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CCIH - Q3 2015 ChinaCache International Holdings Ltd Earnings Call

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CORPORATE PARTICIPANTS

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

An Jing *ChinaCache International Holdings Ltd - CFO*

CONFERENCE CALL PARTICIPANTS

Jun Zhang *Rosenblatt Securities - Analyst*

Bing Chang Chen *China Internet Cafe Holdings Group, Inc - Analyst*

Dennis Wu *UBS - Analyst*

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by and welcome to the ChinaCache Third Quarter 2015 Earnings Call.

At this time, all participants are in a listen-only mode. There will be a presentation followed by question-and-answer session.

(Operator Instructions)

I must advise you that this conference is being recorded today Thursday 3 of December 2015.

I would now like to hand the call over the management of ChinaCache. Thank you. Please go ahead.

Unidentified Company Representative

Hello everyone and welcome to ChinaCache third quarter 2015 earnings web 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 website.

Today you will hear from Mr. Wang Song, ChinaCache's Founder, Chairman and CEO; and Ms. An Jing, 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 includes discussions of certain unaudited non-GAAP financial measures. Our press release 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 will be recorded. In addition, a live and archived webcast of the conference call will be available on our website.

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

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

(interpreted) Thank you joining us today. We're pleased to provide update on the operating and strategic initiatives for the third quarter of 2015.



First, I'd like to spend a few minutes to discuss our Atecsys Cloud Data Center and Internet exchange project.

We announced on December 2 that ChinaCache, Xin Run Technology Company Limited which owns and operates Atecsys Cloud Data Center sold 60% of its equity interest to investors for a total consideration of RMB375 million with a total post transaction valuation of approximately RMB625 million. We believe this transaction provides a clear and fair valuation for Xin Run and it is in the best interest of our shareholders.

The rapid growth of China's Internet industry is generating enormous demand for cloud services and Big Data which requires increased data storage and Internet Exchange infrastructure.

China's data center market size could grow at a compound annual growth rate of more than 40% over the past few years.

However, based on the recent research report from Essense Securities, the total available area of data centers in China is only 50% to 60% compared with the area in Japan and 15% to 20% compared with that in the US. We remain confident that the demand for data centers and Internet exchange services in first-tier cities like Beijing, Shanghai, Guangzhou and Shenzhen, will significantly outpace the availability in the next three years to five years as a result of limited land resources and restricted electricity supply.

Atecsys Cloud Data Center is located in the Shunyi Tianzhu Tax Free Zone in Beijing and is expected to become the largest single campus T3+ Data Center in Beijing in terms of the number of total racks capacity, which will be approximately 15,000 when completed. Atecsys offers over 80,000 square meters of customer space and comprises 10 buildings for the data center and the Internet exchange CHN-IX.

CHN-IX will be the first Internet exchange in China with international standards and capacity to be followed by a node Zhongguancun, at Haidian district of Beijing and with a plan to potentially expand into Eastern China.

In the near future, we will create an Internet ecosystem of data storage to delivery by connecting data centers in different locations with Internet exchanges and our vast content delivery network through a self-owned private backbone line (PBL). This will enable lowered cost and provide an efficient operating environment for those content providers and users. The ecosystem will make us the first provider in China as a Data Center Network or DCN to offer total solutions to Internet companies including cloud storage, cloud computing and cloud distribution.

On November 25 2015 we announced a strategic partnership with Amsterdam Internet Exchange, one of the largest Internet exchanges in the world with multiple regional presences, to develop the Internet exchange in China CHN-IX, a platform that was officially launched at the end of November. With this partnership, AMS-IX will offer consultation on platform design and provide a proven infrastructure management and customer portal software.

Meanwhile Atecsys is expected to start servicing customers in January 2016. And we plan to roll out the operation of 3,500 racks in the first half of 2016. The upper level cloud storage center of our CDN will be located in the Atecsys as well.

As we review the history of China's Internet industry, we were fortunate to be engaged in the CDN industry early and grow with the developments of the Internet. Today, we are once again standing at the forefront of the industry and we hope to create a new era for the data center network.

Now I will provide you with some updates of our core CDN business

First let me talk on video and live broadcasting.

During the third quarter, we provided video acceleration service to Hebei TV to ensure smooth nationwide access while supporting the live streaming of major events.

In August 2015 ChinaCache entered into a strategic corporation agreement with Goldenport Enterprises to provide full-course live streaming solutions during the Hong Kong-Beijing Rally 2015. With 28,000 service in 118 cities around the world we were able to provide superior services during the rally to our city and network consideration, operating maintenance and technical supports.



