21Vianet Group Inc.
Conference Call to Address Recent Allegations
September 11, 2014

世纪互联
www.21vianet.com

Operator:

Ladies and gentlemen, thank you for standing by. Thank you, everyone, and welcome to the 21Vianet Group's conference call to address recent allegations.

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 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 those forward-looking statements.

All forward-looking statements are expressly qualified in their entity by the cautionary statements, risk factors and details of the Company's filings with the SEC.

21Vianet undertakes no duty to reserve 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, Founder, Chairman and CEO; Mr. Frank Meng, President; Mr. Shang Hsiao, Chief Financial Officer; Mr. Feng Xiao, Senior Vice President and President of Data Center Business Group; and Mr. Eric Chu, Vice President of Capital Markets and Business Development.

Following management's prepared remarks, we will conduct the Q&A.

At this time, I would now like to turn the conference call over to Mr. Eric Chu. Please go ahead, sir.

Mr. Eric Chu – Vice President of Capital Markets and Business Development:

Thank you for joining us today. As you are all aware, we've become the latest target in China from a short attack based only on limited circumstantial information that was pieced together in a way to mislead the investors and exaggerate the author's predetermined outcome. We find the assertions and speculation made in this short attack extremely unfounded, unsubstantiated and certainly factually erroneous at all levels throughout their report. These accusations, regardless of how unfounded they are, present us with an opportunity to further explain the true fundamentals of our company, our core business model, our new business opportunities and the future growth direction of 21Vianet to a wider audience. Due to the broadness of these accusations, it will take us a couple of days to fully respond. We will be aiming to issue a more thorough press release in the coming couple of days providing additional color on top of the information we will provide during this call. In addition, we encourage you all to visit our facilities and witness firsthand the tremendous growth we've experienced since our IPO in 2011. Our core IDC business has grown multiple times, and our partners, who are leading global tech companies, can attest to the strong core business fundamentals they have experienced with us at 21Vianet.

21vianet has been an operating company for nearly two decades with substantial tangible assets, customers, and contracts. We were one of the first non-state owned entity to receive a nationwide "ISP" license and the first to also receive a nationwide "IDC" license. And over the course of many years of hard work, we have gradually built strong market positions in both industries. This is why we are successful, not through underhanded or illegal techniques as irresponsibly alleged in the short report.

The report suggested that 21Vianet is running a Ponzi Scheme. Anyone that has been following us over the years and visited our many facilities has witnessed quite directly and knows quite clearly: we are not. The use of the phrase "ponzi scheme" is meant to elicit fear among investors that a company has no ability to generate cash flow from selling its products and instead needs to bring in more investors to support itself. Nothing could be further from the truth in our business. As detailed in our SEC filings, monthly recurring revenue per cabinet is in excess of Rmb 10,000 and has been for the past 9 quarters. Those familiar with the industry and our company would recognize this price point as capable of generating significant cash flow given the costs typically associated with planning, building and operating a cabinet. And those who have come to visit our facilities will see evidence of the recurring nature of our hosting revenue in the form of the substantial equipment being housed in our customer's rented cabinets.

In the report it states that we are overstating financials, utilization and operating figures, have committed securities and financial fraud, and are technically insolvent. We categorically deny these accusations and stand by all the figures previously issued by the Company in our earnings reports. Furthermore, 21Vianet has consistently maintained strong financial and legal controls and is audited by a leading global accounting firm, represented by a leading global law firm, and its IPO and subsequent coverage has been handled by several leading global investment banking firms. In addition, we have also had tremendous amount of due diligence conducted with several of our international partners who spend months combing through financials, interviewing various team members and inspecting all of our facilities throughout China. We welcome any investor to review our financials, visit any of our facilities or speak with us and our partners to gain further insight and understanding into our large and expanding platform of services targeting enterprises in China.

