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Q1 2022 GDS Holdings Ltd Earnings Call

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**Jonathan Atkin** *RBC Capital Markets - Analyst*  
**Michael Elias** *Cowen - Analyst*  
**Frank Louthan** *Raymond James - Analyst*  
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**Joel Ying** *Nomura - Analyst*  
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## PRESENTATION

### Operator

Hello ladies and gentlemen, thank you for standing by for GDS Holdings Limited's First Quarter 2022 Earnings Conference Call. At this time all participants are in a listen-only mode. After Management's prepared remarks there will be a question and answer session. Today's conference call is being recorded.

I would now like to turn the call over to your host, Miss Laura Chen, Head of Investor Relations for the Company. Please go ahead Laura.

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### **Laura Chen** *GDS Holdings Limited - Investor Relations*

Thank you. Hello everyone, welcome to the First Quarter 2022 Earnings Conference Call of GDS Holdings Limited. The Company's results were issued via 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.gds-services.com](http://investors.gds-services.com).

Leading today's call is Mr William Huang, GDS Founder, Chairman and the Chief Executive Officer, who will provide an overview of our business strategy and performance. Mr Dan Newman, GDS Chief Financial Officer, will then review the financial and operating results. Ms Jamie Khoo, our Chief Operating Officer, 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 US SEC. The Company does not assume any obligations to update any forward-looking statements, except as required under applicable law.

Please note that GDS earnings press release and this conference call includes discussions of unaudited GAAP financial information, as well as unaudited non-GAAP financial measures. GDS's 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 Chief Executive Officer, William. Please go ahead, William.

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### **William Huang** *GDS Holdings Limited - Founder, Chairman and CEO*

Thank you. Hello everyone, this is William. Thank you for joining us on today's call. We are operating in a difficult environment. Everyone is having to deal with unprecedented challenges, including the recent COVID lockdown in China. GDS business is resilient and defensive.

We generate recurring revenues, underpinned by long-term contract with high quality customers. Despite the challenges I am pleased to report a solid set of the result for the first quarter. We grew revenue by 32%, and adjusted EBITDA by 29% year-on-year.

We continued to win new business with 18,000 square meters of net additional customer commitments. We strengthened our funding position by raising US\$620 million from a convertible bond issued to strategic investors, and completed a further US\$530 million of project financing.

In the near-term we must deal with the challenges to the best of our ability. However at the same time we will remain focused on strengthening our strategic position for the medium-term and the longer-term through, further developing our customer franchise, adding to our resource pipeline, consolidating the market as opportunities arise, and accelerating our regional expansion.

With scarce resource already secured, greater customer relationships and a proven track record, we have locked in enormous growth potential which will materialize in the future. It is just a matter of time.

So turning to the slide 4. Starting from the late-February, mass city lockdowns happened in many areas of China because of the COVID outbreak. We have a total of 82 data centers in service out of which 58 data centers have gone through lockdown situations. Over 30 data centers are still locked down today.

During these lockdowns around 880 people were isolated inside our data centers, including 660 GDS employees, and 220 from our customers. We needed to keep our data centers in continuous operation, while keeping the people inside safe and healthy. We never failed to deliver.

All of our data centers are running as usual, without interruption. All the people inside are taken care of. We really appreciated every effort from our data center employees. It is also highly appreciated and recognised by our customers.

Turning to slide 5. The first quarter of the year is always a slower season because of the Chinese New Year. On top of this, lockdowns also impacted the move-in rate. Nonetheless, we still achieved over 12,000 square meters of net additional area utilised for the quarter. Our utilization rate increased to 67%.

As shown on slide 6 and 7, we have always maintained a high commitment rate for our area in service and area under construction. We have a very large backlog totaling 243,000 square meters, which is equivalent 73% of our area utilised. It provided us with high visibility to future growth. Our backlog is solid.

Our data centers are concentrated in Tier 1 market where supply is increasingly scarce. Our customers need this resource. We will continue to deliver the backlog. As I said, it is just a matter of time.

Turning to slide 8. We have scaled down our capacity delivery this year to align with the current slower environment. In the first quarter of 2022 we brought 4500 square meters of capacity into service, and initiated one new data center under construction, SH18 Phase 1, which is 68% backed by an anchor customer commitment.