During the September 3rd military parade in Beijing, ChinaCache provided full-course acceleration services for China's Ministry of Foreign Affairs, Xinhua News Agency, People.cn, News.cn, China Internet News Center, China SO and other major domestic and overseas news agencies and video websites. Our total solutions included live streaming acceleration, static page acceleration and acceleration targeting for overseas markets. We also provide a clear, smooth and stable online live broadcasting experience for viewers in China and around the world.

Now, let's move to our enterprise business.

By leveraging our professional CDN services, ChinaCache developed the long-term strategic partnerships with multiple luxury and mainstream auto brands to provide integrated services and total solutions to enhance network access capacity, while maintaining a high level of availability, security and speed.

Now let's turn to our strategic corporation.

Our cooperation with Youku Router is a key milestone as it created a new ecosystem in China's CDN industry, while improving the user experience. In its unique concept, the Routers near the end-users will potentially serve as CDN acceleration nodes. By leveraging the entire idle upload bandwidth resources of the users, the program creates a virtual CDN to release backbone network traffic. We will also work with Youku Router to explore opportunities in other areas including application distribution and game acceleration in the near future.

We also entered into strategic partnership with Baidu Cloud Security to jointly provide comprehensive network security services to improve the security, access speed and availability of our Webluker platform while reducing security risks for hacker intrusion and DDoS/CC attacks.

Last but not least, I would like to update our progress, our HPCC.

We have been focused on a company-wide optimization of our platforms to enhance the overall stability and performance including API optimization, hardware updates and IO optimization as follows.

Optimization on backend storage to enhance throughput and reliability. By tuning up storage policies and reallocation of cached content, the accessibility of larger cached content has shown significant improvement.

Condensing layered structures to streamline local network interaction to improve the efficiency while accessing cached content.

Deploying hardware with higher performance, durability and low energy consumption to optimize IO.

These optimization initiatives are expected to be ready by the end of 2015 to reduce our average latency in the first quarter of 2016. In addition we are also planning actions to further advance our HPCC platform in the first quarter of 2016 such as network hardware upgrade, TCP kernel optimization and SSR name resolving system enhancement.

We currently expect the majority of the overall HPCC optimization to be completed by mid-2016. We remain confident that this is the right platform for our customers and for the long-term growth of our company. And we will continue to optimize and advance the platform. Meanwhile, we will continue to focus on customer retention while targeting new customers, develop high performance and innovative products and services for our customers and improve our execution in order to have -- to drive operating performance while increasing shareholder value.

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

An Jing - *ChinaCache International Holdings Ltd - CFO*

Hello everyone and thank you for your participation. Today my presentation will start with a review of the third quarter of 2015 results followed by our guidance for the financial year 2015. Please note that the denominating currency is RMB, unless otherwise it's specified.



In the third quarter ChinaCache recorded net revenues of RMB325.1 million, a 13.4% decrease year-over-year. The decrease in net revenues was mainly due to the reduced customer traffic as the company continues to optimize and advance its platform operation.

Third quarter, the gross margin was 19.6%, compared with 27.4% in the previous quarter. Excluding the share based compensation, the third quarter gross margin were 19.8%, compared with 27.7% in the previous quarter. The decline in gross margin was mainly due to the reduced bandwidth efficiency as a result of co-existence of the parallel platforms as to guarantee the quality of our service.

In the third quarter, the non-GAAP operating loss, which excludes share-based compensation expenses, was RMB40.1 million, compared with the non-GAAP operating income of RMB1.5 million in the previous quarter and the non-GAAP operating income of RMB12.6 million in the third quarter of 2014. The change was mainly due to a transaction tax on assets transferred from a subsidiary within the company. Excluding the transaction tax of RMB22.3 million, the non-GAAP operating loss was RMB17.8 million.

Looking at operating expenses. Our total operating expenses were RMB107.6 million or 33.1% of revenue in the third quarter of 2015, increasing 0.7% quarter-over-quarter and 4.3% year-over-year. Excluding the transaction tax of RMB22.3 million, the non-GAAP operating expenses were RMB82.1 million or 25.2% of the revenue in the third quarter of 2015, decreasing 14.8% quarter-over-quarter and 19.1% year-over-year.

Sales and marketing expenses for the third quarter were RMB28.1 million or 8.6% of the net revenue, increasing 10.2% quarter-over-quarter and decreasing 8.2% on a year-over-year basis.

R&D expenses for the third quarter were RMB23.8 million or 7.3% of the net revenue, decreasing 11.3% from the previous quarter and 20.8% from the same period in 2014. The decrease in R&D expenses from the same period of 2014 was mainly due to a significant amount of investments made in our HPCC platform throughout of 2014.

