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CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

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CORPORATE PARTICIPANTS

Sai Zhang

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

Zhou Naijiang *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

CONFERENCE CALL PARTICIPANTS

James Wang *Deutsche Bank AG, Research Division - Research Analyst*

PRESENTATION

Operator

Hello, and thank you for standing by for the Fourth Quarter and Full Year 2016 Earnings Conference Call for ChinaCache International Holdings. (Operator Instructions) Please be advised that today's conference call is being recorded. I'll now turn over the call to Ms. Celine Zhang, Investor Relations Manager for the company. Celine, please go ahead.

Sai Zhang

Thank you, operator. Hello, everyone, and welcome to the Fourth Quarter and Full Year 2016 Earnings Conference Call for ChinaCache. We distributed our earnings press release earlier today via newswire services. You can also download it from the Investor Relations portion of our website.

Today's call will consist of management's prepared remarks, followed by a Q&A session. Leading today's call is Mr. Song Wang, ChinaCache Founder, Chairman and Chief Executive Officer, who will provide updates on the business strategy; Mr. Eric Zhou, Senior Vice President and Interim CFO, will then provide commentary on our recent corporate transaction, review highlights of the company's financial results and also provide our outlook for the full year 2017. Our Senior Vice President and Chief Strategy Officer, Cynthia Meng, will also be standing by for questions.

Before we begin, 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. Finally, an archived webcast of the conference call will be available on our website approximately 2 hours after the call concludes.

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 interpretation.

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

[Foreign Language]

Sai Zhang

Thank you, everyone, for joining today's fourth quarter and full year 2016 earnings conference call.



MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

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

[Foreign Language]

Sai Zhang

Before I begin, I'd like to take this opportunity to welcome and announce the joining of Ms. Cynthia Meng as Chief Strategy Officer and Senior VP at ChinaCache.

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

[Foreign Language]

Sai Zhang

Cynthia joins us with 18 years of TMT industry experience in equity research and strategy consulting for Chinese and global technology companies in China, U.S. and Europe. She worked for investment banks, including Jefferies and Bank of America Merrill Lynch, as head of TMT research team and led the coverage of Chinese technology, Internet and telecom companies. We believe her experience and expertise strongly complements our management team and will add value to the company's strategic initiatives.

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

[Foreign Language]

Sai Zhang

In review, 2016 was a year of challenge for us. Compared with 2015, our full year revenue declined due to our HPCC platform issue, low exposure to the streaming media sector and heightened industry competition. For example, in 2016, revenue from streaming media products accounted for about 20% of our total revenue, but a large percentage of Internet data traffic is from streaming media sector. We also saw fierce pricing competition as some new comers pursued irrational pricing to win market share. This strategy is, of course, unsustainable but nevertheless disruptive in the short term.

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

[Foreign Language]

Sai Zhang

Despite the difficulties we encountered, we focused on operations and continued to improve our CDN platform and developed new products and saw signs of stabilization and progress in the last 2 quarters of the year. At the end of the year, we met our revenue guidance, and we are setting a higher goal for 2017.

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

[Foreign Language]

MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

Sai Zhang

Recently, some investors and analysts have asked us about the outlook for the CDN industry. I'd like to share my opinions on this topic.

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

[Foreign Language]

Sai Zhang

In the last few years, growth in e-commerce, video on-demand and streaming media products has propelled development of the CDN industry. As nearly all emerging Internet applications now require CDN to allocate traffic, CDN services are becoming an indispensable part of the Internet infrastructure. In this environment, we foresee global CDN traffic will likely double within the coming years.

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

[Foreign Language]

Sai Zhang

In the future, we foresee CDN products will become increasingly decentralized, long-tail oriented and specialized. We also believe it's predictable and that new comers will try to grab market share through lower price and large companies will try to build their own CDN platforms for better efficiencies. Against this backdrop, our strategy is clear: to capitalize on our strengths by integrating our resources to provide a unique 3-layer structured total solution package that clearly distinguishes ChinaCache as the provider of choice in markets we serve. Our strategic actions in 2016 clearly show that we were executing this strategy and moving forward towards this end.

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

[Foreign Language]

Sai Zhang

2016 was a year of transition. During the year, we established our Internet Exchange centers in multiple cities and foresee them becoming an increasingly integral part of our total solution offering. We invested in R&D and are developing new CDN and CDN-related products, including big data analysis, cloud exchange platforms and CDN for the IoT industry. We continued to improve our HPCC platform, along with upgrading our network hardware. We expect to finish a major platform upgrade by the end of the second quarter, which we anticipate will deliver improved performance in a number of areas, including service quality, scalability, customer information separation, scheduling automation and real-time log data analysis and so on.

