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CCIH - Q2 2016 ChinaCache International Holdings Ltd Earnings Call

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CORPORATE PARTICIPANTS

Eric Zhou *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Song Wang *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

CONFERENCE CALL PARTICIPANTS

Tina Hou *Goldman Sachs - Analyst*

Dennis Wu *UBS Investment Bank - Analyst*

Kevin Liu *Rosenblatt Securities - Analyst*

PRESENTATION

Operator

Hello, and thank you for standing by for ChinaCache's Second Quarter 2016 Earnings Conference Call. (Operator Instructions) Today's conference is being recorded. If you have any objections, please disconnect at this time.

Now I will transfer the call to Mr. Eric Zhou, Senior Vice President and Interim CFO of ChinaCache. Please go ahead.

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Thank you, operator. Hello, everyone. I'm Eric Zhou, Senior Vice President and Interim CFO of ChinaCache. Welcome to ChinaCache's second quarter 2016 earnings conference call. With me today is Mr. Song Wang, ChinaCache's Founder, Chairman and CEO. We distributed our earnings release earlier today. You can also find it in the Investor Relations section of our website.

On today's call, there will be a question-and-answer session following management's prepared remarks. Before we begin, please allow me to remind you of the safe harbor statement. During today's conference call, we may make some forward-looking statements, statements that are not historical facts including statements about future expectations, plans and prospects. Forward-looking statements are subject to risks and uncertainties that may cause actual results to differ materially from our 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 relevant laws.

Our earnings press release and this conference call include 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 website.

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

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

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) Thank you, everyone, for participating in today's second quarter 2016 earnings conference call.

During the second quarter, we made progress improving the performance of our cloud-based HPCC platform, constructing Internet Data Centers and expanding our Internet Exchange Centers. We improved the platform's versatility, customized the features for customers with high traffic volume and streaming requirements and improved the overall platform quality at high traffic volumes. As a result, towards the end of the second



quarter, we saw increased CDN data traffic volume compared to the first quarter, especially for streaming media customers. In the third quarter, we plan to focus on some of the modules that supported the HPCC platform, including a distributive billing module and an anti-hacking mechanism.

In addition to optimizing our HPCC platform, we are also expanding our network capacity to meet project future demand. One example of this is the dedicated working team we formed to serve the needs of a large U.S.-based Tier 1 smartphone company. This company has stringent CDN service requirements. Though we've experienced some setbacks lately, it does not alter our continuing mission to be a leading CDN provider with the best technology and business model in China, and we are steadily working towards this goal.

Following nearly three years of preparation and construction, we officially started to market our Cloud Data Center products during the second quarter. Right now, we have approximately 1,500 cabinets that are ready for rent by potential customers, and approximately 2,200 other cabinets are expected to be ready for operations by the end of this year. We are going to provide our service to a variety of customers. In addition to Data Center cabinet rental and management services, we also provide Internet Exchange Center services.

By the end of the second quarter, we had established Internet Exchange Centers in Beijing, Shanghai and Guangzhou and are planning more Internet Exchange Centers in other major cities in China. According to industry intelligence, as of December 2015, there were 617 Internet Exchange Centers in 119 countries, and the network -- the Internet Exchange Centers is growing approximately at 20% annually. Although Internet Exchange Centers are common in other countries, they are a new development in China. As a leader in the Internet Exchange Centers sector in China, we strive to bring innovation to the Chinese Internet industry to reduce Internet cost for ICPs and ISPs and to improve end user experience. We believe our efforts are complementary to current industry practices and will contribute to a healthy and a stronger Internet industry in China.

We are working diligently to improve our performance and to seize the opportunities offered by the CDN and the Data Center business in China. We plan to continue to invest in R&D in order to regain technological prominence. We are expanding our U.S. presence to better serve our customers and acquire more R&D talent, and we are initiating a corporate restructuring program to better reward and retain key employees, streamline operations and pursue sustainable growth.

And finally, in closing, I'm pleased to report that on August 15, the U.S. Central District Court of California dismissed a previously announced class action litigation originally filed against our company in 2015. The plaintiff have the right to file an amended complaint within 30 days.

That concludes my prepared remarks. I will now hand the call to our CFO, Eric.

Eric Zhou - ChinaCache International Holdings Ltd. - SVP and Interim CFO

Hi, everyone. I'm Eric Zhou. Here are the highlights of our second quarter 2016 financial results. Net revenues for the second quarter 2016 were RMB261.5 million, a 2.3% decrease from the previous quarter and a 26% decrease from the corresponding period in 2015. The decrease in net revenues quarter-over-quarter was primarily attributable to reduced customer traffic due to HPCC platform performance and industry competition.

Cost of revenues for the second quarter 2016 decreased by 5.7% quarter-over-quarter and increased by 3.5% year-over-year to RMB265.4 million. Gross margin was negative 1.5% compared with negative 5.1% in the previous quarter and at 27.4% in the corresponding period in 2015. Non-GAAP gross margin, which excludes share-based compensation, was negative 0.7% compared with negative 4% in the previous quarter and a 27.7% in the corresponding period in 2015. The increase in gross margin in the second quarter 2016 compared with that of the previous quarter was mainly attributable to efforts in improving bandwidth utilization.

