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CCIH - Q1 2016 ChinaCache International Holdings Ltd Earnings Call

EVENT DATE/TIME: MAY 24, 2016 / 12:00AM GMT



CORPORATE PARTICIPANTS

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

Jing An *ChinaCache International Holdings Ltd. - CFO*

CONFERENCE CALL PARTICIPANTS

Liping Zhao *CICC - Analyst*

Jun Zhang *Rosenblatt Securities - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the ChinaCache first quarter 2016 earnings conference call and webcast. At this time, all participants are in a listen-only mode. There will be a presentation followed by a question and answer session.

(Operator Instructions)

Please be advised that this conference is being recorded today, Tuesday, May 24, 2016.

I would now like to hand the conference over to ChinaCache now. Thank you. Please go ahead.

Unidentified Company Representative

Hello, everyone, and welcome to ChinaCache's first quarter 2016 earnings conference call. We distributed our earnings release earlier today through internet Newswire services. You can also find it posted in the Investor Relations section of our website www.chinacache.com.

Today you will hear from Mr. Wang Song, ChinaCache Founder, Chairman and Chief Executive Officer, and Ms. An Jing, Chief Financial Officer.

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 include, but are not limited to, those outlined in our public filings with SEC. ChinaCache doesn't undertake any obligation to update any forward-looking statements except as required under relevant law.

Our earnings press release in this call include discussions 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. In addition, a live and archived webcast of the conference call can be available on our website.

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

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

(Interpreted) Thank you everyone for joining our first quarter 2016 earnings call.

With advancements in cloud computing, big data, mobile internet applications, the Internet of Things and internet finance, the CDN industry has evolved from simply facilitating content delivery to an advanced cutting-edge field in computer science, as well as the essential elements of cloud computing. So without question, we are in the right market with enormous growth opportunities.

One of our strategies is to lead the CDN evolution with advanced technology, including enhancing our CDN cloud platform while leveraging our private backbone transmission network and datacenters in tier 1 cities to connect the internet exchanges and our extensive content delivery network. This will effectively create a dedicated carrier and internet-neutral data center network, or DCN, which offers our clients a total solution, including cloud storage, cloud computing and cloud distribution.

For the advanced platform, which is our high-performance cloud cache, or HPCC, we continue to be committed and focused on the optimization process as we believe our solution will be instrumental in advancing and accommodating the rapidly growing demand in the cloud market in China, thus driving our revenue growth for the mid to long-term.

In general, we have three phases for the HPCC platform optimization. The first phase is to improve the common functions for key verticals such as web pages, downloading and video, by simplifying the layers and optimizing the logic process with the goal to significantly improve overall long-term performance.

The second phase is to work closely with key clients in each vertical who have higher traffic volumes and stringent service requirements with the goal to enhance the quality of their service and increase their traffic volume on the HPCC platform.

The third phase is to improve overall traffic volume from all of ChinaCache clients.

As of today, we have completed the second phase of the optimization process for downloading online video services. We are working closely with key clients with large traffic volumes and strict service requirements to prepare for increased traffic. The initial results and increased traffic from these efforts are encouraging. Our goal remains to normalize traffic growth and enhance both revenue and profitability by leveraging the economies of scale and improving operating efficiencies by the second half of 2016.

Now let me provide an update on the cloud datacenter and internet exchange business.

In the first quarter we were pleased to officially launch Beijing CHN-IX and Atecsys Cloud Datacenter. We also successfully launched the Guangzhou CHN-IX on April 22 and plan to establish another internet exchange in Shanghai in June. As we continue to expand our internet exchange business, we plan to facilitate the efficient exchange of local content and the interconnections between content creators and users by establishing internet exchanges in more tier 1 and 2 cities, including Tianjin, Zhengzhou, Shenzhen and Hangzhou.

Despite the temporary challenges we have encountered, we are well-positioned in the market with positive trends, increasing customer demand and tremendous opportunities. We will concentrate our resources to overcome the challenges and prepare for significant ramp-up of customer demand.

That concludes my prepared remarks. I will now turn the call over to our CFO, Ms. An Jing.

Jing An - ChinaCache International Holdings Ltd. - CFO

Today my presentation will start with the review of the first quarter of 2016 results followed by our guidance for the full-year of 2016. Please note that the denomination currency is RMB unless otherwise specified. I will start with a brief review of the first quarter results.

In the first quarter, ChinaCache recorded net revenue of RMB267.8 million, a 14% decrease quarter-over-quarter. The decrease was mainly due to the continued platform optimization process. Cost of the revenue for the first quarter increased by 5.2% quarter-over-quarter and 9.8% year over year to RMB281.4 million, primarily due to the increased bandwidth cost. The gross margin was negative 5.1%, compared with positive gross margin of 14.2% in the previous quarter and 29.5% in the corresponding period in 2015.

Excluding share-based compensation, first quarter non-GAAP gross margin were negative-4%, compared with the positive gross margin of 14.5% in the previous quarter and 29.9% in the corresponding period in 2015.

I would like to provide more detail on our gross margin. Our negative gross margin in the first quarter was primarily due to the increased bandwidth costs as a percentage of the revenue. Typically, the bandwidth cost is about 60% to the revenue. In the first quarter of 2016, it was 80%. A key to our business model is we charge our customers based on their peak traffic usage. During the non-peak hours, we use that bandwidth for other customers. The ability to balance the traffic [variations] between the different verticals is essential to remaining optimal operating efficiency and higher margin levels. For example, the peak hours of the downloading service are mainly happen in the daytime. On the other hand, our video service it occurs during the evening. Again, the ability to reuse the bandwidth is a major driver for our margin.

