

## VNET Group Inc

Bloomberg: VNET US Equity | Reuters: VNET.O

Refer to important disclosures at the end of this report

DBS Group Research . Equity

25 May 2022

### BUY

Last Traded Price (24 May 2022): US\$4.62 (NASDAQ : 11,264)

Price Target 12-mth: US\$12.40 (168% upside) (Prev US\$13.60)

#### Analyst

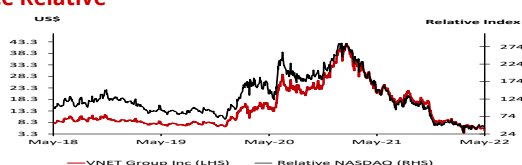
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#### What's New

- Adjusted EBITDA grew by 21.9% y-o-y in 1Q22, higher than market expectations
- FY22 guidance and expansion target are unchanged
- Lockdown impacts on project delivery and customer move-in to continue in 2Q22
- Maintain BUY for its promising wholesale transformation, TP lowered to US\$12.4

#### Price Relative



#### Forecasts and Valuation

FY Dec (RMBm)	2020A	2021A	2022F	2023F
Turnover	4,829	6,190	7,471	8,675
EBITDA	1,106	1,289	1,811	2,209
Pre-tax Profit	(2,571)	627	(235)	(343)
Net Profit	(3,180)	500	(375)	(508)
Net Pft (Pre Ex) (core profit)	(636)	(329)	(375)	(508)
Net Profit Gth (Pre-ex) (%)	(248.8)	48.2	(13.9)	(35.6)
EPS (RMB)	(26.61)	3.47	(2.17)	(2.55)
EPS (US\$)	(4.00)	0.52	(0.33)	(0.38)
EPS Gth (%)	(1,527.5)	N/A	N/A	(17.9)
Diluted EPS (US\$)	(0.80)	(0.33)	(0.33)	(0.38)
DPS (US\$)	0.00	0.00	0.00	0.00
BV Per Share (US\$)	6.94	7.55	5.98	4.82
PE (X)	nm	8.9	nm	nm
P/Cash Flow (X)	5.1	3.2	9.2	5.7
P/Free CF (X)	nm	nm	nm	nm
EV/EBITDA (X)	4.2	4.4	5.1	5.8
Net Div Yield (%)	0.0	0.0	0.0	0.0
P/Book Value (X)	0.7	0.6	0.8	1.0
Net Debt/Equity (X)	CASH	0.1	0.5	0.9
ROAE (%)	(60.7)	7.8	(5.3)	(7.7)
Adi EBITDA	1,324	1,754	1,989	2,397
Adi EBITDA Gth (%)	26.0	32.4	13.4	20.5
Adi EBITDA Rev (%)			(2.6)	(4.1)
Consensus EPS (RMB)			(0.91)	(0.99)
Other Broker Recs:		B:15	S:1	H:0

Source of all data on this page: Company, DBS Bank (Hong Kong) Limited ("DBS HK"), Thomson Reuters

### Transformation to bear fruit

#### Investment Thesis

Riding on growing data centre demand from various industries. VNET has a diversified retail customer base across various industries, and data centre demand has been strong as these companies embark on their digital transformation.

**Strong capacity expansion to support growth.** Despite macro uncertainties, VNET aims to expand its capacity by 14.4k-17.4k cabinets in FY22 to meet rising demand, representing 18%-22% growth.

**Expect to secure more wholesale contracts,** given the existing retail relationships with internet and cloud customers. VNET currently has 252MW wholesale capacity in service or under MOU.

#### Valuation:

Our TP of US\$12.4 is based on 12x FY22F EV/adjusted EBITDA, slightly higher than its historical average given its wholesale transformation.

#### Where we differ:

**Expect expansion into wholesale market to trigger re-rating.** The market is concerned about VNET's growth outlook due to its retail business model which has lower visibility. We believe the company will successfully expand into the wholesale market, supported by existing retail relationships with wholesale customers and a strong project pipeline.

