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Q4 2018 GDS Holdings Ltd Earnings Call

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CORPORATE PARTICIPANTS

Laura Chen *GDS Holdings Limited - Head of IR*
William Huang *GDS Holdings Limited - Founder, Chairman and CEO*
Dan Newman *GDS Holdings Limited - CFO*

CONFERENCE CALL PARTICIPANTS

Jonathon Atkin *RBC - Analyst*
Frank Louthan *Raymond James - Analyst*
Gokul Hariharan *J.P. Morgan - Analyst*
Colby Synesael *Cowen and Company - Analyst*
Yang Liu *Morgan Stanley - Analyst*

PRESENTATION

Operator

Hello ladies and gentlemen, thank you for standing by and welcome to the GDS Holdings Limited Fourth Quarter and Full Year 2018 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 will 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***

Thank you Kevin. Hello everyone. Welcome to the 4Q 2018 and the full year 2018 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.

Leading today's call is Mr. William Huang, GDS's founder, Chairman and CEO, who will provide an overview of our business strategy and performance. Mr. Dan Newman, GDS's 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 U.S. 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 U.S. 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 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's founder, Chairman and CEO, William Huang. Please go ahead William.

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

Thank you Laura. Hello everyone. This is William. Thank you for joining us on today's call. 2018 was an amazing year for GDS. We achieved outstanding results in terms of new business, resource development and the financial performance. We see a sustained high level of demand for data center capacity in China and we are clearly better positioned to capture this opportunity.

Starting with our sales achievement. In 2018 we signed up customers for over 81,000 square meters of net additional area committed, or over 180 megawatts of IT power capacity. Almost double what we did the year before. This may be the highest ever reported by a data center company.

To support this level of sales we scaled up our resource development adding around 100,000 square meters of total capacity. We increased our data center count from 20 at the beginning of the year to 35 at the year end.

We invested nearly $700 million in CapEx, compared with $300 million in 2017. The flow through to our financial results was impressive. Our growth accelerated hitting over 70% for full revenue and over 100% for adjusted EBITDA year-over-year. In the last quarter our adjusted EBITDA margin hit 40%, almost a 10 percentage points higher than in 4Q 2017.

Meanwhile we maintained our disciplined approach to capital management with every project fully funded. Over the year we secured over $1 billion of funding raised. Today I am excited to announce that we have secured a $150 million strategic investment from Ping An which I will talk about later.

Turning to the slide 5. We ended 2018 with another quarter of strong sales growth. In fact, 4Q 2018 was a record for us. 22,000 square meters of net add, all organic, all in Tier 1 market. How did we achieve this staggering sales performance? The growth of our business is highly geared to key verticals such as cloud, AI and FinTech. These verticals have been growing at high rates and will continue to do so.

During the first wave of growth we have succeeded in establishing very strategic relationships with the top tier of cloud and internet customers in China. Cloud went from 0% to 70% of our area committed in three years. We continue to deepen these customers relationships and they continue to generate significant new business. In 2017 our top three customers contributed 35,000 square meters to our new bookings. In 2018 the same three contributed 47,000 square meters.

Building on this space we targeted new strategic customers. Companies which are reaching an infraction point in their business. This yielded results faster than what we expect. New strategic customers such as JD, Kingsoft, NetEase and Ping An Technology contributed 28,000 square meters or 35% to our new bookings in 2018.

Looking forward, I feel confident that we will be able to sustain our current sales momentum. Our strategic customer relationships give us bottom up visibility into new demand. We are now tapping into a large and more diversified group of hyperscale customers which includes every significant domestic and global cloud service provider in China.

The digital economy is not slowing. Chinese government policies are promoting growth. New technologies are coming which can be demand multipliers. China is forecast to spend around $200 billion on 5G CapEx up to 2025. This can enable a new wave of ultra-low latency data which makes our data centers even more in demand.

Let's turn to slide 7, results progress. Turning to results on slide 7. We focused on Tier 1 markets where demand is concentrated and align our resource development around the growth plans of our customers. This enables us to maintain exceptionally high commitment rates.

In 2018 we started 15 new data centers with a total capacity of 100,000 square meters and brought 10 new data centers into service, adding 59,000 square meters. We probably have one of the largest construction programs in the world. We ended the year with a 48% pre-commitment rate for area under construction and a 95% for area in service.

