BLUE ORCA CAPITAL

"Primary research is crucial and not as many people do it as you think."

-**Jim Chanos**

THIS RESEARCH REPORT EXPRESSES SOLELY OUR OPINIONS. We are short sellers. We are biased. So are long investors. So is GDS. So are the banks that raised money for the Company. If you are invested (either long or short) in GDS, so are you. Just because we are biased does not mean that we are wrong. Use BOC Texas, LLC's research opinions at your own risk. This report and its contents are not intended to be and do not constitute or contain any financial product advice. Because this document has been prepared without consideration of any specific clients' investment objectives, financial situation or needs, and no information in this report should be construed as recommending or suggesting an investment strategy. Investors should seek their own financial, legal and tax advice in respect of any decision regarding any securities discussed herein. You should do your own research and due diligence before making any investment decisions, including with respect to the securities discussed herein. We have a short interest in GDS's stock and therefore stand to realize significant gains in the event that the price of such instrument declines. Please refer to our full disclaimer located on the last page of this report.

COMPANY: GDS Holdings Limited | NASDAQ: GDS
INDUSTRY: Telecommunications Infrastructure

On July 31, 2018, we published our investment opinion (the "Report") on GDS Holdings Limited (NASDAQ: GDS) ("GDS" or the "Company") a US-listed developer and operator of data centers in China. On August 1, GDS issued a response (the "Response"), a two-page press release of boiler plate denials almost devoid of details.

While the Company's Response failed to address the substance of our report or the independent evidence presented therein, it appears as though the Company has given a more detailed response in private conversations with sell-side analysts.

It should be an immediate red flag that GDS is afraid to publish a detailed response which we and other market participants could scrutinize. Rather, the Company is hiding behind the plausible deniability of private conversations with analysts who duly repeat such claims to the market. In this Rebuttal, we will address not only the Company's tepid Response but also the Company's claims published second-hand to the market through duly pliant sell-side analysts.

1. Inflating the Purchase Price of Undisclosed Related Party Acquisitions.

In our Report, we presented SAIC filings and other publicly available records in the PRC which indicate (in our opinion) that in 3 of GDS's 4 major post-IPO transactions, GDS not only acquired data centers from undisclosed related parties, but overstated the purchase price of such acquisitions in its SEC filings.

On this topic, GDS's Response contained three lines of boiler plate denial. Without addressing any of the evidence or analysis put forth in our investment opinion, the Company said that such SAIC filings reflected only a portion of the consideration and that the acquired entities were not undisclosed related parties.

Behind closed doors (and away from the scrutiny of the markets), the Company apparently provided more detail because certain sell-side analysts published notes with various, sometimes contradictory explanations or excuses.

We can group these explanations into two types of responses: (a) that the acquired entities were not undisclosed related parties, and (b) that the structure of the acquisitions was such that there was an off-shore element to the acquisition which was not reflected in the SAIC filings. We will address each in turn.

a) Related Parties

Only one sell-side analyst directly addressed the multitude of related party connections between GDS and the acquired entities discussed in our Report, and in doing so only addressed one such transaction.

To recap, in June 2017, GDS supposedly purchased Shenzhen Yaode Data Services ("Shenzhen Yaode"), which operates a Shenzhen datacenter ("SZ5"), for RMB 312 million from a "third party." However, publicly available SAIC filings show that **prior to the acquisition**, two individuals served as the acquisition target's (Shenzhen Yaode's) director and supervisor. SAIC filings state these same two individuals also served as the financial controller and supervisor for GDS subsidiary Guangzhou Shi Wan Guo Yun Lan Data Technology Co. Ltd. ("WGYL").

Guggenheim's analyst note alleged that we got it wrong because WGYL and GDS share two of the five Chinese characters and thus have "similar names." This, according to Guggenheim, led to "confusion" although "**WGYL and its employees were in no way related** to or a subsidiary of the GDS organization."

> **Related Party Deal…or Something Lost in Translation?** The short report alleges that in the SZ5 acquisition, target group employees were also employees of GDS and that this was a "related party transaction". (Target group refers to the asset-co and license-co companies). The employees named were working for "WGYL" (Guangzhou Shi Wan Guo Yun Lan Data Technology) – which the report alleges was part of the target group while also subsidiary of GDS. GDS mgmt states that in Chinese characters, WGYL and GDS have similar names (with two of five characters the same) - which leads to confusion – though WGYL and its employees were in no way related to or a subsidiary of the GDS organization.

Source: Guggenheim Note on GDS, 8-2-2018

If the Guggenheim analyst note is to be believed, GDS is now denying that WGYL is a subsidiary or in "any way related" to the GDS organization.

