

CMBI Credit Commentary

VNET (B2/B rated) – 3Y New Issue: FV 8.7%

VNET (B2/B, all stable outlook) proposed a 3-year USD bond at IPG 8.75%.

We do not find this new issue attractive in view of its high capex need, negative free cash flow prospect, and its narrowing equity funding channels. VNET's ongoing free cash flow deficit will bring potential new USD bond supply risk. **As such we see its fair value at 8.7%, after requiring 20bps premium from the mid-point of EHICAR 24 (YTM 7.66%) and CARINC 24 (YTM 9.25%).** Fundamentally we believe VNET skew more towards CARINC (B- rated) due to its ongoing funding need.

Strong wholesale datacenter demand from Internet customers have prompted VNET to pursue aggressive expansion, with its guidance of RMB 5bn – RMB 5.5bn annually. This will give rise to a free cash flow deficit of RMB3.5bn annually next two years and require successful project financing/bank loans to follow through. VNET will likely bear front-load land acquisition/construction capex first, then seek bank loans on its fully ramp-up datacenters with long-term and stable wholesale contract from customers. S&P estimate that the wholesale IDC segment will make up 12%-17% of 21Vianet's data center revenue by 2021 and about 30% in 2022. Recall VNET just managed to raise additional RMB900mn bank loan in 1H21, bringing its total bank loan balance of RMB1,827mn as of Jun, 2021.

Overall, we find this funding need too big, especially in times when its equity story momentum wanes, due to its VIE structure and Chinese internet regulatory overhang.

In addition, its CB holders (USD 200mn and USD600mn) have the right to require VNET to repurchase all or part of the CBs on Feb 2023 and Feb 2024, or in the event of certain fundamental changes. These option to repurchase can potentially take place earlier than this USD bond maturity in Nov 2024, prior to their respective final maturity date in 2025 and 2026. We note these CBs conversion price are USD 12 and USD 54.47 per ADR respectively, the latter USD 600mn CB is severely out of money vs current share price of USD16.

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