In 4Q18 alone we started five new data centers. I would like to highlight the two in Kunshan. This is a site 45 kilometers from the center of Shanghai where we own the land. The project is our largest to date greenfields project, and 100% pre-committed.

Securing real estate and power capacity in Tier 1 market is very challenging. As the scale increases so does the challenge. At the end of last year we had a 79,000 square meters held for future development in Tier 1 markets. This is enough for about one year new business at the current run rate.

Despite the challenges we have successfully added new capacity downtown area. For example, during 2018 we were able to increase our capacity in Beijing by over three times.

In order to strengthen our development pipeline and maintain our resource advantage we have started to acquire the land in strategic location on the edge of the big cities. This is a long and a complicated program. A process as it involves identifying sites which work for our customers, have the right telecom network connectivities, sufficient developable area and the power capacity, and where the local government is supportive.

Availability of land and power is still major barrier. In January 2019 we completed an acquisition of a strategic site in Guangzhou which can support 34,000 square meters of data center capacity.

We are also at an advanced stage with strategic sites in Changshu near Shanghai, Langfang near Beijing, Chengdu and the Chongqing which would be a new Tier 1 market for us.

Within the next few quarters we expect to have locked up at least three years' supply, and have further strengthened our resource advantage.

Finally we are seeing quite a few attractive M&A opportunities. These are asset deals which could add capacity in key locations and shorten our time to market. We are currently evaluating several targets.

We are highly selective and we will only move forward if the deals are strategic and the value accretive.

Let's turn into slide 11. GDS today is in the strongest position ever. We have the largest market share in the fastest growing market in the world. Fantastic customer relationships and the proven ability to executive in a superior way.

Our team has demonstrated for many years that it can set big goals and exceed them. Our growth has accelerated and underpinned by a stronger secular trends .

With that as a strategic backdrop we will continue to build on our competitive advantages and the further increase the gap between ourselves and the other players.

My priorities for 2019 are clear. Enhanced resource supply in Tier 1 markets, both organically and by acquisitions. Build on our strategic customer relationships and reduce our unit development cost and maintain investment returns.

Let's move slide 12. Before I hand over to Dan I would like to say a few words about Ping An's strategic investment which we have just announced.

Ping An has been an investor in GDS for the past six years. We are honored to count them as one of our top customers. Ping An is the third largest non-SOE company in China by market cap and finance and a technology powerhouse.

Ping An is the market leader in key digital verticals, such as fintech, healthcare, auto services, real estate, and smart cities. Their platforms include the largest online finance marketplace, insurance provider, and the healthcare ecosystem.

GDS and Ping An are committed to working together to realize synergies in technology, real estate, and financing. We are proud of the trusted relationship we have built with Ping An and are excited to work more closely together in future.

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

Dan Newman *GDS Holdings Limited - CFO*

Thank you William. Starting on slide 16 where we strip out the contribution from equipment sales and the effect of FX changes.

2018 finished strongly and I am pleased to say that we beat our revised guidance for revenue and adjusted EBITDA. In 4Q18 our service revenue grew by 10.2%. Underlying adjusted NOI grew by 13%, and underlying adjusted EBITDA grew by 15.9% in consecutive quarters.

Our underlying adjusted EBITDA margin hit 40% in the last quarter. For the whole year our reported adjusted EBITDA margin increased to 37.5%, compared to 31.7% in FY17.

Turning to slide 17, the main driver of revenue growth was the increase in area utilized. With over 7600 square meters added in the fourth quarter and nearly 47000 square meters added over the whole year.

Monthly service revenue, or MSR per square meter, declined slightly in 4Q18 and we expect that it will continue to decline by around 5% over the course of FY19. The MSR trend is tracking the reduction in our unit CapEx cost. It is our strategy to share this benefit with our customers while maintaining our returns.

As shown on slide 18, our profit margins are on an upward trend. At the data center level our adjusted NOI margin was nearly 50% in 4Q18.

As illustrated on slide 19, 58% of our portfolio is now stabilized, up from 45% this time last year. This shift has been a major contributor to the NOI margin increase.

As shown on slide 20, our SG&A was just over 10% of service revenue in 4Q18. We expanded our headcount by 20% last year to gear up for our accelerated growth. We expect to realize significant further operating leverage over our central costs and target SG&A to be around 8% by the end of FY19.