Sales and marketing expenses for the second quarter 2016 were RMB24.4 million or 9.3% of the revenue, a 2.9% increase over the previous quarter and a 4.4% decrease from the corresponding period in 2015. The decrease in sales and marketing expenses in the second quarter 2016 compared with the same period last year was primarily due to cost control measures.

G&A expenses for the second quarter 2016 were RMB65 million or 24.9% of the net revenues, a 25.7% decrease from the previous quarter and a 19.3% increase from the corresponding period in 2015. The decrease in general and administrative expenses in the second quarter 2016 compared with that of the first quarter 2016 was primarily attributable to a decrease in share-based compensation expenses.

Net loss was RMB108.9 million in the second quarter 2016 compared with a net loss of RMB138.5 million in the previous quarter and a net loss of RMB7.3 million in the corresponding period in 2015. Net loss per basic and diluted ADS for the second quarter 2016 was RMB4.31 each. Each ADS represents 16 ordinary shares of the company.

Adjusted net loss was RMB91.4 million in the second quarter 2016 compared with adjusted net loss of RMB87.5 million in the previous quarter and adjusted net income of RMB4 million in the corresponding period in 2015. Non-GAAP net loss per basic and diluted ADS for the second quarter 2016 was RMB3.62 each.

As of June 30, 2016, the company had cash and cash equivalents of RMB367.8 million compared with RMB606.8 million as of December 31, 2015. Capital expenditures for the second quarter 2016 were RMB27.7 million. Finally, based on the first half of 2016 performance, we have revised our full year revenue guidance to the range of RMB1.04 billion to RMB1.1 billion.

That concludes my prepared remarks. Now let's begin the Q&A session. Operator, please go ahead.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from the line of Tina Hou from Goldman Sachs. Please ask your question.

Tina Hou - *Goldman Sachs - Analyst*

(Spoken in Foreign Language).

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(Spoken in Foreign Language).

Unidentified Company Representative

Tina, we're just going to translate your first question to English and then we'll get to your second one, okay?

Tina Hou - *Goldman Sachs - Analyst*

Oh, yes, sure. Thank you.

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

I do a brief translation of the previous caller's question and answers.

Basically, she asked during the second quarter this year if there were any changes in the sale prices and also the purchase cost of the bandwidth. And Mr. Wang said basically in the first half of this year, we haven't seen -- we didn't see any major changes in the sales price or the purchase cost. But for certain sectors like video streaming sector, we see some big changes in pricing, but this is only for one sector. And for the year, we do not expect any big changes for the cost of bandwidth purchase.



And she also asked the number of customers we have right now, and as of the -- at the end of the second quarter, we had approximately 2,000 traditional CDN customers. These are our large corporate customers. In addition to these traditional large customers, we also have many, maybe around 20,000 to 30,000 other customers because they can purchase our products online. These are small companies.

Okay. Go ahead for your next question.

And she also asked what measures we are going to take regarding our corporate restructuring programs we just initiated, and we are basically we are trying to do a couple of things regarding our corporate restructuring program. First, we need to review our product lines. We will put more priority and promote more profitable products. Today, if you go to our website, you will see we have a variety of products. But some products are more profitable, some are less profitable, so we think we need to focus on those products that can bring the most profit.

Second, we also are going to reviewing our corporate structure. And as one of the largest CDN provider in the industry, we believe -- we think -- our progress -- our recent progress was not as fast as we would like to. And for this reason, we need to review our corporate structure to see if we can become more nimble and more agile in order to adapt ourselves to the fast-changing business environment.

And finally, we also will review our business procedures. I mean, the way we're doing business within the company, we would like to have our operations more efficient. For instance, we would like to process our internal orders faster and in order to meet -- better meet our customers' requirements. These are the few initiatives we are planning to do in the coming months. Thank you.

Tina Hou - Goldman Sachs - Analyst

Thank you very much, management. Just two very quick follow-ups. First of all, what are the more profitable products that you just referred to? And then second and my last question is what is your CapEx plan for this year? Thank you.

Eric Zhou - ChinaCache International Holdings Ltd. - SVP and Interim CFO

Some of -- basically asking what are more profitable current products and less profitable products. Our traditional customers, basically like web page services and downloading, these are our more profitable product sales. And less profitable product lines including like broadcasting and streaming video products, even though they are the fastest-growing business -- product lines in the industry, but we believe they are not profitable -- as profitable as our traditional products.

And regarding the CapEx for the coming months, we do not have large CapEx for our CDN product lines. But for our Data Center construction business, we budgeted approximately RMB300 million per year for the next two to three years to complete all our Data Center buildings and equipment -- equip them with servers in the next two to three years, so approximately RMB300 million per year for the Data Center business and not significant CapEx for our CDN business.

Tina Hou - Goldman Sachs - Analyst

Thank you very much, management.

Operator

Your next question comes from the line of Dennis Wu from UBS. Your line is open. Please ask your question.

