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## Q2 2019 GDS Holdings Ltd Earnings Call

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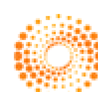

## CORPORATE PARTICIPANTS

**Laura Chen** *GDS Holdings Ltd - Head of Investor Relations*
**William Huang** *GDS Holdings Ltd - CEO and Chairman*
**Dan Newman** *GDS Holdings Ltd - CFO*

## CONFERENCE CALL PARTICIPANTS

**Jonathan Atkin** *RBC - Analyst*
**Yang Liu** *Morgan Stanley - Analyst*
**Frank Louthan** *Raymond James - Analyst*
**Robert Gutman** *Guggenheim Securities - Analyst*
**Gokul Hariharan** *JP Morgan - Analyst*
**Colin McCullum** *Credit Suisse - Analyst*

## PRESENTATION

**Operator**

Ladies and gentlemen, thank you for standing by for the GDS Holdings Ltd second quarter 2019 earnings conference call. (Operator instructions) Today's conference call is being recorded. I will now turn the call over to your host, Ms. Laura Chen, Head of Investor Relations for the Company. Please go ahead, Laura.

**Laura Chen** ***GDS Holdings Ltd - Head of Investor Relations***

Hello, everyone. Welcome to 2Q 19 earnings conference call of GDS Holdings Ltd. The Company's results were issued to newswire services earlier today and are posted online. A summary presentation, which we will refer to during this conference call, can be viewed and downloaded from our IR website at investors.gdsservices.com.

Leading today's call is Mr. William Huang, GDS founder, Chairman and CEO, who will provide an overview of our business strategy and performance. Mr. Dan Newman, GDS CFO, will then review the financial and operating results.

Before we continue, 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 involve inherent risks and uncertainties. As such, the Company's results may be materially different from the views expressed today. Further information regarding these and other risks and uncertainties is included in the Company's prospectus as filed with the US SEC. The Company does not assume any obligation to update any forward-looking statements except as required under applicable law.

Please also note that GDS Earnings press release and this conference call include discussions of unaudited GAAP financial information, as well as unaudited non-GAAP financial measures. GDS press release contains a reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures.

I will now turn the call over to GDS founder, Chairman and CEO, William Huang. Please go ahead, William.

**William Huang** ***GDS Holdings Ltd - CEO and Chairman***

Thank you, Laura. Hello, everyone. This is William. Thank you for joining us on today's call. I am pleased to report another good quarter, with strong results across all aspects of our business.

In the second quarter, we signed up customers for almost 21,000 square meters of net additional area committed, or around 52 megawatts of IT power, which should generate over $90 million of annual recurring revenue when fully delivered.

Maintaining datacenter supply in Tier 1 markets continued to be a critical success factor. We made a significant progress in securing key resource, both organically and inorganically, enabling us to maintain our resource advantage.

During this quarter, we initiated three new projects, and today we are announcing another new acquisition.



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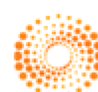

We continued to deliver operationally, resulting in over 50% service revenue growth, and over 80% adjusted EBITDA growth year-on-year. Our utilization rate moved up to 70% which drove our NOI margin to 53%, and adjusted EBITDA margin to 43.5%, putting us well ahead of the guidance track.

Last but not least, we are particularly excited about our new strategic partnership with GIC, Singapore's sovereign wealth fund, to develop and operate build-to-suit datacenters, initially focusing our program for one of our top customers. This is a milestone achievement, both from a business and from a financing perspective.

During the second quarter, our new business is up with the run-rate for the past six quarters. We did two big deals of over 20 megawatts, each with two existing hyper-scale customers. We also did one deal over 5 megawatts from a brand-new large enterprise customer, a market leader in China providing smartphone solutions.

We are in a period when there are all kinds of macro factors which may affect the market. We do not know how long it is going to last, and where it will go. However, the digital economy in China is still strong. According to the IDC research, IaaS in China is growing at 86% year-on-year and is forecast to grow at 45% CAGR over the next five years.