Turning to our CapEx on slide 21, 4Q CapEx increased to RMB1.7 billion, including nearly RMB700 million related to the Hong Kong land acquisition. For the full year our CapEx totaled around RMB4.7 billion, or $690 million, which was higher than we guided due to the accelerated delivery of a project in Beijing and the initiation of five new projects in the last quarter.

For the data centers currently under construction the unit CapEx is RMB59,000 per square meter, excluding the real estate portion. For comparison the unit CapEx for everything we have completed so far is RMB68,000 per square meter.

With regard to financing on slide 22, during FY18 we obtained RMB3.8 billion, or $550 million, of debt facilities including refinancing. We have established an excellent track record for project financing, and in current conditions are getting the best terms ever.

On the equity side, we've just announced a convertible preferred share issue to Ping An. The key terms of which are summarized on slide 23. It's a $150 million investment with 5% annual dividend, payable in cash or kind at our option. A conversion price of $35.60.

We can force conversion after year three if our share price goes up above 150% of the conversion price, i.e. $53.40. The instrument is treated as equity for accounting purposes. On completion it will take our pro forma year end 2018 net debt to last quarter annualized adjusted EBITDA multiple down from 8 times to 7.2 times.

As William mentioned, we feel really good about our market position, customer franchise, resource pipeline, and opportunities in front of us. Financing is the final ingredient.

You may have seen our announcement regarding the launch of an ADR offering. Since we are in process I cannot comment on the offering on this call. However I hope you can see that today we are putting in place the capital we need to position GDS strongly for the next phase of growth.

Turning to slide 24, at the end of 4Q18 our backlog had increased again to over 75,000 square meters. We currently have around 108,000 square meters which is revenue generating.

The backlog therefore implies that we can grow our revenue generating space by 70% without signing any new customer contracts.

Finally on page 25, we base our revenue and adjusted EBITDA guidance on the installed base, the project delivery schedule, and the expected customer move-in rate.

We start from a solid base as quarterly churn was only 0.9% last year. Less than 7% of our total area committed is due for renewal this year. We also have a high degree of visibility from our substantial backlog.

With that said, we expect full year 2019 total revenue to be in the range of RMB3.9 billion to RMB4.1 billion, implying a growth rate for total revenue of over 43% at the mid-point of the range.

We expect adjusted EBITDA to be in the range of RMB1.64 billion to RMB1.7 billion, implying year-on-year growth of close to 60% at the mid-point of the range.

Our revenue and adjusted EBITDA guidance implies an adjusted EBITDA margin of 41.7% for FY19, which would be 4 percentage points higher than FY18 using the mid-point guidance numbers.

We also expect CapEx of RMB4.5 billion to RMB5 billion. Included in this guidance is a budget of around RMB500 million for land acquisitions.

With that I will end the formal part of our presentation. We would now like to open the call the questions. Kevin.

QUESTIONS AND ANSWERS

Operator

Thank you ladies and gentlemen. (Operator Instructions) And our first question is from Jon Atkin from RBC. Please ask your question, Jon.

Jonathon Atkin ***RBC - Analyst***

Yes, thanks very much. I had a question about build costs, and you talked about kind the reduction in the cost per square meter. If you were to normalize that for power, and just think about some of the design parameters around your data centers and resiliency levels and so forth, is there further improvement that you think you can make in CapEx spent per unit of a capacity?

And then, my second question is just in terms of the scale of the business, and as you go to more square meters sold and commissions over the next year, are you able to accommodate numbers significantly greater than 80,000 in terms of your ability to construct quickly and accommodate demand, if it were to further increase? Thank you.

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

Hi Jon, I will start by answering on build cost.

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

Hi Jon.

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

Sorry? Jon, I'll start by answering on build costs, and then let William address how we are reducing it. Just in terms of numbers, I mentioned that what we have under construction right now has an average unit cost of RMB59,000 per square meter. We're excluding a couple of thousand RMB, because certainly projects, have some real estate portion, so we normalize for that. It's RMB59,000 per square meter.

So we're building, let's say on average, around 2 kilowatts per square meter, or slightly higher. So, you can see on a per kilowatt basis, that would imply around RMB29,000 or RMB30,000 per kilowatt.

