

ChinaCache 1Q14 Earnings Call

Friday, 16th May 2014

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Conference Code: 33944234

Company: NASDAQ OMX

Operator: Hello and thank you for standing by for ChinaCache First Quarter 2014 Earnings conference call. At this time all participants are in a listen-only mode. After management's prepared remarks, there'll be a question and answer session. Today's conference call is being recorded. If you have any objections, you may disconnect at this time.

Now I would like to transfer the call to Ms Edith Kwan, Investor Relations Director of ChinaCache. Ms Kwan, please proceed.

Edith Kwan: Hello everyone and welcome to ChinaCache First Quarter 2014 Earnings conference call. We distributed our earnings release earlier today. If you have not received a copy, you can find it in the Investor Relations section of our website.

Today you will hear from Mr Song Wang, Founder, Chairman and Chief Executive Officer of ChinaCache; Dr Ken Zhang, President of ChinaCache; and Ms Jing An, Acting CFO of ChinaCache. There will be a question and answer session following management's prepared remarks.

Before we proceed, please note that today's discussion will contain forward-looking statements made under the Safe Harbor provisions of the US Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our current expectations. Potential risks and uncertainties include but are not limited to those outlined in our public filings with the SEC. ChinaCache does not undertake any obligation to update any forward-looking statements except as required under applicable law.

Our earnings press release and this call includes discussion of certain unaudited non-GAAP financial measures. Our press release contains a reconciliation of the unaudited non-GAAP measures to the most directly comparable unaudited GAAP measures and is available on our IR

website. As a reminder, this conference call will be recorded. In addition, a live and archived webcast of the conference call will be available on our IR website.

I will now turn the call over to our CEO Mr Wang who will make his remarks in Chinese, and then I will provide an English translation.

Song Wang: [Mandarin, 00.02.10–00.02.16]

Edith Kwan: Good morning everyone. Thank you for joining us to discuss our first quarter results.

Song Wang: [Mandarin, 00.02.23–00.03.10]

Edith Kwan: I am very pleased to report another very successful quarter. With the continuous growth of our business, simplified organisation structure and improved efficiency, we had a very good start to 2014. We are happy to achieve financial and operating breakeven in the first quarter, thanks to all our employees and management team who made it happen. I have great confidence that ChinaCache is well positioned to build upon this momentum to take our company to the next level.

Our net revenue for the first quarter exceeded the top end of our guidance, reaching RMB323.9 million and representing a 40.4% year-over-year increase, adjusted net income in the first quarter reaching RMB2.7 million in the first quarter. Additionally, our customer base is growing at a healthy pace.

Song Wang: [Mandarin, 00.04.06–00.04.48]

Edith Kwan: Today I want to focus my remarks on the two big achievements in the first quarter: first, our strategic partnership with China Telecom to build and manage a content delivery network and second, we have entered a whole new business area. We were pleased to announce in April that we have signed a framework agreement with People.cn relating to the development of the Cloud infrastructure to meet their rapidly growing Cloud computing and storage needs. We are very pleased with these two agreements and we are confident it will be very beneficial for each party. First, let's review our China Telecom partnership.

Song Wang: [Mandarin, 00.05.28–00.06.07]

Edith Kwan: As we announced in late March, ChinaCache and China Telecom will jointly build out and manage a CDN platform that combines China Telecom's extensive network resources and vast experience regarding CDN technologies and services, including, technical support and customer services. China Telecom is world's largest wireline telecommunication, CDMA mobile network and broadband Internet service provider with more than 100 million broadband subscribers. They account for more than 50% of broadband traffic across China and are the largest Internet infrastructure provider.

Song Wang: [Mandarin, 00.06.49–00.07.41]

Edith Kwan: China Telecom sees the need for a stronger content delivery capability to handle large data flow and heavy traffic load content as there is rapid shift in demand from voice transmission to data transmission. To China Telecom, our CDN can help them to strengthen network efficiency and enable their ability to provide more Internet-related value-added services to their customers. Also, CDN can enhance their ability to support large data transmission and facilitate the development of mobile Internet business. Their large customers

including traditional enterprises, media companies, Internet commerce firms and government agencies require faster response time, higher level of reliability and security as well as total network solutions. This is precisely what ChinaCache is able to provide.

