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Q3 2019 GDS Holdings Ltd Earnings Call

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PRESENTATION

Operator

Hello ladies and gentlemen, thank you for standing by for the GDS Holdings Ltd third quarter 2019 earnings conference call. (Operator Instructions)

Today's conference call is being recorded. I will now turn the call over to your host, Ms. Laura Chen, Head of Investor Relations for the Company. Please go ahead, Laura.

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

Thank you. Hello, everyone. Welcome to the 3Q19 earnings conference call of GDS Holdings Ltd. 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.gdsservices.com. Leading today's call is Mr William Huang, GDS founder, Chairman and CEO, who will provide an overview of our business strategy and performance. Mr Dan Newman, GDS CFO, will then review the financial and operating results.

Before we continue, please note that today's discussion will contain forward-looking statements made under the safe harbor provisions of the US Private Securities Litigation Reform Act of 1995. Forward-looking statements involve inherent risks and uncertainties. As such, the Company's results may be materially different from the views expressed today.

Further information regarding these and other risks and certainties is included in the Company's prospectus, as filed with the US SEC. The Company does not assume any obligation to update any forward-looking statements, except as required under applicable law.

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

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

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

Thank you. Hello, everyone. This is William. Thank you for joining us on today's call. A couple of weeks ago, we passed three years anniversary of our IPO. Life as a listed company has been exciting. Sometimes, too exciting, but it has made us considerably stronger.

Today, we are reporting revenue and adjusted EBITDA which is three times and six times what we reported for 3Q16. Our total area commited is almost double what we forecast at the IPO. It's been an outstanding three years in terms of growth. However, we firmly believe that the best is yet to come.

As I go through our results, I will highlight our strategic progress in key areas. During the third quarter, we signed up customers for over 21,000 square meters of net additional area committed, or over 57 megawatts of IT power, which should generate over $90 million of annual recurring revenue when fully delivered.

We had three orders of over 10 megawatts from existing customers, a sign that order size is getting bigger. We also won a 9-megawatt order from a new internet customer, a market leader in short-video streaming.

At the end of 3Q, we reached 58,000 square meter net add for year-to-date. As of today, we are done in terms of meeting our full-year sales target of 80,000 square meters.

In the past few months, customer sentiment has become a lot more positive. Cloud adoption continues on a steep upward path, with market leaders reporting 65% to 100% growth. 5G deployment is starting to drive another wave of demand. All of our focus is on next year, and the 2020 sales pipeline looks very promising.

We have talked on prior calls about the diversification of our customer base. At the end of 2016, we had three hyperscale customers. Now, we have 13, and in the current quarter, we signed a new hyperscale customer, a prestigious global technology company with a consumer focus.

The combination of sustained demand from established customers plus new high-growth accounts has enabled us to deliver 20,000 square meters net add per quarter. There are still new customers and markets for us to penetrate. With all, we are well positioned for a higher level of sales over the next few years.

20,000 square meters of sales means starting three to four new datacenter projects each quarter. For us to do this, we need a large development pipeline. As you know, it is difficult these days to get approval for new datacenters in downtown areas. We continue to have some success organically and supplement our capacity with acquisitions. However, it is not nearly enough to satisfy our customer demand. We have therefore evolved our strategy to include large edge-of-town sites.

Our first major move was in Langfang, on the edge of Beijing. This is already proving a great success. Within a couple of quarters, we have commitments from three different hyperscale customers for 100% of three datacenters, Langfang 1, 2, and 3. While we still have inventory of land and power in Langfang, we are moving rapidly to secure even more resource.

We aim to repeat this success in other Tier 1 markets. In Shanghai, we got approval today for new downtown capacity. In addition, we are purchasing more land near our established edge-of-town site in Kunshan. We have also obtained substantial power capacity for another edge-of-town site in Changshu. The power plus land at these locations will support around 90,000 square meters of new capacity.

In the Greater Bay Area, we have power plus land at a location near Guangzhou. We have leased shell buildings at two other locations near to our existing datacenters, and we also have the Hong Kong 2 acquisition, which I will talk about next.