#### Key Risks to Our View:

**Excess DC supply.** Excess DC capacity could result in pricing pressures for the whole industry.

**Slowdown in DC demand.** The slowdown in demand for DC could lead to overcapacity and pricing pressure.

#### At A Glance

Issued Capital (m shrs)	148
Mkt Cap (US\$m)	684
Major Shareholders (%)	
TT International Asset Management Ltd	9.4
GIC Private Limited	8.8
Fidelity International	7.8
Blackstone Tactical Opportunities Advisors L.L.C.	7.3
Majara Investment Ltd	6.3
Free Float (%)	60.4
3m Avg. Daily Val. (US\$m)	21.48
GICS Industry: Information Technology / Software & Services	



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## WHAT'S NEW

### 1Q22 results exceeded market expectations; lockdown impacts to continue in 2Q22

#### 1Q22 results highlights

Revenue increased by 18.6% y-o-y to Rmb1,645m in 1Q22. Project delivery and customer move-in during 1Q22 were impacted by lockdowns in major cities in China. Total cabinets in service increased by 41.2% y-o-y to 79k, with net additions of 0.4k cabinets in 1Q22. Utilised cabinets increased by 28.1% y-o-y to 43k. Utilisation rate dropped 5.5ppts y-o-y to 54.5%. Retail monthly recurring revenues (MRR) increased by 1% y-o-y (-0.7% q-o-q) to Rmb9,301 in 1Q22.

Adjusted cash gross profit increased by 13.1% to Rmb685m, with adjusted cash gross margin contracting 2ppts y-o-y to 41.6%.

Adjusted EBITDA increased by 21.9% y-o-y to Rmb506m, with adjusted EBITDA margin expanding 0.9ppt y-o-y to 30.8%.

Net profit was Rmb91m in 1Q22, compared to a net loss of Rmb85m in 1Q21, with the swing coming from the increase in fair value of convertible promissory notes and foreign exchange gains.

#### Outlook

The company's FY22 guidance for revenue and adjusted EBITDA remains unchanged at Rmb7,450m-Rmb7,750m and Rmb1,975m-Rmb2,125m, with midpoints implying 22.8% and 16.9% y-o-y growth respectively. The higher than expected adjusted EBITDA in 1Q22 was largely due to better operating cost control and a one-time other operating income. Management expects the margin to normalize in subsequent quarters.

Management has kept the expansion target of 14.4k-17.4k in FY22. There is no significant change for customer verticals from the retail side. The company expanded its wholesale capacity by c.16MW with 4 contracts in 1Q22, including an extended pre-committed order of 11MW from a leading social platform operator. As of the end of 1Q22, the company has 252MW wholesale capacity in service & under MoU. VNET recently exclusively partnered with People Data in Apr 2022 to build and operate People Cloud, serving local governments and SOEs' need for cloud

computing. The partnership demonstrates VNET's solid government relationship and ability to serve SOEs.

Looking forward, project delivery and customer move-in in 2Q22 are still adversely impacted by lockdowns in major cities in China. We expect customer move-ins to recover in 2H22 when strict control measures are gradually removed.

We have cut our adjusted EBITDA forecasts by 2.6% and 4.1% for FY22 and FY23 respectively, as project delivery and customer move-ins would be adversely impacted by lockdowns in major cities in China. We project adjusted EBITDA to grow by 13.4% and 20.5% in FY22 and FY23 respectively. We maintain our BUY call on VNET for its steady capacity expansion and promising wholesale transformation. Our TP of US\$12.4 is based on 12x FY22 EV/adjusted EBITDA (unchanged).

#### Company Background

VNET is one of the leading and fast-growing carrier-neutral data centre (DC) operators in China. The business, which is based in Beijing, was founded by Sheng Chen and Jun Zhang in 1999 and started the first carrier-neutral DC in China. It operates in more than 20 cities throughout China, servicing a diversified base of 1,400+ IDC customers.