China has now become the second-largest cloud market globally. 90% of the China cloud market is local CSPs. Each of our cloud customers is competing with each other intensely for a bigger piece of the market. Everyone understands that this is the ground they have to win in order to win the future.

From the bottom-up perspective, we have a solid sales pipeline from an increasingly diversified customer base, which gives us good visibility for the coming quarters. We remain confident of achieving our target of around 80,000 square meters net additional area committed for this year, and the pipeline is building nicely for next year.

As you are aware, it has become more and more difficult to get approval for new projects in Tier 1 markets. As a result, supply is constrained. To deal with this challenge, we have evolved our resource strategy. We keep looking for new opportunities within metro areas, while also taking steps to secure highly strategic sites at the edge of town.

We have made significant progress on both counts, particularly in Beijing, which is the largest market in China. During the second quarter, we initiated one new project in the metro area of Beijing, and two new projects in Langfang, at the edge of Beijing.

Our Langfang land purchase, which we disclosed last quarter, has attracted great customer interest. We recently commenced construction of the first building on this greenfield site, and we are expecting to obtain pre-commitments very soon. The Langfang land will cost us around US $30 million in total, which is a relatively small up-front only. It comes with over 240 megawatts of the total power supply which will enable us to create a lot of value.

We have today signed an agreement for the acquisition of a datacenter which we call Beijing 9, located in Yizhuang, a primary datacenter hub very close to our Beijing 1, 2, 3 cluster. Beijing 9 has an IT area of around 8,000 square meters and is fully committed and stabilized. The enterprise value is at RMB693 million. We target closing by the end of this year.

With growing demand from customers, we believe that metro datacenters like Beijing 9 will become more valuable. We believe that the resource we are building up at Beijing metro and the edge of town will position us to future increase our market share in China's largest market.

We are very pleased to announce today our new tie-up with GIC, the partner of choice in the datacenter industry. Our business is strategically positioned to fulfil the requirements of the most demanding customers from all sorts of datacenter capacity in Tier 1 markets, where there is a high barrier to entry and the supply is scarce.

However, we recognize that our large internet and cloud service provider customers also require substantial capacity in the locations outside of Tier 1 markets to host their less latency-sensitive data and applications. In the past, customers typically developed such



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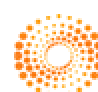

capacity in-house, but are now actively seeking ways to outsource this part of their requirement as well. Our first foray is the three build-to-suit data centers in Hebei, we did for one of our customers last year. We gained experience from these projects and the outcome is highly successful.

Since then, we have been proactively seeking an approach which will enable us to do more for our customers outside of Tier 1 markets, while leveraging our professional skills, generating additional earnings and continuing to prioritize capital allocation to Tier 1 markets. The partnership with GIC is the solution we've found. It is indeed a three-way partnership with strong endorsement by our customers. It makes us even more unique in that we are able to serve our customers wherever and whenever.

With that, I will hand over to Dan for the financial and operating review. Thank you.

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**Dan Newman** ***GDS Holdings Ltd - CFO***

Thank you, William. Starting on slide 12, when we strip out the contribution from equipment sales and the effect of FX changes, we see even stronger growth and margin improvement than is apparent in the reported numbers.

In 2Q19 our service revenue grew by 10.6%, underlying adjusted NOI grew by 14.1% and underlying adjusted EBITDA grew by 15.2% in consecutive quarters. Our underlying adjusted NOI margin reached 53% and our underlying adjusted EBITDA margin hit 44.3%, which is 9 percentage points higher than a year ago.

Turning to slide 13, with two quarters completed our revenue is well up with our expectations, having reached 46.9% at the midpoint of our original guidance. Service revenue growth is driven mainly by customers moving into the space which they previously committed. Move-in during the first half totaled 18,781 square meters. We're expecting move-in in the second half to be slightly higher than in the first half, on top of which we will have additional revenue generating capacity from Beijing 9, when the acquisition closes.