We understand that investors expect adequate and sufficient transparency when making meaningful investments into companies and we do the utmost to provide all of you, our investors, as much transparency as possible into our business on a regular basis to help you make intelligent and informed investment decisions. Due to the hyper-competitive business environment in China, often we need to make disclosure decisions that balance our business growth prospects, with our partners, with the government, with our competitors (who are sometimes partners) and with our investors. Such complexity often results in not being able to discuss as much detail as we would like to with our investors, but we still certainly provide as much as we can without negatively impacting our business operations and growth prospects.

With that, I would like to begin with the discussion to address the accusations in the report, on our core business, the **IDC business' growth and utilization metrics**.

The allegations question the growth of the data center market in China as well as the correlation between cabinet growth and utilization, stating that future cabinet growth should see larger decreases in utilization. This demonstrates that authors of the report failed to understand the macro dynamics, the definitions of our key reporting metrics and the basic mathematical relationship in its calculations used to support its allegations.

First, in regards to general market dynamics in China, per the leading third party global research firm, IDC, the demand for data center services throughout China is far from flat-lining. In IDC's most recent reports, it estimates that the data center market will grow from US$2.7 billion in 2014 to over US$3.4 billion in 2015. This is a 28% year over year growth rate with the market **doubling** to almost US$6bln by 2017. This is far from being stagnant.

Second, the company never discloses data center level information on our official website for competitive reasons, so we strongly question the legitimacy of the source of these data shown in the report. It is unclear how the authors of the report had obtained these figures and they are very inconsistent with our audited actual numbers. If not entirely fabricated, these data used in the report appeared to be at least grossly out of date.

Third, regarding the correlation between cabinet growth and utilization, there are many errors in the report. Beginning with our 82 data centers, of which 67 are partnered and 15 are self-built versus their use of only 72 data centers. The fact that the report failed to include 10 data centers has resulted in the difference between our reported total number of cabinets, utilization rates and those that clearly have been miscalculated in the report. Additionally, many of the details included in their channel checks regarding the numbers of cabinets were off considerably including the Beijing B28 data center which had over 1,900 cabinets with 1880 cabinets billable as compared to their own estimate of 1,400 cabinets and with 1350 cabinets billable. This clearly leads one to believe that their "inside sources" were guestimating and not providing accurate numbers used in their analysis. One point to reiterate here as well is that in our smaller partnered data centers, we typically only sign 1 year contracts depending on our estimated needs in a coming year. These estimates change yearly, as do clients needs from a bandwidth perspective, geographic perspective as well as strategic perspective. We see this often when clients will want to consolidate their cabinet footprint and simply reduce their footprint for various reasons or sometimes shift their focus to other areas. So we will have some volatility with our partnered datacenters, but it is for these obvious reasons.

Next, regarding utilization rates, these are calculated using a weighted average formula based on time of deployment for cabinets during the quarter. Cabinets that are deployed earlier in the quarter receive a larger weighting because they are utilized for a longer period of time than cabinets that are deployed later in the quarter. As a result, previously deployed cabinets serve as a base with a large weighting in the utilization calculation, and incremental additions to cabinets will not affect the utilization calculation as dramatically since the base is also increasing. Near the end of the 2nd quarter of 2012, about 1,900 new cabinets were deployed. By the end of 3rd quarter 2012, only about 25% of those newly deployed cabinets were utilized, thus bringing the total weighted average utilization rate for the quarter down quite significantly. This represented the large sequential decline in utilization rate from 2nd quarter 2012 to 3rd quarter 2012.

However, utilization rates from 4th quarter 2012 to 3rd quarter 2013 steadily increased, even while new cabinets were being deployed. This showed the strong demand for new cabinets among our customers as they were being ramped up and utilized at a fast pace. From 3rd quarter 2013 to 2nd quarter 2014, utilization stayed relatively stable. During this period, new cabinets were still being deployed, but they were being ramped up and utilized at a slightly slower pace.

Finally, to address the concerns about future cabinet growth leading to a larger decrease in utilization, the reason we remain confident in maintaining stable utilization is a result of the pre-selling we have accomplished so far. Of the approximately 7,000 cabinets set to deploy in the 2nd half of 2014, about half will be deployed in the Beijing area where utilization rates and MRR per cabinet are the highest, thus helping boost our utilization rates.