Adjusted net loss in the third quarter was RMB44.4 million compared with adjusted net income of RMB4 million in the previous quarter and an adjusted net income of RMB8.9 million in the same period of 2014. However, excluding the transaction tax, I mentioned previously, the adjusted net loss was RMB22 million. Our non-GAAP diluted loss per ADS in the third quarter was RMB1.68. Again, excluding the transaction tax, the non-GAAP diluted loss per ADS was RMB0.84.

We had an adjusted EBITDA of RMB2.5 million in the third quarter compared with RMB41.8 million in the previous quarter and RMB36.9 million in the same period of 2014. Excluding the transaction tax, the adjusted EBITDA was RMB24.8 million and adjusted EBITDA margin was 7.6%. Our balance sheet remained healthy. We had RMB618.6 million in the cash and cash equivalents as of September 30, 2015, compared with RMB375.9 million as of December 31, 2014.

Our capital expenditures in the third quarter were RMB7.7 million representing 2.4% of total revenue.

As for our guidance, ChinaCache currently expect to generate total net revenue in the range of RMB1.34 billion to RMB1.44 billion for the financial year of 2015. We remain optimistic about ChinaCache's future and are committed to creating long-term value for our shareholders.

As of December 1, 2015, the company has repurchased about 1.6 million ADS in the open market for a consideration of US\$12.3 million under our share buyback programs.

As we announced earlier on Wednesday, that the ChinaCache's Xin Run Technology in Beijing, which owns and operates Atecsys cloud data center sold 60% of its equity interest to investors for a total consideration of RMB375 million. Regarding the total post-transaction valuation of Xin Run of RMB625 million. We believe this transaction provide a clear and fair valuation of Xin Run and is in the interest of our shareholders. This transaction has been approved by the audit committee of the company's board of directors.

The proceeds will be used for expanding our datacenter network, upgrading our existing private back online and to provide the capitals for the blended Internet exchange in transaction we will recognize an investment gain of about RMB100 million.



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

QUESTIONS AND ANSWERS

Operator

Thank you. We will now begin the question-and-answer session.

(Operator Instructions)

Thank you.

Our first question comes from the line of Jun Zhang from Rosenblatt. Please go ahead.

Jun Zhang - Rosenblatt Securities - Analyst

Thanks for taking my question. So my first question is about our gross margin. So Jing could you give us more color on why the gross margin decline in quarter-to-quarter? And what do you expect the gross margin normalize or rebound going forward? Thanks.

An Jing - ChinaCache International Holdings Ltd - CFO

In terms of the gross margin, there are two reasons due to the decrease of the gross margin. The first reason is, because now we run two platforms simultaneously so that decrease the efficiency of the bandwidth utilization. And accordingly increase the bandwidth cost as a percentage of point into the revenue. This is first.

And second is that this is a mathematical issue. And because you can see that our -- the topline the revenue decrease. So that will lead to the close up sales increase, as a percentage of point into the revenue. And I think also we -- finished optimization and upgrade of our HPCC platform. So we can -- we don't have to run the two platforms parallelly. And in this way we can increase the bandwidth utilization and increase the growth margin to the normal level.

Jun Zhang - Rosenblatt Securities - Analyst

Okay thanks, yes thanks. So my second question is that the data center business you said about 60% stakes to the Chinese local investors. And could you just give us some more color on that deal. And what do you expect the data center business to do in the next couple of quarters and how that benefits the US investor of ChinaCache? Thanks.

Unidentified Speaker

(spoken in foreign language)

An Jing - ChinaCache International Holdings Ltd - CFO

Okay, so as we mentioned in the remarks, we totally raised RMB375 million and the post-money valuation for this transaction is RMB625 million and through this transactions we gathering enough cash to expand our data center business and internet exchange business. And in the next three or four quarters, we will start as we mentioned, we will start providing service of the data center business and we already open our internet exchange. So we hope that will contribute -- I think the data center business start to generate revenue from the first quarter of 2016.



And that's what financial part, in terms of the data center business in the bigger picture Mr. Wang will give you some color.

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

(interpreted) So as to your question about the data center business why do we introduce the investors into our company, is just -- it's not just the data center businesses. Actually we call this business a DCN it actually the world leading next generation new Internet service platform and it is also a supporting platform for CDN.

Although we have done a lot of work, we still need to scale out our input in this area. We have many arrangements, for example for the next step we will intend to build an Internet exchange center in Eastern China and we also have DCI which is also our strength. So for the next step we will have a three-layered service, the data center, the interconnectivity with the operators and CDN.

Jun Zhang - *Rosenblatt Securities - Analyst*

Okay, thanks. That's all my questions. Thanks.

Operator

Thank you. (Operator Instructions)

Our next question comes from the line of Bing Chang Chen from CICC. Please go ahead.