Altogether, we have around 230,000 square meters of developable capacity in these key Tier 1 markets, and we are not stopping. It is a very strategic resource, and it positions us to respond to a higher level of demand.

We established operations in Hong Kong over five years ago, relying on third-party datacenters to serve just a few of our many Chinese financial institution customers. We took the first step to upgrade our presence with the purchase of the Hong Kong 1 property in 3Q18. The site is now cleaned, and we will start construction of the new building. The redevelopment timeframe is three years.

Hong Kong is the gateway for most of the international bandwidth connecting China. Our hyperscale and high-growth customers use Hong Kong as a launchpad for their international service. They are pushing us to further increase our presence in the market. Our strategy is to always go where our customers have critical mass of demand. We have therefore taken a significant step with the purchase of a second building for redevelopment.

Hong Kong 2 is located only 150 meters from Hong Kong 1, enabling us to realize investment and operational synergies. We view Hong Kong as integral to our Tier 1 market platform. With proven demand from our China hyperscale customers, and the presence of more than 200 of our Chinese financial institution customers in Hong Kong, we believe that the success of our project is assured.

We announced last quarter the formation of a partnership with GIC for remote build-to-suit projects for hyperscale customers. The initial focus is on seven projects which we have committed to develop and operate for one customer at three of their campuses. We have almost completed the first project and expect to sell a 90% equity interest to GIC early next year. We have started to work on two more projects.

The beauty of this partnership is that it enables us to fulfil the broader requirements of our strategic customers outside of Tier 1 markets. We see this as a real opportunity to strengthen our franchise, gain scale, and create additional value. We have therefore formed a group within GDS to focus on remote build-to-suit projects as a distinct product.

The seven projects committed to date will require around $150 million of equity. It's relatively small by GIC standards, and they have given us their backing to scale up this partnership in a material way. We are already in discussion with a couple of other customers. It's going to take time, as these deals are complex, but I'm hopeful that over the next few quarters, we will have some more wins.

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

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

Thank you, William. Starting on slide 13, where we strip out the contribution from equipment sales and the effect of FX changes. In 3Q19, our service revenue grew by 7.5%, underlying adjusted NOI grew by 9.2%, and underlying adjusted EBITDA grew by 11.4%, in consecutive quarters.

Our underlying adjusted NOI margin reached 53.8%, and our underlying adjusted EBITDA margin hit 45.9%, which is 7.9 percentage points higher than a year ago, and 1.6 percentage points higher than the prior quarter.

Turning to slide 14, service revenue growth is driven mainly by customers moving into space which they previously committed. Move-in during 3Q19 was over 10,000 square meters. We're expecting a similar level of move-in during 4Q19, on top of which we will have around 7,000 square meters of additional revenue-generating space from Beijing 9 when the acquisition closes at the end of the year.

Our MSR has been pretty much flat over the past few quarters. However, we are expecting a small drop in 4Q19.

Slide 15 shows the quarterly trend in margins. 2019 has been a great year for margin improvement, but with over 17,000 square meters coming into service in 3Q19, plus another 13,000 square meters in 4Q19, including the GZ6 acquisition which just closed, we expect to end the year with margins at a similar level.

Turning to slide 18, our CapEx picked up in 3Q19 due to a higher level of ongoing construction. In 4Q19, the initial consideration is due for the GZ6 and BJ9 acquisitions, and for the purchase of the Hong Kong 2 property, bringing total CapEx for 2019 to the level of our original full-year guidance, namely RMB4.5 billion to RMB5 billion. At the end of the year, we will have around RMB1 billion of remaining balance of purchase consideration for our acquisitions to date.

Up to the end of 3Q19, we have incurred over RMB300 million, and paid RMB170 million, for CapEx related to remote build-to-suit projects. We have included a page in the appendix showing how we account for the GIC joint venture projects pre and post-sale.

On slide 19, currently the debt capital market environment in China remains supportive for us, and we're taking advantage to get longer tenor and cheaper facilities. In 3Q19, we completed financing across four new projects, and refinancing of three existing projects, totaling RMB1.4 billion.