Song Wang: [Mandarin, 00.08.38–00.09.12]

Edith Kwan: The core products we are providing include webpage content acceleration, file transfer, rich media delivery as well as value added services like security. We also provide mobile acceleration solutions in support of the 3G and 4G network.

There are many significant benefits of this partnership to ChinaCache. First, we can fully leverage China Telecom's superior performing broadband network.

Song Wang: [Mandarin, 00.09.41–00.10.38]

Edith Kwan: Second, we can leverage China Telecom's large enterprise sales team to jointly promote the CDN network. Their team has developed mature channels and networks covering a broad base of installed customers and they are known for having the largest group of government and enterprise customers in China. This will further increase the CDN penetration across the country, particularly among the Internet enterprise, traditional enterprise and government and media customer segments. In addition, for enterprise and government customers, because we typically bundle our services and disconnect bandwidth cost in our packages, we can get economy of scale and significant higher margin compared with traditional CDN pricing methods.

Song Wang: [Mandarin, 00.11.30-00.12.01]

Edith Kwan: I'm pleased to say that the partnership is already underway and making significant progress. In the few weeks since the partnership was announced, we have completed the training programme for 500 of sales representatives for China Telecom's sales teams in Guangdong, Shanghai, Beijing and Zhejiang Province. This includes areas with the highest concentration of large enterprise customers. Looking forward, we believe this partnership will lead to additional collaboration between the two companies for a series of value-added services, including Big Data, mobile Internet and Cloud computing.

Song Wang: Okay. [Mandarin, 00.12.45–00.13.54]

Edith Kwan: Now let's discuss our framework agreement with People.cn. We can see the rapid growth of Internet business in recent years and with the quick emergence of Cloud computing, there is huge demand in China for Cloud data centres. But in China, more than 80% of the data centres are provided by carriers and 99% of data centres in China could only be rented. Therefore, China's data centres cannot meet the customers' requirements in an efficient manner. In recent years, the Internet giants in the US are moving to build their own data centres. This triggers a demand by sizable companies in China to do the same.

We realise there could be a huge market potential and opportunity in this area. Therefore, we converted the purpose of the land we bought last year which was intended for our own use. Instead, we are now using it to service our customers. To do this, we are helping our customers to build their own data centres. We have established a dedicated team for marketing and operations to support our business in building customised data centres for customers.

Song Wang: [Mandarin, 00.15.12–00.16.04]

Edith Kwan: Our business model is that first we have already obtained 35,000 square metres of land in Beijing Tianzhu free trade zone. During stage one, a total of three customised data centres will be put up for sale. The target customers are those super-large traditional and Internet enterprises as we find that these big companies are considering building their own data centres. Thus our service provides these companies with an effective alternative. At the same time we are tapping into a new market by providing solutions for those companies that no one else is offering. People.cn is our first customer and they already disclosed that they intend to pay ChinaCache RMB650 million for their own customised data centre. It will be put into service after one year. Upon the construction completion, ChinaCache will continue to provide support and service for the data centre building, including operations and management, as well as our leading CDN solutions and interconnection network support.

Song Wang: [Mandarin, 00.17.18–00.18.01]

Edith Kwan: ChinaCache's Atecsys data centre infrastructure includes three stages. In addition to the three customised data centres in stage one, there will be three buildings each in phase two and phase three. Combined, we have supplied 80,000 square metres of floor area. The total value of the output including managed service income will exceed RMB4 billion in five years. Our first customer, People.cn, has prepaid RMB225 million for the cost to construct the data centre which minimise any impact on ChinaCache cash growth during the construction phase. Upon the completion of the data centre, the ownership will then transfer to the customer. The customer will continue to enjoy long-term Internet solutions and other services from ChinaCache.

Song Wang: [Mandarin, 00.19.01–00.19.27]

Edith Kwan: People.cn has been our long-term customer. They are a large-scale information interaction platform constructed by *People's Daily* and is also one of the world's largest comprehensive Internet media on the Internet with a market cap of RMB20 billion. The agreement with People.cn is representative of our innovative business model for extending our business in Cloud computing. There are a number of advantages to ChinaCache in our approach to this opportunity.

