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CCIH - Q1 2015 Chinacache International Holdings Ltd Earnings Call

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Ken Zhang *ChinaCache - President*

Jing An *ChinaCache - CFO*

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Jun Zhang *Rosenblatt Securities - Analyst*

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PRESENTATION

Operator

Hello. Thank you for standing by for the ChinaCache First Quarter 2015 Earnings Conference Call.

At this time, participants are in a listen-only mode. After management's prepared remarks, there will be a question and answer session.

Today's conference is being recorded. If you have any objections you may disconnect at this time.

Now, I would like to transfer the call over to ChinaCache. Thank you. Please go ahead.

Unidentified Company Representative

Hello, everyone, and welcome to ChinaCache first quarter 2015 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 Web site.

Today, you will hear from Mr. Song Wang, ChinaCache Founder, Chairman and CEO; Dr. Ken Zhang, the Company's President; and Ms. Jing An, Chief Financial Officer. 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 relevant law.

Our earnings press release and 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 Web site.

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 Web site.

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



Song Wang - *ChinaCache - Founder, Chairman, CEO*

(interpreted) Thank you for joining us today. I am pleased to report our first quarter 2015 financial results and to provide updates on many of the operational and the strategic initiatives that we mentioned during our last call.

During the first quarter, we continued to improve our network infrastructure and operational efficiency. Our High Performance Cloud Cache, HPCC for short, platform migration has been completed on schedule. During the first quarter, the platform demonstrated a significant improvement in efficiency, leading the industry on all performance indicators. HPCC is the first of cloud-based CDN platform in the industry.

We've also launched our Bandwidth Schedule Platform, BSP for short. This is a cloud-based bandwidth allocation system, combining real-time data computing and big data analysis to realize predictable bandwidth capacity and intelligent scheduling. By optimizing automation and balancing traffic throughout the entire CDN network, BSP has reduced the manual operation by 70%, lowered error rates by 50% and most importantly elevated bandwidth utilization as the stability of the new platform continues to improve.

The successful launches of HPCC and BSP have formed a solid foundation for our Big Data Platform, BDP, which we initiated in January. As the very first client of BDP, Huawei has been vested in the founder platform since March with more efficient real-time data collection and analysis.

Reviewing the first quarter 2015 results, we saw strong revenue growth from the video, mobile usage, mobile applications and enterprise sectors, as the trend towards cloud-based services and applications continues.

Turning now to our video sector. Revenue reached RMB113 million in the first quarter of 2015, up 45% year-over-year. Zhejiang Satellite TV, or ZJSTV for short, our latest media client, worked seamlessly with us to successfully launch its live streaming business as an addition to its video-on-demand service. During the National People's Congress and the Chinese Political Consultative Conference, we ensured the smooth streaming of the event with zero technical errors for people.cn, China Radio International, and Beijing Radio and Television Network.

Our proprietary media platform, SMS, which stands for Smart Media Server, that enables interactive live streaming of content in different formats for online delivery to multiple networks and devices, was launched in the first quarter with stable performance and has been profitable to the Company. Recently, bianfeng.com became our client for SMS.

For our video sector in the second quarter, we look forward to further meeting the demand of key customers, including bianfeng.com, huomaotv.com and Wasu. We aim to enhance penetration and expand market share within the online video, OTT and education sectors, and to partner with small carriers to reduce bandwidth pressure and costs.

Lastly, we envision connecting SMS to our enterprise self-provisioned platform, Webluker, for clients with higher automation requirements. We look forward to teaming up with more cloud-based customers and agents to generate future growth.

Turning to mobile, we have added Nice and In, the two largest photo sharing social applications to our growing list of MPlus clients during the first quarter. Demand for photo sharing continues to grow very rapidly in China, with In dominant in Southern China and Nice dominant in the North. We're well-positioned to be part of this transformation as we stay ahead of the mobile CDN industry.