But this is ridiculous and directly contradicted by GDS's SEC filings. In exhibit 8.1 of its FY 2017 20-F, GDS listed Guangzhou Shi Wan Guo Yun Lan Data Technology Co., Ltd. (WGYL) as **one of its subsidiaries**. The Company even included the Chinese characters of WGYL (广州市万国云蓝数据科技有限公司) in its 20-F, ensuring there is no ambiguity.

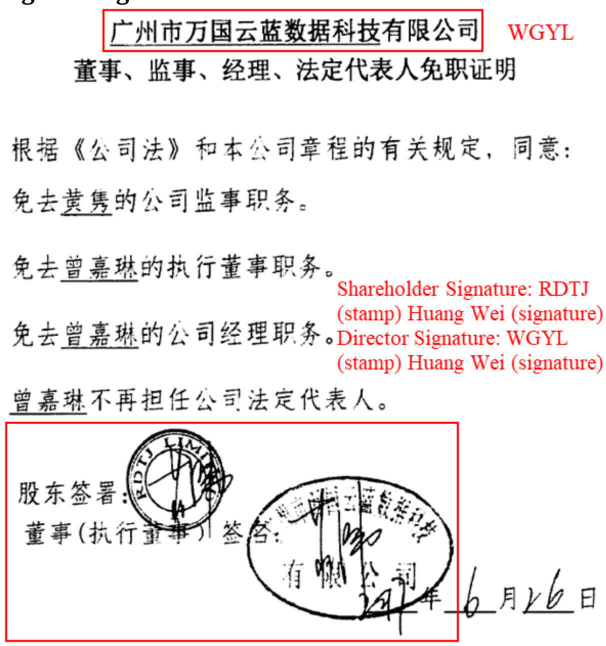
GDS Services (Hong Kong) Limited	Hong Kong
RDTJ Limited	Hong Kong
EBSD (HK) Limited	Hong Kong
EDF (HK) Limited	Hong Kong
EDSN (HK) Limited	Hong Kong
RAOJIN Limited	Hong Kong
EDP (HK) Limited	Hong Kong
FEH (HK) Limited	Hong Kong
EDKH (HK) Limited	Hong Kong
RDKH (HK) Limited	Hong Kong
EDC (Chengdu) Industry Co., Ltd.* 万国数据(成都)实业有限公司	PRC
EDC Technology (Kunshan) Co., Ltd.* 万国数据科技发展(昆山)有限公司	PRC
EDC Technology (Suzhou) Co., Ltd.* 万国数据科技发展(苏州)有限公司	PRC
Guojin Technology (Kunshan) Co., Ltd.* 国金数据科技发展(昆山)有限公司	PRC
Shanghai Yungang EDC Technology Co., Ltd.* 上海云港万国数据科技发展有限公司	PRC
Shenzhen Yungang EDC Technology Co., Ltd.* 深圳云港万国数据科技发展有限公司	PRC
Beijing Hengpu'an Data Technology Development Co., Ltd.* 北京恒普安数码科技发展有限公司	PRC
Beijing Wanguo Shu'an Science &Technology Development Co., Ltd.* 北京万国曙安科技发展有限公司	PRC
GDS (Shanghai) Investment Co., Ltd.* 万数(上海)投资有限公司 (formerly known as Shanghai Free Trade Zone GDS Management Co., Ltd.* 上海自贸区万国数据管理有限公司)	PRC
Shenzhen Pingshan New Area Global Data Science & Technology Development Co., Ltd.* 深圳市坪山新区万国数据科技发展有限公司	PRC
Shanghai Shuchang Data Science & Technology Co., Ltd.* 上海曙长数据科技有限公司	PRC
Shanghai Wanshu Data Technology Co., Ltd.* 上海万曙数据科技有限公司	PRC
Guangzhou Shi Wan Guo Yun Lan Data Technology Co., Ltd.* 广州市万国云蓝数据科技有限公司	PRC
Guangzhou Wanxu Technology Services Co., Ltd. *广州万旭科技服务有限公司	PRC

Source: GDS FY 2017 20-F

Not only does GDS admit that WGYL is a subsidiary in its SEC filings, but just to be sure, we reviewed WGYL's SAIC filings using the Chinese characters disclosed by the Company in its 20-F.

Sure enough, GDS's **Chairman's signature appears in WGYL's SAIC filings**!