Song Wang: [Mandarin, 00.20.03–00.21.06]

Edith Kwan: People.cn is experiencing rapidly growing demand for Cloud services due to the greater availability of broadband in China and the rapid expansion of mobile Internet use. In this environment, traditional data networks are experiencing bottlenecks as a result of the increased demand. People.cn, like many enterprises in China, would like to build a high capacity and customised data centre. However, there are obstacles to doing this.

First, it will require significant time and investment to gain the resources needed to build and manage the facility, and second, finding an appropriate land in a tier one city in China in a location with sufficient power supply to support data centres would be a significant challenge. People.cn through cooperation with us will be the first large enterprise in China to have its own customised data centre like those companies in the US. With the land value appreciation every year in China, this investment will reduce our customers' long-term investment in the Cloud infrastructure. According to our estimation, the savings on long-term co-location and operation cost a customer may enjoy could be up to 50% over a 20-year period.

Song Wang: [Mandarin, 00.22.34–00.23.36]

Edith Kwan: Through this programme ChinaCache can help our local and overseas customers to leverage huge advantage. Firstly, the land in use for data centre is located in Beijing Comprehensive Free Trade Zone. The advantage of having data centres in a free trade zone is that our customers have access to tax refunds and exemptions for all the equipment they purchase, whether imported or from local suppliers. The percentage is around 15% to 17%. For international companies, this could offset the extra cost of moving data centres to China. Second, for international companies, if they want to move data centres to China the free trade zone is an ideal option. It is also a good option for those Chinese companies who conduct international ecommerce business as they can operate under a friendly customs policy. Third, after ChinaCache sells the data centre we can continue to supply managed service and other value-added services to the data centre. This provides us an additional income stream and this cooperation also further solidifies our customer relationship.

Song Wang: [Mandarin, 00.24.55–00.26.10]

Edith Kwan: The overseas market already has a mature ecosystem from digital real estate to managed data centre business and to Cloud computing with different players in each sector. But in China there is only simple businesses like equipment cabinet leasing. Therefore, our innovative business model is created to address infrastructure difference between China and other countries.

First, with the rise of Cloud technology there will be more of our customers' desire to own rather than to rent as the data centre is seen to be a strategic resource of the company. Second, there is currently a shortage of Cloud infrastructure. The development of Cloud infrastructure can hardly meet the market demand which creates bottlenecks for our customers. With our help, our customers can have their own data centre and can avoid a bottleneck.

Finally, there is widely variable network performance in China unlike overseas countries which are covered with efficient network. Thus, obtaining a location in tier one city with effective network resources to run a data centre is a relatively scarce resource. We are optimistic about the long-term value of the digital real estate. Once our customers own this data centre, they can avoid the long-term increase in operating cost while enjoying the advantage of a land premium.

Song Wang: [Mandarin, 00.27.43–00.28.16]

Edith Kwan: In addition to People.cn, our other large Internet customers can also benefit from this opportunity and we look forward to cooperating with them on developing proprietary data centres to meet their rapidly growing demand for Cloud computing in China.

I am pleased to report this meaningful business achievement in the beginning quarter of 2014. We will continue to drive our execution to deliver them. I will now turn the call over to our President, Ken, to discuss technology and operation in the first quarter. Ken, please?

Ken Zhang: Thank you Mr Wang. This first quarter was a strong quarter for us and that it shows we are staying focused on our execution and gradually improve our product offering. We believe we are on track to achieve growth and further success this year. In addition to the major achievements that Mr Wang just reported, I would like to run through our progress this quarter towards our two big strategic initiatives, expanding enterprise customers and

developing mobile Internet technology. I will also cover our growth drivers for the first quarter and our efficiency enhancement programme across the organisation.

The China Telecom CDN deal is a milestone in the company's business development. It demonstrates our CDN leadership in China. With this strategic partnership, we can further accelerate our business with enterprise segment. In term of enterprise customers, we have sequentially increased the number of enterprise customers by 7% with revenue from this sector growing by 5% in the first quarter 2014. It is obvious that companies in many industries are shifting from offline to online to build consumer awareness. For example, in automobile industry many companies are complementing their own websites now by working closer with Internet portal as they see the need to integrate online and offline marketing channels and to get better consumer efficiency.