Blued, the first Chinese mobile social application for the LGBT community with more than 15 million registered users, also became a customer in the first quarter. We're also running tests with three additional high-profile companies, all of which are expected to become MPlus clients in the second quarter. The first is an e-commerce company with over 90 million registered users, including 36 million mobile users. The second is a famous online medical company, and the third is a global professional social network with over 300 million registered users.

Now moving on to our Enterprise segment. Enterprise remains a key area of focus for our company in 2015. Our strategy is to provide total network solutions to our current enterprise customers from untraditional Internet sectors, including banking, Internet finance, automobiles, and healthcare. Our leading position in these sectors has enabled us to add S.F. Express to our growing list of enterprise customers. S.F. Express is the oldest and the largest logistics company in China, and the addition of this highly regarded customer will enable us to gain more exposure to the logistics industry.

During the first quarter, we formed a strategic partnership with evervc.com, a professional startup crowd-sourcing platform to provide total solutions for startup companies on its Web site. As a popular platform for Internet and entrepreneurs, evervc.com will help ChinaCache identify companies that can benefit from our total CDN solution while obtaining first-hand data from the front line of the Internet industry. This data will ultimately benefit our R&D process to enhance the Company's core technology strength.

For our broadcast and television clients, we provide CDN solutions based on visual data analysis. Through ongoing customized solutions, ChinaCache helps these clients strengthen competitiveness, focus on core business expansion, and achieve the user experience optimization and speed. We have successfully partnered with broadcast and television clients in many provinces and municipalities, including Jiangsu province, Hubei province, Tianjin, Heze, and Weihai, et cetera.

ChinaCache also formed an exclusive partnership with China Telecom Shanghai to explore international cache business to reduce bandwidth costs. We will leverage our experience with banks and Internet finance companies to explore the needs of local commercial banks and the joint equity commercial banks. As a result of our efforts during the first quarter, we anticipate that new projects will be forthcoming in the second quarter.

Turning now to Webluker. We achieved more total customized CDN volume from small and medium-sized enterprises in the first quarter of 2015 than we recorded during the entire year of 2014. We believe demand for Webluker will continue to grow in the coming quarters. During the second quarter following a successful trial run, we expect to provide Webluker services to several world-class companies, including Samsung, Ford Motor, and Chinese cloud computing expert, Kingsoft Cloud.

I am very pleased with our achievements in R&D, operations, and new products, and I am confident of continued progress in the second quarter.

I would now like to turn the call over to our President, Mr. Ken Zhang, for an operational update. Ken, please?

Ken Zhang - *ChinaCache - President*

Thank you, Mr. Wang. Q1 has been very important for our new product and the new platform. We are pleased to see a successful ongoing transition to our cloud-based HPCC, high performance cloud cache platform. Last quarter, we provided an update on the status of our super node, high performance cloud cache HPCC, and bandwidth scheduling platform BSP initiative.

During the first quarter, we made further progress on the HPCC migration work. With the deployment of more flexible and redundant super node and the successful migration of services to our cloud-based HPCC platform, and the launch of bandwidth scheduling platform, which optimizes bandwidth usage and balances traffic throughout the entire CDN network, we can provide to our clients with a more efficient and a stable network. By end of Q1, over 90% of traffic is supported by HPCC platform now.

A well-known microblogging client has been experienced a stable and efficient operation on our HPCC platform for the last two quarters. During this time, HPCC has proven to over better optimize the bandwidth usage with less than 10% fluctuation on single node utilization; single node storage capacity exceeded over one billion files and 10% reduction in backhaul traffic.

MPlus. In the first quarter, our MPlus solution received the most innovative product award from IT Time Weekly Magazine Beijing, alongside with other well-known brands such as HP and Lenovo. This was shortly after our launch of MPlus in December 2014.

MPlus is a network-aware, terminal-aware, application-aware network solution that realize acceleration through the implementation of file merge, deferred loading and HTML analysis. MPlus demonstrate clear advantages for mobile e-commerce, mobile games, mobile social, and other mobile Internet services start to generate heavy data traffic, allowing them to achieve substantially higher transmission speed. By integrating this customized one-stop toll free data solution for end users, MPlus helps our customers lower their operating costs while significantly enhancing the end-user experience. This will enhance mobile Internet companies' competitive advantages in the increasingly competitive market and help lower their marketing costs.