Turning to the slide 9 and 10. While delivery is slower for some customers, there are still other customers out there with substantial new requirements. In 1Q22 we booked 18,000 square meters of new commitments, including three hyperscale orders. Two came from the existing cloud, and the large internet customers. Then the remaining one came from a new financial institution customer.

Turning to slide 11. Continuing the chain which we highlighted last quarter, financial institution and the large enterprises accounted for around 45% of new book in 1Q. We are still confident of achieving our full year sales target of around 90,000 square meters net add. From what we see in the pipeline, there could be large contributions from Hong Kong and South-East Asia than we thought before.

Turning to slide 12. I have been in Singapore for the past few months, along with our COO Jamie. We have made substantial progress in our regionalization plan. According to the Cushman & Wakefield, Singapore is a Top 5 data center market globally. It was one of the fastest growing. We know from our home market customers how much latent demand there is for Singapore. Currently Singapore governments has elected to pursue a moratorium on data center constructions.

While it may soon allow some new development, the numbers clearly indicate that excess demand will have to go elsewhere. We are one of the first movers to establish hyperscale green data center projects in close proximity to Singapore. To our understanding, there are no significant legal constraints on the flow of data cross-border between Singapore, Malaysia and Indonesia.

Our sites are therefore well-placed to serve both as regional hub, and the domestic market. Furthermore we are the only peer to have established projects both in Johor, Malaysia, to the north of Singapore, and at Batam, Indonesia, to the south of Singapore. The first phase of our 54 megawatt projects at Nusajaya Tech Park, Johor, is now under construction.

To compliment this site we recently signed a partnership with YTL Power to co-develop 168 megawatt of capacity across an [initial design of 8 individual] (corrected by the company after the call) facilities at the visionary YTL green data center park, Johor, approximately 30 kilometers from Singapore. This data center will be powered by on-site solar generation.

We have completed the land purchase in Nongsa Digital Park, Batam. The construction of the first phase of our 28 megawatt project will start in the next couple of months.

According to the Cushman & Wakefield, Hong Kong is top 10 data center market globally which offers excellent network connectivity and availability of all major cloud services. In the first quarter, we signed a build-to-suit lease for HK3. Together with our existing projects, HK1, HK2 and HK4, this will give us a continued supply of high-quality data center capacity over the next five years, all concentrated in the favorite West Kowloon area. This is an extraordinary achievement considering how difficult it is to solve for real estate in Hong Kong.

In Macau we are launching the first ever carrier-neutral data center project to meet new internet and the digitalization requirements. Across Southeast Asia, Hong Kong and Macau, we now have visibility for over 300 megawatts of capacity. Our customers are very excited about this unique strategic presence. We expect to announce several anchor orders over the course of this year. Leveraging the strength of our franchise in Mainland China, we believe that within a short period of time we will create significant additional value for our shareholders through regional expansion.

Now I will hand over to Dan for the financial and the operating review. Thank you.

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

Thank you, thank you William. Starting on slide 15 where we strip out the contribution from equipment sales and the effects of FX changes. In 1Q22 our service revenue grew by 2.6%, underlying adjusted gross profit grew by 2.3% and underlying adjusted EBITDA grew by 2.4% quarter on quarter. Our underlying adjusted EBITDA margin was 47.1% compared to 47.2% in the previous quarter.

Turning to slide 16. Service revenue growth is driven mainly by delivery of the committed backlog and closing of acquisitions. Net additional area utilized during 1Q22 was 12,545 square meters. Around 7500 square meters was in Tier 1 markets affected by lockdowns and 5000 square meters was in BOT projects in unaffected remote areas. During the second quarter, we expect a similar level of net additional area utilized.

Monthly service revenue per square meter was RMB2296 per square meter per month, down by 2.4% compared to the previous quarter. It is mainly due to dilution from move-in at BOT and edge of town projects. For FY22 we still expect MSR to decline by mid-single digits in percentage terms year on year.