Their digital integration initiative in addition to driving current sales are also actively focusing on data compilation and building a knowledge portal. Therefore our total network solution has become a more integral part of their online strategy. For finance industry in China some Internet giants have shake up the industry recently by promoting aggressively new opportunity in O2O financing, with a service that allows users to invest money stored online into a money market firm. Many traditional banks are facing new competition with this investment option in the market from Internet companies. Not just that, this online finance operation can use Big Data based on clients transaction activity which analyse clients' behaviour and characteristics and offer responsive finance service. This is a completely new trend that may overturn traditional business model entirely. Though the enterprise customers, especially banks, are in need of effective online presence and technology to help them compete effectively in the market, this trend quickly heats up the business opportunity for the demand of our one-stop network service across the finance portal, investment funds, security houses and the insurance companies.

We welcome to see more O2O trend across other industries like this as it will contribute more opportunity for us to provide services to the market to both electronic platforms as well as to the traditional enterprises. Meanwhile, for the enterprise customers, we are working towards to change traditional bandwidth pricing policy into platform pricing and solution pricing. This poses both opportunity and also challenge to us as it is a change of customer mindset and behaviour. With the continuous improvement in our internal system, it now helps us to have a more flexible pricing strategy. We can either have by PV, by click, by service fee or by platform fee.

We are continuously working towards this as we pave our way for the future mobile Internet business where there is no direct relationship to bandwidth cost. We are confident that with the ramp up of our mobile business will help to improve our margin in the longer term.

Next, let's talk more about mobile Internet. In early May, ChinaCache participated in the Global Mobile Internet Conference, one of the main events of mobile Internet in Asia and globally. During this conference, we officially launched and demonstrated our one-stop mobile Internet solution, the Mobile Content-aware Networks service, namely mCaN. Our solution is made up of three modules that are web and mobile application organisation, mobile SDK integration and the caching of radio-access network. Today we are pleased to announce that our mobile Internet solution is applicable for all industry including finance, social media, ecommerce, gaming and so on.

We deliver an optimised network performance through a wide spectrum product feature such as intelligent image compression, front-end optimisation, mobile protocol enhancement and the base station caching to create a seamless transmission from our ad server through the mobile network and all the way to end-user device. That includes handset, iPad and also home gateway like Wi-Fi access point and set-top boxes. Our initial trial results show that our solution can enhance mobile network speed up to 60%, reduce bandwidth usage up to 40% and then increase website service availability up to 15% during an unfavourable networking environment.

We are really pleased with this result and the level of execution of our business and product development. When you look at our growth, we have also made good progress in view of our major growth driver for the year, the video business. In the first quarter, we supported a live broadcast of Spring Festival Gala exclusively for CCTV, China Central TV station, with more than seven million viewers. This show has been a tradition for Chinese families to watch together on a Chinese New Year's Eve and is one of the most popular events of the year.

In March, we supported CCTV further for the live broadcast of the National Congress meeting with more than three million viewers, and again this is a spotlight event for the whole nation. In the second quarter, we are very excited to be selected to support the live broadcast of the World Cup for CCTV, and we will be exclusively helping to live broadcast this event across the country. We won a solid reputation by providing CDN support for all these nationwide important events. It is strong testament for our proven service and technology.

In terms of product enhancement on the video front, since the first quarter we have been able to handle user-generated content uploaded to our EDGE network. Also, we have provided value-added service to monitor live events in real time, including real-time analysis for bandwidth usage, object delivery, streaming connection and purge and storage condition. Going forward, as we continue to see more hardware integration with applications for OTT video and the 4K video delivery, we are confident our platform is capable to fulfil this kind of requirement. As you can see from the first quarter results, we now have better operating leverage through our continued execution of a number of cost efficiency programmes.

