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Q4 2019 GDS Holdings Ltd Earnings Call

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PRESENTATION

Operator

Hello, ladies and gentlemen. Thank you for standing by for GDS Holdings Limited fourth quarter and full-year 2019 earnings conference call (Operator Instructions). I will now turn the call over to your host, Miss Laura Chen, Head of Investor Relations for the Company. Please go ahead, Laura.

Laura Chen ***GDS Holdings Limited - Head of IR***

Hello, everyone. Welcome to the 4Q2019 and the full-year 2019 earnings conference call of GDS Holdings Limited. We are deeply sorry to keep you guys waiting for so long, but we just had some technical issues last minute to file our release with the SEC. So we assure you that everything's fine.

The Company's results were issued via newswire services earlier today and are posted online. A summary presentation, which we'll refer to during this conference call, can be viewed and downloaded probably soon 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. Ms. Jamie Khoo, our COO, is also available to answer questions.

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's earnings press release and this conference call include discussions of unaudited GAAP financial information, as well as unaudited non-GAAP financial measures. GDS's press release contains the reconciliation of the unaudited non-GAAP measures to the unaudited most directly comparable GAAP measures.

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

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

Hello, everyone. This is William, I'm here in Hong Kong with Dan and Jamie. Thank you for joining us on today's call.

With all the recent developments, 2019 feels like a long time ago, but please allow me to begin by talking about our great achievement last year. First of all, we hit our sales target, adding over 81,000 sqm or 174 MW of new customer commitments. When fully delivered, this will add RMB2.4 billion, or US$345 million of annual recurring revenue.

We expanded the data center capacity in line with sales, adding over 90,000 sqm in service and under construction. In addition, we expanded our development pipeline. We currently have over 320,000 sqm secured for future development, which is far more than anybody else in the market. It's very valuable and key to our continuing success.

All of our sales and all of our capacity additions were in tier 1 markets. Our financial results were impressive. We grew revenue by 47.6% and adjusted EBITDA by 74.3% year-over-year. We beat guidance on both metrics. Our adjusted EBITDA margin came out nearly 7 percentage points higher.

We raised US$900 million of equity to ensure that we can keep on growing at the current pace or faster. Furthermore, we established an innovative strategic partnership with GIC, which expands our addressable market and gives us access to an alternative source of equity.

Let's turn to slide 5, demand was consistently stronger throughout 2019. What is driving this? First and foremost, is cloud adoption. AliCloud, the market leader reported over 60% revenue growth for the last quarter. Tencent Cloud just reported nearly 90% growth.

The cloud in China is still at an early stage in terms of penetrating large enterprises. In addition to cloud, we have recently started to see our customers gearing up in anticipation of 5G take-off.

Let's turn to our customer franchise on slide 6. The major highlight is the expansion of our hyperscale customer base. On the one hand, demand from our top two customers was very well sustained and continues to drive around 50% of our sales.

On the other hand, we made breakthroughs with several key accounts, as a result of which we are now a significant service provider to almost all of the hyperscale customers in China.

The winning factors are our multi-market platform continues supply, long-term track record, reputation for operational excellence, transparency, and financial capability. These are the differentiators which have taken years to develop and are not easily matched. We believe that our market share has increased in tier 1 markets, with our current customer mix, we are plugged into growth across the digital economy.

In addition to hyperscale, we added some highly prestigious new logos. In the last quarter, we signed a master sales agreement with Apple and won our first business from PayPal.

We entered this year with great sales momentum. As a result, we have raised our sales target for 2020 to 100 sqm net add, made up of 80,000 sqm organic growth and 20,000 sqm from the pending acquisition in Beijing. This target did not reflect any flow through from increased usage of digital services in the current period.

In 1Q20 we are on track to achieve comfortably over 20,000 sqm net add and next quarter also looks very strong. This demonstrates that customers are not holding back. We expect to make a lot of progress towards the 100,000 target by the middle of the year.

Turning to slide 7, not only is demand strong, it is also very noticeable that customers have changed their approach. They are pre-committing earlier to secure their supply. This is reflected in the upward trend in our pre-commitment rate. In reality almost everything that we do is driven by specific customer requirements.

On slide 9, as we have been saying for a while, the biggest challenge is keeping up with demand in tier 1 markets. To deal with this challenge we have evolved our approach to project sourcing in three major ways.

First, because of the restriction on data center development in urban areas, we have established a supplementary presence at the edge of town, such as Langfang to serve Beijing and Kunshan and Changshu to serve Shanghai.

Second, we have increased our property ownership, existing buildings in urban areas and greenfield land at the edge of town. We now own over 50% of our entire capacity, including the development pipeline, as compared with around 20% at the end of 2018. Increased ownership gives us much more flexibility and certainty of supply.