Turning to Slide 17. Our underlying adjusted gross profit margin was 52.4% for 1Q22 compared to 52.5% in the previous quarter. As a result of higher coal prices and a raising of the ceiling on thermal power tariffs in China, we experienced around 10% increase in unit power cost in 1Q22 as compared to the prior quarter. On a per kilowatt hour basis, we are now paying around 15% more than we were a couple of quarters ago.

Thermal power tariffs appear to have stabilized at the current level. As we indicated on previous calls, we estimate that elevated power tariffs will have around a 1% to 1.5% point impact on our profit margin for this year, however over time, we expect thermal power tariffs to

normalize.

Turning to slide 18. Our CapEx for 1Q22 was RMB4.9 billion, consisting of RMB2.2 billion for organic CapEx and RMB2.7 billion for acquisition consideration. As at the end of 1Q22 we had a liability of around RMB1.6 billion on our balance sheet in respect of deferred and contingent consideration payable for acquisitions which had closed by the end of the first quarter. We have a further RMB463 million for the acquisition of Shenzhen 11 which we announced during 1Q22 and closed in April. These amounts do not include the cost of buying out partner interests in a few of our projects.

Looking at our financing position on slide 19. At the end of 1Q22 we had RMB11.3 billion, or US\$1.8 billion, of cash in our balance sheet and our net debt to last quarter annualized adjusted EBITDA ratio was 7.0x. Our effective interest rate for 1Q22 was 4.7%, compared with 5.4% in the previous quarter, or 5.5% for the full year of 2021. During 1Q22 we successfully raised US\$620 million through the issue of convertible senior notes with a 0.25% coupon and a seven year tenure. During 2Q22 we will reduce working capital loans, which is shown here as short-term debt, by around RMB2.3 billion, or US\$350 million.

Turning to slide 20. As at the end of 1Q, we had total capacity in service and under construction of 660,000 square meters. Against this, we had total area committed by customers of 575,000 square meters. Assuming that we deliver all the backlog and sell out the small amount of remaining inventory, our area utilized or revenue generating capacity would increase by around 90%. The total cost to complete all existing projects is around RMB11.2 billion, or US\$1.7 billion, which we can finance with existing resources. It is a relatively small amount of CapEx to generate a large amount of growth because we have already made most of the investment.

On top of our existing projects, we have secured another 460,000 square meters of pipeline held for future development. It's land and buildings with project approvals and energy quota, predominantly located in Tier 1 markets, which we believe is a very valuable asset.

Turning to slide 21. Based on our performance in 1Q22 and what we know so far of the current quarter, we are still on track to deliver results within our original guidance range for revenue and adjusted EBITDA. This assumes progressive relaxation of lockdowns over the next one to two months and a moderate pick up in the move-in rate in the second half of the year. We think that this is a reasonable assumption to make at this point in time. Accordingly, we are leaving our original guidance unchanged.

We would now like to open the call to questions, so please operator.

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## QUESTIONS AND ANSWERS

### Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Tina Hou at Goldman Sachs. Please go ahead.

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### Tina Hou *Goldman Sachs - Analyst*

Hi, good morning, Management and thank you very much for your time. One question from me is that in terms of the overseas market, especially in Southeast Asia, in the longer term, say 5 to 10 years, how big of a potential market do you think it could be versus the domestic China market and what kind of growth rate can we expect from our projects in progress there. Thank you.

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### William Huang *GDS Holdings Limited - Founder, Chairman and CEO*

Yes, I will answer first. I think the Southeast Asia market are mainly driven by the Chinese customer and the US player and we see the huge potential for the local domestic market because there is a large number of unicorns. The number of the unicorns increased very significantly in this region. [This indicates] (corrected by the company after the call) the future market has huge potential.

In terms of the population in this area, it's around 600 million population in this region. I think, over the time, I think the market will grow to a similar level of the Chinese market because let's say at least 50%, right, around 50% of the Chinese market. That's my view, but the

market is still in the early stage. It's more like years ago in China but the potential is high. Yes, so in terms of the growth rate, I think the Southeast Asia market is the most fastest growing market in the world based on some analyst reports. Now that total amounts -- demand in current stage compared with China is still small, but we should be well positioned in this region. That's our thinking, yes.

