

BCP Research: 21Vianet Group Inc (VNET B2/B/B+)- Thoughts on New VNET '26 Convert Issuance-Initiate 'Neutral'

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Summary: Chinese Internet Data Center 21Vianet Group Inc ("VNET") announced the pricing of US\$525 mm in private placement convertible notes. Notes are senior unsecured, maturing February 1, 2026, with a softcall put on February 1, 2024 at par, and zero interest (non-accretive) due over the course of their tenure. Bondholders are eligible to purchase another US\$75 mm under a 13-day greenshoe option. Proceeds will be used towards repayment of the outstanding US\$300 mm in October 15, 2021 sr. unsecured notes, with the remaining US\$225-300 mm used towards expansion of VNET's data center infrastructure and general corporate purposes.

VNET equity currently trades at US\$41.44 v. VNET '26s conversion price of US\$54.47 per ADS (VNET US). We estimate a 410 bps spread at 50% vol on the new VNET '26s, in line with soon-to-be retired VNET '21s, and reflective of VNET's extended amortization runway and strengthening of its balance sheet. Spread implies bonds are 6% cheap at their current price of 105c v. fair value of 112c, and with a bond floor of 88c. Meanwhile, implied volatility on the VNET '26 converts of 38% appears relatively attractive v. 100D (63%) and IVOL (65%) for the listed calls on the common. Management guided towards single-digit revenue and EBITDA growth v. ~US\$295 mm in capex requirements in 4Q20. Meanwhile, VNET '26s use of proceeds indicates heavy capex use may continue into FY21. Therefore, we initially rate VNET 0% '26s 'Neutral', awaiting detail on the state of 4Q20 cash flows and management projections for the year ahead.

	Amt Out (US\$ mm)	Ratings (M/SP/F)	Mid Price	Mid YTM	Ranking
VNET 7.875% 10/15/2021	300	B2/B/B+	102.25	4.64%	Sr Unsecured

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	VNET US Price
VNET 0% 02/01/24	525	104.8	(0.92%)	37.71%	6.00%	66.29%	\$54.47	\$41.44

Source: Equity information sourced from Bloomberg. Convertible pricing as of January 22, 2021

3Q20 Financials

- Revenue increased 12% q/q to US\$180mm.
 - Number of cabinets increased 17% q/q to 51,476.
- Reported EBITDA increased 23% q/q to US\$53mm.
- Gross margin decreased q/q to 20%. EBITDA margin increased q/q to 30%.
- Guidance for 4Q20: US\$191~194mm revenue, US\$55~58mm EBITDA.
- Cash burn (before equity financing) increased 94% q/q to US\$113mm.
- The company issued US\$388mm ADS in August, FCF after equity financing increased 202% q/q to US\$274mm.
 - Reported capex (higher than US\$247mm capex in cash flow statement) in 9M20 was US\$289mm, capex guidance for 4Q20 was US\$294mm.
- Gross debt decreased 13% q/q to US\$820mm, including:
 - US\$300mm VNET 21s.
 - US\$84mm bank loan.
 - US\$209mm capital leases.
 - US\$200mm convertible bond, matures in 2025 and payable at 115% of the outstanding principal.
 - The convertible bond was reported at fair value but adjusted at 115% of par value in our calculation

- Total cash increased 16% q/q to US\$805mm.
- Net debt decreased 94% q/q to US\$16mm.
- LQA gross and net leverage both decreased q/q to 3.9x and 0.1x, respectively.
- On Nov 30, State Council's inspection team in Heilongjiang Province advised to lower electricity costs for IDCs.

Parent Company

- As of Sept 2020, Tuspark Innovation Venture Ltd ("Tuspark") owned 16.6% of stake and 48.8% of voting power of VNET. Tsinghua University owns 51% of Tuspark.
- On Nov 5, 2020, Tsinghua University intended to sell 14.8% stake in TUS Holdings to a LGFV, as universities are requested by State Council to divest assets not related to teaching & education. (see Exhibit 2)
- On Nov 9, 2019, Tsinghua University intended sell certain stake to Xiongan Management Committee. The agreement was still under regulatory review.