Dennis Wu - UBS Investment Bank - Analyst

(Spoken in Foreign Language).



Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

He asked basically the -- last half of -- the second half of last year, we saw a fast growth in broadcasting by demand industry. And he's asked us in addition to this industry, if there are any sectors or industries we may see potential high growth in the coming month or years.

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) And we have seen nice -- a high growth rate in the streaming media sector. In addition to this streaming media sector, we also see fast growth rates in Internet and mobile usage like [intelligent] broadcasting, etc.

And also we -- in the Internet sector, we also see some demand in securities business, Internet security, and also customized application, etc.

Also, a brand-new sector is the SaaS applications as in the case of Microsoft product, and we may see some traditional customers switching to SaaS applications.

Operator

(Operator Instructions)

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Thanks, again, for participating in today's conference call. If you have any questions, please feel free to contact us.

Unidentified Company Representative

Operator, I think we have one more question, a follow-up from Tina. So could you please take that?

Operator

Certainly. Tina Hou from Goldman Sachs. Your line is open. Please go ahead.

Tina Hou - *Goldman Sachs - Analyst*

(Spoken in Foreign Language).

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) In addition to the points we mentioned before, another point regarding our corporate restructuring is we need to provide our customers with value-added services like an end-to-end product instead of a simple CDN product. We need to have this value-added service to differentiate ourselves from our rivals.

Tina Hou - *Goldman Sachs - Analyst*

(Spoken in Foreign Language).

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

She asked if our so-called end-to-end applications is something like what would augment products to its customers like security services, and Mr. Wang said what we are going to do will be more than what today augments offer to its customers. For instance, we also will include the storage business for our customers, best content distribution and cloud calculation as well as other services.

Tina Hou - *Goldman Sachs - Analyst*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

She's also asking what about the gross margin for Data Center business.

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

And she asked us about the gross margin for our Internet Exchange Centers, and Mr. Wang said for the Internet Exchange Centers itself, even though the gross margin may be high, but the business itself probably won't bring us a lot of profits because the Internet Exchange Centers itself, we view it as a value-added service for customers. And we hope the Internet Exchange Centers will bring customers to our Data Centers as well as they will use our CDN services. So overall, it will be a great service to our customers and in the total sense, it will add to the -- contribute to the bottom of our company.

Tina Hou - *Goldman Sachs - Analyst*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Okay. Thanks, again.

Unidentified Company Representative

Next question, please.

Operator

Your next question comes from the line of [Kevin Liu] from Rosenblatt Securities. Please ask your question.

Kevin Liu - *Rosenblatt Securities - Analyst*

Good morning. So when do you expect CDN business will start recovering?

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Yes, we have complete most of the HPCC platforms core functions, and actually we saw some pickup in traffic volumes in [drive] especially from media stream customers. But please remember, the platform optimization is a continuing process as customers' requirements may change on an ongoing basis. So as a total solution provider, we need to adapt to customers' changing requirements. But that said, we have high hope we are going to reach its full capacity towards the end of this year.

Kevin Liu - *Rosenblatt Securities - Analyst*

Thank you. And my second question is could you give us some updates on IDC business, Internet Data Exchange Centers?

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

(Spoken in Foreign Language).

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

And out of the total 85,000 square meters of the spaces, and we have one building, the approximately like --

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

I'll do translation.

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) Basically, we have 10 buildings within our IDC centers with a total area of 85 square meters. And today, we have completed our Internet Exchange Center buildings and it is in operation. And also we have one IDC buildings, which is scheduled to be completed at the end of August, and also we have scheduled another two buildings to be completed at the end of this year.

Kevin Liu - *Rosenblatt Securities - Analyst*

Thank you. I also need the updates of the Internet Data Exchange Center.



Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

(Spoken in Foreign Language).

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) And to date, we have in -- for the Internet Exchange Centers business, to date, we have Internet Exchange Centers in Beijing, Shanghai and Guangzhou. They are in operations, and we have few dozen customers who are connected to the Internet Exchange Centers.

Kevin Liu - *Rosenblatt Securities - Analyst*

Thank you. Have a good day.

Operator

Thank you. Your final question today comes from the line of Dennis Wu from UBS. Your line is open. Please go ahead.

Dennis Wu - *UBS Investment Bank - Analyst*

(Spoken in Foreign Language).

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

He asked to have more color on end-to-end services and that he would like to know when we can have some numbers on the financial statements showing our progress in providing end-to-end services.

Song Wang - *ChinaCache International Holdings Ltd. - Founder, Chairman and CEO*

(interpreted) And to date, there are fewer large customers that are using our end-to-end services, and we anticipate by the end of this year or the beginning of next year, we may see some financial contributions from these customers.

Operator

Thank you. There are no further questions from the telephone lines. I would now like to hand the conference back to Mr. Zhou for closing remarks. Thank you, and please continue.

Eric Zhou - *ChinaCache International Holdings Ltd. - SVP and Interim CFO*

Thank you, again, everyone for joining us today. This concludes our call.

Operator

Ladies and gentlemen, that does conclude our conference for today. Thank you for your attendance. You may all disconnect.



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