We are considering a number of options for financing our Hong Kong projects, including a sale and lease-back of the redeveloped properties, or a joint venture. We have had a number of approaches from existing and new partners and are keeping an open mind.

Turning to slide 20, our backlog consists of binding commitments from customers. It has increased to over 104,000 square meters, representing 76% of our current utilized capacity. It provides high visibility to our future growth. Our backlog is almost entirely made up of large orders from hyperscale customers. They are all high-quality counterparties and household names.

58% of the backlog, or 60,000 square meters, relates to datacenters which are currently under construction. The remaining 42%, or 44,000 square meters, relates to datacenters which are already in service. This part is moving in at the rate of about 10,000 square meters per quarter.

To finish on slide 21, after 9 months our revenue is tracking towards the top end of the revised guidance range, which we provided last quarter. For adjusted EBITDA, we are tracking above the top end of the revised guidance range. We are therefore once again raising the EBITDA guidance range to RMB1.80 billion to RMB1.82 billion. With regard to CapEx, we'll keep the original range unchanged.

With that, I will end the formal part of our presentation, and we would now like to open the call to questions. Operator?

QUESTIONS AND ANSWERS

Operator

Thank you, sir. Ladies and gentlemen, we will now begin the questions. (Operator instructions)

We have the first question from Jonathan Atkin from RBC Capital Markets. Please ask your question.

Jonathan Atkin ***RBS Capital Holdings - Analyst***

Thanks very much. I was wondering, I see the pre-commitment rate has been steadily increasing despite the fact that your business continues to scale at a higher rate. And I wondered what that says about the competitive environment. You mentioned deals were getting bigger, but any comments from your perspective about competitive supply in general?

Then, the second question I had relates to Shanghai. I think you said you did get some approval just today about downtown development, and how many square meters or megawatts or cabinets are we talking about in terms of the ability to develop in municipal Shanghai? Thank you.

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

So, John, answering the first question, this is William. I think from the competitive perspective, I think our resource inventory, let's say held for development, compared with this market share, our percentage, I think it's very significant, more than our current revenue share. So, that means that in the future, our supply is much higher number than our competitors.

The second question is, Dan?

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

About the recent allocation for our capacity in Shanghai.

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

Actually, we got the approval for 5,000 racks. let's calculate it at 2.5 square meters per rack. That means more than --

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

13,000 square meters, roughly.

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

Yes, roughly, right? So, in Shanghai, there's this approval is quite diversified or all the local players get some small piece of that. We are one of the largest one to get approval. So, this is definitely cannot satisfied by our customers' future demand profile. They want much more larger scale than what we get in a Tier 1 market, is the number one. Number two, they want a campus type, with high visibility for future expansion, so that's why we will continue to develop the edge-of-town site, make sure to satisfy our customers' future demand, but what we can tell is that our strategic customers future demand, it looks like that the number will be accelerated in the next few years. Yes, that's all.

Jonathan Atkin ***RBS Capital Holdings - Analyst***

Yes, thank you, and then maybe just lastly, on the new hyperscale logo, the nine-megawatt order, is that at a single location, or is it across multiple metros?

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

Yes, it's a single location, Jon.

Jonathan Atkin ***RBS Capital Holdings - Analyst***

Great. Thank you very much.

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

Okay.

Operator

We have the next question from the line of Colby Synesael from Cowan and Company. Please ask your question.

Colby Synesael ***Cowen and Company - Analyst***

Oh, great, thank you. Two questions, if I may. The first one, just given all the organic builds that you're doing and intend to do, as we go on to 2020, plus what sounds like some interest in some bigger M&A to help satisfy the demand, just can you remind us what you're thinking, in terms of potential equity raises, or how you plan to finance these various projects? It would be good to get some color on that.

Then I guess, secondly, you noted that you're already at 80,000 square meters for 2019, just initial thoughts on 2020, to the extent you can share, as it relates to revenue, EBITDA, bookings, et cetera? Thank you.