And third, we have put tremendous effort into building up our pipeline of future projects. We aim to have at least three years' supply in each market and have made great progress towards this goal. The change of approach is already yielding great results.

Let's move to page 10. Take Langfang as an example on slide 10. It's 50 kilometers from Beijing, and a viable edge of town location, due to the existing concentration of carrier data centers. We selected Langfang with the endorsement of our top customers and spent a long time working with the local government on a framework agreement for power, land and investment.

One year ago we had nothing in Langfang. As of today, we have 30,000 sqm of capacity, in service and under construction, across five data centers, all of which are 100% committed by our top customers. And we have secured another 83,000 sqm of developable capacity. We aim to repeat this success in other tier 1 markets.

Another way in which we have evolved our approach is with regard to acquisitions. We started off a few years ago viewing M&A as a means of adding to our supply. Now we also view it as a way of increasing our presence in key locations, expanding our relationship with strategic customers and accelerating our growth on value accretive terms.

We have stepped up our M&A efforts and if the opportunity allows, we aim to do more deals. We are actively pursuing several targets.

Before I hand over to Dan, I would like to say a few words about the current situation. From the outset of the coronavirus epidemic, our top priorities have been to ensure: (1) The safety and well-being of our employees and of the people we interact with. And (2)-Incident free operations.

So far, I'm pleased to say we have achieved both of our goals, with zero infections and zero SLA breach. It has not been easy, we made many changes to our policies, procedures and the communications, but business continuity is where we come from, it's part of our DNA.

The steps that we have taken have been very much appreciated by our customers. We have received a lot of positive feedback. It's at a time like this that you get tested, that the quality of our operations sets us apart, that customers remember why they do business with us.

Our reputation has been enhanced. Coming into 2020, we felt that our market position and capabilities had got a lot stronger over the past year, while the opportunity in front of us keeps getting bigger.

The virus epidemic is a tragedy, and our thoughts and prayers are with all those who have been affected. During these tough times, digital service has played a critical role. We have all had to change our behavior, and this may result in a structural shift in how we live and work. The importance of the underlying infrastructure has been recognized at the highest level of the Chinese Government and may result in favorable new policies. We are waiting to see the specifics.

However long it takes to get through this period, we believe that the fundamentals of our market position and opportunity will remain intact, if not stronger. With that, I will hand over to Dan for the financial and operating review. Thank you.

Dan Newman ***GDS Holdings Limited - CFO***

Thank you, William. Starting on slide 15, where we strip out the contribution from equipment sales and the effect of FX changes. FY19 finished strongly, and I am pleased to say that we beat our guidance for revenue and adjusted EBITDA.

In 4Q19 our service revenue grew by 9.5%. Underlying adjusted NOI grew by 7.4%. Underlying adjusted EBITDA grew by 8.8% in consecutive quarters. Our underlying adjusted EBITDA margin was fractionally down last quarter at 45.6%. However, for the full year our underlying adjusted EBITDA margin was substantially higher at 44.7%, compared with 37% in FY18.

Turning to slide 16. Service revenue growth is driven mainly by customers moving into the space which they previously committed.

Move-in during 4Q19 was 18,000 sqm, including 7,800 sqm from BJ9. BJ9 is an acquisition which we entered into last year. It is not closed yet, pending a final CP. As an intermediate step, the existing customers have entered into new contracts directly with us, and we have taken over operation of the data center under a management contract.

Our MSR was quite stable over the course of 2019, however we expect a slight drop in 2020, mainly due to customer location mix, acquisitions, and the timing of move-in.

Slide 17 shows the quarterly trend in margins. In 4Q19, underlying adjusted NOI margin decreased by 1 percentage point, mainly due to 45,000 sqm of new capacity coming into service in the last two quarters. In addition, under the BJ9 arrangement we are getting a low double-digit profit margin until the deal closes, which is a slight drag.

The decrease was partially offset by leverage on SG&A, which went down to 7.8% of service revenue, compared with 8.4% in the prior quarter. Adding it all up, our 4Q underlying adjusted EBITDA margin was just 0.3 percentage points lower.

For FY20, we expect around a 1 percentage point improvement at the NOI level, and a further 1% from leverage on SG&A, but the quarterly trend could be a bit up and down.

Turning to slide 20, our total CapEx in FY19 was RMB5.3 billion, including RMB1.5 billion related to acquisitions of data centers, property, and land. In 4Q19 we paid for the HK2 site, the SH14 building, and most of the consideration for the GZ6 acquisition.

Up to the end of last year, we had also paid out RMB270 million for build-to-suit joint venture projects, which will be reversed when we sell the 90% equity interest to GIC.