Moving on to the second core argument, which includes inaccurate reporting on our cashflow statements, financing rounds, as well as old and new acquisitions. We firmly believe that the use of our cash and cashflow to fund both organic and non-organic expansion is key to growing in new areas where we can leverage our 2,000+ enterprise customers with related services they are demanding from us.

To being with, the false allegation that, and I quote, "VNET is technically insolvent" is quite far reaching. The report provided no substantiated nor quantifiable evidence of this allegation. Neither did the report provide any proof that we have falsified our financial statements. On the contrary, based on most recent audited reports, our Company remains in good standing with strong financial fundamentals. For our balance sheet, we have over RMB 3.2 billion in cash and cash equivalents. Addressing the adequacy of our balance sheet for funding our future growth needs, we believe we can complete our expansion based on our existing cash on hand and traditional project financing options available from commercial banks to fund our existing expansion plans.

Another key accusation was in regards to our balance sheet, more specifically the account receivable. The report simply looked at the relative rate of increase of our revenue and account receivable in the last several quarters and quickly jumped to the conclusion that our revenues must have deteriorated or have been fabricated. Actually, it was this report has fabricated a conclusion without understanding the basic drivers. As many of you who have covered us for a while are aware, the primary reason for account receivable increase was due to loosening our financing terms due to competition being more accommodative. Due to the transition from business tax system to value added tax system in China and the fact that the telecom industry was one of the last to change due to the government's implementation plan, quite some of our customers have delayed cash payments to us and intended to wait until we could issue VAT invoices in order to minimize their net VAT liabilities. That situation has gradually improved with the official transition by Telecom industry into Value Added Tax system which started in early June. In fact, we have received over 150mm RMB in delayed cash payments by our customers, mostly around late August, which should meaningfully improve our account receivable situation in 3Q and more so in 4Q.

Now looking at acquisitions. Again, there are numerous mistakes, incorrect correlations and some fabrications all contained in this analysis. For example, in the last 5 years, we have completed 7 material acquisitions each with RMB 70m and above in purchase consideration, not 24 as suggested by the report. The report has simply counted the same acquisition multiple times mistakenly or intentionally. In the example of the acquisition of the Managed Network Entities, the report counted it as 4 separate acquisitions, while in reality there was just one acquisition with four corporate entities.

In general, our acquisition strategy, since the beginning, has been to acquire companies that enable us to help move China's telecommunication network in a direction that resembles the more advanced networks in developed countries. Despite our desire to acquire high quality data center assets, we have also learned to be pragmatic in a still highly regulated market where it is difficult to acquire such assets given the concentration of fewer than 10 IDC players with nationwide IDC licenses in China. This expansion strategy is built around our core IDC business. The first step in expanding our strategy was to turn gateway access to the IP backbone in China from a traditional cost center for IDCs into a profit center; this was the rationale behind acquiring the Managed Network Entities several years ago. This enabled us to generate additional revenue by directly selling backbone access to our enterprise customers. Fastweb and iJoy businesses allowed us to offer CDN services to these same enterprises. The second step is to expand our broadband ecosystem with open or free peering over our network through companies like Aipu that offers direct access to last mile markets, or the Dermott acquisition that enables us to become a VPN market leader immediately. The third stage will be to enable interconnection services similar to developed markets for our enterprise clients. We are not there yet, but hope to be able to offer that at some point in the near future. At the end of the day, each acquisition has a clear objective to further expand our comprehensive portfolio of service offerings, as we increasingly become one of the leading integrated internet infrastructure companies in China. Our clear and stated goal since going public.

Getting into more specifics in the report, we would like to further discuss each of the accusations regarding our acquisitions more specifically.

Beginning with our Managed Network Entities acquisition, this was one company with several subsidiaries. A very traditional business structure for most businesses that we acquired at 6 times 2011 forecasted net profit which included traditional earnouts based on meeting specific performance bogies. As mentioned above, this allowed us to turn a traditional cost center into a profit center by directly connecting our enterprise customers to China's backbone and provide us cheaper access via the increase in bandwidth volume which reduced the unit bulk cost for our IP traffic.