Huang Wei Signed as Director on WGYL Internal Document


广州市万国云蓝数据科技有限公司 WGYL

董事、监事、经理、法定代表人免职证明

根据《公司法》和本公司章程的有关规定，同意：

免去黄隽的公司监事职务。

免去曾嘉琳的执行董事职务。

免去曾嘉琳的公司经理职务。

曾嘉琳不再担任公司法定代表人。

股东签署：

董事(执行董事)签名：

年 6 月 26 日

Shareholder Signature: RDTJ (stamp) Huang Wei (signature)
Director Signature: WGYL (stamp) Huang Wei (signature)

Source: WGYL SAIC Filings

A basic check of WGYL's SAIC filings reveals documents containing the Chairman's signature. Furthermore, according to the SAIC website, WGYL is 100% owned by RDTJ, a Hong Kong entity that GDS also listed as its subsidiary in its SEC filings.


广州市万国云蓝数据科技有限公司 在营（开业）企业 WGYL

统一社会信用代码： 91440101MA59E91U7G
法定代表人： 陈怡琳
登记机关： 广州市黄埔区市场和质量监督管理局
成立日期： 2016年08月17日

发送报告 信息分享 信息打印

基础信息 | 行政许可信息 | 行政处罚信息 | 列入经营异常名录信息 | 列入严重违法失信企业名单（黑名单）信息

营业执照信息

· 统一社会信用代码： 91440101MA59E91U7G
· 企业名称： 广州市万国云蓝数据科技有限公司
· 类型： 有限责任公司(台港澳法人独资)
· 法定代表人： 陈怡琳
· 注册资本： 2850.000000万美元
· 成立日期： 2016年08月17日
· 营业期限自： 2016年08月17日
· 营业期限至： 2046年08月09日
· 登记机关： 广州市黄埔区市场和质量监督管理局
· 核准日期： 2018年06月13日
· 登记状态： 在营（开业）企业
· 住所： 广州高新技术产业开发区科丰路31号自编一栋华南新材料创新园G2栋108-1
· 经营范围： 数据处理和存储服务;信息系统集成服务;信息技术咨询服务;软件开发;计算机技术开发、技术服务;网络技术的研究、开发;信息电子技术服务;计算机网络系统工程服务;计算机和辅助设备修理;计算机及通讯设备租赁;计算机信息安全产品设计;软件服务;

股东及出资信息 股东及出资信息截止2014年2月28日。2014年2月28日之后工商只公示股东姓名，其他出资信息由企业自行公示。

序号	股东名称	股东类型	证照/证件类型	证照/证件号码	详情
1	RDTJ LIMITED	法人股东	其他	2368918	

Shareholder RDTJ

共查询到 1 条记录 共 1 页 首页 上一页 1 下一页 末页

Source: http://www.gsxt.gov.cn

There is no ambiguity that WGYL is a subsidiary of GDS. There is also no ambiguity regarding the individual who worked for GDS subsidiary WGYL and acquisition target Shenzhen Yaode (prior to the acquisition). A registration record of a housing lease contract in WGYL's SAIC registration showed that Zeng Jialin leased a unit in the G2 building in the Guangzhou Innovation Park. The record provided Zeng Jialin's ID number, which ended in 3920. ID numbers are like social security numbers in China, and each citizen over the age of 16 has one. These numbers are unique for each citizen and critical for China's bureaucracy to track its people.

Lease Record From WGYL SAIC File

房屋租赁登记备案证明
Registration Record of Housing Lease

穗租备2016B1604003278号

出租房屋地址 Rental Address	萝岗区科丰路31号G2栋108-1 (广州开发区科丰路31号自编一栋华南新材料创新园G2栋108-1 相赁用途:研发、办公、生产) G2 Building, #108-1 South China Advanced Materials Innovation Park, No.31 Kefeng Road, Guangzhou High-Tech Industrial Development Zone		
出租人			
出租人证件	营业执照	出租人证件号码	440101000130036
承租人 Lessee	曾嘉琳 Zeng Jialin		
承租人证件	身份证	承租人证件号码 Lessee ID Number	[redacted]3920 3920
租赁用途	办公	租赁面积	25.00平方米

Source: WGYL SAIC Filings

The Same Zeng Jialin Was Also Shenzhen Yaode's Supervisor

名称	深圳耀德数据服务有限公司 Shenzhen Yaode		名称证编号	
监事成员备案				
[请在证件种类栏填写相应的字母：A.身份证 B.护照 C.往来内地通行证 D.其他]				
姓名 Name	职务 Position	证件类型	证件号码 ID Number	签名
Zeng Jialin 曾嘉琳	Supervisor 监事	A	3920 [redacted]3920	曾嘉琳 签署人 曾嘉琳 证件号 [redacted]3920

Source: Shenzhen Yaode Registration

The same individual with the same name and the same ID number (ending in 3920) who is listed as the financial controller of WGYL also appears in Shenzhen Yaode's registration filings as its supervisor. There might be two different individuals sharing the **<u>same name</u>**, **<u>but no one shares the same ID number</u>**.