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**Tina Hou Goldman Sachs - Analyst**

Thank you William. Can I just have a quick follow up? So--

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

Oh yes, by the way, yes, by the way, based on my understanding the current total market in Southeast Asia is 2000 megawatt totally. Existing market I mean.

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**Tina Hou Goldman Sachs - Analyst**

Got it.

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

Yes.

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**Tina Hou Goldman Sachs - Analyst**

Thank you, yes. So, my follow up would be, is our target customers also including the local and international companies in addition to the domestic Chinese customers and also what kind of IRR, our project IRRs, should we expect for the Southeast Asia projects?

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

Yes, in terms of customer I [think it is] (corrected by the company after the call) very clear. Our methodology is serve for all kinds of customers in this region, but of course the first priority is serving our intra-based customer which have implementation, the business implementation, in this region already. So, I think this is our first target. As you said, we are not just serving Chinese customers. We potentially will also practice to all the international players and also local internet and cloud player as well. In terms of the return, Dan, maybe you can add some color?

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**Dan Newman GDS Holdings Limited - CFO**

Yes. I think the returns will be well up to the levels in China, probably towards the top end of the range of what we typically achieve in China right now.

We have a favorable dynamic where the Singapore market is very constrained and there's a very substantial amount of excess demand. In the adjacent markets in Malaysia and Indonesia, development cost and the operating cost, including power tariffs, are substantially lower than Singapore.

We already have a very good handle of what the development cost is going to be for us. We also have a pretty good idea of what the selling price is going to be for the initial orders because of course we've been in dialogue with potential customers for quite some time. So based on those inputs, we believe that we can offer a very competitive price for this nearshore capacity and still generate returns, as I indicated, which are compare at least on par if not towards the top end of the range of what we can achieve in China these days.

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**Tina Hou Goldman Sachs - Analyst**

That's very clear, thank you very much.

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**Operator**

Our next question comes from Jon Atkin from RBC Capital Markets. Please go ahead.

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**Jonathan Atkin RBC Capital Markets - Analyst**

Thank you. Two questions. One is I think the CapEx spend is unchanged, but you talked about a slowing schedule, so what is the offset there? Then on M&A, just your view on the M&A environment and how you view financing options going forward in case you needed [technical difficulty].

**Dan Newman GDS Holdings Limited - CFO**

Yes, so I'll answer the questions, William. Firstly just to remind, we gave CapEx guidance a couple of months ago in the previous quarterly earnings of RMB12 billion for this year and in the script I gave a breakdown saying that it would be RMB8 billion organic, of which RMB6 billion was in China and RMB2 billion is in Hong Kong and Southeast Asia; RMB6 billion in Mainland China and RMB2 billion in Hong Kong and Southeast Asia. Then the balance of RMB4 billion would be acquisitions and land bank.

So the acquisitions and land banking is a bottom-up estimate, so that's deals which have already been done. That number, no change. Out of that RMB4 billion, we've already incurred around RMB2.7 billion in the first quarter and we have the balance of payments, acquisition consideration and land purchase payments, which will mainly be made in the second quarter.

For the remaining part, the RMB8 billion which is organic in Mainland China and regionally, we only incurred just over RMB2 billion out of the RMB8 billion in the first quarter, so that part, you could say, is in line with our quarterly run rate. I mean four quarters at that run rate would add up to, say, RMB8 billion. And in actual fact, because we've made adjustments to the delivery schedule, which of course involves a lot of coordination with customers as well, it takes some time for that to work its way through to CapEx paid.

First of all we have to slow down the incurrance of CapEx and then it gets reflected in the timing and amount of CapEx payments. But I think the CapEx in the second half of the year could be somewhat less than it will be in the first half of the year.

On M&A, I think your question, Jon, you were breaking up, but you were saying how would we finance M&A?

**Jonathan Atkin RBC Capital Markets - Analyst**

Yes, you talked about the RMB1.7 billion that you made to meet your current development pipeline, but you wanted to get more aggressive on expansion or to achieve organic growth and how you view the financing environment?

**Dan Newman GDS Holdings Limited - CFO**

Yes. Well if I may, I'll start off by answering that we are fully financed for what we've committed to already. I mean that's always been our approach; we set aside cash to capitalize the projects with equity and we secure project debt as early as we can in the lifecycle of each individual project and then we have some surplus resources over and above that.