After the organisation streamlining in the late 2013, our organisation is now more flattened with a simplified structure. Also, we continue to upgrade our internal system to increase visibility, predictability across organisation. We can better match cost with revenue generated. We are also pleased to report that our construction of the resource management system is on track. With a more flexible, scalable pool of network resources, we are confident in our ability to embrace more market opportunities.

With a positive market dynamic ahead of us, I have good confidence that we are in strong position to continue making progress towards our strategic initiative. With that, I would like to hand the call over to Jing, our Acting CFO for financial recap. Please?

Jing An: Thank you Ken. Hello everyone and thank you for your participation. Today my presentation will start with a review of first quarter 2014 results followed by our guidance for the second quarter of 2014. We will then open the call for your questions. Please note that the denominating currency is RMB unless otherwise specified.

ChinaCache delivered another strong top line performance in the first quarter with net revenue increasing 40.4% year-over-year to RMB323.9 million from RMB 230.7 million in the first

quarter of 2013. We beat our original guidance by 5.2% as we showed stronger-than-expected business, with particular strength in the media and entertainment and enterprise verticals as each of them increased one percentage point in proportion to revenue. Compared to the previous quarter, net revenue has a slight correction by 4.6%. First quarter gross margin was 30.3% compared to 31.6% in the previous quarter. We had lower bandwidth and co-location charges as a percentage of revenue, but this was offset by higher equipment depreciation and amortisation.

In the first quarter, we achieved operating income of RMB0.2 million compared with an operating loss of RMB6 million in the previous quarter. Non-GAAP operating income which excludes share-based compensation expenses and impairment of an available for sale investment was RMB3.7 million compared with a non-GAAP operating loss of RMB1.1 million in the previous quarter and a non-GAAP operating loss of RMB5.3 million in the first quarter of 2013. We are very pleased that with our strong growth, we have maintained strict control of our operating expenses throughout the company.

Looking at the operating expenses line, our general and administrative expenses for the first quarter was RMB37.2 million or 11.5% of net revenue compared with RMB43.4 million or 12.8% of net revenue in the previous quarter. The decline in general and administrative expenses was primarily attributable to the decrease in personal related expenses. Sales and marketing expenses as a percent of revenue were 10.1%, down from 11.2% in the previous quarter. Total sales and marketing expenses decreased 14.1% to RMB22.7 million quarter-over-quarter, probably due to the cost control measures across the board and reduced personnel-related expenses.

R&D expenses for the first quarter were RMB28.2 million, 8.7% of the net revenue compared with RMB30.6 million or 9% of net revenue in the prior quarter. The quarter-over-quarter decrease in R&D spending was mainly related to the company incur less personnel-related expenses. Our total operating expenses including impairments of an available for sale investment were RMB98.1 million or 30.3% of revenue compared to RMB113 million or 33.4% of revenue in the previous quarter. This decrease reflects our focus on controlling expenses and improving our internal operating efficiency.

We continue to refine our ERP system to provide a better visibility across the organisation. In addition, we have made a significant improvement to our sales cycle. In the first quarter our DSOs were 98 days. Looking at the bottom line, I am very pleased with our performance for the first quarter. We are off to a good start in 2014 with adjusted net income reach RMB2.7 million in the first quarter compared to a loss of 7.2 million in the previous quarter. Adjusted net income is defined as the net income before share-based compensation expenses, foreign exchange loss or gains, penalties and uncertain tax positions and impairment of an available for sale investment.

Our non-GAAP diluted earnings per ADS in the first quarter were RMB0.11 compared with a loss of RMB0.31 in the previous quarter. Adjusted EBITDA was RMB25.4 million in the first quarter, an improvement of about 25% from RMB20.3 million in the prior quarter. Adjusted EBITDA margin for the first quarter was 7.9% versus 6% in the prior quarter. Adjusted EBITDA is defined as EBITDA excluding share-based compensation expense, foreign exchange loss or gain and impairment of an available for sale investment.

I will conclude my portion of today's call with our second quarter guidance. Based on current business projections, we expect our revenue to be between RMB340 million and RMB345 million representing 31.9% to 33.9% growth over second quarter of last year and 5% to 6.5% growth over previous quarter. In conclusion, I want to emphasise that our results and our guidance demonstrate our commitment to long-term profitable growth.