During the first quarter, we have seen a growing popularity of this product. We are confident MPlus will contribute to our mobile growth strategy in the coming quarters.

Smart Media Service. In the first quarter, another important strategic initiative for ChinaCache was the launch of our Smart Media Server. SMS is a propriety platform that enables interactive live streaming of content in different formats for online delivery through multiple networks. SMS is built on top of our cloud-based HPCC platform.

In the next couple of years, we believe video traffic and the live streaming content delivery will be increasingly popular in the sector like gaming, talk show entertainment, education, news portal, and high definition Internet TV. With the launch of our SMS platform, we can quickly adapt to clients' rapidly changing video live content streaming needs, which will allow us to embrace the opportunity and expand our market share.

Our SMS platform provides enhanced accelerated distribution of streaming media content. SMS supports both standard protocol and on-demand real-time messaging protocols, enabling developers to create interactive application that includes multimedia content. SMS also supports SWF, token and refer encryption.

We believe in the second and the third quarter, we will see more business breakthrough from SMS product.

Webluker. Last but not least, I would like to discuss about the Webluker. Webluker is our self-provisioned cloud CDN platform, which we designed to support small, medium enterprise and the individuals looking for CDN solutions with seamless cloud storage and the domain hosting.

In recent years, China online gaming companies looking to expand the overseas market share, while Japanese and Korea online gaming enterprises looking for opportunity to enter the Chinese market. The high cost of IT infrastructure and the poor Internet backbone performance in China is becoming a major obstacle for them.

With our Webluker platform, small, medium enterprise can enjoy a customized full suite of solution that include CDN service bundled with cloud hosting depending on each small medium enterprise unique needs. Small medium enterprise was able to take full control of costs easily and quickly deploy CDN service even in overseas markets.

Supported by ChinaCache's strong technology and the broad domestic and international network, Webluker offers the best coverage of CDN service in China and with coverage in Southeast Asia, Mid East, North America, Europe, Australia, and the South America where domestic online gaming companies see a growing overseas market.

Based on Webluker platform, we are planning to launch a new CDN service called Nova CDN. This service is aimed to supporting global business partners launching their service in China. We will provide more update on Nova CDN during next quarter earnings report.

Since the introduction in 2010, Webluker has specialized in offering complete efficient network service to a wide variety of customers. Over the last four years, Webluker has been transformed from a single cloud product to a much more diversified cloud-based full CDN solution, including self-provision HD video live streaming -- live broadcasting. Currently, Webluker has over 30,000 registered small, medium enterprise customers.

In 2015, with the full upgrade to our new cloud-based platform, Webluker represents a great value for Chinese online companies looking to expand their overseas markets, while also providing connection for overseas online business looking to enter to the Chinese market.

Now, I will turn the call over to our CFO, An Jing to discuss first quarter financial results in more detail.

Please?



Jing An - ChinaCache - CFO

Thank you, Ken. Hello, everyone, and thank you for your participation. Today, my presentation will start with a review of the first quarter of 2015 financial results, followed by our guidance for the second quarter of 2015. We will then open the call for questions. Please note that the denominating currency is RMB unless otherwise specified.

During the first quarter, ChinaCache recorded a net revenue of RMB363.7 million exceeding the high-end of the guidance range by 3.9%, and representing a 12.3% increase year-over-year.

The completion of our customer migration onto the High Performance Cloud Cache platform was better than we expected. That resulting in higher actual first quarter revenue than we originally expected. However, we just launched BSP platform in Q2. We still have work to do and need a little bit more time to continue all of our optimization efforts for these major initiatives. As a result, we expect our second quarter revenues to be between RMB392 million and RMB403 million representing 13.2% to 16.4% growth over the second quarter of last year, and 7.8% to 10.8% growth over the previous quarter.