To give you an idea of where it can go, we have done projects where the build cost has been RMB25,000 or RMB26,000 per square meter, and those are projects in Tier 1 markets. The projects we did in remote locations were another quantum below that level. Well, in that case what we're really looking at is a different kind of product, with a different design, with lower redundancy. All of this gives you an idea of what can be achieved over time. William, do you want to add to that?

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

Yes. I think the product is now very diversified, and based on the current fast-moved market. So we are able to design a different interest, different architecture to our different customers. For the multi-tenant type of product, it's almost standardized. We finalize the standardization. For the future suit product we tried to lead our customer to accept suitable architecture for that. This is number one. So, reduce the costs, is that we have the various way to reduce the costs. We also share some cost savings for our customers.

On the other hand, we are pretty -- like to leverage our current scale. As I mentioned, we are the most -- maybe the largest data center developer in the world. So, we do have the ability to well-manage our supply chain. And this will let us have the huge space to improve the cost.

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

Yes, on the final part of your question, whether we had the capacity to exceed 80,000 square meters, of course assuming the demand is there and that we can capture the orders, Jon, that's certainly our objective. On the resource side, we talk about significantly increasing the amount of resource that we have secured up to three years supply, in each Tier 1 market.

And within a few quarters, we aim to be there. The holding cost of that is also very low, it's insignificant. So, what it does do is give us the ability to respond to whatever level of demand there is. If it's higher, we can accelerate.

The other relevance of it of course is whether we have the financial capacity. That's what we are trying to put in place today, the ability to have a fully-funded two-year business plan, and the flexibility to do more if the opportunity is there.

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

Jon, I would like to say based on our current resource plan, and our funding plan, and you will see we have the ambition to do more, right? But every time we try to manage the expectation properly.

Jonathon Atkin ***RBC - Analyst***

Thank you. And then in addition, as you think about where you want to add new capacity, I'm interested in your views on kind of satellite markets. Kunshan is an interesting example because that's showing signs of life recently, from both you and I think maybe even some others. That's been facilitated by improved fiber connectivity across provinces. So, are there analogous examples that you see in other parts of China that might lead to development opportunities in some new markets?

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

Well Jon, firstly just for the definition point of view, because I -- there can be a lot of confusion about this. Satellite markets are tier -- are just part of the Tier 1 markets. They may be the periphery of the Tier 1 markets. Don't let anyone think we're talking about something else, Tier 2 market or something. We are just talking about sites which are on the periphery of Tier 1 markets, such as Kunshan, and such as the other sites which we are working on in terms of land acquisitions.

Now, there are only very few locations around the edge of Tier 1 markets that work. So William, do you want to address that?

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

Yes, I think in terms of the -- we treat the edge -- surrounded Tier 1 market as a Tier 1 market. So, it should fulfill their local infrastructure. It's very, very good. The second of -- the network connectivity is worked, the third of their local government support. The fourth is that the power, existing power, or potential power capacity, can fulfill our business plan in the next three or five years. This is our criteria.

That means there looks like a lot of the locations you can select, but actually not. Just a very few locations is suitable for you -- for us, meet our criteria. We are -- we try to be a first mover in this land acquisition, to build our next wave resource advantage. And we start working with -- on that almost when it is half-year.

Operator

The next telephone question is from Frank Louthan from Raymond James. Please ask your question, Frank.

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

Great, thank you. Can you walk us through a little more color on what exactly the JV is going to do for you in the asset being put in there? Then can you talk to us about any -- as far as your demand goes, if you talk about going forward, any need to expand outside of China or are you still pretty much looking all domestically? Thanks.

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

Frank, I don't know if we've confused you. We haven't established a JV. If you were referring to the Ping An investment, they are investing in our equity. In fact, they will take their ownership level up to nearly 10%. At the same time, we are increasing our strategic corporation in various areas. William, would you like to comment on some of the potential areas for corporation?

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

Yes, Ping An Group is a big group. They have their financial service and they also have the Ping An Technology. From the -- our GDS sites, we kind of have the more deepened cooperation with them in several areas.

One is that Ping An -- last year Ping An already be our top customer. This isn't new. And we believe we will do more deal in this year and the next few years. So they are our strategic customer right now.

Second of all, Ping An, they also own a lot of property in China. This lets us have the more flexibility to develop our results plan. So we are working on some projects right now, with them.