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

Colby, I'll go first. Let me comment first of all on the M&A environment, because although we're very busy with a lot of organic builds, we're still very focused on the strategic M&A opportunities. There aren't platforms out there for us to acquire. There aren't mini GDSes. There are single sites. To date we've done seven acquisitions, one to close. Each acquisition has been one data center on a site, but there are some opportunities where there are several data centers on a site and maybe some expansion capacity, so, that's what constitutes bigger opportunities.

The last three and a half years we've done seven acquisitions, so it's a run rate of about two per annum, and that's been part of the 80,000 square meters net add. It's provided us mainly with capacity to support the sales, so that's been part of that base case. You can call it organic and semi-organic. But if we were to do what I just referred to as those larger acquisitions, then that's going to be additive. It's going to be on top of, in addition to, to that.

To bring it back to your question about capital raised, we raised $600 million earlier this year, in March, and if we leveraged that 60-40 debt to equity it means that we will have $1.5 billion of financial resources to invest. In RMB that's RMB10 billion. Our top end of our CapEx guidance range this year is $5 billion, so you can say, in a simple way, that we raised enough equity capital earlier this year to support two years of investment at $5 billion per annum, which corresponds to an 80,000 square meters net add business plan.

I did note, when we did that capital raise, that it was not sufficient if we were growing at a faster rate, and it was not sufficient if we were to do out of the ordinary M&A. So whilst neither of those is certain -- I think William will make a comment about growing at a faster rate -- but neither of those is certain, but it's clear that if we were to do something, then we would need to consider financing, whether it would be in the capital market or whether it be through one of our partnerships, but it would be linked to a transaction or linked to demonstrated level of sales.

William, do you want to comment on the possibility or potentiality for higher level of sales? I think Colby is asking for your early thoughts about next year.

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

It looks like, frankly speaking, that we are more confident to maintain the 80,000 square meter, that's for sure. I think, Yes, no doubt about that. But during recent couple of months, we have talked to our customers for a couple of times. It looks like their next few years' plan will accelerate, so as I just talked very early in this year, the sentiment is not good, but now it's totally a shift. Everybody is very, very positive, so a lot of them start to execute their original plan, and even based on the 5G coming, it looks like that they will be more aggressive, but we will see. We're hoping we can do more, right, but it's not right timing to commit more.

Colby Synesael ***Cowen and Company - Analyst***

Yes, I mean it seems like your biggest issue is not the demand, it's simply finding the space and then ultimately financing it, and it sounds like other than Beijing, you still like in Shanghai and Shenzhen are looking for those bigger edge of city type developments, and it seems like to an extent you're able to get those, we could see greater than the 80,000 square meters in some of those outer years. Does that sound right?

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

It is right, Colby. Obviously there's always going to be a lot of things going on which has not yet reached the stage where it can be disclosed. What we're showing, I think for the first time, in our earnings presentation is effectively the developable area, or area held for future development, and very roughly it corresponds to three years' sales growth at the concurrent run rate.

But we would like to have considerably more than that. We'd like to have double. In fact, we have no upper limit in our minds. The amount that we've had to invest to secure this resource is really quite small. Our budget for Land Bank in China this year was RMB500 million, less than $100 million, and we have not spent all of that, by any means. And it's very valuable, so we're going to keep on going.

We are very well positioned in Shanghai. You said we still had a lot to do. The site that William referred to in Changshu, we've been allocated several hundred megawatts of power capacity, but once again, we're still looking to add more.

Colby Synesael ***Cowen and Company - Analyst***

Great. Thank you.

Operator

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

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

Great, thank you. Can you comment on the situation in Hong Kong, the unrest there? Is that impacting your business? And any thoughts on how that might impact your ability to develop in this site? And then, how many sites do you think that you will develop with the JV through the course of the next 12 months? Thanks.

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

Yes, Frank was asking whether there's been any short-term impact in Hong Kong, or maybe impact our view of Hong Kong?