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

[Foreign Language]

MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

Sai Zhang

As recently announced, we've entered into definitive agreements to sell 79% of our equity stakes in our Xin Run data center business. This transaction will allow us to reduce future CapEx and near-term operating losses. Following this transaction's closing, ChinaCache will continue to work closely with Xin Run and leverage our strength in marketing and network technology alongside Xin Run's strategic resources. By utilizing the 3-layer structured network of CDN, data center and exchange center network with content and applications at its core, we will clearly distinguish ourselves as the provider of total solution services. I have every confidence in the future of ChinaCache.

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

[Foreign Language]

Sai Zhang

In closing, I'd like to provide an update on the company's ongoing class-action litigation. Following its initial decision last September to dismiss the plaintiff's complaint, the United States District Court for the Central District of California, in January of this year again dismissed the plaintiff's amended complaint. Plaintiff has filed a notice of appeal in March, which formally started the appeal process.

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

[Foreign Language]

Sai Zhang

This concludes my prepared remarks. Now I will turn the call over to our Senior Vice President and Interim CFO, Eric Zhou. Thank you.

Zhou Naijiang - ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment

Good morning, and good evening, everyone. I'd like to begin by providing you commentary on our recent announcement to sell the majority stake in our data center business. This transaction, when closed, will bring approximately RMB 221 million in cash to the company. It will significantly strengthen our balance sheet and allow us to speed up our research and development and hire and retain talented employees. This transaction values Xin Run's shareholder equity at about RMB 280 million.

In December 2015, we announced a group of investors planned to invest in Xin Run. At that time, the pre-money valuation for Xin Run was RMB 250 million. So the valuation of this transaction is higher than the previously announced one. As of December 31, 2016, the shareholder's deficit of Xin Run was RMB 33.2 million. We believe this transaction will benefit our shareholders. Since we expect Xin Run to continue to require substantial CapEx investments and may incur operating losses in the current stage, we believe selling the majority stake of these assets not only will reduce our future CapEx requirements but also our operating losses. In addition, after transaction closes, Xin Run will become a domestic company which will make it much easier for it to access domestic capital markets. We expect to use the cash proceeds from the transaction for R&D, working capital and other purposes that may create value for our shareholders.

To be clear, after the transaction, ChinaCache will establish a strategic partnership with Xin Run, which will provide the framework to leverage each other's strengths and resources and provide total solutions to customers and benefit all stakeholders. We will work out a detailed partnership agreement in the near future. In summary, this transaction enables ChinaCache to be a light asset entity, focused on content and application with the ability through strategic partnership with Xin Run, to provide total solution offerings.



MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

Now moving to the financial highlights. For the fourth quarter of 2016 financial results, net revenues were RMB 263.3 million, a 0.6% increase from the previous quarter and a 15.5% decrease from the corresponding period in 2015. The sequential revenue stabilization in the fourth quarter of 2016 was largely due to improvement in the performance of our HPCC platform and partially offset by increased competition.

Cost of revenues for the fourth quarter of 2016 increased by 1% quarter-over-quarter and decreased by 3.6% year-over-year to RMB 257.7 million.

Sales and marketing expenses for the fourth quarter of 2016 were RMB 22.5 million or 8.5% of net revenues, representing a 2.4% decrease over the previous quarter and a 25.5% decrease from the corresponding period in 2015.

G&A expenses for the fourth quarter of 2016 were RMB 50.3 million or 19.1% of net revenues, representing a 19.2% decrease from the previous quarter and a 17.7% decrease from the corresponding period in 2015. The company will continue to work to reduce costs and improve efficiency.

Operating loss was RMB 139.3 million in the fourth quarter of 2016 compared with an operating loss of RMB 99.5 million in the previous quarter and an operating loss of RMB 64.1 million in the corresponding period in 2015. The operating loss includes the impact of share-based compensation expenses of RMB 2.7 million and a one-time impairment of long-term investments of RMB 18.2 million.

Income tax expenses was CNY 21.8 million in the fourth quarter of 2016 compared with an income tax benefit of RMB 0.4 million in the third quarter of 2016 and an income tax benefit of RMB 22.9 million in the corresponding period in 2015. The income tax expenses for the fourth quarter of 2016 include RMB 1.1 million for the current tax expenses and RMB 20.7 million for deferred tax expenses.