The third one, Ping An is the -- in China, they had their insurance bank, and other financial institutions in China. Security. So, we also potentially maybe can work with them in the project level in order to get more lower interest rates and to get more strong support in our project.

Dan Newman: Frank also asked about our thoughts about expanding outside of China?

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

I can -- current, so our study is still in China. That is our main focus. It doesn't change. Outside China, we are more expect to have some more projects in Hong Kong. So, everybody knows last year we acquired a piece of land in Hong Kong. We already start to -- in the process to design and try to build as soon as possible, because we have got a lot of the -- our meeting China-based customers' demands already. So we try to seeking more projects in Hong Kong. That is our current plan.

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

Got it, okay. Thanks for the better explanation on Ping An. Then, what's the outlook for adding new logos over the next 12 months? How has the sales force focused and compensated on that? Can - what do you expect for new logo growth?

Dan Newman: Yes, Frank, I think we take it in two parts, William. First of all, in terms of strategic customers, more targets in that category. Then, the second part, the growth of our enterprise customer-base.

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

Enterprise?

Dan Newman: Yes.

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

Yes, I think our sales strategy is very simple. I think it -- number 1, current priority is [still follow up] the cloud, because cloud is still in the very early stage in China.

The good thing is that GDS is already ready for ride on their growth, because we have the -- all the major cloud player customer in China. They deploy their computing and cloud PoPs in a significant way in GDS. That is very unique. That is where we are confident to ride on this trend.

Second of all, I think there is a lot of new internet giants still growing very fast. Everybody knows last year we acquired a lot of the new internet vertical giants, like Ctrip, like DiDi, like Netease. They are all largest -- they biggest supplier in each vertical. We believe this new logo will let us have another key driver to drive the demand for us.

Then for the retail side, we kept developing some well-known named customers, especially in financial service. Last year, we gathered the two significant new customers. One is the China UnionPay, one is JP Morgan. I think this is where we will still keep this development in the three major verticals.

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

Great thank you very much.

Operator

(Operator Instructions). Our next questionnaire is from Gokul from J.P. Morgan, please ask your question.

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

Yes hi, William and Dan, thanks for your comments. Just first question I had, could you talk a little bit about the details of what you talked about pricing potentially going down 5% in 2019, are these primarily for the newer contract you're signing? Is it because of the expansion to more satellite locations? And the 5% down is it excluding the impact of Hebei?

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

Yes, Gokul the multiservice revenue per square meter, in 2019 will largely (technical difficulty) price that's in the contracts which are already in the backlog. So if those contracts are delivered, that's what will result in a change in the MSR. That trend has been there for at least three years, our MSR went up and down, but it's actually overall has trended down.

So, I tried to point out, which I think I actually try to point out on every earnings call, is our unit CapEx is also trending down. And our target is to maintain our returns, which we have done so very consistently in the 13% to 15% IRR range over multiple years, and with certain customers that's very transparent.

What I think is the positive in this is that because we're able to reduce our unit CapEx cost, we can create a value for our customers, we can create a cost benefit to them. And that is something which is very positive to them, if we can do that whilst maintaining our returns, is absolutely win-win.

Operator

Our next telephone question is from Colby from Cowen and Company, please ask your question Colby.

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

Great, thank you, two questions if I may. I think your book-to-bill is something just over a year long and at this point in the year I think you said you had somewhere around 79,000 square meters in your backlog.

Taking those things in to consideration, what are some of the bigger dynamics that we should be paying attention to, that could swing you either below or potentially above the guidance that you've put out there for 2019?

And part of what's behind that question is that in 2018, despite that structure being the same, you were able to raise your guidance a few times through the course of the year. Then secondly you seem like you're going to be doing a lot more M&A of assets, data center assets in 2019.

Would that be in lieu of CapEx or would this be in addition, and I guess to the extent that you're successful with those, could that potentially be a source of revenue growth acceleration or at least how should we think about that in terms of revenue impact and also, I guess how one would fund that? Thanks.

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

Hi Colby, good questions. Last year you're right, we experienced a shorter book-to-bill time lag than we had done historically. This year for the purpose of guidance we kept the assumption that we've had from past years, which is more like 15 months or five quarters.