Our MSR has been pretty much flat over the past few quarters. However, we are expecting a 1 or 2 percentage point drop over the next couple of quarters. The decline over the course of 2019 may be slightly less than we were previously expecting.

Slide 14 shows some quarterly trend in margin improvement at the underlying adjusted NOI and EBITDA levels. Most of the recent margin improvement has been at the data center level. Last year we scaled up our operations materially. Now we're seeing the operating leverage on the enlarged base. In the next couple of quarters, we're expecting the NOI margin to stay at around the current level, because we have a lot of new capacity coming into service which will lead to a step-up in fixed costs.

For reference, we brought an additional 20,000 square meters into service in first half 2019 and as shown on slide 17, we will bring a further 40,000 square meters into service in second half 2019, not including the Guangzhou 6 and Beijing 9 acquisitions. We are continuously realizing operating leverage on SG&A, hence at the EBITDA level we could see some further margin improvement in the second half.

Turning to slide 17, in the first half of the year our CapEx is around RMB1.4 billion versus our full-year guidance of RMB4.5 billion to RMB5 billion. Our CapEx will pick up in the second half 2019 with ongoing construction and payments due for acquisitions. We still expect full-year 2019 CapEx to be within our guidance range.

On slide 18, currently the debt capital market environment in China is exceptionally favorable for us and we are taking advantage of this to get longer and cheaper facilities. We are also refinancing out some foreign bank loans so that we can keep that capacity in reserve to use for situations which may take longer with local banks, such as acquisition financing.

Our policy has always been to minimize FX exposures. GDS's business is almost entirely RMB denominated across revenue, OpEx and CapEx, with a small exception of our Hong Kong operations.

In the income statement we booked small translation gains and losses each quarter, as a result of moving US dollars onshore and when permitted, converting it into RMB.



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With regard to the balance sheet, 80% of our debt is denominated in RMB. Out of the 20% which is not RMB, most of it relates to the convertible bond which we issued in May 2018 and which we hope will one day become equity. We only have US$118 million in term loans denominated in US dollars and our strategy is to keep foreign currency borrowing to a minimum.

Turning to slide 19, I'd like to add to what William said about our GIC partnership. To begin with, we have signed a binding MOU with one of our largest customers for seven build-to-suit data centers at three campuses, to be developed over the next couple of years. The number of projects can change, it is up to the customer. We are certainly open to doing a lot more. The fact that this program is concentrated on a few sites makes it very practical for us.

Under the agreement with GIC, when these projects complete, we will offer them one by one for GIC to acquire at 90% equity interest. The acquisition price is designed for us to recover our development cost, including the financing element. We will retain our 10% equity interest and provide management and operating services.

Over the life of the project, we will earn a return from our equity investment plus recurring service fees. It may not be all that meaningful to talk about return on equity when our equity participation is relatively small, but on this metric these projects should look very good.

In terms of accounting, the service fees will come in at the top line and we will account for the equity interest as an associate, as we have one board seat out of three. Initially, we will bear the CapEx for each project, which could be in the order of a few hundred million RMB, which will then be reversed when we sell the 90% equity interest.

A typical project size is around 5,000 to 7,000 square meters per data center. We already have one project under construction, which we expect to complete and sell the 90% equity interest to GIC before year end.

Believe me, it is very complicated and challenging to establish a partnership like this in China. It has taken 18 months and required great commitment from GIC, from our anchor customer and last but not least, from our team led by our COO, Jamie Khoo.

I'm really proud of this achievement and grateful to our partners. It is a great solution to financing build-to-suit data centers in remote areas. But more than that, we believe that the ability to access this kind of capital will be of great strategic value to us as we develop our franchise.

Getting back to slide 20, our backlog consists of binding commitments from customers. It has increased again to over 93,000 square meters, representing 74% of our current utilized capacity. It provides high visibility to our future growth.