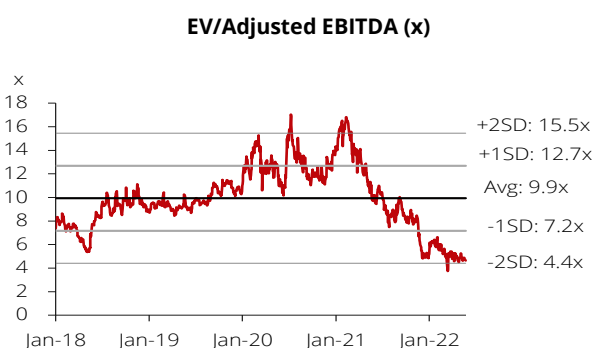
## VNET Group Inc

### Quarterly Results

Rmb '000	1Q21	2Q21	3Q21	4Q21	1Q22	y-o-y %chg	q-o-q %chg
Total net revenues	1,386,923	1,496,978	1,560,460	1,745,440	1,645,486	18.6%	-5.7%
Total cost of revenues	(1,063,611)	(1,137,463)	(1,185,225)	(1,365,472)	(1,289,965)	21.3%	-5.5%
Gross profit	323,312	359,515	375,235	379,968	355,521	10.0%	-6.4%
Total operating expenses	(243,180)	(262,471)	(261,333)	(649,741)	(259,463)	6.7%	-60.1%
<b>Operating (loss) profit</b>	<b>80,132</b>	<b>97,044</b>	<b>113,902</b>	<b>(269,773)</b>	<b>96,058</b>	<b>19.9%</b>	<b>nm</b>
Interest income	5,709	8,103	9,148	8,937	4,549	-20.3%	-49.1%
Interest expense	(84,479)	(87,095)	(88,013)	(75,363)	(53,119)	-37.1%	-29.5%
Other income and expenses	(43,737)	495,524	166,200	328,926	90,066	nm	-72.6%
(Loss) gain before income taxes and (loss) gain from equity method investments	(42,375)	513,576	201,237	(7,273)	137,554	nm	nm
Income tax benefits (expenses)	(37,299)	(29,499)	(29,060)	(15,549)	(46,700)	25.2%	200.3%
Gain (loss) from equity method investments	(1,305)	(23,605)	(12,027)	(1,729)	2,047	nm	nm
Net (loss) profit	(80,979)	460,472	160,150	(24,542)	92,901	nm	nm
Minority interests	(3,680)	(4,620)	(3,967)	(2,736)	(2,195)	-40.4%	-19.8%
Net profit (loss) attributable to the Company's ordinary shareholders	(84,659)	455,852	156,183	(27,278)	90,706	nm	nm
Operating (loss) profit	80,132	97,044	113,902	(269,764)	96,058	19.9%	nm
Plus: depreciation and amortisation	300,105	297,739	316,951	352,783	349,609	16.5%	-0.9%
Plus: share-based compensation expenses	34,855	27,507	4,608	253,040	43,245	24.1%	-82.9%
Other adjustments	-	2,816	14,959	126,902	17,260	nm	-86.4%
<b>Adjusted EBITDA</b>	<b>415,092</b>	<b>425,106</b>	<b>450,420</b>	<b>462,961</b>	<b>506,172</b>	<b>21.9%</b>	<b>9.3%</b>

Source: Company, DBS HK

### Historical EV/Adjusted EBITDA and PB band



Source: Thomson Reuters, DBS HK

## VNET Group Inc

### Key Assumptions

FY Dec	2019A	2020A	2021A	2022F	2023F
IDC MRR per cabinet (Rmb/month/cabinet)	8,127.0	8,955.2	9,037.4	8,992.2	8,947.2
Total number of cabinets	36,291.0	53,553.0	78,540.0	92,940.0	109,940.0
Overall utilisation rate of cabinets (%)	66.0	60.4	61.6	54.2	54.5

Source: Company, DBS HK

### Segmental Breakdown (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
<b>Revenues (RMB m)</b>					
Revenue from IDC services	2,223	3,025	4,015	4,970	5,924
Revenue from cloud services & VPN services	1,566	1,804	2,175	2,501	2,751
<b>Total</b>	<b>3,789</b>	<b>4,829</b>	<b>6,190</b>	<b>7,471</b>	<b>8,675</b>

Source: Company, DBS HK

### Income Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Revenue	3,789	4,829	6,190	7,471	8,675
Cost of Goods Sold	(2,850)	(3,753)	(4,752)	(5,827)	(6,723)
<b>Gross Profit</b>	<b>939</b>	<b>1,076</b>	<b>1,438</b>	<b>1,644</b>	<b>1,952</b>
Other Opng (Exp)/Inc	(757)	(959)	(1,417)	(1,427)	(1,657)
<b>Operating Profit</b>	<b>182</b>	<b>117</b>	<b>21</b>	<b>217</b>	<b>295</b>
Other Non Opng (Exp)/Inc	(67)	206	79	0	0
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(291)	(349)	(303)	(452)	(638)
Dividend Income	0	0	0	0	0
Exceptional Gain/(Loss)	0	(2,544)	829	0	0
<b>Pre-tax Profit</b>	<b>(176)</b>	<b>(2,571)</b>	<b>627</b>	<b>(235)</b>	<b>(343)</b>
Tax	(5)	(109)	(111)	(125)	(150)
Minority Interest	(1)	(29)	(15)	(15)	(15)
Preference Dividend	0	(471)	0	0	0
<b>Net Profit</b>	<b>(182)</b>	<b>(3,180)</b>	<b>500</b>	<b>(375)</b>	<b>(508)</b>
Net Profit before Except.	(182)	(636)	(329)	(375)	(508)
EBITDA	954	1,106	1,289	1,811	2,209
<b>Growth</b>					
Revenue Gth (%)	11.4	27.4	28.2	20.7	16.1
EBITDA Gth (%)	9.4	15.8	16.6	40.5	21.9
Opg Profit Gth (%)	(23.3)	(36.0)	(81.7)	916.5	36.1
Net Profit Gth (%)	11.1	(1,644.4)	N/A	N/A	(35.6)
<b>Margins &amp; Ratio</b>					
Gross Margins (%)	24.8	22.3	23.2	22.0	22.5
Opg Profit Margin (%)	4.8	2.4	0.3	2.9	3.4
Net Profit Margin (%)	(4.8)	(65.9)	8.1	(5.0)	(5.9)
ROAE (%)	(3.6)	(60.7)	7.8	(5.3)	(7.7)
ROA (%)	(1.4)	(18.9)	2.4	(1.5)	(1.8)
ROCE (%)	1.8	0.9	0.1	1.1	1.2
Div Payout Ratio (%)	N/A	N/A	0.0	N/A	N/A
Net Interest Cover (x)	0.6	0.3	0.1	0.5	0.5

