GDS Holdings Limited (GDS) CEO William Wei Huang on Q3 2019 Results - Earnings Call Transcript

Nov. 14, 2019 2:39 PM ET
by: SA Transcripts

Q3: 11-14-19 Earnings Summary

Press Release *Slides*

EPS of $-0.12392103239039398342 misses by $-0.06 | Revenue of $151.87M (38.48% Y/Y) beats by $2.79M

Earning Call Audio

Subscribers Only

00:00 -53:52

GDS Holdings Limited (NASDAQ:GDS) Q3 2019 Results Earnings Conference Call
November 14, 2019 8:00 AM ET

Company Participants

Laura Chen - Head of Investor Relations

William Wei Huang - Chief Executive Officer

Daniel Newman - Chief Financial Officer

Conference Call Participants

Jonathan Atkin - RBC Capital Markets

Colby Synesael - Cowen & Company

Frank Louthan - Raymond James

Robert Gutman - Guggenheim Partners

Gokul Hariharan - JPMorgan

Colin McCallum - Credit Suisse

Operator

Hello, Ladies and gentlemen. Thank you for standing by for the GDS Holdings Limited Third Quarter 2019 Earnings 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 now turn the call over to your host, Ms. Laura Chen, Head of Investor Relations for the Company. Please go ahead, Laura.

Laura Chen

Thank you. Hello everyone and welcome to the 3Q 2019 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 the 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 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, Mr. William Huang. Please go ahead, William.

William Wei Huang

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 it's 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 3Q, 2016. Our total area committed is almost double what we focused as IPO. It's being an outstanding three-year 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 meter of net additional area committed, or over 57 megawatt of IT power, which should generate over $90 million of annual recurring revenue when fully delivered.

We had three orders for over 10 megawatt 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.

And with the end of three quarter -- 3Q, we've reached 58,000 square meter net add for year to-date. As of today we are down in terms of meeting our full year sales target of 18,000 square meters.

In the past few months customer sentiment has become a lot of more positive. Cloud adoption continues on a steep upward path, with market leaders reporting 65% - 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 the consumer focus.

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

20,000 square meter of sales means starting three to four new data center 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 data centers 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 largely edge-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 data centers; 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 aimed 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 on the 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 data centers. And we also have the Hong Kong 2 acquisition, which I will talk about next.

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

We established operations in Hong Kong over five years ago, relying on third-party data centers 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 3Q 2018.

The site is now clean and we will start construction of the new building. The redevelopment time frame is three years. Hong Kong is a gateway for the most of the international bandwidth connecting China.

Our hyperscale and high gross customers use Hong Kong as a launch pad 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 significance step with the purchase of 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's hyperscale customers and represents 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 campus.

We have almost completed the first project and expect to sell 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 fulfill the broader requirements of our strategic customer outside of Tier 1 market.

We see this as real opportunities 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.

Daniel Newman

Thank you, William. Starting on slide 13, where we strip out the contribution from equipment sales and the effect of FX changes. In 3Q, 2019, 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 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 3Q, 2019 was over 10,000 square meters.

We're expecting a similar level of move-in during 4Q, 2019, 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 4Q 2019.

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

Turning to slide 18. Now CapEx picked up in 3Q 2019 due to a higher level of ongoing construction. In 4Q 2019 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. After the end of 3Q 2019, we have incurred over RMB300 million and paid RMB170 million for CapEx related to remote build-to-suit projects. We've 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 tenure and cheaper facilities. In 3Q 2019, we completed financing across four new projects and refinancing of three existing projects totaling RMB1.4 billion.

We're considering a number of options for financing our Hong Kong projects including a sale-leaseback of the redeveloped properties or joint venture. We've had a number of approaches from existing and new partners and keeping an open mind.