Now let's open the call for questions.

Operator: [Inaudible]. The question and answer session of this conference call will start in a moment. In order to be fair to all callers who wish to ask questions, we will take two questions at a time from each caller. If you have more questions, please request to try to queue again after your question has been addressed.

We will now begin the question and answer session. If you wish to ask a question, please press *1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the # key. Your first questions come from Jun Zhang from Rosenblatt. Please ask your questions.

Jun Zhang: Thanks for taking my question. Congratulations on the solid results. And Jing, I just want to ask you about on opex side, should we expect the increase in capex in the next couple of quarters on the expansion of capacity in some of big nodes going to affect the gross margin and maybe the operating margin in the next few quarters? Thanks.

Jing An: I think your question is to – one is about opex, right, another one is about capex? Capex –?

Speaker: Right, right. The capex, yeah.

Jing An: Okay. Let's start with the opex first. Actually this quarter we already saw a significant improvement like three percentage point in the opex, and that's mainly due to that we do have a very strict control and evaluation system of the HR cost. And we will continue to drive – at the same time, we will continue to drive top line growth while managing expenses in different ways.

We are very carefully managing our cost in line with our business needs. As we have mentioned, we have slowed down our overall hiring since the end of 2013. However, this year we are still working to recruit, select new talent in conjunction with our sales force reorganisation and HR – sorry, and R&D teams. We expect to incur a limited additional cost related to these efforts. So that's about opex.

And for the capex, we in – we start to – we are in the process to build up our new resource management system, and this quarter is the first stage and that will continue through the next two quarters. So in the coming two quarters, our capex will continually increase. But after that, when we finish all the construction, the capex will be back to the normal, close to 10% levels. Thank you.

Jun Zhang: Okay, thanks. And my second question is on the partnership with China Telecom. When do you expect the revenue contributions from this partnership to be meaningful? And also if you compare the gross margin and operating margin with partnership with China Telecom with your current CDN strategy at which point it's a little bit higher? Thanks.

Jing An: Let me start, and I think maybe Wang Song can help through – to help me later. So first of all I think we just signed the contract and we build out the cooperation at the beginning

of – at the end of first quarter. So in the second quarter everything is still in the warm-up section or in the warm-up stage. Now, the two teams work together and we provide the training programme for the sales team of China Telecom and we prepare to build up the network of – CDN network of China Telecom.

So in this quarter – in the coming second quarter, we don't really expect to see the revenue come in with us and we expect that maybe from the third quarter of this year we will start to see the revenue from [inaudible]. And in terms of the margin, we believe that will provide better performance with our average gross margin. So, Wang Song?

Song Wang: [Mandarin, 00.51.23–00.51.33]

Edith Kwan: In the future as the proportion of revenue contributed from this cooperation we expect the margin from this part of business will be higher.

Ken Zhang: I will add one thing. This year, the beginning of cooperation, we will – it will generate revenue and margins to ChinaCache, but I think more meaningful contribution next year.

Jun Zhang: Okay, thanks. And I will have one more question and then back to queue. So, my last question is about your data centre business. As Wang Song mentioned, right now you start building the data centre opportunity and you sell those specifically to some of the big Internet companies. Jing, I just want to ask you about how do you recognise the revenue? Is it going to be within one quarter or a couple of quarters, and how about margins on this data centre business? Thanks.

Jing An: You know, in terms of the top line of the business, we have a very [inaudible] estimate about like RMB4 billion to put – altogether three stage. But it is a very early stage estimate. And in terms of the margin, it's about – it's really early stage, and we have confidence about that but it's about a business secret and we would not talk about this in this stage. And I think maybe Wang Song has something to –? Okay, we are fine. Thank you.

Speaker: Thanks. I'll back to queue. Thanks a lot.

Operator: Thank you. Next question will come from Liping Zhao from CICC. Please ask your questions.

Liping Zhao: Thanks for taking my questions and congratulations for the quarter. I have two questions. So, the first one is that can we expect the profit to continue in second quarter this year and the full year 2014? And my second question is related to also the IDC service, because in my understanding the People.cn cooperation is mainly about IDC service. So how unique is ChinaCache IDC service compared to other peers in the market, for example ChinaNetCenter or 21vianet? Thanks.