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

Yes, I think our logic is to follow-up with our customers, that's our strategy to do the location expansion. Hong Kong has become a very important portal for all our install base, so expanding to the international market. That's always the first step. As I mentioned it just now, I mean, a lot of our hyperscale customer, plus more than 200 financial institutions, mainly China based, they have the very, very clear demand in the next few years in Hong Kong.

So our view is the certainty was given by our customers, not [given by] (added by company after the call) any situations, so we are very confident the demand is very, very strong in Hong Kong, from our order in store base customer.

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

Frank, the second part of your question, I can't give the precise answer to, because we're not far enough along for me to be able to quantify how many new, remote, build-to-suit projects we'll take on.

Regarding the customer who we're diverting these seven projects for, definitely there will be more projects awarded by them. Then for now, we just identified a couple of other customers who could be interested in working with us in a similar way. I'd say, from seven today, let's take a two-year view, it could be double or treble.

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

Yes. Okay, great. Thank you very much.

Operator

We have the next question from the line of Robert Gutman, from Guggenheim Partners. Please ask your question.

Robert Gutman ***Guggenheim Partners - Analyst***

Yes, thanks for taking my question. Just a couple of things. Just a little bit about changes in the expansion table. It looks like Beijing was pushed out to next year from the second half of this year. I was just wondering the color on that. Also, the move in pace that you mentioned, you said it's looking like about 10,000 a quarter, I just want to verify that. It looks like a little acceleration from the past couple of quarters. Just want to verify that.

And just more broadly, there's a lot of talk about on a macroeconomic level, about China's GDP growth and I was wondering if we could just tailor that a little more specifically to the digital economy in China, rather than expectations for the overall economy? Whether that's accelerating, compared to the rest of the economy?

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

Yes, Rob, the first question, you picked up that there's sometimes we revise the ready for service period for particular projects. Remarkably we're up to like 45 projects now, and I've been here from number one, and almost all are complete on time and within budget, but inevitably there's going to be sometimes a delay of a few months or an acceleration of a few months. Normally it's got nothing to do with us. It's out of our control. It may be to do with when the power infrastructure is installed or activated, so that's all. It's really nothing to make a fuss about.

The move in pace. Yes, the move in pace this year has been slightly slower than last year, but last year was slightly faster than normal. I know given the macro that people are going to associate slightly slower with some slowdown in terms of our customers' business. But we have to be careful about how we analyze this because there's many factors that can affect the move in rate. It can be M&A can affect that statistic, how early customers commit, the development time frame, and also within the flexibility which our contracts give the customer whether they choose to deploy a little bit faster or a little bit slower.

When we review the contracts which are actually in delivery right now, and I pointed out there's like 44,000 square meters of commitments which relate to data centers already in service. So when we review where those contracts are at in terms of move in relative to the minimum commitment in the contract, they're almost all far ahead of the minimum commitment. That indicates it's a healthy situation.

There are some specific reasons sometimes why a particular customer may move in a little faster and a little slower but nothing we can generalize. I cannot generalize and say there was a slow down or there was an acceleration. Yes, the last question was about the macro situation

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

I think everybody talks about the China GDP it goes to 6%, although the 6% is still a very big number but what I actually say recently just I read a report, I mean the MS report is China new economy, that's meaning to say the digital economy representing 16% of China GDP.

This growth rate is around 8.5% to 9%. That means new economy very clearly is already being a new engine or driver in China economy.

So we're lucky we're in this space, not in the traditional space, so I think this is good for us to get confidence to grow our business in the next few years.

Robert Gutman ***Guggenheim Partners - Analyst***

Great, thank you.

Operator

We have the next question from the line of Gokul Hariharan, from JP Morgan, please ask your question.

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

Hi, great result and thanks for taking my questions. My first question is I think you illustrated that the number of hyper-scale label have gone up significantly over the last two or three years. Now the top two customers are still roughly about 50% of area committed and occupy multiple data centers probably about high teens number of data centers each.

As we add a lot of these new labels especially in the last couple of years could we have a bit of a view two to three years out? Is that top two customers number of 50% plus area committed going to come down meaningfully when you think about the next two or three years of area committed or revenues, that's my first question?