Turning to slide 20. Our backlog consists of binding commitments from customers. It is increased to over 104,000 square meters representing 76% of our 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 data centers which are currently under construction. The remaining 42% or 44,000 square meters relates to data centers 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, up to nine months our revenue is tracking towards the top end of the revise guidance range which we've provided last quarter. For adjusted EBITDA, we are tracking above the top end of the revised guidance range , where we are therefore once again raising EBITDA guidance range to RMB1.8 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?

Question-and-Answer Session

Operator

Thank you, sir. [Operator Instructions] We have the first question from Jonathan Atkin from RBC Capital Markets. Please ask your question.

Jonathan Atkin

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

And then second question I had relates to Shanghai. I think you said you did get the 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 Wei Huang

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

The second question is, Dan?

Daniel Newman

…about the recent allocation for our capacity in Shanghai.

William Wei Huang

Yes. Actually we got the approval for 55,000 racks. Let's say, let's calculate it at 2.5 square meter per rack. That means more than…

Daniel Newman

13,000 square meters roughly.

William Wei Huang

Yes, roughly, right? So in Shanghai, this approval is quite diversified. All those local player get some small piece of that. We are the one of the largest ones to get an approval. So, but this definitely cannot satisfy our customers' future demand profile. They want a much larger scale than what we get in the Tier 1 market. This is number one.

Number two, they want a campus type with high visibility for future expansion. So that's why we will continue to get back to edge-of-town site to make sure to satisfy our customers' future demand. But what we can tell is our strategic customers' future demand looks like the number will be accelerated in the next few years. Yeah. That's all.

Jonathan Atkin

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?

Daniel Newman

Yes. It's a single location, John.

Jonathan Atkin

Great. Thank you very much.

Operator

We have the next question from the line of Colby Synesael from Cowen & Company. Please ask your question.

Colby Synesael

Hi, 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?

And 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.

Daniel Newman

Colby, I'll go first. Let me comment first of all on the M&A environment, because we're very busy with a lot of organic build. We're still very focused on strategic M&A opportunities. There aren't platforms out there for us to acquire. There aren't many GDSs. 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 the sites and maybe some expansion capacities. 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 about two per annum. And that's been part of the 80,000 square meters net adds, it's provided us mainly with the capacity to support the sales. So that's been part of that kind of base case.

You call it organic and semi-organic. But if we were to do what I've just referred to as those larger acquisitions, I mean, that's going to be additive. It's going to be on top of, in addition to that.

To bring it back to your question about capital raise. We've raised $600 million earlier this year in March. And if we leverage that 60/40 debt-to-equity, it means that we will have US$1.5 billion with 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 raise enough equity capital early 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, while needs of those are certain. I think, William will make a comment about growing at a fast rate, neither of those are certain, but it's clear that if we were to do something, then we would need to consider a financing whether it would be from the capital markets or whether it would 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 the potentiality for higher level of sales? I think Colby asking for your early thoughts about next year.

William Wei Huang

It looks like, frankly speaking, that we are more confident to maintain 80,000 square meter, that's for sure. I think there’s 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 this year, the sentiment is not good. But now it's totally shift. Everybody are very, very positive. So a lot of them start to execute their original plan and then even based on the 5G coming, it looks like 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

Yes. I mean it seems like your biggest issues 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 we could see greater than those 80,000 square meters in some of those outer years. Is that sounds right?

Daniel Newman

It is right Colby. Obviously there's always going to be a lot of things going on which is not yet reached the stage where it can be disclose. What we're showing, I think for the first time in our earnings presentation is effectively the developable area, area held for future developments. And very roughly it corresponds to three-year sales growth at the concurrent run rate. But we would like to have considerably more than that. We would like to add 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. A budget for Land Bank in China this year was RMB500 million, that's US$100 million and we have not spent all of that by any means. It is 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 the power capacity. But once again, we're still looking to add more.

Colby Synesael

Great. Thank you.

Operator

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

Frank Louthan

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 it 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.

Daniel Newman

What Frank asking whether there's been any short-term impact in Hong Kong or maybe impact our view of Hong Kong.