Our backlog is almost entirely made up of large orders from hyperscale customers. They are all very high-quality counterparties and household names. 55% of the backlog relates to data centers which are currently under construction. 55% is the highest proportion it has ever been. Over the past 12 quarters it was typically 30% to 40%. The reason why the proportion has increased is because our customers are pre-committing earlier and because we have a larger number of greenfield projects, which take longer to build.

To finish on slide 22, for FY19 we are well on track in terms of revenue relative to our guidance and, therefore, we are raising the bottom end of the guidance range to the midpoint of the guidance range, while leaving the top end unchanged.

Our EBITDA growth has been so strong that we are raising the bottom end of the guidance range by 7.3%, so that it is above the top end of the original guidance range. And we are raising the top end by 5.9%.

With regard to CapEx, we'll keep the original range unchanged. With that, I will end the formal part of my presentation. We'd now like to open the call to questions. Operator?

## QUESTIONS AND ANSWERS



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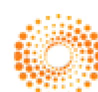

**Operator**

Thank you, sir. Ladies and gentlemen, we will now begin the question and answer session. (Operator Instructions). We have the first question from the line of Jonathan Atkin from RBC. Please ask your question.

**Jonathan Atkin** ***RBC - Analyst***

Thanks, so I have two questions, the first one is kind of on the topic of M&A. And I wondered, Beijing 9 which you have announced, what does the pipeline look like over the next several quarters for additional tuck-in acquisitions? And would they be on roughly the sort of same scale, 8000 square meters, or would it be markedly larger going forward?

And then on the GIC arrangement, I wondered how soon you would anticipate commencing any additional projects under the JV in addition to what you've already agreed upon in Jiangsu province, thanks.

**Dan Newman** ***GDS Holdings Ltd - CFO***

Hi Jon, it's Dan here. Firstly, on M&A, in the past, our business plan for this year was to do one to two M&A transactions and we've now announced two. By the way, Guangzhou 6 has not yet closed, hopefully will close in the next few weeks and Beijing 9 will close very late in the year.

We have an M&A team, we identified a number of targets, we've done diligence on quite a few data centers. We're very selective and we're financially disciplined. We find relatively few that we want to move forward with.

I think we can sustain one to two deals like the Beijing 9 deal, that order of magnitude per annum. However, I would highlight that from time to time larger opportunities come along. Guangzhou 6 and Beijing 9 are being acquired from the same seller, it's a second-tier data center operator which had a portfolio with more than 10 data centers. We diligence them all and we found two out of 10 that we wanted to move forward with.

Right now, there are one or two situations in the market for small portfolios of data centers, or single data center campuses, but there's no certainty about whether we'll proceed with those. But just to give you some color in terms of the kind of opportunity which is out there.

With regard to GIC, maybe we didn't make ourselves quite clear. We have signed an MOU with one of our largest customers. Now, under that MOU, we are committed to develop seven data centers at three campuses, so that means three locations. We mentioned one location in Jiangsu, the other two locations are in other parts of China. Those seven data centers instantly aggregate over 130 megawatts of IT power. That's the extent or the commitment under that MOU right now, but we expect the same customer to have substantially more requirement than that and over time expect the scale of what we undertake through this partnership to increase.

We're also in early stage but in discussions with three or four other customers who have their own equivalent campuses in remote areas and who are all following the trend of seeking to outsource. We're not close to doing anything but the opportunity is there to expand this to other customers as well. Does that answer your question?

**Jonathan Atkin** ***RBC - Analyst***

Yes, it does. Thank you. Just a commercial question. I think you entered this year with maybe 6% or 7% of your area committed coming up for renewal in calendar 2019. Can you maybe provide an update on what you've seen in terms of customer behavior as they renew contracts? Maybe they depart for various reasons. Are you seeing any customer churn beyond the traditional run rate that you have seen? Are the contract links that you're signing with enterprises and with hyperscalers relatively the same as what we've seen, or have there been any changes? Thank you.

**Dan Newman** ***GDS Holdings Ltd - CFO***

We rarely mention churn, because fortunately for us it's statistically insignificant. In the last quarter it was 0.2%. Occasionally, just every few quarters, there may be a churn event which results from some changes in our customer's own organization or operations, but there isn't sufficient churn to be able to characterize it in any way.