The majority of our CapEx consists of plant and equipment, which is essentially the same in each data center, and the cost is easily benchmarkable. We have been able to reduce our unit CapEx for P&E by 3% to 4% per annum over the last few years and expect to continue doing so.

The remainder of the CapEx relates to the building, which can be leased or owned, and to the external power infrastructure. The unit CapEx for this part can vary depending on the specifics of each project, but on average has stayed at around the same level.

On slide 22, we ended 2019 with gross debt of RMB16.2 billion, or US$2.3 billion, around 80% of which was in the form of mostly local currency denominated project term loans and finance leases. This debt is structured to fit around project cash flows and is substantially covered by our multi-year contracts with investment-grade customers. The term loans are covenant-light or have no covenant at all.

The remaining 20% of our debt is made up of the CB at HoldCo level, which is unsecured and has a remaining term of over 5 years, and of working capital facilities which we have rolled over numerous times.

In 2020, we are guiding for RMB7.5 billion of CapEx which is elevated due to payments for pending data center and property acquisitions. Assuming a conservative financing ratio of 40:60 equity to debt, we will need RMB3 billion of equity and RMB4.5 billion of debt to finance our CapEx.

For the equity part, we are sitting on RMB5.8 billion of cash, plus we expect positive operating cash flow this year. For the debt part, most of the facilities are already in place. We have RMB2.5 billion committed but undrawn, leaving about RMB2 billion which we are working on right now across seven facilities with local and foreign banks.

To put this remaining requirement into perspective, last year we secured nearly RMB6.5 billion of new debt facilities. The banking market in China is very supportive. We have a great track record as a borrower and have developed great banking relationships. I foresee no reason at all why this should not continue.

Finally, we established partnerships with Ping An and GIC to ensure that we have access to diverse funding sources and are not reliant on the public market. Regardless of the current situation, we are always considering alternative funding options with these and other potential partners to optimize our capital structure and cost.

Turning to slide 23, our contract backlog has been increasing each quarter. We ended FY19 with 108,000 sqm, equivalent to 70% of our revenue-generating area. Part of the backlog relates to data centers in service. The amount has remained in the 40,000 to 50,000 sqm range in the past five quarters, driving organic move-in of around 10,000 sqm per quarter, which implies about a four-to-five-quarter move-in period.

The remaining part of the backlog relates to data centers under construction. The amount has increased significantly, from just over 31,000 sqm at the end of 2018 to just over 57,000 sqm at the end of last year. There are two reasons for this. One, as William mentioned, customers are pre-committing earlier, and to a much greater extent. Two, as you can see from the table on page 21, we are undertaking more greenfield projects, where the construction period is around six months longer.

As the backlog related to data centers in service increases, we would expect the quarterly move-in to increase. However, this is subject to the timing of project completion and other factors in the current uncertain operating environment.

To finish on slide 24 with our guidance, we are nearly at the end of the first quarter of 2020, so before I talk about our outlook, I should mention what we have already seen in the year to date.

The Covid-19 epidemic is affecting us in two main ways, construction and move-in. At the end of January, construction across our 16 self-developed and build-to-suit projects came to a halt for Chinese New Year and did not resume until recently due to government restrictions. We are not experiencing significant problems with our supply chain as we had placed orders well in advance. Nonetheless, we have lost a couple of months, which we will try to make up. The kind of delay which we have experienced will not materially impact our financial results in the current year.

Move-in is a more material issue in the short term, as it is the primary driver of our revenue and profit growth. The first quarter is usually a seasonal low for our business, and this was reflected in our original forecast assumptions for the current year. As of today, it looks like our 1Q20 move-in will end up a few or several thousand sqm short of our original target. Nonetheless, we should still be able to achieve 1Q20 revenue and EBITDA growth in the mid to high single digits, quarter-on-quarter.

Looking forward, the situation is that we have a large amount of capacity in service, ready and waiting for our customers to move in. Our customers want to move in, but there are still many operational limitations and uncertainties in their supply chains, particularly with regard to IT hardware.

China appears to be on the path to recovery, but this will be affected by what is happening with supplies from inside and outside the country. Given the lack of visibility about the pace of recovery, we took the view that we should revise down our move-in assumption by several thousand square meters incrementally per quarter. We have not changed any other assumptions in our forecast.

Putting this into our model, we are guiding for revenue of RMB5.63 billion at the midpoint, implying 36.6% growth year-on-year, and adjusted EBITDA of RMB2.61 billion at the midpoint, implying 43.1% growth year-on-year. These growth rates are around 5 percentage points lower than what we originally intended to guide.

Our sense is that this guidance is conservative, but appropriate in the circumstances. We believe that the risk to the upside is greater than the risk to the downside.

I mentioned already our CapEx guidance of around RMB7.5 billion, of which RMB2.5 billion mainly relates to the pending acquisitions of BJ9, BJ10/11/12, and the building in Minhang district, Shanghai.

