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CORPORATE PARTICIPANTS

Don Zhou *Chindata Group Holdings Limited - Investor Relations*
Nick Wang *Chindata Group Holdings Limited - CFO*
Zoe Zhuang *Chindata Group Holdings Limited - Senior Vice President of Finance*

CONFERENCE CALL PARTICIPANTS

Mingran Li *China International Capital Corporation Limited, Research Division - Associate*
Sara Wang *UBS Investment Bank, Research Division - China Telecom and Equipment Analyst*
Yang Liu *Morgan Stanley, Research Division - Research Associate*

PRESENTATION

Operator

Good morning and good evening, ladies and gentlemen. Thank you for joining, and welcome to Chindata Group Holding Limited Second Quarter 2023 Earnings Conference Call.

We will be hosting a question-and-answer session after management's prepared remarks. Please note that today's event is being recorded. I'll now turn the call over to the first speaker today, Mr. Don Zhou from Investor Relations of Chindata Group. Please go ahead, Don.

Don Zhou ***Chindata Group Holdings Limited - Investor Relations***

Thank you, Amber. Hello, everyone, and welcome to Chindata Group's 2023 Second Quarter Earnings Conference Call. This is Don from Investor Relations team of the company. With us today are Mr. Nick Wang, our CFO; and Ms. Zoe Zhuang, our Senior Vice President, Finance.

And during this call, Nick will take you through the quarterly review of our operation performance, and Zoe will present our financial results. Management team will be here to answer your questions afterwards.

Now I will quickly go over the Safe Harbor. Some of the statements that we make today regarding our business, operations, and financial performance, may be considered forward-looking and such statements involve a number of risks and uncertainties that could cause actual results to differ materially. For more information, please refer to the risk factors discussed in our filings with the SEC.

During this call, we will present both GAAP and non-GAAP financial measures. A reconciliation of non-GAAP to GAAP measures is included in our earnings press release, which is distributed and available to the public through our Investor Relations website located at investor.chindatagroup.com. We have also updated our quarterly presentation on the company's Investor Relations website, which you can refer to as a supplementary material for today's call.

Without further due, I will now turn over the call to Nick. Nick, please go ahead.

Nick Wang ***Chindata Group Holdings Limited - CFO***

Thank you, Don. Hello, everyone and thanks for joining the call. Concurrently with the ongoing progress of privatization of the company, management and the entire team continued to work diligently on our business, delivering another strong quarterly performance in the second quarter of this year. As a quick summary for our quarterly performance, we adhered to our demanding schedule and delivery was on time. Demand from our existing clients remained satisfying, with demand in Southeast Asia market being a key driver during the second quarter. Ramp up was usual as always, with overall and single project level utilization ratio in good shape. And we continued to build our partnership, and invested in research and development to prepare ourselves for the further AIGC era, and patiently waiting for any signals of recovery of the market.

To start with some key highlights for the second quarter.

On Slide 4, two new projects were put under construction in the second quarter, total capacity increased by 47 megawatts to 945 megawatts, and total number of data centers was 35. Two hyperscale data centers were put into service in our Datong campuses in Shanxi and Johor campuses in Malaysia, bringing our total in-service capacity to 730 megawatts, an increase of 91 megawatts during the quarter.

Total client demand increased by 34 megawatts in the second quarter, bringing our total contracted and IOI capacity to 850 megawatts with total client commitment rate remaining at a healthy level of 90%. Ramp up was strong as we added 48 megawatts of utilized capacity in the quarter, bringing our total utilized capacity to 585 megawatts, with a solid utilization rate of 80%.

Financials remain under healthy momentum and in high quality. Revenue in the second quarter was RMB 1,553.8 million, representing 49.7% year-over-year growth. Adjusted EBITDA grew by 49.9% year over year to RMB 816. 1 million with adjusted EBITDA margin remained well above 50%, at 52.5% in the second quarter.

Net income grew by 9.8% year over year to RMB 219.2 million with a net margin of 14.1%. With the current business momentum, we reiterated our full year guidance range with revenue in the range of RMB 5.88 billion to RMB 6.08 billion and adjusted EBITDA in the range of RMB 3.1 billion to RMB 3.22 billion.