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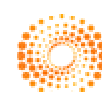

With regard to contract length, most of the hyperscale deals now are in the 6-to-10-year band. Actually, most are in the 8-to-10-year band. Just want to take this opportunity to make a comment. When these contracts are signed, it's almost invariably pre-commitment, these days quite often pre-commitment one year before the data center comes into service.

Some of the contracts have no right of early termination for the customer to terminate early at any time over the life of the contract, except, of course, if there's a serious failure in performance. The other contracts where they do have an early termination right, it typically only kicks in after the end of the move-in period. That would be, say, two years after the beginning of the service delivery. Then, there's a very severe penalty. It's tens of percent of the total contract value. So our backlog really is very solid in terms of underpinning our growth.

**Jonathan Atkin** ***RBC - Analyst***

Thanks. A question for William in terms demand trends that you're seeing whether it's gaming or AI, cloud, social networking or enterprise. Any particular industry verticals or types of companies where you're seeing demand trends notably different than three months ago?

**William Huang** ***GDS Holdings Ltd - CEO and Chairman***

So far, we didn't see any change, especially on our customer base, but what we can tell is AI is overwhelming to deploy in a different vertical right now. That's why our customers, their demands for the power capacity, each order, the size is much bigger than before. I think the current three key drivers in our view are, cloud is still the number one driver. The second is internet companies, and enterprise, especially the financial institutions, still maintain very strong demand right now. The demand profile in single order is much bigger than before.

**Jonathan Atkin** ***RBC - Analyst***

Thank you very much.

**Operator**

(Operator Instructions). We have the next question from the line of Yang Liu, Morgan Stanley. Please ask your question.

**Yang Liu** ***Morgan Stanley - Analyst***

Thanks for the opportunity to ask questions. The first one, I think Dan just mentioned that the debt financing environment is quite favorable for GDS now. Could you please give us some numbers in terms of the current debt interest rate or refinance interest rate compared with the previous terms from the banks?

The second question is, when GIC acquired the 90% stakes of the build-to-suit data centers, what is the premium in terms of the valuation compared with the cost of GDS? Thank you.

**Dan Newman** ***GDS Holdings Ltd - CFO***

Hi, Yang. It's Dan again. First of all, on the current cost of debt, we've done some refinancing of data centers recently with Chinese banks, in fact new relationships. We've also done a financial lease. The all-in cost came to less than 6%, which is three-quarters, almost 1 percentage point lower than it was a few quarters ago. I stress that is for refinancing of the data centers where we would expect to get a slightly lower price.

We also got longer tenors. We've got 8- and 10-year tenors, which is quite exceptional for project term loans with back-ended amortization. So really just about as good as it gets, I think.

You asked about the premium that we pay for acquisitions. In a way, Yang, you can figure it out, because it costs us about $5 to get $1 of EBITDA. When we do these acquisitions, it costs about $8 to get $1 for EBITDA, so you can see the premium is around 50%. But in some ways, it's academic, because we've done the acquisitions because there hasn't been an opportunity for us to do the project organically.

Sorry, can you repeat the question?



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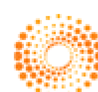

**Unidentified Company Representative**

Yang, can you repeat the second question?

**Operator**

(Operator Instructions).

**Dan Newman** ***GDS Holdings Ltd - CFO***

If I understand correctly the question was, what is the premium when we sell equity interest in a build-to-suit project to GIC? The premium is 8%. If we've incurred financing during the construction phase, that will enable us to recover our financing costs.

**Operator**

Mr. Yang, your line is open, sir.

**Yang Liu** ***Morgan Stanley - Analyst***

I have finished my questions, thank you.

**Operator**

(Operator Instructions). We have the next question from the line of Frank Louthan from Raymond James. Please ask your question.