In terms of the financial year of 2015, we are still confident that we are on track to achieve our full year target and will remain fully committed to the long-term profitable growth.

The first quarter gross margin were 29.5% compared to 30% in the previous quarter. The change was primarily due to two factors. First, our depreciation expenses increased slightly as a percentage of revenue due to the increased capital investment in upgrading our super node in 2014. Secondly, our share-based compensation increased.

Excluding the share-based compensation, the first quarter of 2015 gross margin was 29.9% compared to 30% in the previous quarter. Despite these increases, we will maintain a stable bandwidth cost as a percentage of the total revenue.

In the first quarter, non-GAAP operating income, which excludes share-based compensation expenses, was RMB14.1 million compared to a non-GAAP operating loss of RMB20.8 million in the previous quarter and a non-GAAP operating income of RMB3.7 million in the first quarter of 2014. We are very pleased that we achieved successful operational leverage throughout the company, and that they drove a substantial increase in our non-GAAP operating income on a year-over-year basis.

Looking at operating expenses lines, our general and administrative expenses for the first quarter was RMB49.7 million, representing 13.7% of net revenue, compared to RMB73.8 million or 21.8% of the net revenue in the previous quarters.

Sales and marketing expenses for the first quarter was RMB31.8 million or 8.8% of the net revenue, a slight increase from 8.6% of the revenue in the previous quarter. Total sales and marketing expenses increased 9.1% quarter-over-quarter, primarily due to the share-based compensation in the first quarter of 2015. However, on a year-over-year basis, sales and marketing expenses declined by 2.6% primarily due to the continued operation efficiency.

R&D expenses for the first quarter were RMB27 million or 7.4% of the net revenue, compared to RMB28.1 million or 8.3% of the net revenue in the previous quarter, representing a 4.1% decrease from the previous quarters and a 4.4% decrease from the corresponding period in 2014. The overall decrease was mainly due to increased investments in the advancing of our infrastructure development throughout 2014.

Our total operation expenses were RMB108.5 million or 29.8% of the revenue, compared to RMB131.1 million or 38.7% of the revenue in the previous quarter. This decrease was mainly due to the one-time debt provision that we recorded in the fourth quarter of 2014.

We are off to a good start in 2015 with adjusted net income reaching RMB10.4 million in the first quarter compared to a net loss of RMB16.8 million in the fourth quarter of 2014, and RMB2.7 million in the corresponding period in 2014.

I'm pleased with our performance in the first quarter despite the ongoing platform migration interruption we experienced in the first quarter of 2015.

Our non-GAAP diluted earnings per ADS in the first quarter were RMB0.39, compared with a loss of RMB0.63 in the previous quarter. Adjusted EBITDA was RMB49.7 million in the first quarter compared with RMB12.1 million in the first quarter of 2014, representing a quarter-over-quarter of growth of 309.6% and year-over-year growth of 95.2% from RMB25.4 million in the corresponding period in 2014.

Adjusted EBITDA margin for the first quarter of 2015 was 13.7% versus 7.9% for the corresponding period in 2014.

Moving to the balance sheet, we had RMB681 million in cash and cash equivalents as of March 31, 2015. Our cash balance increased from year-end 2014 primarily because of cash prepayments from the customer for our cloud data center infrastructure. In addition, we have made significant improvements of our sales cycle. In the first quarter, our DSOs declined to 101 days as we implemented more strict internal control policies, compared to 111 days in the previous quarter.

Also, we spent RMB56.1 million for the CapEx in the first quarter of 2015, mainly for the increased storage in the proportion with the increased revenue. Now, let's open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Okay. Our first question comes from the line of Jun Zhang of Rosenblatt. Please ask your question.

Jun Zhang - Rosenblatt Securities - Analyst

Hey, Wang Zong, Ken Zhang, thanks for taking my question. So, yes, my first question is that, could you give us more color on the Q2 guidance. It seems to be it sequentially grows with 7% to 10%, but also it seems to be a year-over-year growth rate still below the 10% year-over-year. That's my first question. Thanks.

