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PRESENTATION

Operator

Good morning and good evening, ladies and gentlemen. Thank you, and welcome to the 21Vianet Group's First Quarter 2020 Earnings Conference Call. With us today are Mr. Alvin Wang, Chief Executive Officer and President; Ms. Sharon Liu, Chief Financial Officer; and Mr. Rene Jiang, Investor Relations Director of the company. Now I'll 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 first quarter 2020 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 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.

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 on our earnings call today.

First and foremost, all of us here at Vianet hope that you and your loved ones are staying safe and healthy. While both the IDC industry and our company continue to grow in the period, we are acutely aware of the pandemic's toll on society. Even so, we also saw some of the best in humanity as medical workers, grocery store workers, police officers and our own employees came together in support of their communities. On behalf of the company, I would like to say a special thank you to all those fighting against the virus on the front lines. Now this continue to be a source of inspiration, we are all truly grateful.

In the first quarter of 2020, we grew our revenues to RMB 1.091 billion and adjusted EBITDA to RMB 259 million, meeting both of our previous guidance release. Meanwhile, EBITDA margin declined to 23.8% due to our continuous expansion of IDC capacity. During the quarter, we added over 3,300 cabinets to our locations in Shanghai and Jiangsu provinces, which brought our total cabinet capacity to 39,646 by quarter end. This solid performance was a product of our effective execution during the crisis, which enabled us to maintain our construction and cabinet delivery schedules.

In regard to market conditions, China's IDC industry continued to grow at a good pace in the first quarter despite the uncertainty brought about by the outbreak of COVID-19. While the pandemic caused a momentary pause in construction, social distancing policies around the country, have begun loosening in the second quarter. And the demand for IDC services remains strong. Furthermore, IDC, data centers are increasingly recognized as an important component of China's digital transformation. The government has begun taking a more supportive stance towards their development. We expect that the ongoing movement towards corporate digitalization as well as deployment of 5G will continue to help drive industry expansion over the long term.

For our retail IDC services, which includes connectivity and other value-added services, customer demand was remarkably resilient during the quarter as various industries shifted to work-from-home arrangements during the quarantine period. We also saw a robust number of orders across certain verticals, namely online education, online gaming and entertainment and software as a service. Meanwhile, due to the lockdown period and the social distancing policies, certain verticals experienced a slower quarter while the demand are now moving from other verticals, although relatively removed from the pandemic impact. Some business had modest delay as a result of holiday extension and remote work measures. As of now, we are monitoring the situation attentively and remain in close contact with our business partners, customers as the pandemic development becomes more positive in the second quarter. We expect that the demand for retail IDC solutions will maintain its healthy growth trajectory.

On the wholesale front, we continue to cement our relationships with large-scale enterprises while proactively engaging with our partners during the pandemic to fortify our market leadership. These clients are attracted by national coverage of our pipeline resources. The quality of our hybrid scale IDC services and our ability to help augment their operating efficiencies.

In May 2020, we signed 2 MOUs with a leading Chinese Internet company to provide colocation services in both the North and Eastern part of China based on our existing resources. Going forward, we plan to complete construction in stages during 2020 and 2021.

In summary, we remain committed to generating value for both clients and shareholders. The essential nature of our services, commitment to protecting employees safety and the ability to maintain operations when part of our staff worked from home, allowed us to prosper in the face of the global pandemic. Based on the stability and the growth of industry demand as well as price recovery in the post-pandemic period, we remain confident in our prospects going forward.

Now I would like to hand 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, 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 on a year-over-year basis unless otherwise stated.

In an uncertain macro environment, we concluded the first quarter with strong financial results, improved our operating efficiency and kept our construction and cabinet delivery schedules on track. Notably, in the first quarter, our revenue reached the high end of our previous guidance range, while our adjusted EBITDA was around the midpoint of our previous range.