Now let's go into details and first take a closer look at project delivery and construction on Slide 7 to 9. We continued to work on the highly demanding schedules to ensure timely delivery, especially for our Malaysia business. In the second quarter, we put two projects into service with a total capacity of 91 megawatts. CN20, a 49-megawatt hyperscale project in our Datong campus, Shanxi province was delivered as originally scheduled. The project supports the anchor clients and is currently 100% committed by the client.

MY06 Phase 2 in Johor, Malaysia was also delivered as scheduled. The 42-megawatt project supports the anchor client as well and was already running at 76% utilization ratio in the first quarter since operation. Two new under construction projects were added. Our flagship MY06 project saw further capacity expansion in the second quarter with the inclusion of MY06 Phase 4, a 12-megawatt new hyperscale project. It is scheduled for delivery starting from the first quarter of 2024 and was 100% committed.

CN23, the other new under construction project, is located in one of our Zhangjiakou campuses in Hebei. The 26-megawatt hyperscale project is intended for one of our key international clients, and is scheduled for delivery starting from the first quarter of 2025. The project is currently 49% contracted.

Furthermore, thanks to the healthy momentum of our clients in Southeast Asia market. Our existing MY06 Phase 3 project was further expanded by 10 megawatts in the second quarter, now reaching 53 megawatts. The project is currently 100% committed. With the above changes during the quarter, as you can see on Slide 9, we have brought our total capacity up by 47 megawatts, reaching 945 megawatts by the end of the second quarter, with 730 megawatts in service and 214 megawatts under construction. Of the under-construction capacity by quarter end, we currently expect another 50 megawatts to be delivered in 2023 and our teams in China and overseas are working diligently to ensure our supply readiness.

Now regarding demand on Slide 10. We continued to receive additional demand on existing and new projects, with overseas business contributed meaningfully. We received a total amount of 34 megawatts new demand in the second quarter. Among which 22 megawatts of additional demand were received from our anchor client following the expansion of the MY06 project, and another 12 megawatts new demand received from one of the key international clients on the new under construction project in Zhangjiakou.

Meanwhile, contracted capacity increased by 60 megawatts in the quarter, including 16 megawatts of IOI conversion from CE02, CN12 and CN23 supporting one of the key international clients and 45 megawatts IOI conversion and newly contracted capacity on project MY06 Phase 3 for the anchor client.

In general, we are optimistic about the opportunities in the Southeast Asia market. The additional demand that we received during the quarter further strengthened our view and the company has been devoting dedicated internal resources to ensuring timely project delivery while securing necessary resource for future development in advance.

Regarding the market in China, we are patiently watching the evolvement of the market condition, waiting for further signals of recovery to emerge, while we continued to build our partner ecosystem to lay the foundation for future opportunities. We believe our healthy business and financial profile, as well as our continued effort in research and development, would be the key fundamentals for the company to win more opportunities as the market gradually recover and to compete in the AIGC era.

With the dynamics of demand in the quarter, the commitment status of our asset portfolio continues to look healthy.

On Slide 12, for our existing 730 megawatts of in-service capacity, 95% was committed by clients in either contract or IOI by the end of the second quarter, the same proportion as in the previous quarter and in the same quarter of last year. For our total capacity, on Slide 13, the commitment ratio was 90% at the end of the second quarter, compared with 91% in the previous quarter and 84% in the same quarter last year. The visibility of our business remains there, as by the end of the second quarter, over 95% of our contracts were for 10 years term or longer, leading to a weighted average remaining term of a current contracted capacity of 8.6 years and we expect less than 4% of our existing contracted capacity to expire by the end of 2027.

Now, coming to a customer move-in on Slide 14. Our ramp-up remains healthy and in line with our schedule, with overseas projects as the key driver. We added 48 megawatts of utilized capacity in the second quarter, bringing our total utilized capacity to 585 megawatts compared with 401 megawatts in the same quarter last year. This represents 45.9% year-over-year growth.