Source: Company, DBS HK

**VNET Group Inc**
**Interim Income Statement (RMB m)**

<b>FY Dec</b>	<b>2H2019</b>	<b>1H2020</b>	<b>2H2020</b>	<b>1H2021</b>	<b>2H2021</b>
Revenue	2,029	2,235	2,594	2,884	3,306
Cost of Goods Sold	(1,559)	(1,728)	(2,025)	(2,201)	(2,551)
<b>Gross Profit</b>	<b>470</b>	<b>506</b>	<b>570</b>	<b>683</b>	<b>755</b>
Other Oper. (Exp)/Inc	(402)	(391)	(569)	(506)	(911)
<b>Operating Profit</b>	<b>69</b>	<b>116</b>	<b>1</b>	<b>177</b>	<b>(156)</b>
Other Non Opg (Exp)/Inc	(17)	(63)	269	11	68
Associates & JV Inc	0	0	0	0	0
Net Interest (Exp)/Inc	(155)	(184)	(165)	(158)	(145)
Exceptional Gain/(Loss)	0	(1,612)	(932)	415	414
<b>Pre-tax Profit</b>	<b>(103)</b>	<b>(1,743)</b>	<b>(828)</b>	<b>446</b>	<b>180</b>
Tax	15	(43)	(66)	(67)	(45)
Minority Interest	3	(5)	(24)	(8)	(7)
<b>Net Profit</b>	<b>(86)</b>	<b>(2,262)</b>	<b>(918)</b>	<b>371</b>	<b>129</b>
Net profit bef Except.	(86)	(650)	14	(44)	(285)
<b>Growth</b>					
Revenue Gth (%)	14.5	27.0	27.8	29.0	27.4
Opg Profit Gth (%)	(46.8)	2.0	(98.5)	53.3	(14,929.9)
Net Profit Gth (%)	40.2	(2,245.7)	(969.3)	N/A	N/A
<b>Margins</b>					
Gross Margins (%)	23.2	22.7	22.0	23.7	22.8
Opg Profit Margins (%)	3.4	5.2	0.0	6.1	(4.7)
Net Profit Margins (%)	(4.2)	(101.2)	(35.4)	12.9	3.9