For first quarter, the HPCC platform optimization is still in the process and that resulted in the temporary traffic decrease from some customers; in particular those online video service. The traffic decline of these verticals significantly changed our operating balance as we were unable to fully reuse our bandwidth by making timely adjustments among the different verticals.

In Mr. Wang's comments today, he described the important steps we are taking to complete the platform optimization process. We are encouraged by the increasing traffic flow from some key customers, particularly in the online video vertical, as we continue to make progress in our platform optimization. We believe that once the HPCC platform reaches optimal capacity and stability, there will be a rapid growth in the traffic driven by the significant customer's demand and our ability to provide greater capacity. This will enable us to maximize the reuse of our bandwidth and balance the bandwidth among our verticals. The expected result is an increased bandwidth utilization rate, lower cost, and a significantly improved overall operating efficiency.

It's important to note that ChinaCache remains one of the largest firms in the industry and has strong competitive positioning in the market. While the optimization work continues, we remain disciplined with our cost control in the first quarter; that demonstrates by our operating expenses level and operating efficiency.

Our total operating expenses were RMB179.2 million, or 52% to the net revenue. Excluding the share-based compensation, our non-GAAP operating expenses were RMB91.8 million, or 34.3% of the net revenue, which decreased 12.4% from the previous quarter and decreased 3% from the first quarter of 2015.

Specifically, non-GAAP sales and marketing expenses in the first quarter were RMB22.2 million or 8.3% of the net revenue, representing a quarter-over-quarter decrease of 24.7% and a year-over-year decrease of 27.8%. The non-GAAP G&A expenses in the first quarter were RMB43.6 million, or 16.3% of the net revenue; representing a quarter-over-quarter decrease of 3.6% and a year-over-year increase of 12.8%. The non-GAAP RMB expenses in the first quarter were RMB26 million, or 9.7% of the net revenues; representing a quarter-over-quarter increase of 5% and a year-over-year increase of 2.8%.

As a result of the foregoing, the non-GAAP operating loss in the first quarter, which excludes share-based compensation expenses, was RMB97 million, compared with a non-GAAP operating loss of RMB45.9 million in the previous quarter. And non-GAAP adjusted net loss was RMB87.5 million in the first quarter compared with a non-GAAP adjusted net loss of RMB21.2 million in the previous quarter.

Excluding the transaction tax, adjusted EBITDA was a loss of RMB56.9 million in the first quarter compared with RMB3.9 million in the previous quarter, and a gain of RMB49.7 million in the corresponding period in 2015.

Moving to the balance sheet; we had RMB589.5 million in cash and cash equivalents, including short-term investments of RMB176.6 million as of March 31, 2016 compared with RMB632.9 million as of December 31, 2015. Our cash expenditures for the first quarter were RMB31.7 million, representing 11.8% of the total revenue compared with RMB56.1 million in the first quarter of 2015.

Let me now address our full year of 2016 outlook. We currently expect to generate total net revenues in the range of RMB1.45 billion to RMB1.55 billion for the full-year of 2016, which represents a year-over-year growth is about 7.1% to 14.5%. We currently expect to improve the performance of our advanced HPCC platform by the latest of 2016 and the majority of our revenue growth is expected to be realized in the second half of the year.

In conclusion, our strategy for 2016 is to focus on the optimization of our HPCC platform and ongoing cost-saving initiatives in order to position us well for the sustainable revenue growth and margin improvement as well as enhanced shareholder value.

This concludes my remarks; now let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Liping Zhao from CICC.

Liping Zhao - CICC - Analyst

I have two questions. The first one is regarding to the IDC business. Could Wang Song help us to elaborate the development and strategy of IDC business, please?

And my second question is about the - for second quarter, because we haven't revised on any guidance for the full-year, did you see any recovery on the financial performance of the second quarter?

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

(Interpreted) You know that the datacenter has been initiated at the initial stage and which includes our data exchange, it also starts to provide service. In the meantime, we are speeding up our efforts to establish the datacenter and exchange business beyond Beijing; to be specific, in Shanghai, Guangzhou and Shenzhen.

Jing An - ChinaCache International Holdings Ltd. - CFO

I will take the second question about the Q2. As we mentioned in my remarks, we're still in the process to optimize our HPCC platform. And by now we start to see some customers increase, some traffic come back to our platform. But I think we will get more confidence in the later half of the year. Now we would like to see - we just continuing to optimize our platform and try to acquire or call back our customers' traffic.

Operator

(Operator Instructions) Jun Zhang from Rosenblatt Securities.

Jun Zhang - Rosenblatt Securities - Analyst

(Mandarin Language Spoken) So my second question is, after the last time the IDC business getting some investments from outside investor, what's your next step on the IDC strategic development?

Jing An - ChinaCache International Holdings Ltd. - CFO

You just mentioned that the strategic investor part. We're still in the process to close that. So I think Mr. Wang will be more focused to answer the strategy about this part.

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

(Interpreted) As a matter of fact, we are the first to introduce the exchange center in domestic China. There is no denying the fact there are many aspects for us to include resources as well as to promote in the market.

Like in overseas countries, in China for the datacenter concept either for the operators or enterprises, it is quite a new concept and model. You will also find it is likewise for the China's infrastructure supplying facility.

There is a great significance for the development of such kind of business that is still demanding either in terms of the time and effort. I think it will bring a revolutionary reform for China's internet infrastructure establishments.

Operator

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

Jing An - *ChinaCache International Holdings Ltd. - CFO*

Hello, everyone. I think in my remarks, I believe I accidentally misspoke the figures of our total operating expenses. The correct number should be RMB139.2 million; that's the right number.

Thank you again for joining us today. If you have any further questions, please feel free to contact the Investor Relations of ChinaCache IR or TPG. Have a good day.

Operator

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

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