I'd like to reiterate that all of our fundamentals remain intact. Customers have not changed their plans, and despite the tough conditions, we expect our business performance to be highly resilient. We're as confident as ever about our medium- and long-term growth prospects.

With that, I'll end the formal part of my presentation and we'd now like to open the floor to questions. Operator?

QUESTIONS AND ANSWERS

Operator

Certainly, sir. Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press the pound or hash key. For the benefit of all participants on today's call, please limit yourself to two questions.

Your first question comes from the line of Yang Liu from Morgan Stanley. Please ask your question.

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

Hello. Good evening. This is Yang from Morgan Stanley. I have two questions. The first one is for William, on government policy. We noticed that recently Central Government in China encouraged the data center as a new infrastructure for the first time, and what are you expecting in term of the future policy support? Can we see more power quota or more funding support, and whether this kind of policy will change the investment and return profile, this industry?

And the second question is for the new booking target. I'm not sure if the acquisition announced in December last year, will this bleed into 2019 and 2020, or all of the around 20,000 square meter will fall to 2020's new booking? Thank you.

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

Okay, I answer the first question. I mean, yes, you're right, the first data center was categorized by the Central Government as a new strategic infrastructure in China right now. It's mainly driven by the 5G strategy, right? So I think the effect to us is now it's too early to say what happen, what's the new policy will launch specifically, but we were invited by the Central Government to discuss how to help you guys, how to give them more advice, how to give the better growth in this industry.

So, what I can tell is that there's a topic we discussed with the Central Government. I have to say, we are the only data center vendor that has been invited.

So, number one, I think what we talk about is how to release some carbon quota, in the shareable market to release the supply a little bit. But the government still have a concern about the total carbon quota deployment. So, we have discussed how to properly to release some carbon quota to data center industry.

Number two is, I mean, we talked about some topics around how to reduce the power cost in the future, and how to reduce the long interest rate. This is all discussed. So, in general, I think it's positive for us, and the Central Government want to help to develop this industry, but so far, I still say now is the stage is too early to say something right now. That's my view, yeah.

The second question.

Dan Newman ***GDS Holdings Limited - CFO***

Yes. Hi, Yang. Last year we entered into three acquisitions. Two were included as part of last year's new business, GZ6 closed, BJ9, we took over, the way I described. The third acquisition, if you call Beijing 10/11/12, announced in December. We're working hard to close that, hopefully by the middle of this year.

So, when we talk about our 100,000 sqm sales target for this year, it will be 80,000 sqm organic, and 20,000 sqm through that specific M&A deal. You know, 80,000 sqm organic is significantly more than we've done before, organic, and we believe that 80,000 sqm organic is sustainable. So that's the new normal. Beyond 80,000 sqm, it's either M&A or...

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

New increment.

Dan Newman ***GDS Holdings Limited - CFO***

...maybe some upside, yes.

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

Yes, may I add one point? We also talk about it to the Central Government, how to close some inefficiency small data center and in-house data centers, to force they use the professional data center, like us.

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

Got it. Thanks a lot.

Operator

Your next question comes from the line of Jonathan Atkin from RBC. Please ask your question.

Jonathan Atkin ***RBC Capital Markets - Analyst***

Thank you. Dan, you just sort of answered one of my questions, which was about the 100,000 being the new norm, and I wondered, do you think you can potentially do more than that, given the boost in demand that you're seeing from the current environment, either organically or through M&A?

Then I wondered if we could also pivot a little bit to the changes that have been taking place at CyrusOne and any impacts on Board membership? And just the overall relationship? I do know that Tesh, their new CEO, has spent a lot of time in China, but if you could maybe comment on CyrusOne, that would be interesting. Thank you.

Dan Newman ***GDS Holdings Limited - CFO***

Two questions -- can we do more, is the first part.

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

Yes, I think we didn't change our view. Actually, last quarter, when we talk about the market demands, we still sit on that view. The China data center market is accelerated. It was not impacted by the virus, because we believe that virus stuff is a short-term impact. So, from the mid-term and long-term view, we still think that total market will accelerate. Still number one.

That means we have the chance to do more in the future, but at this year, this first half year may be a little bit tough, but it will not change. It will not change our view for the future market, because we believe the digitalization is the overwhelming trend in China, even in global market, right.

Dan Newman ***GDS Holdings Limited - CFO***

The second one about CyrusOne.

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

The CyrusOne, I think the number one, we still maintain the relationship with CyrusOne. We still have some deals, talk about it together. It will not change that Gary stepped down or anyone - we deal with the institution, not deal with the individual, right? So, I think it will not change our relationship with CyrusOne. We still help each other. Tesh, and Jonathan, called me after the announcement, and Gary, also, we have the conversation with Gary.