**Frank Louthan** ***Raymond James - Analyst***

Thank you. Does the current guidance that you've given out, does that include anything for the build-to-suit projects with GIC either on the revenue or the CapEx side?

Secondly, you generally get a rolling look at your customers' business over a several-year period, updates throughout the year. Any change in how they're looking at their business over the next years going forward based on the current US trade situation? Thank you.

**Dan Newman** ***GDS Holdings Ltd - CFO***

Hi, Frank. The guidance does include the CapEx for the build-to-suit assets that we are incubating if you like during the construction period, but it's only a few hundred million. In terms of income statement, once we transfer 90% equity interest and the data centers come into service, during the first year the customer is moving in and has some flexibility about how fast they move in, so we won't be recognizing any significant service fees probably until 9 or 12 months after the data center comes into service. So there will always be that time-lag from when we complete the project.

Going back to my previous answer about the CapEx, of course when we transfer the 90% equity interest to GIC, the CapEx that we've incurred will then be reversed, or 90% of it will be reversed.

**William Huang** ***GDS Holdings Ltd - CEO and Chairman***

Frank, the second question is customers rolling demand, right? I think typically the big customer will show their three-year demand to us, especially the larger cloud and internet companies. We are pretty focused on keep talking to them regularly.

**Frank Louthan** ***Raymond James - Analyst***

Thank you very much.

**Operator**

(Operator Instructions). We have the next question from the line of Robert Gutman from Guggenheim Securities. Please ask your question.

**Robert Gutman** ***Guggenheim Securities - Analyst***

Thanks for taking the question. I'm curious on the MSR which is looking better than you'd originally anticipated. I think guidance for the year was for a decline of 5% year over year. What is underlying the fact that it's coming in a little better?



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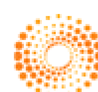

**Dan Newman** ***GDS Holdings Ltd - CFO***

Rob, when we talked about 5%, I was talking about 4Q 2018 to 4Q 2019. I talked about 5%, hoped it was going to be a little less. I'm hopeful it will be a little bit less.

When we look at the average MSR for the whole of 2019, compared with the average MSR for the whole of 2018, we're still looking at something close to about a 5% year-on-year decline, if you calculate it that way.

**Robert Gutman** ***Guggenheim Securities - Analyst***

Okay, thanks. And then just in terms of the strong results in the quarter, in terms of revenue, would you say it was more from just faster move-ins and sort of a pull forward, or was it greater-than-expected sales in the quarter with immediate commencements?

**Dan Newman** ***GDS Holdings Ltd - CFO***

Actually, Rob, the revenue was pretty much what we were expecting, internally. It's tracking the top half of guidance, at least, and that's what we forecast. What is surprising was - which even surprised us, was the profit, the EBITDA, the NOI growth. The amount of operating leverage we've been able to realize. That did exceed - that has exceeded our own expectations. Last year, we, I think, increased the headcount by 20% to 25%, because our business has gone from a 40,000-square-meter-net-add business to an 80,000-square-meter-net-add business, on an annual basis. So we had to scale up to take account of that.

And then since early this year, we've barely increased our operating cost base and that's why it's come through in very sharp margin improvement.

**Robert Gutman** ***Guggenheim Securities - Analyst***

Great. Thank you very much.

**Operator**

(Operator Instructions) We have the next question from the line of Gokul Hariharan from JP Morgan. Please ask your question.

**Gokul Hariharan** ***JP Morgan - Analyst***

Yes, hi. Thanks for taking my questions. My first question, Dan, can you talk a little bit about how much further operating leverage that is likely to happen over the next year or so, given you've seen a pretty strong operating leverage improvement over the last four to five quarters?

The second question I have is maybe for Dan and William. When talking about 80,000-square-meter pipeline capability in terms of every year potential new pipeline coming in, and the ability to prospect that and build it out, now with this GIC partnership also, would that number start to go up and be largely dedicated to Tier 1 and satellite sites? Or would some of the purpose-build sites be also included in this 80,000 square meter ability to furnish each year?