Revenue in the first quarter increased by 25.1% to CNY 1.09 billion from CNY 871.9 million in the same period of 2019. Such growth was mainly due to the industry's healthy trajectory which is being driven by the ongoing trend of corporate digitalization across China. It was also partially due to an uptick in IDC demand from retail customers resulting from certain industry tailwinds that emerged during the pandemic.

Retail IDC MRR per cabinet in the first quarter decreased slightly to CNY 8,747 from CNY 8,788 in the same period of 2019. We net added 3,355 cabinets during the first quarter of 2020. As of March 31, 2020, we operated and managed 39,646 cabinets.

Compound utilization rate in the first quarter was 60.4% compared to 65.6% in the fourth quarter of 2019, which was mainly due to our continued delivery of additional cabinets in the period. More specifically, our utilization rate for those mature IDCs delivered prior to 2019 improved to 72.3% in the first quarter of 2020 compared to 71.8% in the fourth quarter of 2019. At the same time, our utilization rate for those newly built and ramped up IDCs delivered since 2019 improved to 12.3% compared to 8.6% in the fourth quarter of 2019.

Adjusted cash gross profit in the first quarter, which excludes depreciation, amortization and share-based compensation expenses, was

CNY 417.1 million compared to CNY 406.7 million in the same period of 2019. Adjusted cash gross margin was 38.2% compared to 46.6% in the same period of 2019. The decline in margin on a yearly basis was due to the delivery of additional IDC capacity.

Adjusted operating expenses in the first quarter, which excludes share-based compensation expenses and impairment of receivables from equity investees, increased to CNY 177.8 million from CNY 171.3 million in the first period of 2019. As a percentage of net revenues, adjusted operating expenses decreased to 16.3% from 19.6% in the same period of 2019. Adjusted EBITDA in the first quarter grew by 2.3% to CNY 259.4 million from CNY 253.5 million in the same period of 2019. Adjusted EBITDA margin decreased to 23.8% from 29.1% in the same period of 2019 due to the delivery of additional capacity.

Net loss attributable to ordinary shares in the first quarter was CNY 138.8 million. Basic and diluted losses were CNY 0.18 per ordinary share and CNY 1.08 per ADS, respectively. Each ADS represents 6 ordinary shares.

Moving on to our balance sheet and liquidity. At the end of this first quarter, our debt to asset ratio was 66.8%, and our debt to adjusted EBITDA ratio was 4.2. Net cash generated from operating activity was CNY 58.7 million in the first quarter. As of March 31, 2020, we reported a cash position of CNY 3.49 billion. Going forward, we plan to maintain a healthy balance sheet as a means of maximizing our ability to capture potential growth opportunities and future expand our services in key markets.

In order to support the company's organic growth and meet its delivery target of 15,000 cabinets, we are planning for CapEx to be between RMB 2.4 billion and RMB 2.8 billion in 2020, which is in line with our 3-year growth plan.

Looking forward, we expect net revenue for the second quarter of 2020 to be in the range of CNY 1.14 billion to CNY 1.16 billion and adjusted EBITDA to be in the range of CNY 290 million to CNY 310 million. For the full year of 2020, we now expect net revenue to be in the range of CNY 4.6 billion to CNY 4.8 billion, and adjusted EBITDA to be in the range of a CNY 1.25 billion to CNY 1.35 billion. This forecast reflects our current and preliminary views on the market and operational conditions, which are subject to change and do not factor in any of the potential impact that could be caused by the COVID-19 epidemic (sic) [pandemic] in the future.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first telephone question is from Edison Lee from Jefferies Hong Kong.

Yu Sang Lee *Jefferies LLC, Research Division - Equity Analyst*

So first of all, congratulations on a very strong revenue growth in the first quarter. I have 2 questions. Number one is I would like to know -- because one of your peers actually told investors that power cost was actually a little bit lower than expected in the first quarter owing to some government support policy. So I would like to see whether Vianet also saw something like that. And whether you expect some more government policy on power cost in the rest of the year can emerge to actually help lower the cost for you guys. So that's question number one. Question number two is that I would like to just clarify as to your capacity growth in the first quarter, the 3,300 cabinets, whether it includes any wholesale in that number. And if it does, how much is that?