So, I think the number one, we will not change the policy right now, and Gary is a respected professional in the industry. Always bring the valuable opinion in for GDS, so we appreciate that. And on the other hand, I think we, as I said, we deal with the institution, not the person, so I think the CyrusOne and GDS relationship will be not changed.

Jonathan Atkin ***RBC Capital Markets - Analyst***

Thank you. Then I wanted to maybe talk about any or ask you, have you seen any differences in the pace of deliveries and construction by the rest of the industry? You talked about how the virus has affected you, from essentially a labor standpoint and slowdowns related to that, but has that been affecting the competitors equally, or more so? I'd be interested in your perspective on that.

Then you also mentioned again, the increase in demand, and how does that influence your thinking about entering new markets? In the past, you've alluded to a couple of new metros in China that you would think about investing in. Is the appetite for that equally as strong now? Or has customer demand trends changed your thinking on that? Thank you.

Dan Newman ***GDS Holdings Limited - CFO***

Just explain to William, the first question is whether competitors have been affected like us, or to a lesser or greater extent?

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

I mean, our competitors, the effect?

Dan Newman ***GDS Holdings Limited - CFO***

Are they affected by the current situation? Have they been affected in terms of their construction timelines? Their movements?

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

I think that in general, I mean, the current situation is equal for all of our competitors, right. I think that's number one signal. An advantage for GDS, since we have the scale. We are a more easy -- more well managed internally, in my view, right, so in terms of other construction point of view, I believe we've managed better than the other competitor. This is in my view. Yeah.

Dan Newman ***GDS Holdings Limited - CFO***

Yes, and the second question from Jon, is whether we see increasing demand in other markets, new markets, and whether we have appetite to go to those places?

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

Yes, I think we would tend to go. We are ready to go any new tier one market. We feel we didn't change our view. We will go to some new market, as we mentioned last couple of quarters. Hong Kong market, Chongqing market, and something new, like Nanjing, and Hangzhou is our targets in the future.

On the other hand, we also think about the - based on our current info base customer requirement, we have serious thought about how to go to the Southeast Asia.

Jonathan Atkin ***RBC Capital Markets - Analyst***

Thank you very much.

Operator

Ladies and gentlemen, once again, for the benefit of all participants on today's call, please limit yourself to two questions. Thank you.

Your next question comes from the line of Colby Synesael, from [Cowen] (corrected by company after the call). Please ask your question.

Colby Synesael ***Cowen - Analyst***

Great, thank you. From Cowen. Two, if I may? Number one, I think you guys said in your prepared remarks, you gave some color on what leasing was looking like. I couldn't tell if you were talking specific to the first quarter or the second quarter, both, but I was hoping you could just dig a little bit deeper into what you're currently seeing.

Then, secondly, as it relates to the move-in rate, and I appreciate that you're being more conservative in that number right now, but would you expect at some future point, and I appreciate you're not going to tell us what quarter that is, or you might not know what quarter this is, but would you expect for all this to catch up?

In other words, would you expect at some point we're going to see a very sizeable quarter or two, to make up, if you will, for the lost ground, considering these developments are actually still going on, and at some point, everything's going to get completed and ultimately get to a point where all the installs are back on track? If so, if that's the case, would you expect then to see a notable impact on outer year expectations, or is this really focused on a slower 2020, but by 2021 we're back on the trajectory that we may have previously been assuming?

Dan Newman ***GDS Holdings Limited - CFO***

Yes, that's good. Thanks, Colby.

Well the first one as we are nearly at the end of the first quarter we already know what we've done from a sales point of view in the first quarter and we just said comfortably over 20,000 sqm organic. We already have a I would say a very good idea of what we're going to be able to do in the second quarter, on top of which hopefully the BJ 10/11/12 acquisition will close in the second quarter and that's 20,000 sqm there as well.

So if you add all that up versus a full year target of 100,000 you said we're going to be a long way from target, yes, but certainly means more than half way and maybe quite a bit more than half way towards that target. We just mention that because we know that as a fact and to give some confidence in what we're saying in terms of our sales target.

So for the second part what you said it could quite possibly be the case. We looked at different scenarios. We spoke to our customers and listened to the other earnings calls, people not predicting what the shape of the recovery is. We could have assumed there would be little moving the second quarter and then an enormous ramp up in the third and fourth quarter.

We decided in the end just to take the haircut to the numbers for each quarter, it's only a few thousand square meters. The resulting reduction in revenue and EBITDA was kind of the thing whether you're looking at V shaped, U shaped, or whatever. Interesting statistic that I'll throw out, in the last I guess five or six weeks from just before Chinese New Year and until a few weeks ago there was no move in, so the amount of capacity that was being utilized in our data centers was static.