Source: Company, DBS HK

## VNET Group Inc

### Balance Sheet (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Net Fixed Assets	5,444	8,106	10,092	13,089	14,667
Invt in Associates & JVs	0	0	0	0	0
Other LT Assets	3,532	5,076	7,670	7,949	8,227
Cash & ST Invt	2,721	3,402	1,708	2,003	2,291
Inventory	0	0	0	0	0
Debtors	657	847	1,406	1,944	2,258
Other Current Assets	1,920	1,942	2,218	2,320	2,428
<b>Total Assets</b>	<b>14,274</b>	<b>19,374</b>	<b>23,095</b>	<b>27,306</b>	<b>29,871</b>
ST Debt	1,178	2,158	384	384	384
Creditors	303	289	494	479	553
Other Current Liab	2,988	3,675	4,302	4,302	4,302
LT Debt	2,140	887	2,215	5,215	8,215
Other LT Liabilities	2,433	5,467	8,099	9,699	9,699
Shareholder's Equity	4,953	6,565	7,242	6,882	6,389
Minority Interests	279	333	359	344	329
<b>Total Cap. &amp; Liab.</b>	<b>14,274</b>	<b>19,374</b>	<b>23,095</b>	<b>27,306</b>	<b>29,871</b>
Non-Cash Wkg. Capital	(714)	(1,175)	(1,172)	(516)	(169)
Net Cash/(Debt)	(597)	357	(891)	(3,596)	(6,308)
Debtors Turn (avg days)	56.9	56.9	66.4	81.8	88.4
Creditors Turn (avg days)	60.9	39.1	41.0	41.9	39.1
Inventory Turn (avg days)	0.2	N/A	N/A	N/A	N/A
Asset Turnover (x)	0.3	0.3	0.3	0.3	0.3
Current Ratio (x)	1.2	1.0	1.0	1.2	1.3
Quick Ratio (x)	0.8	0.7	0.6	0.8	0.9
Net Debt/Equity (X)	0.1	CASH	0.1	0.5	0.9
Net Debt/Equity ex MI (X)	0.1	CASH	0.1	0.5	1.0
Capex to Debt (%)	39.1	82.2	108.3	87.0	43.8
Z-Score (X)	NA	NA	NA	NA	NA

Source: Company, DBS HK

### Cash Flow Statement (RMB m)

FY Dec	2019A	2020A	2021A	2022F	2023F
Pre-Tax Profit	(176)	(2,571)	627	(235)	(343)
Dep. & Amort.	772	989	1,268	1,595	1,914
Tax Paid	(42)	(102)	(83)	(125)	(150)
Assoc. & JV Inc/(loss)	0	0	0	0	0
(Pft)/ Loss on disposal of FAs	(23)	6	(11)	0	0
Chg in Wkg.Cap.	(121)	(510)	(496)	(655)	(347)
Other Operating CF	392	2,902	83	0	0
<b>Net Operating CF</b>	<b>803</b>	<b>714</b>	<b>1,388</b>	<b>580</b>	<b>1,073</b>
Capital Exp.(net)	(1,297)	(2,502)	(2,816)	(4,870)	(3,770)
Other Invt.(net)	(115)	71	278	0	0
Invt in Assoc. & JV	0	0	0	0	0
Div from Assoc & JV	0	0	0	0	0
Other Investing CF	(200)	(1,459)	(1,235)	0	0
<b>Net Investing CF</b>	<b>(1,612)</b>	<b>(3,889)</b>	<b>(3,773)</b>	<b>(4,870)</b>	<b>(3,770)</b>
Div Paid	0	0	0	0	0
Chg in Gross Debt	832	(554)	3,260	3,000	3,000
Capital Issues	(22)	(130)	(1,702)	0	0
Other Financing CF	(349)	4,848	(590)	1,585	(15)
<b>Net Financing CF</b>	<b>462</b>	<b>4,163</b>	<b>968</b>	<b>4,585</b>	<b>2,985</b>
Currency Adjustments	44	(229)	9	0	0
Chg in Cash	(304)	759	(1,408)	295	288
Opg CFPS (RMB)	8.29	10.24	13.06	7.14	7.14
Free CFPS (RMB)	(4.44)	(14.96)	(9.90)	(24.79)	(13.55)

Source: Company, DBS HK

**VNET Group Inc**

**Target Price & Ratings History**



S.No.	Date	Closing Price	12-mth Target Price	Rating
1:	26-May-21	US\$21.22	US\$47.50	Buy
2:	25-Aug-21	US\$18.20	US\$27.00	Buy
3:	19-Nov-21	US\$18.86	US\$27.00	Buy
4:	20-Jan-22	US\$9.31	US\$15.30	Buy
5:	31-Mar-22	US\$7.12	US\$13.60	Buy

Source: DBS HK

Analyst: Tsz Wang Tam  
Harry Zhuang

**VNET Group Inc**

DBS HK recommendations are based on an Absolute Total Return\* Rating system, defined as follows:

**STRONG BUY** (>20% total return over the next 3 months, with identifiable share price catalysts within this time frame)

**BUY** (>15% total return over the next 12 months for small caps, >10% for large caps)

**HOLD** (-10% to +15% total return over the next 12 months for small caps, -10% to +10% for large caps)

**FULLY VALUED** (negative total return, i.e., > -10% over the next 12 months)

**SELL** (negative total return of > -20% over the next 3 months, with identifiable share price catalysts within this time frame)

\*Share price appreciation + dividends

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Sources for all charts and tables are DBS HK unless otherwise specified.

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