21Vianet Group, Inc.
4Q17 Earnings Conference Call Script

Operator:

Good morning and good evening, ladies and gentleman. Thank you and welcome to 21Vianet Group's fourth quarter and full year 2017 earnings conference call.

At this time all participants are in listen-only mode. We will be hosting a question and answer session after management's prepared remarks. Before we begin, I will read the safe harbor statement.

This call may contain forward-looking statements made pursuant to the safe harbor provisions for the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and observations that involve known and unknown risks, uncertainties, and other factors not under the company's control which may cause actual results, performance, or achievements of the company to be materially different from the results, performance, or expectations implied by these forward-looking statements. All forward-looking statements are expressly qualified in their entirety by the cautionary statements, risk factors, and details of the company's filings with the SEC. 21Vianet undertakes no duty to revise or update any forward-looking statements for selected events, or circumstances after the date of this conference call.

With us today are Mr. Steve Zhang, Co-Chief Executive Officer, Mr. Alvin Wang, Co-Chief Executive Officer and President, and Ms. Sharon Liu, Chief Financial Officer. At this time, I would now like to turn this conference call over to Mr. Steve Zhang, Co-CEO of 21Vianet. Please proceed, sir.

Steve Zhang, Co-CEO:

Thank you, Operator. Good morning and good evening everyone. Thank you for joining us for the earnings call today. I want to first start by welcoming Alvin to 21Vianet. He has vast experience in the telecom industry, and his expertise will prove invaluable to 21Vianet. Alvin, would you like to say a couple of words?

Alvin Shiqi Wang, Co-CEO:

Thank you Steve.

Hello everyone. This is Alvin Wang Shiqi. I am honored and excited to join the 21Vianet management team and talk to you all today. Having spent over 20 years in the telecom industry and having worked closely with VNET's board for more than a year and a half, I'm looking forward to putting my experience, expertise, and contacts to work inside the Company. At this moment, I'd like to turn the call back over to Steve, to remark on our 4Q and 2017 full year results.

Steve Zhang, Co-CEO:

Thank you Alvin.

2017 was an exciting year for the Company, one that was full of change, but also new opportunities. We were able to restructure the Company by optimizing and then ultimately divesting our loss-making MNS business. We were also able to raise 300 million dollars through a bond offering to support our growing hosting business. We faced numerous challenges along the way, but were able to maintain our focus on our long-term goals, and come into 2018 revitalized and stronger.

Looking forward, I am excited for all the new opportunities in our business. As public cloud adoption becomes more widespread, our customers are employing more complex IT architectures, utilizing hybrid IT and hybrid cloud infrastructures, which presents us with fantastic growth opportunities.

Moving on to our business, we are pleased to report another quarter of solid growth in both our top-line and profitability. For the fourth quarter, revenue for our core hosting and related services business increased by 9%, and Adjusted EBIDTA increased by 229%.

For our core business, we increased the number of our self-built cabinets by 2,550 this past quarter, while at the same time decreasing our lower margin partnered cabinets by 894 cabinets, bringing the total cabinets under management to 29,080. Of the 894 partnered cabinets, 570 were removed due to the MNS spinoff.

In anticipation of future market demand and limited prime real estate resources in tier 1 cities in China, we entered into an agreement with TUS for a land parcel in SongJiang, Shanghai, where two buildings are being planned for data center use. Upon completion in the middle of 2019, the two buildings are expected to have a capacity of around 3,000 cabinets for our clients in Shanghai.

During the fourth quarter of 2017, we expanded our client base, including new relationships with Meitu (美图), Douyu (斗鱼), Tujia (途家网), 99Bill (快钱), and Bohai Life Insurance (渤海人寿). At the same time, we have seen increased demand for cabinet space from our existing clients as well, including Xiaomi, Momo (陌陌), Huawei, and Lian Jia (链家).

On the cloud side, we witnessed the continued migration of China's internet companies from public cloud to hybrid cloud and their rising demand for customized cloud solutions. To capture this growing demand, we broadened and customized our service offerings to cater to our customers' specific requirements. For example, we recently entered into a partnership with a global shipbuilding company. The company will build luxury cruise ships for the China market and will require a complex hybrid IT infrastructure for the ships. 21Vianet will provide a mixture of Microsoft cloud services, IDC services, and technical support to the company. The initial term will be for multiple years, with revenue contribution of roughly 24 million.

Together with our unique competitive edge of being carrier- and cloud-neutral, we are well-positioned to capitalize on these opportunities and consolidate our leading position in this blooming Chinese market.

We were also able to establish new and exciting partnerships while expanding on old ones during the past year. For example, we strengthened our cooperation with both AliCloud and Tencent Cloud by building out direct fiber lines between certain 21Vianet data centers and those of Alibaba and Tencent. This will enable us to offer public cloud connectivity to our customers, as well as assist them in building out their hybrid cloud infrastructure.

Overall, we are pleased with the results of our business restructuring and strategy shifts during the past year. Looking ahead into 2018, we will continue to fully focus on our core business and with our lean, asset-light approach we are confident that we will accelerate our growth and meet the evolving demands of our customers.