If there are opportunities that we wish to pursue, which could be acquisitions or it could be other new business opportunities, then we need to obtain the capital to be able to pursue those. I think that even in the current environment we have a very good range of options. Firstly we have to make a decision whether to do something through public capital raising or through private capital raising and then within public and private, there's a range of options.

What I would highlight is that since 2016 when we IPO'd in the US, we've done four private placements, if you recall, with CyrusOne, with Ping An, with Hillhouse and then recently with Sequoia and sovereign wealth fund. That was equity convertible preferred and convertible bonds. We've also done two joint ventures, one with a sovereign wealth fund, one with CITIC Private Equity, the largest private equity firm in China and just recently we announced a co-development with YTL.

These are all in the category of private capital raisings or accessing capital privately. So we did this during the six years that we've been a publicly listed company in the US. The business fundamentals we believe are still very solid. As we keep emphasizing, we have very high visibility for future growth from our asset base and from our backlog. There is very strong interest from private capital providers investing in this sector, particularly with market leaders.

So bottom line of this is that if there are opportunities that we wish to pursue, we will undoubtedly be able to access capital on reasonable terms, to be able to do what we wish to do.

**Jonathan Atkin RBC Capital Markets - Analyst**

If I could ask one last question then, so the mix of internet versus enterprise versus cloud inside of China, you talked a little bit about FSI demand and so forth, so maybe just a little bit of an update on what you talked about in the script as well as last quarter?

**Dan Newman GDS Holdings Limited - CFO**

I don't know if William wants to add, but we talked last time, or we've talked actually for quite a few quarters about being positioned for where demand comes from and the demand profile changes over time. So during last year we saw significantly increased new business from financial institutions both domestic Chinese and foreign. We had some tremendous wins including most of the top 10 global banks and better banks on Wall Street.

In the first quarter, FSI and enterprise business was 45% of new bookings and in the second quarter it'll probably be a similar level, maybe 40%. That demonstrates that we've positioned ourselves and our asset base correctly. William, would you like to add something, what we're doing on the FSI enterprise side?

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

Yes, I think to diversify our customer base is always our goal, right, from day one. So that's what let us catch up any kind of growth from the different industry. If you look back last 10 years, we start from the enterprise customer and then we catch up the internet booming. Then we go to the cloud takeoff and now the demand also more balanced from the cloud internet and also the enterprise as well. So I think we have a very solid customer base that's allowed us to catch any kind of demand from the - because the market always changes. So right thing to do is always building your solid customer base, which we have, so now, so last quarter and this quarter, maybe last quarter and last few quarters, I think we saw the growth from the enterprise and the financial institution. Obviously the cloud a little bit of slowdown, right, but we still can meet our target. So since last year, we already saw that change, so last year we started to hire more, increase our sales people, to penetrate to the enterprise customer and the financial institute. Now we see the effort coming and we did the right thing last year.

**Operator**

Thank you. (Operator Instructions) Our next question comes from Michael Elias at Cowen. Please go ahead.

**Michael Elias Cowen - Analyst**

Hi, this is just one from Michael. I just wanted to touch on the organic leasing target and you noted in your prepared remarks that you could see a little bit more coming from Southeast Asia in 2022. I wonder if you could provide a little bit of color around the exact split between Southeast Asia/Hong Kong, along with Mainland China.

And secondarily, your guidance does imply a step up in leasing to reach that 90,000 square meter target. What are you hearing from your customers that indicates an acceleration is coming? And as part of that, what level of visibility do you have in your existing pipeline for that leasing to come along? Thank you.

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

Dan, you go ahead.

**Dan Newman GDS Holdings Limited - CFO**

Yes, on the first part of the question, we deliberately didn't provide any quantification of a split. We can make our targets a number of different ways, so it's not really appropriate for us to put some kind of quota on orders from a particular type of customer or particular region. We have a couple of projects in Hong Kong where we haven't yet disclosed anchor custom orders and we have three major projects around Singapore, three campuses, two in Johor and one in Batam. So that's five projects in total.