Net loss was RMB 155.2 million in the fourth quarter of 2016 compared with net loss of RMB 94.3 million in the third quarter of 2016 and a net loss of RMB 36.8 million in the corresponding period in 2015.

Adjusted EBITDA was a loss of RMB 78.6 million compared with a loss of RMB 46 million in the third quarter of 2016 and RMB 3.9 million in the corresponding period in 2015.

Adjusted net loss was RMB 141.6 million compared with RMB 86.6 million in the third quarter of 2016 and adjusted net loss of RMB 15.8 million in the corresponding period in 2015.

For the full year 2016 financial results.

For the full year ended December 31, 2016, net revenues were RMB 1.1 billion, representing a 22.1% decrease from the previous year. Gross loss in 2016 was RMB 5.3 million compared with gross [profit] (corrected by company after the call) of RMB 312.2 million in 2015.

Adjusted EBITDA in 2016 was a loss of RMB 236.9 million compared with an adjusted EBITDA of RMB 120.2 million in 2015.

Net loss in 2016 was RMB 496.9 million compared with a net loss of RMB 88.7 million in 2015. Adjusted net loss was RMB 407.2 million in 2016 compared with an adjusted net loss of RMB 23.4 million in 2015.

Now let me provide you with guidance for 2017. We expect to generate total net revenues in the range of RMB 1.18 billion to RMB 1.24 billion for the full year of 2017, representing year-over-year growth of approximately 12% to 18%. On a year-over-year basis, we expect revenue growth to recover starting from the second half of 2017. This also reflects our [current] (corrected by company after the call) estimate, which is subject to change.

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



MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Also, for the benefit of all our participants on today's call, if you choose to ask your question to management in Chinese, please immediately repeat your questions in English. (Operator Instructions) We have our first question from James Wang from Deutsche Bank.

James Wang - *Deutsche Bank AG, Research Division - Research Analyst*

[Foreign Language] So my question is just around the HPCC platform upgrade. Just wanted to know what functionalities were improved and also whether the second half recovery in the net revenue is dependent on the HPCC upgrade and whether the revenue recovery will come from existing customers or from new customers.

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

[Foreign Language]

Zhou Naijiang - *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

And basically, we expect to improve the platform performance without the additional CapEx by almost 50%.

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

[Foreign Language]

Zhou Naijiang - *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

So after the upgrading of this platform, we expect the old customers on our platform take on increased traffic volumes. And at the same time, we can also have new customers and new products on our platform.

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

[Foreign Language]

Zhou Naijiang - *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

And when the upgrading of the platform is completed, we expect the platform performance can reach and exceed our original expectations.

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

[Foreign Language]

Zhou Naijiang - *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

So in the coming quarters, we expect our revenue performance will recover and then return to our previous levels of performance.



MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

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

[Foreign Language]

Zhou Naijiang - ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment

And improve our ability to generate profits and to improve our services.

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

[Foreign Language]

Zhou Naijiang - ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment

And the end goal, of course, is to return to profits in the future.

James Wang - Deutsche Bank AG, Research Division - Research Analyst

[Foreign Language] My question is...

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

[Foreign Language]

Zhou Naijiang - ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment

And the new applications include the improved network security and a large-scale cloud caching and mobile-end applications, et cetera.

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

[Foreign Language]

Zhou Naijiang - ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment

And of course, for the front-end applications, it's easily seen. But most importantly, it will enable us to develop our 3-layered network structure, which consists of CD networks, Internet exchanges and data center networks.

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

[Foreign Language]



MARCH 28, 2017 / 12:00AM, CCIH - Q4 2016 ChinaCache International Holdings Ltd Earnings Call

Zhou Naijiang - *ChinaCache International Holdings Ltd. - Interim CFO and SVP of Corporate Strategy & Investment*

And at present, most of the so-called specialized CDN providers, they largely provide a single or repeated CDN services. But for new CDN network in the future, it will meet the needs of variety of Internet applications.

Operator

(Operator Instructions) As there are no more further questions, I'd like to hand the call back to management for any closing remarks. Please continue.

Sai Zhang

Well, thank you again for joining today's earnings conference call. If you have any further questions, please feel free to reach out to us through the contact information provided on our website.

Operator

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

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