Quarterly move-in was contributed by projects in our northern China campus supporting the anchor client, and the Chinese cloud client, as well by our overseas projects in India and Malaysia supporting the anchor client and one of the key international clients. MY06 Phase 2 is 76% utilized in the first quarter following its opening, indicating a strong overseas demand. These quarterly dynamics lead to a quarter-end utilization ratio of 80% compared with 78% in the same quarter last year.

On a quarter-over-quarter basis, utilization ratio is 4% lower, mainly due to the inclusion of the 49 megawatts new in-service project, that was just starting to ramp up. Looking at the utilization ratio at single project level, 16 out of the existing 27 in-service projects or 59% of them are over 90% utilized. Geographically, with the fast ramp-up of our Johor projects, overseas business now contributed to 14% of total utilized capacity during and by this quarter end.

On some other aspects of business development on Slide 16, we released our 2022 ESG report on July 24, 2023. We continued to run our business in an energy-efficient way. With a total power consumption of 3.032 billion kilowatt hour in the year 2022, we managed to keep the annual PUE for our Chinese business at 1.21, remarkably lower than industry average. We reinforced our "SAFE" ESG strategy that was set forth in the year of 2021, while committing ourselves to the mission of efficiently converting electricity into high-quality computational power in the stable, eco-friendly, and high-quality manner, thereby increasing operational stability and enhancing partner confidence and building a more sustainable brand. More information can be referred to in our ESG report.

On Slide 17. As a first mover in executing energy abundant lower-tier region layout strategy, our years of operation in Huailai county, Zhangjiakou city of Hebei Province, is gaining more recognition. Hebei Qinhuai, a subsidiary of Chindata has earned a place on the National List of Specialized and Innovative 'Little Giant' enterprises. This accolade is bestowed upon companies that focus on niche markets, demonstrate strong innovation, maintain a significant market share, master core technologies and attain remarkable levels of quality and efficiency.

We are the first data center enterprise in Hebei to earn this esteemed recognition. Our "Four Campuses Layout" in Huailai County is now well-established, with our IT capacity surpassing 300 megawatts and a server deployment scale constituting 80% of the total in Huailai County. Furthermore, in this region, as we mentioned previously, we continued to build our partner ecosystem to lay the foundation for future opportunities.

On Slide 18, on July 28, we entered into a ten-year strategic cooperation agreement with Zhangjiakou Construction & Investment Group. This local SOE boasts a wealth of experience and capabilities in asset management, capital operations, resource development and industrial investments. Through the partnership, both parties would engage in deep cooperation in land and water resource development, energy development, data center collaboration and operation and integrated projects of source-grid-load-storage and further explore other collaborative opportunities in the big data industry chain. This partnership signifies the continued commitment of Chindata in Huailai, Zhangjiakou to further strengthen and optimize the local digital economy.

With that, I have concluded my part. And I will turn to Zoe for the details of our financial performance. Zoe, please.

Zoe Zhuang *Chindata Group Holdings Limited - Senior Vice President of Finance*

Thank you, Nick. Now let me walk you through our quarterly financial performance. Generally speaking, we have maintained a very healthy financial momentum in the second quarter of year 2023.

Our revenue growth in the second quarter remained healthy, recording a 49.7% year-over-year growth to reach RMB 1,553.8 million, which is in-line with the 45.9% year-over-year increase in utilized capacity. Overseas business contributed to 14% of total utilized capacity in the second quarter up from around 9% in the previous quarter.

Looking further down on Slide 25. Total cost of revenue in the second quarter increased by 51.3% to RMB 911.2 million from RMB 602.2 million in the same period of 2022, mainly driven by increase in utility costs, and depreciation and amortization expenses.

Total operating expenses in the second quarter of 2023 increased by 56.9% year over year to RMB 197.6 million, primarily due to more marketing activities conducted by the company, higher professional service fee, increase in research and development personnel and the higher share-based compensation expense.

