserved a very strong pipeline resources in Tier 1 cities, and so we already secured majority of these resource projects to get necessary approval or pre-approval from the government and our partners as well. Thank you.

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

I just have one more follow-up. So in Q1, so I just want to see your idea about the future MRR because in Q1, we see a significant -- an 11% increase in like year-over-year increase in MRR. And do you see this sustainable? This is because like the churned customer is more on the low-price side and you're actually having better customer mix now. So like how do see the MRR in the next couple of quarters? Or is this growth sustainable? And also the outlook for 2020 and 2021.

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

Rex, yes you are right. If we exclude the loss of the low ARPU customers in Q1, exclude the inconsistent impact of our MRR, we expect the MRR to be stable at a range of RMB 8,400 in this year. Thank you.

Operator

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

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

Thank you once again for joining us today. If you have further questions, please feel free to contact IR. Thank you. Good day.

Operator

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