In our opinion, the records show unambiguously that GDS's WGYL employed two individuals in key positions who at the same time worked for the target company, Shenzhen Yaode, **<u>prior to the acquisition</u>**. **These two individuals were on both sides of the deal (buyer and target)**. We believe that such overlapping connections clearly demonstrate that the SZ5 acquisition was an undisclosed related party acquisition.

It is also notable that GDS has been silent on the other multitude of overlapping connections between GDS and the other acquisitions and sellers identified in our Report, **<u>including common registered phone numbers and email addresses</u>**. Entities with the same registered email addresses and phone numbers, in our view, are likely connected through common ownership or control; and such connections indicate that the acquisition was an undisclosed related party transaction.

b) Overstating Purchase Price of Undisclosed Related Party Transactions

In our Report, we also highlighted publicly available SAIC filings which indicated that GDS inflated the purchase price of post-IPO datacenter acquisitions.

In its boiler plate two-page Response, GDS made the excuse that such SAIC filings reflected only a portion of the consideration. Again, it was only behind the veil of plausible deniability through conversations with sell-side analysts that the Company appears to have provided more detailed, apparently contradictory explanations.

For instance, Citi's analyst note suggests that according to GDS, the SAIC filings only reflect the acquisition consideration for the **assets**. Additional consideration, Citi implies, is paid to a hold-co offshore because of the VIE structure.

> – **Purchase price and related-party nature of certain acquisitions:** GDS reaffirms the accuracy of the amounts as disclosed in their SEC filings while the allegation of SAIC filings only reflects a portion of the amount. GDS clears that none of the key figurers of the acquired assets in the short report were management or related parties of GDS. **Citi's view:** our discussion with GDS mgmt indicates that the SEC and SAIC difference is driven by VIE structure when they acquired overseas hold co (vs. asset co in SAIC).

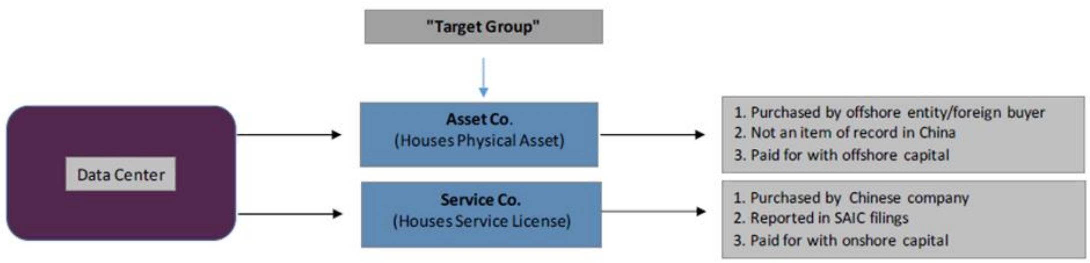
Source: Citi Research Note on GDS, August 2, 2018

According to Citi, SAIC filings should reflect only the value of the acquired assets.

But this is directly contradicted by Guggenheim's sell-side note, which says that according to GDS, SAIC filings **only reflect the license-co part of the deal**. So apparently GDS told Guggenheim that the asset-co is purchased by a foreign entity (often based in Hong Kong), while the license-co is purchased by a Chinese entity.

> **Our View – The Short Report is Missing Information and Disregards Standard Business Practices in China.** While a foreign entity is permitted to own physical real estate in China (e.g., a data center), it is not permitted to obtain a license to provide telecom or value added services in that physical space. Transactions are therefore executed in two steps (and this applies to GDS as well as other Chinese foreign listed companies, and broadly to infrastructure investment in China). Assets are divided into "asset-co" (the physical asset holding company) and "license-co" (the license holding company to offer services on the physical asset). Asset-co is purchased by a foreign entity (often based in Hong Kong), while license-co has to be purchased by a Chinese company (to maintain the licensed status). SAIC filings only reflect the license-co part of the deal as it is internal to China and part of the Chinese public record. The offshore (asset-co) part of the transaction is not a matter of public record in China – and therefore not in the SAIC filing. GDS reports the consideration paid for both parts of the deal. The SAIC filing alone is missing the "asset-co" part of the transaction. We believe mgmt will provide greater detail on this in the upcoming earnings call on Aug. 14.