Specifically, selling and marketing expenses in the second quarter of 2023 increased by 4.1% year over year to RMB 16.1 million. General and administrative expenses in the second quarter of 2023 increased by 69.6% year over year to RMB 154.5 million. Research and development expenses in the second quarter of 2023 increased by 39.3% year over year to RMB 27 million. As a result of these, operating income in the second quarter of 2023 increased by 43.5% to RMB 445 million recorded operating income margin of 28.6%.

Net income in the second quarter of 2023 increased by 9.8% year over year to RMB 219.2 million, with a net margin of 14.1% compared with 19.2% in the same period of 2022 and 17.5% in the first quarter of this year. The year over year change in the net margin was mostly contributed by increase in interest expense.

For a breakdown of core cost and expense item on Slide 26. With the growth of our business, we continued to maintain our adjusted EBITDA margin at above 50% level. Maintenance and other cost was 7.5% of revenue in the second quarter, compared with 6.6% in the previous quarter. Adjusted SG&A was 9.7% of revenue, compared with 6.8% in the previous quarter. On a quarter-over-quarter basis, utility price did not see material fluctuation across the regions in which we operate, leading to the stable utility cost percentage point of revenue at 31.2% in the second quarter, similar to the previous quarter. On a year-over-year basis, utility cost of revenue rose by roughly 2 percentage points.

With this, on Slide 27, adjusted EBITDA recorded a 49.9% year-over-year growth or 0.3% quarter-over-quarter growth to reach RMB 816. 1 million and a margin of 52.5%. Adjusted net income increased by 6.7% year over year in the second quarter to RMB 258.2 million at a margin of 16.6%. Details in the GAAP to Non-GAAP reconciliation on EBITDA and net income would be available in our 6-K filing or the appendix in our IR PPT.

On Slide 28, given the highly-demanding delivery schedule, we continued to incur a similar level of CapEx during the quarter that we covered existing under-construction projects as well as some initial investment in potential pipeline projects with good certainty. CapEx in the second quarter was RMB 1,254.6 million, compared with RMB 1,653.9 million in the previous quarter.

On Slide 29, our operating cash flow continued to recover and improve following the COVID-19 epidemic in 2022 and the completion of client system upgrade. Operating cash flow in the second quarter was RMB 1,186.8 million, which is around 145% of our adjusted EBITDA compared with RMB 693.3 million in the first quarter of 2023. Such improvement of operating cash flow is also in-line with substantial lower value of our account receivables by quarter end. Financing cash flow was RMB 259.1 million in the second quarter, with another RMB 1,396.4 million investing cash flow. We ended up with a higher total cash position of RMB 5,915.3 million by quarter end and a net debt position of RMB 5,569.3 million. Our leverage and the coverage ratios remain in a reasonable and healthy range.

On Slide 30, key leverage ratios do not see much fluctuation quarter over quarter, neither are key coverage ratios.

On Slide 31, asset return continued to improve in the second quarter. With an overall utilization ratio of our total in-service capacity at 80%, we are seeing the company defined pre-tax ROIC further rise to 19.3% compared with 18.7% in the previous quarter and 17.0% in the same quarter last year.

Finally, based on the company's current and the preliminary views on the market and operational conditions, we reiterated our 2023 revenue guidance in the range of RMB 5,880 million to RMB 6,080 million and adjusted EBITDA guidance in the range of RMB 3,100 to RMB 3,220 million. This reflects the company's preliminary views, which are subject to change.

This concludes our prepared remarks for today.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Yang Liu from Morgan Stanley.

Yang Liu ***Morgan Stanley, Research Division - Research Associate***

(foreign language). My question is related with the patent on the cooling technology supporting the AIGC future demand. We noticed that Chindata has a lot of patents in immersion liquid cooling and cold-plate liquid cooling, et cetera. And I would like to ask what is your customers' acceptance, especially anchor customer and global cloud customers' acceptance of such kind of technology route in AIGC-related computing hosting. And related question is whether such kind of technology can increase the ROIC of the company.