Jing An: Okay. Let me take your first question about the sustainability of the profitability, and later I think Edith can help to translate your second question about the data centre to other management team to help you answer the latter one.

And so the first question about the profitability, you know, we are very pleased about our revenue growth and combined with continued operating efficiencies and economies of scale make us to achieve the profitability in the first quarter. And however, we are continuing to invest in the marketing and R&D in order to explore several strategic growth opportunity. For that reason, we are not committing to profitability in the very near-term on the whole year, but

we will work very hard to improve our operating efficiency and we are more confident in our ability to achieve and sustain profitability towards the end of the year and into 2015. Thank you.

Song Wang: [Mandarin, 00.55.27–00.55.56]

Edith Kwan: First of all, let me explain the difference of our business model compared to those of those data centres in China. It's completely different business model compared to VNET, China Telecom or China Unicom. You know, the difference is because they would have to invest a lot to build their centre.

Song Wang: [Mandarin, 00.56.19–00.56.27]

Edith Kwan: And our business model is that we are customising the data centre for our large enterprise or Internet customer.

Song Wang: [Mandarin, 00.56.36–00.56.45]

Edith Kwan: So the major difference is that we don't invest heavily to build data centre on our own.

Song Wang: [Mandarin, 00.56.51–00.57.00]

Edith Kwan: The main difference is that we are using the capital from our customers to help them build. What we contribute is mainly our ability, our experience.

Song Wang: [Mandarin, 00.57.11–00.57.24]

Edith Kwan: Such business model is very common in the US or other countries. Like Google or Facebook, they all have third party to help them build their centre.

Song Wang: [Mandarin, 00.57.34–00.57.38]

Edith Kwan: So in China really no one else is for providing these services.

Song Wang: [Mandarin, 00.57.43–00.57.53]

Edith Kwan: So first of all why we can do it good, because first of all the customers really already belong to us and they have this demand.

Song Wang: [Mandarin, 00.58.03–00.58.20]

Edith Kwan: And in China because of this rapid development, no matter the power supply or land is all scarce resources. So we can see a really good appreciation on the real estate project.

Song Wang: [Mandarin, 00.58.34–00.58.40]

Edith Kwan: So aside providing value to our customers, ourselves can also have a really good return for this – on this business.

Song Wang: [Mandarin, 00.58.48–00.58.57]

Edith Kwan: So after building it in the long run, we can also provide the management and other value-added services to customers.

Song Wang: [Mandarin, 00.59.05–00.59.06]

Edith Kwan: So we will have income stream enjoy all the way in the long run.

Song Wang: [Mandarin 00.59.13–00.59.18]

Edith Kwan: So, so far we don't see any similar competition in here yet.

Ken Zhang: Yeah, I think I just want to add in one more thing is that actually the major difference, ChinaCache will not own that business, it will be owned by the customer, large Internet companies. We won't own that. ChinaCache will in the longer run to provide operation and maintenance, all those kind of service support. So this is totally different business model compared to traditional IDC service.

Liping Zhao: Alright. Thanks Ken, Jing and Wang Song for the elaboration.

Operator: Thank you. Your next questions come from Sam Li from Goldman Sachs. Please ask your questions.

Sam Li: Thank you. Thanks for taking my questions Wang Zong, Ken Zhang, Jing An and Edith. First, could you just give us more colour on the revenue bit in the first quarter? For example, what's the reason for the particular strength in media and entertainment segments? Was it just because of any special event or it's just that we are taking market share. Thank you.

Jing An: First of all, in the first quarter, you know, the growth was across the board. I mean, well, we saw an upside in our media and entertainment vertical which is mainly driven by our video business and part of it – part is from gaming industry.

Sam Li: But why – I mean, it was above all expectations. So anything unexpected?

Jing An: No. Actually, I think this is all coming from the booming of video and entertainment industry. It just grows with the Internet demand in China. We don't see any special event in this quarter.

Sam Li: Okay. Good. So the demand is quite good.

Jing An: Yeah.