But during that time period our customers' power usage went up by nearly four percentage points which means in simple terms that they're running their servers at a higher utilization rate, higher than normal, and higher than they would normally do given their operational parameters, and that's indicative of requirements to deploy more capacity. That's why we said customers want to move in so it's really a question of whether they can.

I believe that most of the current inventory of servers has already been deployed, so the next wave of move in is dependent on the production and the supply. If that comes through quite quickly or in size then, yes, I would actually expect quite a sharp ramp up in move in. Yes, and that might be what we describe as risk to the up side.

Colby Synesael ***Cowen - Analyst***

Great, thank you.

Operator

Your next question comes from the line of Gokul Hariharan from JP Morgan. Your line is open, please ask your question.

Gokul Hariharan ***J P Morgan - Analyst***

Thanks for taking my questions. I hope everybody is safe. Just first question on - could you talk a little bit about maybe, William, on how you are seeing the dynamic of better than expected demand due to work from home and more consumption, et cetera, versus the relative lack of ability to execute on move in or archiving in a component like Tencent also indicated yesterday that they are facing some degree of tightness in terms of some capacity, some hardware or the other?

Could you talk about how your customers and you are dealing with this and what are they doing to mitigate that? Are there any kind of near term measures to be able to mitigate that? What are you expecting, how is it going to manifest over the next couple of months? Are we kind of past the peak of that or are we still going to be in that kind of phase in the next couple of months or so?

The second question I had was on some of your remote sites. I think if we can take Langfang as a case study you already have one data center on the service. Could you talk a little bit about how the dynamics are shaping up in terms of operating a data center in a remote location, and how you are able to manage capacity ramp up and how the dynamics are for this kind of a data center compared to a city center data center.

One last question if I can, if I may. On the financing side I think you clearly explained where you stand in terms of availability of financing, both equity and debt. This is an industry which saw a lot of financing come in over the last couple of years for your competitors as well, especially private equity as well as other sources of financing. We talked a little bit about industry wide in terms of what you are seeing on financing pipelines, are they still intact, do we see some degree of compression on financing on an industry wide basis, thanks?

Dan Newman ***GDS Holdings Limited - CFO***

So first question - sorry, go, first question was what can be done about the - just using the supply chain, have our customers got any solutions, have we got any solutions to --

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

Yes, the customers (inaudible) or what's my question?

Dan Newman ***GDS Holdings Limited - CFO***

Gokul was asking is there anything you know any solution to that - for that problem, is there anything that we can do?

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

Yes, we can do nothing frankly speaking. We are not in this server industry. I think what I've heard above all that our customers try to get more servers, as much as possible in the current market right. So I think they pushed a lot of the suppliers to get some inventory in other country or other market to try to mitigate the impact of the supply. So that's what they're doing.

But so far we don't know what's the percentage of the target we can achieve right. So in general they are doing their best right now, what our customers have told us. So it looks like Q2 maybe we'll catch up the revenue a little bit. That's my current view.

Dan Newman ***GDS Holdings Limited - CFO***

Okay, the second question is about operating in Langfang and maybe I'll go first and you can (inaudible) talk a bit. Yes, so Gokul, the Beijing Municipal Government started to introduce restrictions on new data center approvals I think at the end of 2016, and it became apparent in 2017 that it would not be possible to maintain sufficient supply to fulfill demand within the urban area. We started then to work on the backup plan.

I'd say it took us about two years of discussions, interactions, and so on with the Langfang Government, resulting in a framework agreement which addresses allocation of substantial amount of power. In fact, you know substantial amount of the power which is available in that area and the sale of greenfield land and investment. We chose Langfang because the telecom carriers have already established major data center hubs in that market, therefore, the connectivity at least from that part of Langfang not the whole of Langfang, but that part into Beijing is very good. So in terms of latency it's only a small drop off versus the latency within Beijing.

But in order to be proceed we really had to cover two bases, one was the government and one was our customers. We had to convince our largest customers because at a place like this you're not looking for just one order from a customer, you're looking for a customer to deploy a major amount of their own capacity. So at the end of the framework agreement we were in a position to acquire the greenfield land and start the development but we'd already got our customers wound up so we found that we needed to accelerate our time to market.

So in actual fact, the first thing we did was acquire the land which is LF 3, 4, and 5. It should have been 1, 2, and 3 but because of the time to market requirement we leased a number of buildings. We leased LF1, we leased LF2, we leased LF6, we leased LF7, and that's why we have 5 data centers in that area, all 100% committed. I mean going forward the intention and the better approach would be to have all of our development on the greenfield sites, on the campuses but here it was just out of necessity.