Nick Wang ***Chindata Group Holdings Limited - CFO***

Thank you, Mr. Liu Yang. I think the reason why we think that our anchor client and the future customer will be very willing to accept our diversified cooling solution is simply because we are operated in such a diversified geography, especially if you compare our North China campus versus our Southeast Asia Johor campuses, the weather conditions, humidity conditions and also temperature conditions are completely different.

So you need to have a lot of tools, tool boxes. So when the customer went to different conditions or the demand from a technical perspective, given the AIGC more requirements on the air flowing and also the cooling requirements, you need to be ready. So therefore, we are very confident with all this technology patents in-house and most importantly, with our talent pool in-house leading by our CTO, Mr. Zhang Bing Hua. We are very confident that all this liquid cooling patents and technology and solutions or cold-plate cooling solutions will be well accepted by our customers. And actually, as a matter of fact, some of them already been applied in our campuses in China as well as overseas.

In terms of a financial return, yes, there will be a marginal, I would say, the ROIC improvement, especially if you look at the full life cycle of this solution application, they're going to be a requirement in more investment, but they're going to be a cost saving later, especially on energy saving part. So overall, I think our study shows that the ROIC is going to be improved marginally.

Operator

Our next question comes from the line of Sara Wang from UBS. Please ask your question, Sara.

Sara Wang ***UBS Investment Bank, Research Division - China Telecom and Equipment Analyst***

(foreign language) So according to the latest SEC filing, it seems the 2023 CapEx is estimated at USD 1.3 billion. So just wondering what's the key driver of the CapEx for this year?

Nick Wang ***Chindata Group Holdings Limited - CFO***

Thank you, Sara. I think you are referring to the documents whatever filing we already filed to SEC regarding the privatization issue, right? So that's where you see this USD 1.3 billion. I would say that, first of all, that's actually the part of the work prepared by Citigroup, who is the adviser to our special committee who reviewed the whole process. So for any -- I would recommend for any evaluation and also the financial forecast as part of the valuation process, methodology, you better ask Citi. But from our side, we're only focusing on our business progress, delivery schedule and obviously, the future pipeline on potential project, not only the project we disclosed to the marketplace.

So having said that, that we used -- in the previous conference call, we used to estimate our whole year CapEx number going to be around RMB 5 billion to RMB 7 billion. Now I would say that the number for the whole year 2023 is going to be in the range of RMB 7 billion to RMB 9 billion from the latest internal estimate for the whole year 2023. Now we already have -- the first year, you see the number, we already spent like RMB 3 billion, the cash outflow on CapEx related stuff. So in the second half, we're probably going to spend RMB 4 billion or RMB 6 billion for other.

We think that this potential upside or increased spending will be a good news for everybody. Why is good news, because this is driven by the progress of some incremental pipeline projects, new projects, which company is optimistic to obtain in the second half of this year. And these pipeline projects may bring better revenue and EBITDA for future years, not necessarily this year in 2023, but future year in 2024 and 2025, beyond previous estimate.

In addition, a large significant portion of this incremental pipeline project, again, not the project we have disclosed, this project is actually driven by our overseas business. In other words, overseas project will have a larger-than-expected shares. And that basically means the increase of the unit CapEx accordingly. So obviously, the timing of the spending may vary around late 2023 or start of beginning of 2024.

So part of the $1.3 billion you saw on those privatization documents, and very small part of it, may be carryover 2024 to spend. But on an aggregate level, if you combine 2023 and 2024 CapEx together, this should stay the same. So, yes, that's -- hopefully, I'm answering your questions. It's a good news, actually.

Sara Wang ***UBS Investment Bank, Research Division - China Telecom and Equipment Analyst***

Yes, very clear.

Operator

Our next question comes from the line of Mingran Li from CICC.

Mingran Li ***China International Capital Corporation Limited, Research Division - Associate***

(foreign language) I want to ask about more color about the AI-related demand, like what percentage of new capacity using this year is AI-related and beside our anchor customer, either in your clients with new AI demand you're seeing recently? And also, we see some domestic peers decided to buy their own GPUs to start competing infrastructure business. Do you have any plan or strategy about this? Or are you just want to focus on our colocation service because your demand is strong.