William Wei Huang

Yes. I think, our logic is to follow up on customers. That's our strategy to do location expansion. So, Hong Kong has become a very important part for all our customer installed base to expand into the international market. That's always the adverse effect. As I mentioned just now, I mean, a lot of our Hyperscale customer plus more than 200 financial institutions, are mainly in China base. They have very, very clear demand in the next few years in Hong Kong. So, our view is that the certainty was given by our customer, not given by any situation. So we are very confident that the demand is very, very strong in Hong Kong from all the installed base of customers.

Daniel Newman

Frank, second part of your question, I can't give a precise answer too, 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. Regard to a consumer who were developing these seven projects for, definitely there will be more projects awarded by them. So now we just identified a couple of other customers who could be interested in working with us in a similar way. But I'd say from seven today let's take a two-year view it could be double or triple.

Frank Louthan

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

Yes, thanks for taking the question. Just a couple 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 moving pace that you mentioned, that you said it's looking like about 10,000 a quarter. I just want to verify that. 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 macroeconomic level, about China's you know GDP growth and I was wondering if you 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.

Daniel Newman

Yes, well so the first question, yes you picked up. Sometimes we revise the ready-for-service period for particular projects. Remarkably, I mean, we are up to like 45 projects now. I have been here from number one. And all these are complete on time and within budget, but inevitably, there's going to be sometimes a delay a few months or acceleration a few months. Normally it has 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.

Then the move-in pace, this year has been slightly slower than last year. Last year it was slightly faster than normal. I know, given the macro, the 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 are many factors that can affect the move-in rates. It can be M&A, it can affect that statistic. How early customers commit, the development timeframe and also within the flexibility which our contracts give to customer, whether they choose to deploy a little bit faster, a little bit slower.

When we review the contracts which are actually in delivery right now. I pointed out there's like 44,000 square meters of commitments, which relate to data centers already in service. So when we reviewed 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 sometime why particularly a customer may move in a little faster, a little slower, but nothing we can generalize. I can't generalize and say there was a slowdown or there was an acceleration.

Daniel Newman

Yes, the last question was about the macro situation.

William Wei Huang

Okay. I think everybody talk about China GDP, it goes to 6%. Although the 6% is still a very big number, but what I try to say is recently I just read the MS report saying China new economy, say the digital economy, represents a 16% of the China GDP and 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 are lucky. We are in this space, not in the traditional space. So, I think this is good for us to get confidence to grow our business in next few years.

Robert Gutman

Great. Thank you.

Operator

We have the next question from the line of Gokul Hariharan from JPMorgan. Please ask your question.

Gokul Hariharan

Yes, hi. Great results and thanks for taking my questions. My first question is, I think you illustrated that the number of hyper scale labels have gone up significantly over the last two to three years. 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 customer number of 50 plus percent area committed going to come down meaningfully, when you think about the next two three years of area committed or revenues? That's my first question.

Daniel Newman

Your observation is correct. The top two customers if you aggregate them and you look at the several quarters, you'll see that two to three years the absolute 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 programs 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.

So if you look at the growth rates of their businesses, they're capable of doubling or tripling the size of their commitment with us. I would just have to hazard a guess about what the top two would represent in two years or three years' timeline. I'd 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

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 side projects and as you mentioned the seven projects could go to 2x or 3x of that. Could you talk a little bit about how much resources this kind of projects take, in the form of sourcing people, SG&A etcetera.

And given that now you have growth on both these tracks, do you feel that there is some degree of bottleneck from other sources respective, as we look at the next 12 to 18 months. And how do we think about I think about smoothing that out?

Daniel Newman

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

William Wei Huang

Yes, Number one, I think we won’t pick up every remote project. I think that we are quite picky, right? Number one fulfill our deliver capabilities, because we are still focused on the Tier 1 market. We always say we focus on our Tier 1 market.