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

Thank you, Edison. I will take your question on the capacity as well as the power cost. Actually, our power cost represents around 15% to 18% of our total revenue in our IDC business. We see that power cost is stable during Q1. Of course, per government's policy when the data center matured, we can apply for the reduce of the power capacity commitment. That will help us to reduce the power cost, but the amount is not so significant. Regarding to your questions related to our capacity delivered in Q1. Actually, we have delivered 2 data centers, one is the wholesale data centers in Jiangsu campus. So it's around 1,000 high-power density cabinet. So company will start to recognize wholesale revenue and EBITDA from Q2.

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

Edison, this is Alvin. I will add a few words regarding your first question. Actually, we do see some favorable policy from government regarding to optimize our power cost. But it's -- that policy will be temporary through just a few months, and we will -- will apply to some of our data center across our data center network. So the impact is positive, but it will be temporary, and it will be a marginal impact.

Yu Sang Lee ***Jefferies LLC, Research Division - Equity Analyst***

If I can also follow-up on the power cost, how much of your power arrangement is actually based on direct power purchase?

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

Welcome. Almost all the power were purchased from the government.

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

[So stage 3].

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

Yes.

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

From north, from south, [stage 3].

Operator

Next telephone question is from Yang Liu from Morgan Stanley.

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

I have 2 questions. The first one, management mentioned that you signed 2 MOUs with one Internet company. Could you please share more detail on that. Size or is it a public cloud or is it a customer or what's this vertical, particularly in? Is it a wholesale or retail customer? The second one is -- could management share your thoughts on the public rate policy issued by CSRC and NDRC. And what is Vianet's plan to leverage that kind of rate policy in the future?

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

Okay. Thank you, Liu Yang, for your questions. I will address your first question. That as you mentioned, we already signed 2 MOU with a leading Chinese Internet player which is our existing customer already. These 2 projects are wholesale projects and also that we expect the first project will be delivered within this year. And the second will deliver in different phases in the second year and in the following years. And actually, it's 2 projects, quite another milestone for us to enhance our cooperation with leading customers, especially from wholesale side. And acknowledge, if we combine all the MOU together with wholesale customers, we have accumulated 90 megawatts contracts already.

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

Yang, regarding to your question on public rate. We noticed that on April 30, NDRC and CSRC joined -- announced pilot program on the infrastructure-related public rate. As the Chinese government has included data centers in a new infrastructure scope, mature data center assets generating stable cash flows are the suitable assets for rate. According to resources we've talked to, the issuers should have the ownership of the IDC land and property and the government likes diversified customer base in the data center. 21Vianet, we have qualified data center assets for public rate, and we believe this will be an alternative funding channels for our mature data centers. We'll keep continuing to focus on the progress because the document announced is only a consultation version. We will reach toward the final version and more clear policy. Thank you.

Operator

Our next telephone question is from Tina Hou from Goldman Sachs.

Tina Hou ***Goldman Sachs Group Inc., Research Division - Equity Analyst***

I have 2 questions. The first one is that, so far, have you seen any supportive policies coming out from government on data center as the new infrastructure area. Has there been any new capacities coming into the market, either in Tier 1 places or the Tier 1 adjacent markets such as Jiangsu? And then related to that, have you seen the competition being up to some extent? And is it getting easier or more difficult to acquire the land and electricity resources? So that's number one. And in terms of the second question, also on the MOUs that you signed recently with a wholesale customer, could you share more details on what kind of size? And then specifically which quarter of this year, can you see the MOU to start generate revenue, please?