Nick Wang ***Chindata Group Holdings Limited - CFO***

Thank you, Mingran. Actually, the client doesn't tell us when they install the server into our IDC centers and how many of them is AI-related. So we -- but we can guess, right? So based on the application and utilization of the high-density cabinets and based on the servers type they put in our data center, we think that the AI portion -- the AI-related servers probably account for around 5% of our current overall capacity.

On an incremental basis, we are still under some serious discussion with them about incremental orders and projects and I believe are going to be a higher portion of them going to be AIGC-related, for sure. And also, you probably heard the same thing. As myself from the Street that simply one of our anchor customers have the biggest reserve for inventory of the AIGC-related GPU units or chips or servers in China for both their China business and also their overseas business.

So hopefully, that we can get a significant share out of it when they consider IDC partners for their future projects. And also, on top of the existing clients, we do -- these days, we do accommodate a lot of visits from quite a number of other AI customers, small and medium-sized these days, particularly to our overseas campus, and we believe the portion will be higher moving forward.

As regard to our future strategy on the computing power service, we will focus on colocation service only. That is our current plan. And I haven't heard anything further about we're going to provide computing power business to our clients. Although we are doing -- as everybody knows, we're doing the best job of converting the electric power to computing power business, but we will not offer the computing powers for now, and I believe in the near future as well.

Operator

(Operator Instructions) Next is a follow-up question from the line of Yang Liu from Morgan Stanley.

Yang Liu ***Morgan Stanley, Research Division - Research Associate***

(foreign language) We recently observed that anchor customers and another datacenter player gained approval in Singapore, also initiated new projects in Johor as well. At the same time, Chindata also got sizable new orders from the anchor customer, so we would like to ask about the competing dynamics in Southeast Asia market.

Nick Wang ***Chindata Group Holdings Limited - CFO***

Thank you, Liu. I think we come back to the issue of whether we want a smaller share of the bigger pie or bigger share of the smaller pie. But the Southeast Asia market, hopefully, our goal is to get both essentially. So the Southeast Asia offers a better prospective market in terms of overall IDC demand than China over the course of next 3 years, that's our belief. And we believe that with our confidence in the efficiency in terms of delivery and operation and the economy of scale, which is going to sooner or rather later going to turn it into a huge cost advantage as well as our track record we demonstrate to our clients in China and in our Johor project, we will get a bigger pie than everybody anticipated in the future.

But the other reality we have to face is actually from day 1 when we had a conversation about our change in Southeast Asia market, I said, I have been keep saying that it's open field competition. So you need to show all your hands or what do you have in the pocket in terms of cooling solutions, your supply chain -- entire supply chain solution from China all the way to Southeast Asia market, your talent pool and your capital power -- your prowess, all these, you're going to actually show much more than you have been doing in China to the client in order to win bigger shares out of this bigger pie.

Yang Liu ***Morgan Stanley, Research Division - Research Associate***

(foreign language) The follow-up question is that do you have any sense on what is the wallet share for the Chindata in those anchor customers demand in Southeast Asia market?

Nick Wang ***Chindata Group Holdings Limited - CFO***

We're striving to get over 50% of the overall shares. And we believe with all the solutions we put on table and all the good performance we put on the table, now we have a very good chance to get it. And our overall objective of the overseas business as a share of our overall portfolio is going to be around 30%, probably by the end of 2025.

Operator

(Operator Instructions) I am showing no further questions. Thank you very much for all your questions. I'll now turn the conference back to the company for any closing comments.

Nick Wang ***Chindata Group Holdings Limited - CFO***

I think everybody has been focusing on Chindata, which we highly appreciated. And also, we highly appreciate all the investors and analysts, the friends, your support for the company in the past 2 or 3 years since the IPO. While there is a privatization process of the company is going on, we can assure you that the management and our entire team will continue to work very hard on delivering our business, sticking to our original mission of converting -- efficiently converting electric power to computing power and again striving to become the best IDC leader in the Pan Asia Pacific regions. Thank you.

Operator

Ladies and gentlemen, we conclude our conference for today. Thank you for participating. You may now disconnect your lines.