When we look at it bottom up, we look at what data centers are coming in to service in which quarter, what do we know about our customers moving intentions, what's the delivery schedule in the contracts. I think our approach is conservative, but leaves some scope for upside, but it can't be very much deviation, if we're talking about one year forward.

On the second question, M&A can be a substitute for organic, if we acquire capacity in a particular location, it may shorten our time to market and then we readjust our organic development program in that market, maybe to hold back or slow down an organic project. If that's the case, it doesn't add to our CapEx in terms of the guidance for this year.

But if the acquisition is in addition to, meaning that we carry on with our organic program as originally intended and this is a supplement to that, then it is on top of what the guidance that we've given. It's hard to say at this stage, we do have several targets which we are quite far along in terms of our evaluation, and frankly they could fall in to both categories.

They could be targets which shorten our time to market and therefore we prioritise them over organic, or they could be targets that add to the extent of our development activities. If they shorten our time to market, it can have positive revenue and EBITDA impacts this year.

Maybe not very material first of all because we're already in March and there's only so much time left in the year, and new data centers coming in to service they may actually have negative EBITDA initially at project level. But I think in terms of forecasts for 2020, yes it could add quite significantly depending on how many projects we do. Does that answer your question?

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

It does and just one quick follow up, you mentioned guidance assuming 15-month book-to-bill which is longer than 2018 when in line with historicals, are you actually expecting the book-to-bill to go back to that longer term, or that just you trying to be prudent in your guidance?

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

Both actually Colby, there's nothing fundamental has changed, to make customers shorten that time period. In fact, we're probably getting pre-commitments earlier in the life cycle of projects and invariably now we have a pre-commitment on day one of a project.

Sometimes we can't announce it because it's a pre-commitment in the eyes of our customer and in our eyes, but it may not be a contract. But with pre-commitment being made earlier then it actually extends that book-to-bill time period. So if we stick around 15 months, I think that's pretty reasonably assumption, I'm not being overly conservative with that. I think it's the appropriate assumption.

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

Great, thank you.

Operator

Our next questionnaire is from Yang Liu from Morgan Stanley, please ask your question Yang.

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

Thanks for the opportunity to ask questions. I have two questions, the first one in terms of the new Tier 1 market potential end of this year, how's the demand and the return profiles and also the exceptional customer moving pace in this current year Tier 1 market.

The second question is that is there any early sign of the other Tier 1 cities in addition to Shanghai the local government will adopt electricity or power quota in terms of the giving approval to a new development? Thank you.

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

Yes, first question was which new Tier 1 markets are we looking at and what are the conditions there? Yes, second question is are there any cities where the government is very supportive.

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

I think Shanghai, Beijing, Shenzhen, Guangzhou still are the Tier 1 market including Chengdu. I mean historically it's the IT center. So last quarter we say we are quite active in the Chongqing market right now, so we think Chongqing given time they will become another Tier 1 market in our view.

In Hong Kong it's our another new target, I think since GDS has been in Hong Kong almost six years and last year we think the opportunity is mature right now. So last year we made our decision to buy one piece of land and then we're seeking further more development in Hong Kong. So Chongqing and Hong Kong are new to market where we are paying attention on.

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

How's the return profile in these 2 new markets?

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

Your return profile?

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

I think it will be similar to what we target, but we are commit all the return profile will be in the 13% to 15% IRR.

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

Thank you. My second question is there any early sign of other Tier 1 cities besides Shanghai that local government will adopt a power quota when giving the approval to build new data centers?

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

Yes, we are very familiar with this and because we are one of the data center players who support the local government to build up their criteria. So definitely we will be one of the beneficiaries. I think the process still in the process, we are talk to the government and I think this will let us have another opportunity to build a data center in the urban town.

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

Did Yang Liu mean whether other cities would adopt the same quota approach as Shanghai?

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

Currently it's only Shanghai, but what we see is Beijing government just last week ask us, they try to understand what Shanghai government is doing right now. We are helping them to understand the new criteria, what's the logical rationale, what we help the government to set up.

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

Got it, thank you.

Operator

(Operator Instructions). As there are no further questions, I would like now to turn the call back to the Company for any closing remarks, please go ahead.

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

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 our website or the Piacente Group Investor Relations, thank you all.

Operator

This concludes the conference call, you may disconnect your lines, thank you very much.