

ChinaCache Forms Strategic Partnership with China Telecom for CDN Deployment

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Operator: Hello and thank you for standing by for ChinaCache conference call to discuss the company's recently announced partnership with China Telecom. At this time, all 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 to Ms Edith Kwan, Investor Relations Director of ChinaCache. Edith, please continue.

Edith Kwan: Hello everyone, and welcome to ChinaCache conference call to discuss our partnership with China Telecom for our CDN Deployment. You can find a copy of the press release in the Investor Relations section of our website.

Today we will have Mr Song Wang, Founder, Chairman and Chief Executive Officer of ChinaCache, Dr Ken Zhang, President of ChinaCache, Acting CFO Ms Jing An and Vice President Leo Fu holding this call. Dr Zhang will first give a brief prepared remarks of this strategic partnership on behalf of the ChinaCache management team. There will be a question and answer session following his remarks.

Before we proceed, please note that today's discussion will contain forward-looking statements made under the safe harbour provisions of the US Private Securities Litigation Reform Act of 1995. Forward-looking statements are subject to risk 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 statement except as required under applicable law.

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 IR website. I will now turn the call over to our President, Dr Zhang.

Ken Zhang: Thank you, Edith. Hello everyone and thank you for participating on today's call as we share with you this very exciting news.

Just a day before, we announced that ChinaCache has entered into a new strategic partnership with China Telecom, the world's largest broadband provider. It is truly a breakthrough in the Chinese CDN market. Under this agreement we will jointly advance CDN penetration throughout China while optimizing China Telecom's network efficiency nationwide. We believe this as a transformational partnership for our Company. It not only positions ChinaCache to pursue substantial new market and revenue opportunities, but is also an important step in our strategy to further scale up our business by teaming up with leading telecom operator to capture the exponential growth of Internet usage.

As telecom usage in China continues to shift from voice transmission to data transmission, telecom operators are increasingly seeking out new technologies that maximize network capacity, network efficiency, and content quality. Internet usage in China is growing at a very rapid pace, driven in large part by the continued expansion of 3G and 4G wireless technologies. With these exciting developments in mind, the ability to provide the highest-quality user experience is more important than ever for the country's telecom operators, which operate in an increasingly competitive marketplace.

We believe this partnership is a win-win for both companies. First, it allows China Telecom to leverage our best-in-class CDN technologies and services, resulting in greater network efficiency and capacity without the need for substantial incremental infrastructure investments. We will be leveraging their network resources to operate this CDN and thus optimize the Company's cost structure. At the same time, it allows ChinaCache to develop a CDN platform for China Telecom's vast broadband network, and just as importantly, promote the Company's CDN offerings leveraging China Telecom's strong enterprise sales force of over 60,000 people and their extensive installed customer base. The end result should be a rapidly growing CDN customer-base that will experience faster download times, higher-quality video, and a significantly improved Internet user experience.

CDN adoption in China is in its earliest stages, and is therefore poised for rapid growth. We estimate that current CDN penetration is in a range of 7% to 10% nationwide, and our partnership with China Telecom, which serves more than 100 million broadband subscribers and carries more than 50% of all Internet traffic in China, should allow us to significantly expand both the size of the market, as well as our revenue. In particular, we see opportunities to expand the traditional enterprise, Government and media customer segments for CDN adoption. It also opens up the future opportunities for us to further cross-sell other value-added services, including big data, mobile internet and cloud computing to this broad base of customers.

As the largest broadband provider in the world, China Telecom represents an important strategic partner, and we view this initial deal as the start of a long and productive collaboration between our two companies in support of the “Broadband China” initiative that seeks to upgrade China’s core broadband network.

In terms of the financial impact, the partnership is structured as a revenue-sharing agreement. We are to operate the CDN services. There will be only minimum bandwidth cost and capex involved from our end.

In summary, we are very excited about the new growth and business opportunities that our China Telecom partnership represents, and we look forward to working jointly to deliver a competitively superior Internet experience. With these moves, we believe ChinaCache is now well positioned along the spectrum of a converging market for CDN, cloud, public, and enterprise networks. We will continue to provide updates on the progression of this partnership, as well as other operational developments, during our regularly scheduled earnings calls.

This concludes my remarks. Now let’s open the call for questions.

Operator: Certainly. The question and answer session of this conference call will start in a moment. In order to be fair to all callers who wish to ask questions, we will take two questions at a time from each caller. You have – if you have more than two questions, please request to rejoin the question queue again after your questions have been addressed. Please be advised if you wish to ask a question you will need to press * followed by 1 on your telephone and wait for your name to be announced.