**Dan Newman** ***GDS Holdings Ltd - CFO***

Yes, Gokul, we talk about operating leverage. We always look at it at two levels, firstly, the data center level, where we look at the margin for the data centers that are stabilized and typically, I say it's 55%, of course it's a little bit higher than that. And then we have the dilution effect or dampening effect from data centers which are ramping up. And over time as the balance has shifted to a greater proportion being stabilized, that's been raising the margin.

I think over the next - you said over the next few quarters, because I think over the next couple of quarters, I expect the NOI margin to stay around the current level. And go into next year, we could be looking at, at least another 1 to 2 percentage point improvement.

I think we talk about operating leverage at the SG&A level, my ambition is to get SG&A down to 5% of revenue, because that's lower than any data center operator has ever disclosed, at any rate. So that would indicate that we've got 3% to 4% still to go, but that will take some time, but I think we continue to make steady progress in that direction.



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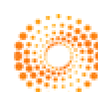

The second question about the 80,000 square meters - let me make sure I've understood correctly, and don't give the wrong answer again. The 80,000 square meters refers to what we do in our Tier 1 markets. we're not including the first project or the future projects that we undertake through this joint venture in that 80,000 square meter number. If we did, I would be adding another 7,000 square meters to our area committed, because that's what we have in project number one, in Jiangsu, so that's not been in any numbers that we've talked about before. It's entirely additive.

**Gokul Hariharan** ***JP Morgan - Analyst***

Understood. So, I just wanted to ask, is there any discussion or any interest in some kind of partnership like the - for some of your satellite and Tier 1 kind of city projects as well, or is it something that on economic basis did you see that it's better for us to actually fulfil them on its own?

**Dan Newman** ***GDS Holdings Ltd - CFO***

Well, you know our business plan and our capital raising is based on what we see in Tier 1 markets. I think we're well capitalized for the opportunity in Tier 1 markets. But as I commented during the presentation, a lot of work went into developing the structure for this partnership with GIC and a large customer. As William said, it's really a three-way partnership. The customer had to provide, to accommodate as well, and having done it now, but adapted specifically for these build-to-suit projects in remote areas, yes, it's certainly something that is in the back of our minds that we could deploy a similar structure, potentially with different ownership level, and we could deploy it with us having the majority and consolidating. Or we could do it with us having a larger stake. But conceptually, it's the same. It's a differential return as a result of having and equity investment plus a management and operating fee.

I think in this industry, given that a very large part of the demand is coming from a relatively short list -- 15 - 20 very large customers, it's important to be able to access the lowest cost equity capital and that's not always the public equity market. So having established channel, well, of course establishing a partnership with a brilliant partner in GIC, I think that positions us very well to be able to look at our requirement and see whether it's best to use our own equity which effectively comes from the public equity market, or whether it's best to use the equity of a partner like GIC.

So I don't rule that out, at all in future, but it's not something that we're specifically contemplating in terms of any actual situation right now.

**Gokul Hariharan** ***JP Morgan - Analyst***

Okay, just if I may ask a little bit more on the demand situation, I think a previous caller alluded to your view on the demand. A lot of your customers on the [better scale] side have had a tough situation in their current businesses, the future businesses are still growing, so has any of that really played into any of the capacity planning, especially [pipeline] discussions that you've had with them? And also from GDS's own perspective, how do you handicap any of those kind of concerns into future planning?

**Dan Newman** ***GDS Holdings Ltd - CFO***

Let me just summarize for William. Gokul was asking, because of the - supposedly - Gokul thinks the hyperscale customers in China may be having some challenges in their own cloud businesses - that may or may not be correct - but does that come through in terms of what we see with resource capacity planning? Any changes in capacity planning, and how do we adapt to that?

**William Huang** ***GDS Holdings Ltd - CEO and Chairman***

I think current, what we commit to the market is the 80,000 square meter, right? We can repeat that. That's what we having seen, right? I think this will not change, and because that we have very, very strong customer base, and the customer base come from the different verticals, and even in the cloud sides, we have the all kinds of the cloud in China, so I think our customer base, whatever from the vertical point of view or industry point of view, we are quite diversified.