In sticking with the gateway connection strategy, the report asserts that we operate illegally when in actuality our nationwide IDC, ISP and VPN licenses allow us to legally operate. To provide more color on this, MIIT does an annual inspection on all license holders including SOEs that operate in this space. We all need to pass this inspection on a regular basis to maintain our licenses which we have never had any problems with. Now discussing the "Blacklisting" by China Telecom. It was initially done approximately 4 years ago and includes almost all companies that offer bandwidth sales to enterprise customers. Being on the "Blacklist" does not make us an "illegal operator" as stipulated in the report since China Telecom is not a regulator. As we've stated many times in the past, China Telecom is a close partner and competitor on many different levels.

Lastly on the Managed Network Services, we understand the concern associated with the slowdown in growth for this business. We recognize it and have been very transparent with the investment community regarding this. As we've mentioned before and will reiterate here, there has been industry wide pressure to reduce broadband costs over the past year, as such, all providers have seen revenue and margins become compressed since then and we believe that we will see approximately 5% year-over-year growth in this business heading into 2015.

Moving on to our more recent acquisitions for iJoy, we purchased iJoy in April 2013 for a total consideration of approximately 96.8 million RMB. They generated approximately 56 million RMB in Sales during 2013 making the acquisition price just shy of 2x 2013 Sales, not the approximately 120 million RMB as stated in the report.

iJoy has been relatively low profile due to the nature of this subsidiary. The offices listed in the report are correct, but the number of employees was off. In that physical office we have approximately 30 to 40 employees versus the 10 cited, more importantly, we have an additional 30 employees that are regularly working out of our partners offices for greater efficiency reasons. In this entity, we offer some local cloud services via iJoy's cloud and CDN business and we also purchase some of our telecom resources through this entity as well. These numbers are disclosed in our consolidated financials, but we have not found it material enough to highlight yet in our quarterly earnings. We believe this is similar to many companies expanding into new businesses and waiting to see traction before highlighting it with the investment community. Regarding the speculation around Mr. Yang Peng, he is a highly respected telecom industry expert and met Josh just under 2 years ago. Josh immediately believed that Yang's company would be able to help 21Vianet expand its nascent cloud business back then and decided to ask Yang to join 21Vianet's family of services and products.

Discussing our AIPU acquisition, in our press release from June 2014, we highlighted our key rationale to the acquisition: " The extension into selected regional last-mile access networks highlights an important component of our long term vision to create an open and seamless network ecosystem. " We firmly believe that this will further enable the transfer of IP traffic over our ecosystem, allowing us to further reduce our bulk bandwidth costs and generate additional revenue.

Whereas in our DYX acquisition, the press release last month, we stated that " The Dermot Entities' VPN business has a unique network footprint and offers best-in-class, fully-managed network enabling connectivity to major Asian cities. " This clearly remains aligned with our long term mission statement of: "Building the next generation of Internet Infrastructure being more open, innovative and dynamic. "

Our current ecosystem comprises of (a) wholly-owned or in partnership data-centers that serves our 2,000+ loyal customers; comprising of the most prominent Internet brands in China; and (b) NMS that provides traffic connectivity to China Telecom and China Unicom as well as many other Tier 2/3 ISPs in China.

Reaching the end-users consumers and business users via the acquisitions of AIPU and DYX would close the loop on the Internet infrastructure value chain. By opening up the last-mile access networks and capability to others, 21Vianet to establish an open ecosystem of third party ISPs serving consumers and businesses and taking another step in realizing our long-term vision in China.

With that, we plan to aggressively pursue every possible legal action against the authors in both the US and China. We firmly believe their misrepresentation of facts, fabricated evidence, unsupported speculation and malicious interpretations only have created short term trading opportunities but over the long term our strong value proposition and execution capabilities will prevail. We realize this is a lot of information, but we appreciate your patience and interest in getting to better understand 21Vianet and our vision for the future of the telecommunication industry in China.