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

Thank you, Tina. Thanks for your questions. Regarding your first question, there's very strong support from the government regarding the data center in China, we do see that local authorities from different provinces have issued policies to support -- or to encourage more investments in data center and so-called new infrastructure for the country. And we expected that -- including ourselves, that we can get more kind of land and property and also power supply for high-tier data center or data center campus in different locations. And at the same time, I would say that this is a very competitive market landscape. As you require very strong customer relationship and also require very strong on your competence, especially with your engineering, technology, capital and, of course, cost control, et cetera. So we do see that we have positioned ourselves well around in the coming years to acquire more resources to serve our customers with their increasing demand. Regarding your second question, as I mentioned before that we signed 2 contracts with our existing customers and at least 2 wholesale projects, a very typical project-based leading customer and also the 1 in Beijing, actually. We expect it will deliver at early Q3 this year and also the second -- another even bigger 1 will be in the central part of China, and that delivery will be the second quarter next year. And also it will be -- have expansion in the following quarters. Thank you.

Operator

(Operator Instructions) Our next telephone question is from Zhenyang Chen from CICC.

Xin Yang ***China International Capital Corporation Limited, Research Division - Analyst***

This is Xin Yang from CICC. I have 2 questions. First one is about our future expansion plans. We noticed that Shanghai government has announced to increase another 15,000 rep quota, and would we have any adjustment accordingly on our IDC portfolio expansion? And how do we expect any other supporting policies in the future? And then my second question is about our customers from the cloud computing. And we noticed that cloud computing has very strong demand on the IDC industry. And for example, BABA, has announced about CNY 200 billion investment. And how would we adjust our future strategies accordingly to meet the hybrid scale customer demand?

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

Okay. It's -- Xin Yang, thank you for your questions. That's -- regarding your first question that's -- we do notice that very strong supporting quality from different local governments, especially Shanghai has very clear announcements already. And actually, we do prioritize Shanghai as one of our top markets. And we do have big projects in the pipeline to apply the power culture in the next batch of approval. And we expect that the approval of projects will be completed in the coming quarters. And we are confident that we can get the strong support from the local authority based on our very strong experience and the very strong capacity plant in Shanghai as well. And also that we -- at the same time, as we expect our capacity, not only in Shanghai, but also in the second tier cities close to Shanghai as well. We do have Jiangsu campus 1 and 2, and we expect we will have further expansion in the surrounding areas as well. And regarding your second question, for the cloud computing, we do see that the strong demand from cloud customers already in the first quarter. And we have very strong engagements with all the leading ones, namely Ali, Tencent, Huawei, and Kingsoft and Jingdong as well. So we expect that we will increase our cooperation with all these leading public cloud players and the public clouds will represent a very big growth driver for our business in the coming years. Thank you.

Operator

Our next telephone question is from Jon Atkin from RBC.

Jonathan Atkin ***RBC Capital Markets, Research Division - MD and Senior Analyst***

I wanted to ask a question about the evolution of cloud demand, public cloud and any trends that you can talk about with respect to enterprise migration from co-location to public cloud, hybrid cloud deployments. And is there anything that you're noticing in your business, or more broadly with respect to cloud migration or hybrid cloud adoption?

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

So -- thank you, Jon, it's -- for your question, it's a very broad question and very strategic question. So we do see very strong kind of business demand from public cloud's customers. And at the same time, that we see many of them have very huge plan, which means that in the coming years that public clouds will have very strong demand for IDC players, including us. And at the same time, we also see some of our own IDC customers, they have strong demand on hybrid cloud, which means that they -- along their developments, they will deploy their business not only on the public cloud but also on hosting as well. And based on our very close cooperation with public cloud players, we can provide the cutting-edge and also very competitive for hybrid cloud solutions to customers. We see that as one of our major competitive advantage compared to other players. Thank you.

Operator

(Operator Instructions) There are no further questions at this time. I'd like to hand the call back to the speakers for closing remarks. Please go ahead.

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

Thank you, again, for joining us today. If you have any further questions, please feel free to contact the company's IR. Thank you.

Operator

Ladies and gentlemen, that does conclude the call for today. You may all disconnect. Have a great day. Bye.