Sam Li: Okay. And second, besides the media and entertainment part, could you give us more colour on the new business development such as enterprise and the mobile Internet segments, I mean, as a percentage of the total revenue in the first quarter?

Ken Zhang: I think we mentioned the business on enterprise, it is in number of customers increased and the business revenue growth is growing faster than other segments. But still it's a small percentage in total revenue. It's about 11% of total revenue. So not really, really significant yet, but growing; it's among our faster growing segments.

Sam Li: Okay.

Ken Zhang: And the mobile Internet is, as you know, China Mobile is deploying 4G in very, very fast speed. So by the end of the year they will have 500,000 base stations deployed with 4G. So we foresee huge traffic growth in mobile Internet in the second half of this year and the beginning of next year. So we are more in the preparation stage rather than seeing the revenue growth –

Sam Li: Yeah.

Ken Zhang: – start the revenue growth right now. It's more we have product available, we are confident we can take the business opportunity when it comes.

Sam Li: Okay. Understood, understood. And lastly, Wang Zong and Zhang Zong maybe you can give us more colour on our progress on the mobile side? I mean, considering your competitor has already launched a mobile product and actually they claimed to make – already recognise the revenue on that product in the past quarter. So maybe some colour on our progress on – in that segment, for example mobile multiple – multilayer solutions or anything else?

Ken Zhang: I don't want to comment on what our competitor is doing, but we believe our mobile Internet solution is – we have the lead in – both in technology and the business development. So as I reported in my speech, we have international cooperation in this field and we have a number of products lining up through the coming up – during this year. Of course the revenue contribution will not be so significant this year, more meaningful in the beginning of the next year. So we are confident that we have the leading position here.

Sam Li: Okay.

Song Wang: [Mandarin, 01.04.24–01.04.56]

Sam Li: Sure.

Edith Kwan: So actually we have some really major difference from our competitor. Mainly our product is in three modules; one is on the application and content side; two is on the network side. On the network side we feel like it's really the core if we have to work with carriers to deliver this technology, not just on our own.

Song Wang: [Mandarin, 01.05.21–01.05.29]

Edith Kwan: Also, we have a team in US that are mainly focusing on the end-device for the mobile solution. So it's really in three modules for our solution.

Sam Li: Great, great to hear that. Okay, that's it for me. Thank you. Thank you.

Operator: Thank you. Your next questions come from Joyce Zhou from Barclays.

Joyce Zhou: Hi, thank you for taking my questions and congratulations on the good results. I have two questions. The first one is about the data centre plan. I understand that you have got prepay from your partners on building the data centre. But is there any like capex still needed from us? Because you mentioned about the three phases of the plan in the long-term. And the second question is can you update us the current utilisation rate of your CDN? Thank you.

Jing An: Okay. Let me take your first question about data centre capex. You know, to the – we got prepay from our customers so that it can partly or mainly help us to – so we don't have to use our own money to do the construction. So the capex definitely is to build up the whole building, so we need to invest, but it is not based on our own cash.

Joyce Zhou: So –

Ken Zhang: The second question about – your question about penetration in CDN, right, or in China?

Joyce Zhou: No, I just want to ask the utilisation rate?

Ken Zhang: Okay. I think what was a normal percentage in the US more than 50% of the Internet traffic is supported by CDN, but in China I think it is only 7% to 8% Internet traffic is supported by CDN. So that shows the growth potential for Chinese CDN market.

Joyce Zhou: Okay, thank you.

Operator: Thank you. We are now approaching the end of the conference call. I will now turn the call over to ChinaCache's President, Dr Ken Zhang, for his closing remarks.

Ken Zhang: Okay. In conclusion, I want to thank all our employees who helped deliver a great quarter and all our shareholders and partners for their continued support. There is a lot of promising opportunity in this fast growing industry. We are very excited for our prospect in 2014 and we are making significant progress in all our business segments including enterprise and mobile Internet technology. At the same time we continue to focus on delivering financial strength and leading the company to long-term profitability and growth. Thanks for your time today. We look forward to seeing you on our next quarterly call. Thank you.

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

[END OF TRANSCRIPT]