As you all are aware, in January this year we promoted Ms. Sharon Liu to the position of Chief Financial Officer. Sharon has been with us for over seven years serving as vice president of finance prior to her promotion. We believe that Sharon's experience and expertise in corporate finance management, M&A, and investor relations will help our team manage our aggressive goals for growth in the years ahead.

With that, I would like to turn the call over to Sharon, our CFO, to go through our financial results.

Sharon Xiao Liu, CFO:

Thank you Steve, and hello everyone, I'm pleased to talk to you as the CFO of 21Vianet. Before I begin, I'd like to state that we will present non-GAAP measures today. Our non-GAAP results exclude certain non-cash expenses which are not a part of our core operations. The details of these expenses may be found in the reconciliation tables included in our press release. Please note that all the financial numbers we are presenting today are in Renminbi and percentage change are year-over-year, unless otherwise noted.

As Steve mentioned earlier, we completed the divestiture of our MNS business in the third quarter of 2017, which has allowed us to shed an extensive financial burden, improve our cost structure, and focus all our resources on our core business. As we move toward a leaner business structure, we expect financial and operating metrics to show continued improvement.

Now, let me walk you through our fourth quarter 2017 financial highlights. After the MNS Spinoff, our income statement only represents the hosting and related services business.

Net revenues were 766 million, compared to 703 million in the prior year period, excluding the MNS business. The increase was mainly due to the increase in total billable cabinets attributable to growing customer demands on IDC and hybrid IT services.

Hosting MRR per cabinet for the fourth quarter was 7,766, compared to 7,878 in the prior year period and 7,817 in the third quarter.

Our adjusted gross profit was 211 million, compared to 222 million in the prior year period, which includes the MNS business. Adjusted gross margin increased to 27.6% percent, compared to 24.7% percent in the prior year period. The margin expansion was primarily due to the company's execution of cost control strategies.

Adjusted operating expenses were 173 million, compared to 310 million in the prior year period. As a percentage of net revenues, adjusted operating expenses were 22.6% percent, compared to 34.4% percent in the prior year period.

Sales and marketing expenses improved to 43 million, compared to 92 million in the prior year period. The improvement was mainly due to the MNS spinoff.

General and administrative expenses improved to 115 million, compared to 187 million in the prior year period. The improvement was mainly due to the MNS spinoff and a reduction in headcount.

Research and development expenses improved to 29 million, compared to 38 million in the prior year period. The improvement was mainly due to the MNS spinoff.

In December last year, we also announced the complete divesture of all remaining equity interest in Aipu, and the elimination of the Aipu put option. This resulted in a non-cash gain of 677 million. However, it is removed from our Adjusted EBITDA.

Adjusted EBITDA increased to 171 million, compared to 52 million in the prior year period. Adjusted EBITDA margin increased to 22.3% percent compared to 5.8% percent in the prior year period.

Adjusted EBITDA for hosting and related services business was 171 million, compared to 130 million in the prior year period, excluding the MNS business. The increase was primarily due to revenue growth as well as improving cost controls and operating efficiency.

Adjusted net gain improved to 52 million, compared to a loss of 71 million in the prior year period. Adjusted net margin was 6.7% percent, compared to negative 7.8% percent in the prior year period.

Adjusted diluted gain per share was 8 cents, which represents the equivalent of 48 cents per ADS.

Turning to our cash flow and balance sheet. We generated 106 million of positive cash flow from operating activities during the fourth quarter. Our cash and cash equivalents and short-term investment were 2.5 billion as of December 31, 2017.

Now, let me provide you with our guidance. Our guidance for 2018 will only reflect hosting and related services.

For the first quarter of 2018, we expect net revenues to be in the range of 770 million to 790 million. Adjusted EBITDA is expected to be in the range of 178 million to 190 million.

For the full year 2018, we expect net revenues to be in the range of 3.25 billion to 3.35 billion. Adjusted EBITDA is expected to be in the range of 750 million to 830 million.

Now I'd like to hand the call back over to Alvin for closing remarks.

Alvin Shiqi Wang, Co-CEO:

Thank you Sharon.

I'd like to take this opportunity to briefly share our Company's strategy going forward. As we previously communicated, we will refocus on our core business: IDC and related services, cloud computing operations and VPN services.

In regards to IDC and related services, we view the market as having retail and whole-sale segments. In order to defend our leading position and gain market share in the retail segment, we will continue to increase our supply capacity in tier 1 and select tier 2 cities. We will continuously optimize our operational efficiency. Our increasing Hybrid IT / Cloud capability also gives us competitive advantages and creates greater value for our customers, as well as increasing stickiness. And for the wholesale market, by leveraging our major stakeholders and strategic partners, we are building up our capabilities and customer base in this segment. We already have numerous whole-sale projects in our pipeline, most of which will come online in 2019.

Also for this year, we're going to implement Performance-based Stock Units for senior executives and key employees, which will focus on KPIs such as revenue, EBITDA, and share price.

With our re-aligned strategy in place, strong support from major stakeholders, and a fully motivated team, we're confident and ready to embrace the growth opportunities going forward.

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

Closing remarks

Once again, thank you all for joining us today. Please don't hesitate to contact us if you have any further questions. We look forward to talking with you in the coming quarters.