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

Liping Zhao: Good morning and congratulations and thank you for taking my questions. So my first question is what do you think will be the impact on China’s CDN competitive landscape after this deal? And my second question is will some of the original clients of ChinaCache be affected by the agreement? Thanks.

Song Wang: [Mandarin 0.09.43–0.09.56]

Edith Kwan: Working with China Telecom, we feel like they are a very more monopolistic company in the Chinese telecom industry.

Song Wang: [Mandarin 0.10.07–0.10.16]

Edith Kwan: We feel that this cooperation is a brand new cooperation mode in the Chinese CDN industry.

Song Wang: [Mandarin 0.10.23–0.10.32]

Edith Kwan: CDN in China before was not a mainstream industry.

Song Wang: [Mandarin 0.10.37–0.10.41]

Edith Kwan: So we see now the telcos are more – see more as important industry in China.

Song Wang: [Mandarin 0.10.48–0.10.52]

Edith Kwan: Following the rapid development of Internet and the mobile Internet.

Song Wang: [Mandarin 0.10.57–0.11.04]

Edith Kwan: We see that there is rapid change of a shift from the data – from the voice transmission to data transmission.

Song Wang: [Mandarin 0.11.12–0.11.16]

Edith Kwan: So CDN's value to the whole network is getting more important nowadays.

Song Wang: [Mandarin 0.11.21–0.11.28]

Edith Kwan: Therefore, the leading telco, China Telecom, now realise the importance of CDN.

Song Wang: [Mandarin 0.11.36–0.11.43]

Edith Kwan: Together, we work together to provide total network solutions to our Chinese customers.

Song Wang: [Mandarin 0.11.50–0.12.05]

Edith Kwan: Now the whole competitive landscape is now very advantageous for both of us, ChinaCache and China Telecom.

Song Wang: [Mandarin 0.12.14–0.12.28]

Edith Kwan: So this strategic cooperation carries a brand new meaning, so that would put the Chinese CDN market to keep pace with the international markets to develop as fast as other markets.

Speaker: [Mandarin 0.12.41–0.12.48]

Edith Kwan: So that it can further enhance our service capability and operations to develop this market in a rapid pace.

Ken Zhang: This is Ken. I also want to just add in one thing. You know, China Telecom's role in China is unique. As I said, China Telecom carries more than 50% the Internet traffic in China. This is unlike any carrier in the US. And I think the China Telecom has huge – has a long experience selling telecom business to enterprise. They actually have almost two-thirds of the total enterprise business in China with their existing telecom service.

And now, joint force with ChinaCache with ChinaCache's experience in Internet – an Internet sale. So we actually draw this – is actually win-win for both companies. So for China Telecom, we expand the service to the Internet space. And for ChinaCache, we expand to their customer base. So this is really win-win and there is – is beneficial for both companies, and as Mr Wang said, this will further accelerate the CDN penetration in China.

Liping Zhao: Okay, thanks, Ken and Wang Song so much. Second question about the original clients of ChinaCache, were they affected by the agreement?

Ken Zhang: No, it was not. We will go after new customers and who doesn't have any – who don't have CDN service today. So we'll – we will not touch our existing customer.

Liping Zhao: Okay, great. So I have a follow-up question. Is the partnership with China Telecom exclusive or not, which – actually, I mean do we have any chance to work with China Mobile or China Unicom as well in the future?

Song Wang: [Mandarin 0.15.21–0.15.42]

Edith Kwan: we view this cooperation should be more meaningful if it's not exclusive which means we could still have a lot more opportunities to work with other telecom services space. So we don't rule out our possibilities. And we feel like it should be more open to encourage the whole development of the industry.

Ken Zhang: Yeah, but we have ongoing business with other carriers today. So it's not exclusive on this side.

Liping Zhao: Okay, thanks.

Operator: Thank you very much. Ladies and gentlemen, once again if you wish to ask a question you will need to press *1 on your telephone and wait for your names to be announced.

Your next question comes from the line of Lucy Liu from JP Morgan. Please ask your question.

Lucy Liu: Hi, good morning. Congratulations. I have two questions. One is particularly on this China Telecom strategic agreement. I just wonder – you know, you mentioned that China Telecom can open the subscriber base to you. So just wondering, you know, in terms of exclusion, will – is the sales force mainly done by CCIH or mainly done by China Telecom, i.e. that perhaps the customer will use then your salesperson to cross-sell the product to them or China Telecom actually will help you to do the sales?