Your third question about financing. I'm clear about our own position. I mean we have access to the public market from time to time but we also have access through partners and some very significant institutions, PRC institutions who have also expressed an interest in working with us. So I think there's a lot of scope in that approach to sourcing equity and other value add.

As far as the competition is concerned, I mean no one is anywhere remotely close to our scale. I think there's been a limited amount of private equity participation by foreign PE and domestic PE. You know from the case histories of our acquisitions that there's quite a few projects that are being undertaken with no equity and in fact no formal debt either, just a reliance on credit from suppliers.

So I don't think that on the whole our competition is particularly well capitalized or financed but I don't mean to damn them all. I'm sure that there are good companies amongst them.

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

Gokul, I added more color to your second question. I mean our original plan is to supplement supply to Beijing supply right. I think the people -- because we realized, a couple of years ago we realized the current quota is getting more tight in that Tier 1 market in the urban city and the demands are huge right. So in the first original plans we tried to convince our customer to shift a little bit to the demand to the edge of town.

But now customers and us realize those products are different, they have a same latency sensitive criteria from our customers but our customers need more big scale and more big power capacity. They want to deploy more big power density. Now we realize this type of campus and hyper scale campus is an independent product.

It means it will fulfill our customer latency sensitive but a high visibility for the future supply and a hyperscale development and a hyperscale power capacity. This cannot be replaced in the urban town. That's my view. That's instead, now it becomes a new product, in our view.

Gokul Hariharan ***J P Morgan - Analyst***

Thanks William.

Operator

Your next question comes from the line of John Wang from Macquarie. Please ask your question.

John Wang ***Macquarie - Analyst***

Hi management. Congratulations to the strong results. So, I guess my first question is, in the past, GDS is doing a very excellent job in managing the financial leverages. I do see you guys are guiding a very strong CapEx spending in 2020. I guess I want to follow up on the previous question on, do we funding the CapEx purely from the bank loan side or we need additional equity raising this year.

My second question is, so can management share some colors on whether the pandemic was actually helping or slowing down the utilization ramp-up in the first quarter? Thanks.

Dan Newman ***GDS Holdings Limited - CFO***

John, on the first question, our approach is to raise equity capital ahead of requirement so that as we initiate new projects, we can allocate from our capital we have in hand to capitalize new projects on an individual basis. We try to maintain around sufficient capital to capitalize around two years' worth of new projects. The end of last year -- we ended last year with RMB5.8 billion of cash. Most of that, effectively, is the equity for future projects.

I said that we would need about RMB3 billion of equity for new projects in 2020, so that means we'd need to use about half of that. But then there's also operating cash flow coming through. So it would look like we have sufficient equity to get us through two years. The debt side, in normal circumstances, is just about execution. It's about having relationships and a track record and sound project fundamentals and so on.

The situation we're in, actually, is that we require about RMB4.5 billion of additional debt to finance our CapEx this year. We already have RMB2.5 billion of it in committed but undrawn facilities. The remaining RMB2 billion, and actually we're working on RMB3 billion of new debt facilities right now, some of which are almost done. So there really isn't any financing risk, to what we're planning to do, at least for the next one to two years.

So the second question was whether the virus impact is actually slowing things down or speeding things up. I suppose -- I think probably you could state there's a difference between slowing things down in terms of moving, but maybe speeding things up in terms of demand.

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

Right. I think it's neutral. They're moving a little bit. Stay on the current point, what we can say is that the service supply chain looks like uncertain. So it will impact our customers move in this quarter, or maybe a little bit next quarter. But what we can tell is that in China, inside China, the manufacture is recovering right now. So I think it is a little bit positive for the Q2, as I mentioned just before.

But for the demand side, I think everybody knows this current situation left a lot of the SaaS player, a lot of Internet player and a lot of ecommerce player, a lot of the applications were well educated introduced to the market. So I think that in the mid-term, long term, maybe it will drive more demand in the future.

John Wang ***Macquarie - Analyst***

Great. Thanks.

Operator

Your next question comes from Arthur Lai from Citi. Please ask your question.

Arthur Lai ***Citi - Analyst***

Hi. Good morning, good evening. This is Arthur Lai from Citi. I have two quick questions and maybe to Dan. So the first question is, can you talk about the contract renewal schedule. The reason we ask this question is we recall at the IPO stage you talk about countries sometimes going with four years or even longer. Are we in the middle of the negotiation with the clients? Diving into the detail, in the Tier 1 city or in the retail client, was the pricing trending up or can we get the beta EBITDA margin for the new contract? That was my question. Thank you.

Dan Newman ***GDS Holdings Limited - CFO***

Thanks, Arthur. On page 36 of our earnings presentation is a summary of the amount of capacity which we have coming up for renewal in each year. In the current year it's 23,000 sqm of capacity. It's 8.9% of our total committed area and around the similar level in each of the next few years.