Exhibit 1: 3Q20 Financials

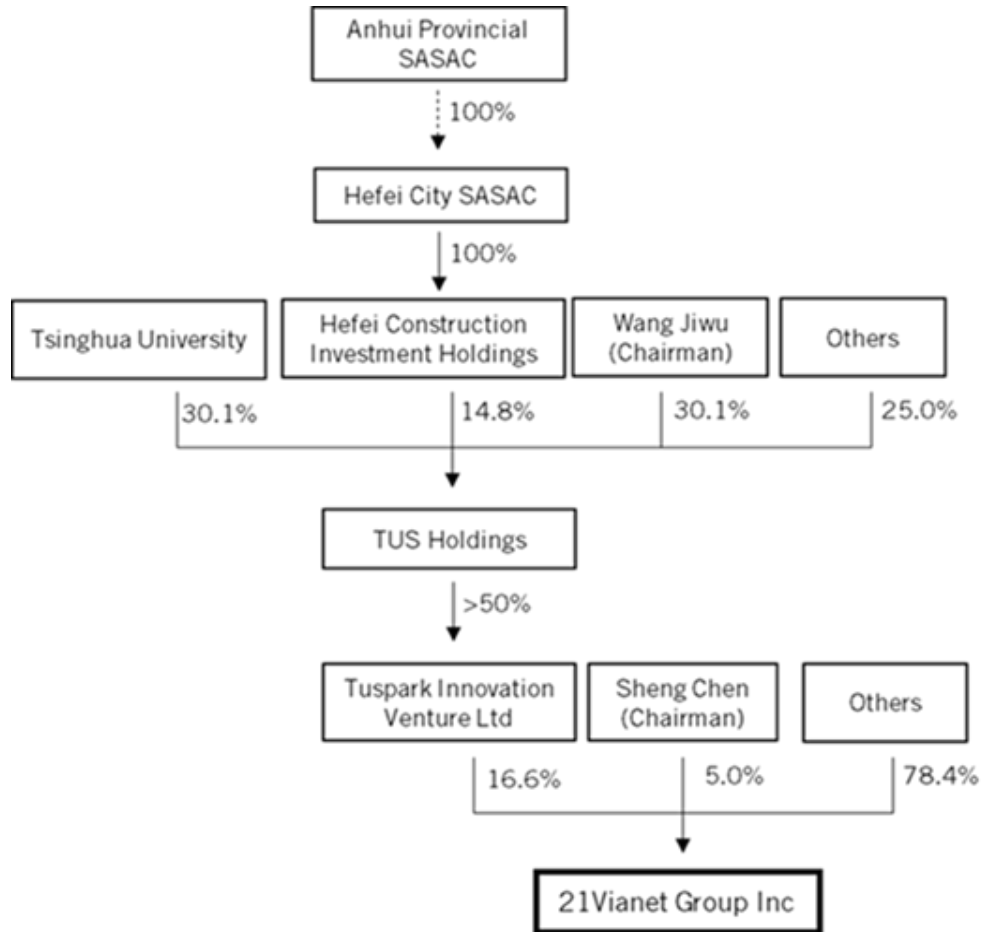
Income Statement (US\$ mm)	3Q20	2Q20	3Q19	y/y	q/q
Revenue	180	161	140	29%	12%
Reported EBITDA	53	43	39	37%	23%
Gross margin	22%	24%	23%	(60 bps)	(172 bps)
Reported EBITDA margin	30%	27%	28%	180 bps	279 bps

FCF (US\$ mm)	3Q20	2Q20	3Q19	y/y	q/q
Reported EBITDA	53	43	39	37%	23%
WK investment	(18)	(27)	(10)	72%	(35%)
Capex	(115)	(70)	(65)	77%	65%
Investment	(17)	11	(22)	(24%)	(255%)
Interest expense	(13)	(13)	(12)	12%	1%
Tax benefit (expense)	(4)	(3)	(1)	155%	27%
FCF	(113)	(58)	(72)	57%	94%
Equity financing	388	149	-	-	160%
FCF after equity financing	274	91	(72)	(481%)	202%

Debt (US\$ mm)	3Q20	2Q20	3Q19	y/y	q/q
Gross debt	820	947	596	38%	(13%)
- ST	65	214	61	5%	(70%)
- LT	756	733	534	41%	3%
Cash	805	695	402	100%	16%
- Cash	766	612	293	162%	25%
- ST investment	12	22	50	(76%)	(47%)
- Restricted cash	26	60	60	(56%)	(56%)
Net debt	16	252	194	(92%)	(94%)
LQA gross leverage	3.9x	5.5x	3.8x	0.0x	(1.6x)
LQA net leverage	0.1x	1.5x	1.2x	(1.2x)	(1.4x)
LTM gross leverage	4.8x	6.0x	3.9x	0.9x	(1.2x)
LTM net leverage	0.1x	1.6x	1.3x	(1.2x)	(1.5x)

Cabinets	3Q20	2Q20	3Q19	y/y	q/q
Self-built	47,651	40,157	27,267	75%	19%
Partnered	3,825	3,893	4,849	(21%)	(2%)
Total cabinets	51,476	44,050	32,116	60%	17%
				-	-
Retail MRR per cabinet (US\$)	1,312	1,262	1,241	6%	4%
Utilization rate	64%	61%	66%	(200 bps)	280 bps

Exhibit 2: Ultimate Shareholders, Pro Forma.



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"Market Outperform" – The bond's total return is expected to exceed the total return of the J.P. Morgan Corporate Emerging Markets Bond Index series ("CEMBI") Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Perform" – The bond's total return is expected to be in line with the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Market Underperform" – The bond's total return is expected to be below the total return of the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

"Not Rated" or no comment – Currently, the analyst does not have adequate conviction about the bond's total return relative to the CEMBI Broad Diversified High-Yield Index over the next 3 – 6 months.

Quasi Sovereign Universe

"Market Overweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to decrease over the next 3 – 6 months.

"Market Weight" – The spread of the bond to its similarly duration sovereign controller bond is expected to remain unchanged over the next 3 – 6 months.

"Market Underweight" – The spread of the bond to its similarly duration sovereign controller bond is expected to increase over the next 3 – 6 months.

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High Octane Universe

"Speculative Buy" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the upside

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"Negative" – Bonds that in our view have an equity investment risk profile and we think risk/return is skewed to the downside

"Speculative Sell" – Bonds that in our view have an equity investment risk profile and we think risk/return is significantly skewed to the downside

Convertible Universe

“Outright” – Convertible bonds that, in our view, present risk/return significantly skewed to the upside (3x upside v. 1x downside)

“Swap” – Convertible bonds that, in our view, offer attractive volatility differential between implied volatility of the convertible bond option call v. the 100D realized volatility and listed calls in the option market for the corresponding equity

“Busted” – Convertible bonds trading with out-of-the-money option calls that, in our view, offer an attractive yield to maturity, relative to risk/return

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