And also you mentioned the revenue sharing. So can you shed us with more light in terms of exactly what the percentage of the revenue could be shared?

And then lastly, on the cost side, you just mentioned that, you know, there are little network of bandwidth cost that the capex will be involved. So is that just applicable to the new incremental business or, you know, that will actually result into some bandwidth cost-saving to our existing CDN business given the agreement? Thank you.

Song Wang: [Mandarin 0.17.39–0.18.15]

Edith Kwan: Yes. Before, we just served our customers on our own. But now, we are looking into the new market together. Looking into right now, we just have around like 100,000 to 200,000 for our whole business. But if you look at China Telecom, they have a sales force over 60,000 and even like up to 100,000 sales that mainly serve the enterprise and government market.

Song Wang: [Mandarin 0.18.44–0.18.55]

Edith Kwan: So in future our sales to work closely with their government enterprise sales to tap into the new markets together.

Song Wang: [Mandarin 0.19.07–0.19.26]

Edith Kwan: Our revenue sharing would be different; it depends on how our sales work with each other. But for how about – and about the regular sharing percentage, it – we'll leave it to ourselves and we – it is reserved as a commercial secret to us.

Song Wang: [Mandarin 0.19.41–0.20.17]

Edith Kwan: For the advantage of China Telecom can bring to this field is they have a lot of Internet resources which include they have the wide coverage of the network, they have an extensive broadband network, they have a lot of data centres and even servers. So on the resources space, they're providing a lot of the resources on this cooperation. And on our side, we have rich service experience and technologies and also we have a lot of processes in place to serve the CDN market.

Lucy Liu: [Mandarin 0.20.54–0.21.20]

Edith Kwan: Lucy was asking about on the cost side, how does it help us to save cost? And can we quantify if – the cost savings in the future and how do we share the resources?

Jing An: You know, let me take her questions. You know, we did sign a contract, so in the second quarter we are still at the initial set-up stage. So we would expect this revenue gradually coming as early as in quarter three.

And, you know, in our side we, you know – but first of all, we are not required to make any forefront investment in this cooperation. So the revenue share come in with the minimum bandwidth cost and the capex. And, you know, the cooperation, we expect to provide a

service and technical support on the labour side, and the expansion that labour force would be a very much sale-driven. So overall, I think we will see the partnership would improve overall cost structure of our company as part of the revenue from this CDN service, CDN cooperation. So –

Lucy Liu: Thanks.

Jing An: – yeah.

Leo Fu: [Mandarin 0.22.42–0.23.37]

Edith Kwan: Leo, our VP, added that we are now actually training the China Telecom’s sales extensively on this product. And we have already finished the sales training in Beijing area and then we will also expanding to train those more developed locations such as Guangdong and Shanghai area.

And then later part, we will further expand our training to the middle and west parts of China. And actually all this training has been put online in the China Telecom’s internal website in a video format. So it should be able to train all the sales at one time based on the online training.

Lucy Liu: Thank you. Can I ask one more question, if I may? I think, you know, last week you guys announced an agreement with Nokia to include your mobile solution into Nokia’s NSN strategy. So just can you elaborate more in terms of the working model you have with Nokia? And also, you know, whether you expect to see any contribution and starting from when? Thank you.

Ken Zhang: Okay, I can take it. With the NSN, we actually developed a total solution for mobile carriers to be able to cache the content inside the mobile network. Before, all the CDN network is actually outside the mobile network. Now we are talking about caching the content inside the mobile networks and also caching the content in the radio-based stations because, you know, this – we are talking about huge number of mobile base stations covered everywhere in China. As you know, China Mobile announced that it will deploy 500,000 base stations for 4G networks.

So if we – the technology we developed together with Nokia solution is to be able to cache the content all the way to the radio base station, that kind of process will save the capex for carrier and also increase end-user experience. So, this solution is under development and we will go out and perform trials with China Mobile and China Unicom and the China Telecom in the future. So we have agreement with the carrier to try out this network – the solution.

Operator: Okay, thank you. Thank you very much. Once again ladies and gentlemen, if you wish to ask a question please press * followed by 1 on your telephone and wait for you name to be announced.

Your next question comes from the line of Peter Halesworth from Heng Ren Investments. Please ask your question.