Of course we've made these investments in close consultation with our leading customers and there's been a sale dialogue going on for a long period of time. But when we actually disclose the sales order, depends on there being a firm commitment. It's too hard to say right now how many of those projects will have firm commitments within this financial year. It could be a combination, so that's why it wouldn't really be meaningful or appropriate to put a number on it.



I think we will have enough anchor orders in Southeast Asia to give investors a very strong feeling about, call it proof of concept as to what we're doing. I think that's probably the most important thing.

Your second question was about visibility on the 90,000 square meters. William, would you like to add something?

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

Yes. I think number 1, at 90,000 square meters we confirmed we still can achieve, we are confident on that but it is a little bit early to talk about it accelerates. But in general I think all our customer are preparing for the future growth.

We monitor our customer's business plan very closely in order to well position to catch up whatever accelerate or still maintain the current demand profile. I think our goal is short term we cannot say whether it will accelerate or not. But still, we are confident for the mid-term and long-term. The demand still will not change.

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**Operator**

Thank you. Our next question comes from Frank Louthan at Raymond James. Please go ahead.

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

Great, thank you. I just want to go back to the guidance. When you came in at the end of the year the guidance was a little bit lower because of supply chain issues, your customers were having supply chain issues and getting inflation. Now obviously they've been precluded from installing because of the lockdowns.

What's the bigger factor now in your mind that if there's something that would keep you from hitting the guidance or have to have you lower it later this year? Are you confident that they do have the equipment and they have gotten through the supply chain issues, they'll be able to do the installations and now is it just the assumption that the lockdowns will bolster it, or how should we think about those two factors?

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

The main difference is the lockdowns. I think when we gave guidance in mid-March it was still relatively early. I don't think anyone had anticipated then that Shanghai would be in lockdown for two months.

I don't know how much specific detail investors have about the extent of the lockdowns but what we saw was the lockdown in Shanghai, which is quite well known, but also the surrounding areas where the government I think as a precaution went into lockdown that's in Jiangsu Province.

Then there's quite a bit of news about some restrictions in Beijing but what I don't think is necessarily so well known is that Langfang, which is in Hebei Province just outside Beijing, that's been in lockdown for an extended period of time as well.

If you look at the page in our earnings presentation, and it's in the appendix, where we show what we call ramping up datacenters. Ramping up datacenters is where most of the move-in is taking place.

If you just scan down that table and you just look at the number of datacenters which start with SH, or CS which is Changshu, or NT which is Nantong, that's all in the Shanghai area and surrounding area affected by lockdown. Then you look at Beijing and Langfang, LF, you'll see that a very substantial part of our ramping up datacenters are in the areas which have been amongst the worst affected by lockdowns.

We may be coming to the end of that, certainly from government comments, and when we looked at our guidance we assumed, as I have said during the prepared remarks, that lockdowns come to an end progressively in the next one to two months and thereafter we assume that move-in would recover to the level that it was at last year.

Last year was not affected by lockdowns but it was affected by a number of other factors. If you look at the quarterly move-in last year, excluding acquisitions it was in the high teens in terms of thousands of square meters per quarter. So we would assume that that's what will happen in the second half of the year and then if that happens we will come out with revenue (inaudible) are within our guidance.

I think that everyone can probably do their own cross-check mathematically because we have given a direction saying that our MSR will decline by mind-single digits, and we have revenue guidance so if you divide one by the other you can calculate the average area utilized and then construct a quarterly progression for that metric.

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**Operator**

Thank you. Our next question comes from Gokul Hariharan at JPMorgan. Please go ahead.

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**Gokul Hariharan JPMorgan - Analyst**

Hi. Thanks, William and Dan.

First of all on cloud, one of your biggest cloud customers yesterday mentioned that they are becoming a lot more selective in terms of their cloud investments and were looking for quality growth rather than growth at any cost.

Could you talk a little bit about the discussions you are having with customers, cloud customers in terms of how they think about growth going forward? Is there a meaningful step-down, and what kind of expectations do you have, let's say in the next three, four years in terms of cloud growth?