If you delve into the individual contracts and who are the customers, there's very little cloud or internet business coming up for renewal. It's mostly enterprise business and those contracts one, three, five years, so they renew more often and they renew automatically quite typically.

So I think this question arises from analysts and investors. I know what you'd like to get at, which is to see some benchmarks for what the pricing will be when we do get to have significant renewals with the large cloud and internet customers. But that's not going to happen this year, so I won't be able to give you any empirical evidence on that.

But going back to what William said about our layout now or configuration in terms of downtown and edge of town, if customers don't want to pay the price for downtown we have an alternative option, edge of town. Certainly we believe the downtown capacity has increased in value a lot and maybe our ability to achieve higher selling prices there. So that is something which we can certainly offer to customers.

I think the second question was if you talk about the price actually, you mentioned EBITDA margin, actually we have to talk about the price together with the unit CapEx and then in terms of a return on investment. For us, we look at it in a very fundamental way. So we talk about IRR, we can't really talk about it in terms of EBITDA margin, because that doesn't really tell you what's happening in terms of the project returns.

So the unit CapEx has been coming down, as I said, the majority of it, the P&E, has been coming down by about 3% to 4% per annum. The MFR revenue per square meter if you take over two or three years has come down, I think, by about 5% per annum.

So you can see that the degree of decline is quite close and what that tells you is that actually our returns must be pretty well sustained, if the yield and the investment costs are moving in line with each other. And that is indeed the case for IRR, from an NOI yield point of view, we're still achieving the same kind of returns over the last two to three years, which is exactly what we target to do.

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

Yes, I can answer your question on M&A and more color on that. Number 1, our customers now, how they look at the data center right now, it's the same view with us. Number 1, what they need is an urban town data center, because in the future any work adapted to the edge data center, it will benefit for the edge data center demand.

On the other hand, edge of town always fulfil their mission critical system, as we mentioned before. So I think in the future, edge of town data center will be more valuable. If our customers like to low latency but can tolerate a little bit latency issue and they want to have a big scale, close to the tier 1 market, we can offer the edge of town product to them.

If they want to just pursue the cost effective (inaudible), already we are in fact modelled to build soon for our customers in the remote areas. This is three different products which are well structured to our customers.

Arthur Lai ***Citi - Analyst***

Thank you.

Operator

Your next question comes from Frank Louthan from Raymond James. Please ask your question.

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

Great, thank you very much. Looking back to your comments earlier on the government's position on data centers is critical infrastructure, do you think will that new position make the industry more competitive? Is it going to encourage new entrants or relax foreign companies building, owning and operating data centers?

And then to your comment you just made on pricing and your cost inputs, do you think your costs go up in the short term if labor's in short supply? Thank you.

Dan Newman ***GDS Holdings Limited - CFO***

The first one is whether the government policies could lead to greater, more competition.

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

I think our view is that if government are more flexible to release carbon quota in a tier 1 market, we believe if you look at it in GDS in the Beijing market, for example, in the Beijing market, we lost a lot of deals the last couple of years because we constrained carbon quota.

So if the government release more carbon quota, and we believe we would do more business, we'd get more market share in the tier 1 market, because if the carbon quota bury is equal, that means customers will more focus on the value of the service provider.

So our customers, our major customers, they now look at a service vendor and not just the capacity. They have a lot of different criteria. That means if the carbon quota bury getting lower, that means other criteria will be more focused on from our customer. So we are well positioned in our added value.

Dan Newman ***GDS Holdings Limited - CFO***

Yes, Frank, on the labor costs, I'm not sure if you were talking about the cost of revenue or how it affected construction costs. On the cost to revenue side, most of our staff, headcount by number, is in data center operations. It's a mid to high single digit percentage of our revenue, so it's not the biggest cost item.

And it is one of the parts of our cost structure in which we're getting quite a bit of operating leverage, because whilst there are a certain number of people who have to be dedicated to each individual data center, there's also quite an amount that can be centralized.

So we don't see anything out of the ordinary in terms of inflation there. Most of our people are back at work actually. I think our data centers are fully staffed.

From a construction side, the initial delays were caused by government restricting activities and then once construction resumed, construction workers who came from other parts of the country had to go through quarantine. So it took some time for the number of workers on site to reach the full complement.

It's still not there, I think there's probably like 5000 to 6000 construction workers employed by our contractors across our 16 sites and maybe 75% are back in place. So I don't think this is a fundamental shortage, it's just a transitory thing as people come back to their place of work.

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

Okay, great, thank you very much.

Operator

As there are no further questions, I'd like to now turn the call back over to Laura for closing remarks.

Laura Chen ***GDS Holdings Limited - Head of IR***

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

Operator

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