Peter Halesworth: Hi, thank you. Can you hear me?

Ken Zhang: Yeah. Yes.

Peter Halesworth: Okay, great. Two questions, first is for 2015 what is the revenue and EBIT margin targets? And also for 2014, what is the capex forecast considering this partnership? Thank you.

Jing An: Okay. In terms of the 2015, actually we just signed a contract with them to set up the cooperation. So we will – you know, we will start to really ramp up the revenue in the third quarter of this year and we will see what’s going on in the later half of this year. And then we can provide the forecast of 2015 on this part. But we are very positive about this – this cooperation.

And before the – in terms of the 2014, that capex, actually we just provide very minimum capex for this cooperation actually. The China Telecom will contribute most of the capex in this part – in this part.

Peter Halesworth: Okay, just a quick follow up, though; I mean, what is in it really for ChinaCache and minority shareholders if we’re not really clear on what the upside is? I mean, I hear a lot about, you know, the potential, but we don’t hear anything in terms of, you know, a range of estimates or numbers as a result of it. And I think it’s important for us to have that to be able to assess the value of the partnership and also the stock.

Jing An: Yeah, we understand. So actually, we didn’t put or we didn’t budget for this cooperation and actually that’s a growth in our original plans of this year. So any revenue comes in would be an upside for us. And, you know, the – overall, the cooperation will help us to improve our cost structure of the company. So that will become economics. And of course, we will update the street and our shareholders as we progress more into this cooperation, because now it’s very early to say.

Peter Halesworth: Okay, and just one last –

Jing An: Yeah.

Peter Halesworth: Yeah. Okay. And just one last question is who will decide the pricing on CDN services?

Jing An: Sorry, can you say that again? Sorry.

Peter Halesworth: Sure. Who will decide the pricing on the CDN services? Thank you.

Jing An: We decide. We decide.

Peter Halesworth: Thank you very much.

Ken Zhang: Thank you.

Edith Kwan: Thank you.

Operator: Thank you very much. Ladies and gentlemen, as a reminder, if you wish to ask a question you will need to press * followed by 1 on your telephone keypad and wait for your name to be announced.

Your next question comes from the line of Gary Yu from Morgan Stanley. Please ask your question.

Gary Yu: Hi, thank you. I just have one question. Under this partnership, are we going to target more the enterprise customers versus the traditional Internet companies? And then if it's enterprise, how do we expect this split between, you know, enterprise customer based on the existing business model and the best enterprise customer based on this new partnership going forward? Thank you.

Song Wang: [Mandarin 0.30.13–0.30.56]

Edith Kwan: Before – before, we just – based on our team, we always worked with the top – maybe top three customers in the industry with our customers. But based on the China Telecom's extensive customer base, especially they are very specialised in the enterprise and government space; we are now very focused on the enterprise market for this new CDN product.

Ken Zhang: Yeah, I think China Telecom has very strong brand awareness among all the customer – enterprise customer. And as Leo and Mr Wang said, and – we actually coached China Telecom sales team to sell the CDN business. So together, we can expand the coverage and the penetration of CDN.

Song Wang: [Mandarin 0.31.53–0.32.14]

Edith Kwan: So existing customers will serve them as the same before. And both of our team and China Telecom's team, we already worked together on our sales contact together. And we will have a new strategy to tap into this new market.

Song Wang: [Mandarin 0.32.33–0.32.41]

Edith Kwan: We already have developed a mechanism to prevent any customer conflicts on this new product development.

Song Wang: [Mandarin 0.32.51–0.32.56]

Edith Kwan: We also encourage the sales from both teams to enjoy the benefits together and to open up the market together.

Operator: Thank you very much. Ladies and gentlemen, as a reminder, if you wish to ask a question you will need to press *1 on your telephone and wait for your name to be announced.

Once again, if you wish to ask a question please press *1 on your telephone and wait for your name to be announced.

There are no further questions at this moment. We are now approaching the end of the conference call. I will now turn the call over to ChinaCache President Dr Ken Zhang for his closing remarks.

Ken Zhang: Thank you again for joining us. I'm very excited about the China Telecom partnership. I hope we have successfully communicated our excitement about this partnership and the incremental growth opportunity that represents. I look forward to update you on this initiative on our next quarterly call. Thank you.

Operator: Thank you. Ladies and gentlemen, that does conclude our conference call today. Thank you for your participation. You may all disconnect.

[END OF TRANSCRIPT]