Secondly on the FSI, financial services customers, is there any different profile in terms of financial service customers in terms of the kind of demand that they have on the engagement models that you have? If that becomes a significant part, a much bigger part of your revenue, does that mean anything for IRR or MSR? Thank you.

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

Yes. I think the cloud service provider still is a major driver, main driver to drive the datacenter demand and growth. I think even they talk about selective, they still pursue the high growth rate.

I think this does not mean they will slow down, let's say dramatically. I think that still they maintain I think 20%, 30% growth still is the number they pursue, at least. This is still a big number in my view, but on the other hand things we talk about the demand profile a little bit change and because a lot of the enterprise or internet giants, they start to do their hybrid cloud model.

So, the demand from the cloud a little bit shifted to our end user to direct purchase, such as the datacenter. I think in total, from our perspective the market total demand still maintained a similar size compared with last year, but the demand shifted from one industry to another industry. That's the current trend we saw.

In terms of the enterprise customer and the financial institutions, I think their model [traditionally] (corrected by the company after the call) demand a small size. They also represent very big demand, let's say 1000 racks, 2000 racks, a lot of gear because they change their IT structure from their typical from their mainframe to their server base.

So, the demand profile for each order still is very, very big. You can call it, it's like a semi-hyperscale datacenter demand. In terms of price, Dan, you want to add some color?

Dan Newman: Yes. Semi-hyperscale more or less answered the question about price as well, actually. It's almost entirely I'm trying to think but it is entirely actually what we would call downtown datacenters.

Unless we had continued to pursue the strategy of sourcing datacenters within Beijing and within Shanghai, which we have done sorry, and within Shenzhen, which is very time-consuming and challenging. Unless we'd done that we would not have been able to get this business, so it's mostly downtown.

There is still a significant differential between the pricing for downtown and edge of town which I think all customers recognize and accept. I think the IRRs are probably quite similar now between downtown and edge of town. I don't think this FSI business makes much difference to our average IRRs or to our operating cost structure and so on.

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**Operator**

Thank you. Our next question comes from Joel Ying at Nomura. Please go ahead.

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**Joel Ying Nomura - Analyst**

Thanks, Management, for taking my questions. I actually saw a tightening policy trend for the PV monitoring and carbon emission quota Management in Beijing area. Should we expect any impact to the Company or industry to mid-long term?

Maybe some old datacenters, may need renovations, so we might need some time or might need extra capital to solve such issues maybe in the long run. Can Management talk about that? Thank you.

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

Pardon, what's your question?

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**Dan Newman GDS Holdings Limited - CFO**

Yes. William, I think it was yesterday I'm trying to think was it municipal government or NDRC, and that announced implementation of this year's monitoring of PV levels and list out eight or 10 actions that they would take to try to increase efficiency of small, old datacenters on it.

It's a follow-through from a strategy policy which they've announced several times previously to try to be more assertive in forcing datacenter operators to become more efficient or even creating an economic push for older datacenters to shut down.

It doesn't affect us at all, Joel, not negatively. Maybe positively if there's some demand that shifts from that. In actual fact, I think we've played a very constructive role with the government in helping to establish this exercise because it requires some IT and integration to create the platform for the monitoring of PEVs.

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

Yes. I should add on something on that because GDS is the most efficient datacenter player in the market. I think it is not just the government asked us to do from our self-benefit point of view, to improve the power efficiency always our goal, our day-to-day job. Just like Dan mentioned, it would not affect us.

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**Operator**

Thank you. Our next question comes from Alex Wang at Daiwa. Please go ahead.

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**Alex Wang Daiwa - Analyst**

Hi, Management. Can you hear me? Yes. Congratulations for a strong result. It's Wang Guohan from Daiwa Capital Markets. I will ask a question on behalf of John Choi. The first question is regarding our - yes, customer diversification as we just mentioned earlier. As we are trying to diversify our revenue mix towards non-internet sectors, do we have maybe a target for revenue mix from enterprise and the financial sector in the next one to three years.

Also, we have observed your targets of MSR, also middle, single point decline in this year. With our observation on new contracts acquired in the first quarter, is there any [sort of] (corrected by the company after the call) attempts to negotiate the new cloud contract?