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

Gokul, your observations are correct. The top two customers if you aggregate them and you look over several quarters you will see that two to three years the actual amount of new business that we have won from them has been very well sustained. So there's been no sense of any lessening from them and we believe it will be sustained, if not higher, going forward.

In terms of the overall mix, we don't have any quotas, we don't set any limits but we do target to add more what we call high growth accounts, and the progress in that respect has far exceeded our own expectations. Those high growth accounts they may not be the kind of companies who place an order every quarter. They may place an order once every 12 months or once every 18 months but if you look at the growth rates of their businesses, they're capable of doubling or trebling the size of their commitment with us.

I would just have to hazard a guess about what the top two would represent in two- or three-years' time. I would say 40% to 50%, so not far below where it is now but that's good, it means that we have a very solid underpinning for our business.

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

Understood, thank you. Second, could you talk a little bit about -- I think you mentioned setting up a separate team to look at the remote site projects and as you mentioned the seven projects could go 2x or 3x of that? Could you talk a little bit about how much resources this kind of project takes in the form of sourcing people, SG&A, et cetera? Given that now you have growth on both these tracks do you feel that there is some degree of bottleneck from a resources perspective as we look at the next 12 to 18 months, and how do we think about moving that out?

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

Yes, Gokul is asking how we execute in remote build-to-suit projects whether how much resource it takes, whether we have the capacity to do that?

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

Yes, number one I think not every remote project we will pick up. I think we are quite picky, right, number one for our deliver capabilities because we are still focused on the Tier 1 market. We always say we are focused on our Tier 1 market. Number two, I think since the designs are very simple, remote projects are standard and the operation effort is much less than a multi-tenant data center in Tier 1 market.

So we've developed a lot of the tools to support our operation so I think it's from the delivery point of view it's more simple than Tier 1 market. So we still believe we can take more projects so far.

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

Okay, got it. If I could ask a very quick question to Dan. Dan, could you talk a little bit about what you are expecting on EBITDA margin in the next couple of quarters. We have seen a pretty strong increase in the last two quarters. I think you talked about Q4 being in the same range given a lot of new capacity and new movement, but could you talk a little bit about are they going to be in the same range over the next two or three quarters given that we have a lot of new capacity coming on?

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

Yes Gokul, I've been on the low side in terms of my own forecasts for margin over this year which is, yes, a pleasant surprise. Looking at next year very roughly I think we can still realize operating leverage at the data center level before the adjusted NOI margin. Maybe 1 percentage point, that order of magnitude. Then at the SG&A level I think it also would be about 1%. It could be more but we ask ourselves whether we are actually underspending on SG&A and whether that's a bad thing?

You know, given the way the Company has grown we need to scale up and raise standards and so on and we are doing so in terms of people we're hiring and our focus on product and our R&D. So I think 1 percentage point on SG&A and 1 percentage point at the data center level would be 2 percentage points over the next year. This is just a very rough indication.

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

Got it, thank you.

Operator

We have the next question from the line of Colin McCallum from Credit Suisse, please ask your question.

Colin McCallum ***Credit Suisse - Analyst***

Yes thanks and congrats on the strong numbers. I just had one question, you've alluded a couple of times earlier to power quotas and power commitments and I just want to check sometimes we hear market noises about limits on power constraining growth. I just would be very surprised if GDS would commit to building a data center in an area where you didn't already have the full commitment for the power you would need in that data center and I imagine it's an integral part of the design isn't it?

So could you just touch on this a little bit, is this one of those things that the market talks about? But in the way that you manage your business in reality it's not actually a constraint for your business, or is it something that you just have to do the hard work getting the arrangement with the relevant state-owned enterprises in advance before you sign up to the commitment and do the construction? Any color on that would be helpful, thank you.

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

Yes Colin, I'll go first. You know, finding the right kind of real estate, industrial property in a downtown area or land for -- zoned for industrial use edge of town, which qualifies for a data center and is in a location, which is going to work for our customers, that's difficult. But it's not as difficult as then getting sufficient power to be able to operate a data center, utilize the full plot ratio and so on.