Bing Chang Chen - *China Internet Cafe Holdings Group, Inc - Analyst*

(spoken in Chinese)

My first question is about the CDN business. How does the ChinaCache improve the platform migration of schedule and then when to finish the work? Thank you.

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

(interpreted) As to the HPCC we know that we have done a lot of work in terms of the resources into R&D and the building of HPCC because this is after our revolutionary platform. And we of course have encountered some difficulties in this process. But we are now basically proceeding according to our expectations along the way.

But we know that HPCC cannot be there overnight; it requires constant improving based on our businesses and our users, but we hope that our functions will be ready by the end of the second quarter 2016, so we will keep improving our business in HPCC. Thank you.

Bing Chang Chen - *China Internet Cafe Holdings Group, Inc - Analyst*

(spoken in Chinese)

Could the management give me some more color about the IDC business like its current customers and the business model, what's the difference of the IDC from its competitors in domestic markets? Thank you.

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

(interpreted) We talked a lot about datacenter this morning and you might noted that we don't use "I" in the name of IDC, we only call it DC. I think this is our major difference from the current other companies in China.

Although we don't put an "I" before DC, we put an "I" after DC. We call it DCI. And this is our major difference with the current competitors in China.

In terms of DCI, we aren't -- we not only provide the datacenter interconnectivity, we are also the first company to provide the Internet exchange center.

We can provide the platform for all the content providers, the Internet companies and the operators.

We have also another position of our business. We also position it as DCN service provider and a data center network provider.

You also might notice that DCN companies in the world, for example, it's the world leading internet companies in the US like Google.

I have also mentioned that the three layers of our business of DCN, the data center, the data center interconnectivity, the operators and CDN.

And that's my answer for your question. Thank you.

Bing Chang Chen - *China Internet Cafe Holdings Group, Inc - Analyst*

(spoken in Chinese)

Our company is expect to build the China's first internet exchange, could you give me more details about internet exchange and what the influences and opportunities from this project? Thank you.

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

(interpreted) If we look at the global market of the internet exchange center, we can see that in the North America a number of internet exchange centers, which over 80, and in the Europe that number was over 200, and it led along the global scale. So in such environment, it's a pity that in China the number is almost zero.

Why did we choose the AMS-IX to be our partner? Because AMS-IX is one of the largest Internet exchange centers in the world with presence in several regions.

It has 20 years of experience in the business of Internet exchange centers.

By partnering with Amsterdam, we are aiming to use their technology platform to build a world's leading and high-end Internet exchange center in China.

Last week, we signed an agreement with AMS-IX in Hong Kong. We have the attendances from many major representatives for example, the operators, the BAT representatives and even the government.

And you may notice that we are about to roll out our first Atecsys center in Beijing.

And we are about to build the second node in Zhongguancun with the support of the government. This is going to be the first set regional Internet exchange center.

And we are still proceeding with our building of the Internet exchange center in Eastern China.

So with support of the Internet exchange, our DCN and CDN services will be better, more efficient with lower cost and we will better serve our operators and user as well.

Thank you.

Bing Chang Chen - *China Internet Cafe Holdings Group, Inc - Analyst*

(spoken in Chinese)

Operator

All right, thank you. (Operator Instructions)

Thank you. Our next question comes from the line of Dennis Wu from UBS. Please go ahead.

Dennis Wu - *UBS - Analyst*

(spoken in Chinese) So my first question is regarding the Internet Exchange. So how can we generate the revenue from this business?

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

(interpreted) We know that for Internet Exchange centers the services are very important. And it is the core platform for our data center clusters.

If we look at the global Internet Exchange centers businesses there are two types, one is non-profit and the other is for-profit provided by the companies. But the majority of those business are based on the large scale data center clusters.

I don't know if I have answered your question.

Dennis Wu - *UBS - Analyst*

(spoken in Chinese)

Okay thank you.

I have another question. Can the management comment about the competition landscape about to CDN industry in China especially there are lot of our competitors are also investing a lot too in their technology, in their resources to catch up with that. So how do we look at the industry?

Unidentified Company Representative

(spoken in Chinese)

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

(interpreted)



Of course, I think, in China the CDN market has a large room for all the players. We have now many companies entering this business.

But we have our own advantages accumulated over the years of experience and we have the new generation of DCN business.

As a leader of this industry with so many companies entering this business, I think, it's a good thing we will end to upgrade this entire industry with such -- so many players.

Dennis Wu - *UBS - Analyst*

(spoken in Chinese)

Thank you all, okay.

Operator

Great thank you. There are no further questions. I will hand the call back to the management for closing remarks.

Unidentified Company Representative

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

Operator

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

Editor

Portions of this transcript that are marked (interpreted) were spoken by an interpreter present on the live call. The interpreter was provided by the Company sponsoring this Event.

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