My second question is regarding our [capacity in capacity injection plan] (corrected by the company after the call) as we see this year is more back in the old days. So into the second half, what's our observation on the biggest downward risk for all our capacity injection in the second half because we have seen that over 80% of our capacity actually aggregate in the same half. Thank you, very much.

**Dan Newman GDS Holdings Limited - CFO**

Yes, Alex, we have sales targets, of course but from a strategy and planning point of view, we don't set quotas for particular kinds of customers or particular markets. I mentioned that previously. I mean, that - I don't think that would be the right approach. I mean, we've tried to position to address demand from what we consider to be a strategic high value customer base and we want to be in the right place at the right time to capture that demand.

The comments that I make about MSR, yes, reflect some internal assumptions about - particularly about the pricing for new contracts which itself is reflecting the location of that capacity. Whether it's downtown, edge of town or remote. You know, renewals also goes into that although I'd say renewals is a pretty small part of the change in MSR.

Now you've commented quite a few times before that overall, renewals are close to flat. We do have some older contracts like five to seven year old contracts, particularly for our first few data centers in each market. So it would be like the data center number one, two, three, four in a particular market where we have some, what we would call today, hyperscale customers, but at that time, their order size was a few hundred square meters, not - and the total volume of their business with us has increased by 10 or more than 10x since then.

So those customers, typically they have downtown capacity and edge of town capacity. So when those contracts come up for renewal and it's only a pretty small part of our total contract base, we've seen some very small decline for that there but once you factor that into our overall MSR, it doesn't make much - it did not make a material difference. By far the biggest difference is the location mix. The BOT projects, the edge of town projects and so on.

For the CapEx number, I mean yes, we - if you look back, yes, we added around 80,000 to 90,000 square meters of capacity and service in the last - per annum in the last couple of years. This year, we've brought that down to around 60,000 square meters. So we've done that because of the slower move-in but in order to do that, we have to consult with customers because there's also contractual delivery commitments that we have had to adhere to.

If you're asking whether there was a risk from the point of view of being able to execute, I think that's relatively small. I mean, we're not affected by supply chain issues to any great extent in terms of our construction activity. We deal with suppliers in a very strategic way. We place what we call bulk purchase orders. They produce a lot of equipment and hold it in inventory to be able to deliver to us at very short notice.

So we don't - within mainland China, we don't really experience material issues in terms of getting plant and equipment supplied. It may be had some small effect on our construction in Hong Kong just because of the logistics of mainland China to Hong Kong.

But yes, so that's not really what's driving the 60,000 square meter number, that's more the business decision to slow down the rate at which we bring capacity into service as a sort of ripple through of the slower move-in.

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**Operator**

Thank you. Our next question comes from Sara Wang at UBS. Please, go ahead.

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**Sara Wang UBS - Analyst**

Hi, thank you for the opportunity to ask a question. So I recall during our last earnings call that Management shared that the outlook into next year should be better than this year. So given what happened so far, are we still holding the same view towards next year? Then what are our key assumptions for the outlook into next year? Thank you.

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**Dan Newman GDS Holdings Limited - CFO**

Sara, I can't remember exactly what I said and I'm giving you the benefit of the doubt if I said next year would be better. I don't know if I specifically meant year because that's just a - you know, an arbitrary start and end date but I mean, clearly, we're going through a cycle, right? Everyone knows that and we will - the cycle will bottom at some point and there will be recovery.

We have got many quarters of historic data on the ratio of move-in to backlog and the - although there's quite a wide range, that has

held for a long period of time. Currently we see move-in to backlog ratio has fallen to a level that we've not seen historically. So it's well below historical levels.

I don't think that - yes, I don't think anything fundamental has changed or structurally has changed. I think that's cyclical and a reflection of some of the unprecedented factors which are currently affecting the market. So once that - once those go away and once we see the cycle turn, I don't see why the historical ratio moving to backlog should not return and if that's the case, then we will see higher growth rates than we're seeing currently.

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**Operator**

Thank you. That's all the time we have for questions. I'd now like to turn the call back over to the Company for closing remarks.

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**Laura Chen GDS Holdings Limited - Investor Relations**

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 our website or the Piacente Group Investor Relations. Bye.

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**Operator**

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

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