Jing An - ChinaCache - CFO

Okay. So let me take the question first. This is Jing. We put a lot of effort in Q1 to launch our - to finish our HPCC migration and in Q2 we just launched the BSP platform, so that should take us a little bit time to ramp up everything and run the platform very smoothly and to fulfill the service. That's the primary reason.

Jun Zhang - Rosenblatt Securities - Analyst

Okay. Okay. Thanks. So my second question, could you provide us more details about your - the various updates on the partnership with the China Telecom and China Mobile, because last year they had some partnership with both trying to share the CDN service to the enterprise clients and also trying to partner with China Mobile to build the CDN nodes on the base station towers. So could you provide us some updates? Thanks.

Song Wang - ChinaCache - Founder, Chairman, CEO

(interpreted) Well, so first of all, our cooperation initiative with China Telecom project is still going forward, but because of various reasons on the part of the carriers there might have been some delays.



Now, I would also like to say a few words about our cooperation with China Mobile and our base station projects. Our cooperation on the front of technology and other fronts are still going forward, and we are also now running tests in several other provinces.

But at this point, I can't say much about the details about our corporation initiatives with those major carriers. But what I can say is that, we are now in the process of negotiation with those major carriers.

Jun Zhang - *Rosenblatt Securities - Analyst*

Thanks, Wang. That's all my questions. Thanks.

Jing An - *ChinaCache - CFO*

Thank you.

Operator

Your next question comes from the line of Liping Zhao from CICC. Please ask your question.

Liping Zhao - *CICC - Analyst*

Good morning, Mr. Wang, Mr. Zhang, and An Jing. Thank you for taking my questions and congratulations for a strong quarter. So my first question is about the share-based compensation, so if we look at the non-GAAP numbers, excluding share-based compensation impact, the bottom line is actually very good. I'm wondering what's the full-year guidance for share-based compensation. If there is not as much as - as much share-based compensation as this quarter, can we expect a positive net profit for the whole year? This is my first question. And then I have a follow-on question later.

Jing An - *ChinaCache - CFO*

This quarter's share-based compensation expense is high is mainly due to - we have an option - we see the option for the employees by the end of 2014. So that's a major increase of those expenses. But I think that in the coming year in 2015, we have a plan, by the way I think it's not the right time to discuss about this now. But if we look at share-based compensation expenses, we don't expect the significant increase of, you know, in the coming three quarters in this year.

And in terms of the non-GAAP net income or the net income, I think you just mentioned that that's our target. We put all of our effort upon the technology and operation optimizations to increase the whole company's operation efficiency that we work very hard to realize that in 2015 financial year.

Liping Zhao - *CICC - Analyst*

Okay. Thank you. And my second question is about the bandwidth cost, so can you share the percentage of bandwidth cost as a percentage of the revenue for this quarter, because recently the carriers they have just announced their detailed plan to reduce the bandwidth cost, so how much will this impact on ChinaCache?



Jing An - ChinaCache - CFO

Okay. I will answer you the first part of your question about the percentage points. And in this quarter, the bandwidth cost represents a 55.2% to the revenue, 55.2% is exactly the same percentage point with the previous quarter. So - and I think Mr. Wang or Mr. Zhang can help you about the bandwidth cost.

Song Wang - ChinaCache - Founder, Chairman, CEO

(interpreted) Just now, as you have pointed out, the major carriers in China have announced the details on the reduction of bandwidth cost. And this announcement may not have a major impact on our previous existing products, but it may have a rather a big impact on the MPlus product.

Liping Zhao - CICC - Analyst

Okay. Thank you. That's all my questions.

Operator

(Operator Instructions)

There are no more questions at this time. I'd like to hand the call back to you speakers today. Please continue.

Unidentified Company Representative

Thank you for joining us everyone. If you have any further questions, you can feel free to contact ChinaCache's Investor Relations department or The Piacente Group. Thank you so much and have a wonderful day.

Operator

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

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