That's how we manage our demand and certainty, and so that said, I have to say, we will not change our CapEx plan. In other words, we are confident to deliver another 80,000 square meters every year.



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**Operator**

We have the next question from the line of Colin McCullum from Credit Suisse. Please ask your question.

**Colin McCullum** ***Credit Suisse - Analyst***

Thanks for the opportunity. Hopefully you guys can hear me okay. Actually, I have a bit of a difficult question for you. It's a fundamental question. I'm just wondering on this GIC transaction, why would you choose to do it this way and only be taking a 10% stakes plus service fee on the GDS side? Is it - you alluded a couple of times to remote areas. Is it that you view these areas or the risk attached to these areas or this customer in particular, being way above what you think your public shareholders have signed up for? Or is it an issue just with finance squeezing? Or return that you would expect from these data centers?

Because you've kind of suggested that the return's okay anyway, that the customer's reliable, therefore the risk wouldn't be so big, and you've said earlier on that the financing side is very favorable at the moment, so I'm just intrigued why you've decided to do this, particularly with really such a small equity stake for the shareholders of the current shareholders of the business?

**Dan Newman** ***GDS Holdings Ltd - CFO***

Yes, thanks, Colin. That's a good question. First of all, let's be clear that the kind of project we're talking about is totally different from our mainstream business. These are build-to-suit projects on sites where, in this case, typically, the customer actually owns the real estate, owns the power infrastructure, and is outsourcing the design, the construction, the fitting out and the long-term operation of the data center. So in that respect, it's a different product entirely. It's a build-to-suit data center at a customer's site.

Secondly, we look at the quantum or the volume. I've always said that our value is in fulfilling the customer's requirement for somewhere to locate their latency sensitive data and applications. Customers have a huge requirement, which is not latency sensitive as well. So the volume of what gets put into we call them remote locations, is very substantial and our customers are asking us to follow them there.

And that's not part of our business plan, it's not part of what I said earlier, it's not part of what we've planned for in terms of our capital raising. It requires a lot of additional capital. And for relationship reasons we want to be able to do this, nobody else can do it. If we can do this as well as what we're doing in Tier 1 markets, that gives us even more edge and, to use a term, even greater moat.

The third point is about, yes, undeniably it's about the financial returns. We started off doing three projects for a customer in Hebei and of course, in this kind of situation the customer wants to outsource. But the pricing is lower, the returns are lower.

In the case of Hebei, we made it work from a financial perspective by doing it entirely with debt, senior debt and mezzanine debt. And the projects worked out very well and we got a very good spread over our cost of capital, but it was very time consuming to do that financing and we had to be sensitive about all that leverage which gets consolidated on our balance sheet.

So we started looking around to see if there was, first of all, if there was a better way of doing these projects, specifically off balance sheet, which was replicable, where we could scale up, where we could have the capacity to do as much as the customer wants. And we spoke to a range of different investors and the proposal that we received from GIC was the best one.

We have a significant operational involvement; we must have a significant operational involvement. But we wanted to maximize the fee income and look at it really as a managed project, but for the sake of a partnership and for the sake of the customer, it's important to have some equity involvement and 10% was a number that we and our partner and our customer were comfortable with. There's no particular magic about 10%, but that's where it came out.

**Colin McCullum** ***Credit Suisse - Analyst***

Understood. No, that makes a lot of sense, thank you.

**Operator**

Ladies and gentlemen, as there are no further questions, I'd like to now turn the call back to the Company for closing remarks.



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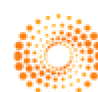

**Laura Chen** ***GDS Holdings Ltd - Head of Investor Relations***

Thank you, once again, everyone, for joining us today. If you have further questions, please feel free to contact GDS Investor Relations through the contact information on our website, or The Piacente Group Investor Relations. Thank you.

**Operator**

This concludes this conference call. You may now disconnect your line, thank you.

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