When you talk about getting power there is really two parts to it. One part is having an agreement with the power supplier, we'll call it the grid, for the supply of the power capacity. That is relatively straightforward but there can be significant economic issues because we have to bear the cost of power infrastructure and the distance from the site to substation or the number of available substations and so on can affect the economics of the project quite materially.

The second part, call it obtaining power, is the really critical and difficult part which is obtaining approval from the government for the use of that power, you can call it carbon quota or some other terminology. In the downtown areas of Beijing, Shenzhen, Shanghai, it's become very restrictive. Projects are still being approved and we have had some success and we mentioned just recently we received an allocation in downtown Shanghai.

But we now I think and other data center service providers realize that in order to obtain power we needed to go outside, further out, find locations where power is available, where the government is willing to allocate it. That is why we put so much emphasis in today's presentation on the pipeline. You can call this land with power or its developable capacity means it's land, real estate and power. That is what makes it very valuable. William do you want anything to it?

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

No, that's okay.

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

Okay, William is satisfied with my answer then.

Colin McCallum ***Credit Suisse - Analyst***

That's fine, I'm satisfied as well. I mean in terms of just the way you do things. Effectively you are saying only would become real pipeline land if you have both, right, you're not going to put yourself in a situation where you buy land and construct $100 million projects and not have power, right, it's just not something you're going to do is it?

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

Actually Colin it's the other way round. Most of the land has been purchased from the government. It starts with an agreement from the government to allocate the power.

The last thing is actually the purchase of the land.

Colin McCallum ***Credit Suisse - Analyst***

Yeah.

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

I mean maybe we chose our words a little carefully and perhaps no one will pick up the nuance but we mentioned in Changshu that we've been allocated power capacity.

We now have to go to the final step of actually purchasing the land. I mean that's a standard process. But the critical part was to obtain the power capacity.

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

So I think I'll add one comment. We realized that in the downtown Tier 1 market it's very difficult to get a power quota. Even you get one, as I mentioned, it's not significant, cannot satisfy our customer. So that's why we evolved our resource strategy from the focus on the downtown city to the edge downtown of the city.

So we are the first mover to get back with this resource in the edge of town of the Tier 1 market. So we will maintain this advantage compared with our competitors.

Colin McCallum ***Credit Suisse - Analyst***

Got it, thank you.

Operator

We have the next question from the line of Jonathan Atkin from RBC Capital Markets. Please ask your question.

Jonathan Atkin ***RBS Capital Holdings - Analyst***

Thanks, I had just a quick follow up on contract renewals, slide 33, I think that's a new slide for you and given the percentage of commitment that's up for renewal over the next two years I just wanted to get your assessment of the likelihood of this revenue renewing or whether there will be any kind of pricing adjustments. Thank you.

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

Jon, I included that page the first time because investors often asked and I think it shows that over the next five years we have a relatively small part about a total contract portfolio which is coming up for renewal. The denominator is our current area committed, which considered that is growing at such a high rate these percentages will actually be smaller as the denominator grows.

I think a lot of this contract renewal is enterprise related business where our churn rate as I like to say has been statistically insignificant. Within these numbers there are a few contracts which relate to our large internet and cloud customers, the business that we did at the end of 2015 or in early 2016.

Those are not very large deployments, certainly not by today's standards. They were very big deals at the time. Now we've just got the so-so deals. But they're in data centers which are very centrally located, like in Shenzhen and Beijing. And I think that kind of facility is very scarce.

I very much doubt that those large internal cloud customers are going to pull back, but frankly if they did it would probably be an upside opportunity in terms of being able to release --

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

Yes, as we used to mention that all our Tier 1 market tenants, our strategic customer, plugged their own rack already in our data center, so it's quite a stickiness for all our customers. So we are confident the renewal will be not an issue.

Jonathan Atkin ***RBS Capital Holdings - Analyst***

Great, thank you very much.

Operator

As there are no further questions I would like to turn the call back over to the Company for closing remarks.

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

Thank you 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. Thank you all.

Operator

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