Number two I think since the design is very simple, remote project is standard and the operation effort is much less than a multi-tenant data center in Tier 1 market. So we have developed a lot of the tools to support our operation. So I think it's from the deliberate point of view, it's more simple then a Tier 1 market. So we still believe we can take more projects so far.

Gokul Hariharan

Okay, got it. If I could ask a very quick question, Dan. Dan, could you talk a little bit about what are you 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 movements. But could you talk a little bit about, are we going to be in the same range over the next two, three quarters, given that we have a lot of new capacity coming on?

Daniel Newman

Yes, Gokul I've been on the low side in terms of my own forecasts for margin over this year, which is a pleasant surprise. And looking at next year, very roughly, I think we can still realize operating leverage at the data center level before adjusted NOI margin. Maybe, one percentage point that order of magnitude.

And then at the SG&A level, I think it would also could be about 1%. I mean it could be more, but we asked ourselves whether we are actually under spending on SG&A whether that's a bad thing. And given the way the company’s growth, we need to scale up and raise standards and so on. And we are doing so in terms of people were hiring and focus on product and R&D.

So I think one percentage point on SG&A and one percentage point to the data center level would be two percentage points over the next year, this is just a very rough indication.

Gokul Hariharan

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

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

So could just touch on this a little bit? Is this one of those things that the market talks, 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 field enterprises in advance before you sign up to the commitments, and do the construction. Any color on that would be helpful. Thank you.

Daniel Newman

Yes, Colin, I’ll go first. Yes, finding the right kind of real estate, industrial property in downtown area or lands for zone for industrial use edge of town, which qualifies for 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 them getting sufficient power to be able to operate a data center, utilize the full plot ratio and so on. It went about getting power, there's really there's really two parts to it. One part is, having agreement with the power supplier, 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 and structure and see the distance from the site to the substation or the number of available substations and so on, can affect the economics of the project quite materially.

The second part, obtaining power is a 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 is become very restrictive. Projects are still being approved. We've had some success, when I mentioned just recently, we received an allocation in downtown Shanghai. But we are now I think, other data center service providers realized 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. And that's why we put so much emphasis in today's presentation on the pipeline you can call this land with power or the developable capacity, means its land, real estate and power. That's what makes it very valuable. William, do you want to add anything to it?

William Wei Huang

No, no. It’s okay.

Daniel Newman

Okay. William is satisfied with my answer.

Colin McCallum

That's fine. I'm satisfied as well. In terms of just the way you do things and effectively you're saying only we've become real pipeline and land, if you have both, right. And you're not going to put yourself in a situation where you buy land and construct [Indiscernible] is just not something you could do, is it?

Daniel Newman

Colin, it's the other way round. Most of the land, the land most of the land is being purchased from the government. It starts with an agreement, the government allocate the power. The last thing is the actually the purchase land. We maybe chose our words a little carefully and perhaps they will pick up the nuance, but we mentioned in Changshu that we've been allocated power capacity. You know, 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 contain the power capacity.

William Wei Huang

So I think, I'll add one comment, I mean, we realized the in downtown tier one market, it's very difficult to get a power quota. Even you get one, as I mentioned, it's nothing significant cannot satisfy our customer. So that's why we evolved our resource strategy from the folks on the downtown city to the edge-of-town of the city.

So, we are the first mover to give back to this resource in the edge-of-town of the tier one market. So we will maintain this advantage compared with our competitor.

Colin McCallum

Got it. Thank you.

Operator

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

Jonathan Atkin

Thanks. I had just a quick follow up on contract renewals, slide 33. I think that's a new a new slide for you. And, you know, 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 be any kind of pricing adjustments? Thank you.

Daniel Newman

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

I think a lot of these contract renewal is enterprise-related business where our churn rates, as I like to say, have 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, but now it's just going to be so-so deals, but they are 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 Internet or cloud customers are going to pull back, but frankly if they did it, it would probably be an upside opportunity in terms of being able to release.

William Wei Huang

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

Jonathan Atkin

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

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 lines. Thank you.