Figure 1. Two Tier Deal Structure



Source: Company reports, Guggenheim Securities, LLC research, FactSet

Source: Guggenheim Note on GDS, 8-2-2018

First, it is notable that either the analysts misinterpreted the Company's explanation or GDS is telling different analysts contradictory things. Citi reported that the assets were held on-shore at a PRC entity and that the SAIC filings reflected the purchase price of this asset-co entity. Guggenheim, meanwhile, said the opposite: that SAIC filings reflected the purchase price of the license-co and that assets were held by an off-shore company.

In our opinion, both explanations are wrong as there is little to support the bifurcation of acquired assets/IDC licenses between on-shore and off-shore entities other than the Company grasping for some narrative to explain why the black and white documents in SAIC filings state that the purchase price was considerably less than GDS claimed in its SEC filings.

For example, in October 2017, GDS acquired Guangzhou Weiteng Network Technology ("Weiteng Network"), which operated a data center in Guangzhou ("GZ2"), supposedly for RMB 234 million. Yet Weiteng Network's SAIC filings state that it was sold to GDS for only RMB 72 million, indicating that GDS inflated the reported value of the acquisition in its SEC filings by 3.25x.

If the analyst notes are to be believed, GDS is telling them behind closed doors that the SAIC filings reflect only the purchase price of the license, not the assets (or vice versa), and that this bifurcation of the license from the assets requires the purchase of an off-shore entity.

Yet evidence indicates that prior to the acquisition, Weiteng Network **owned both the IDC license and the physical assets**, which directly undermines GDS's flimsy excuse that licenses and assets must be separated into two acquired entities.

In the PRC, the Ministry of Industry and Information Technology of the People's Republic of China ("MIIT") provides an **online database** for any investor to check if a data center operator has obtained a cross-provincial IDC permit.[1]

According to the MIIT database, Weiteng Network has a cross-provincial IDC permit to operate a data center. According to GDS's 20-F, MIIT's IDC licenses must be renewed every 5 years. Weiteng Network's license to operate a data center expires in August 2020, implying it was granted in August 2015, prior to Weiteng Network's acquisition by GDS.

[1] The MIIT database lists cross-provincial IDC permits, not local intra-provincial licenses. Provincial licenses are searchable in this database: http://www.miit.cc/telecom-search/.

Source: MIIT Website

Clearly Weiteng Network, which operates the GZ2 data center, carried an IDC license from the MIIT, even though it was an on-shore PRC entity. This undermines any excuse that the license needed to be acquired from some off-shore entity.

Yet Weiteng Network is also the "Asset-co" that leases the building and reports the physical assets on its balance sheet. PRC records show that up until a few weeks before its acquisition by GDS, Weiteng Network was 51% owned at that time by Shenzhen Ningguanghong Technology ("SNT"), whose shares are traded OTC in China on the NEEQ board. In September 2017, SNT released an Asset Sales and Material Asset Restructuring Report (the "Restructuring Report") in which it stated Weiteng Network was the lessee of the building which houses the data center.

SNT Disclosed Weiteng Network Leased GZ2 Data Center

截至本报告书签署之日，维腾网络正在租赁的物业情况包括：

序号	出租方	房屋坐落	租赁面积（平方米）	租赁期限
1	广州华南新材料创新园有限公司	广州高新技术产业开发区科学城科丰路 31 号华南新材料创新园 G2 栋 102 号	822	2015 年 4 月 1 日至 2029 年 7 月 14 日
2	广州华南新材料创新园有限公司	广州高新技术产业开发区科学城科丰路 31 号华南新材料创新园 G3 栋	15,468.5	2014 年 7 月 15 日至 2034 年 7 月 14 日

As of report date, Weiteng Network is leasing these properties:

No.	Lessor	Location	Lease Area (sqm)	Lease Term
1	Guangzhou South China Advanced Materials Innovation Park Co., Ltd.	#102, G2 building in South China Advanced Materials Innovation Park, No.31 Kefeng Road, Science City, Guangzhou High-Tech Industrial Development Zone	822	4/1/2015 - 7/14/2029
2	Guangzhou South China Advanced Materials Innovation Park Co., Ltd.	G3 building in South China Advanced Materials Innovation Park, No.31 Kefeng Road, Science City, Guangzhou High-Tech Industrial Development Zone	15,468.5	7/15/2014 - 7/14/2034

Source: Assets Sales and Material Assets Restructuring Report, September 8, 2017

SNT's Restructuring Report also showed that Weiteng Network's balance sheet included the property, plant and equipment of the acquired data center, which it valued at RMB 167.6 million as of June 30, 2017.

Fair Value of Weiteng Network on June 30, 2017 (Reported by SNT)

Unit: RMB 10K 单位：万元

Appraised Value

项目		账面价值	评估价值	增减值	增值率%
		A	B	C=B-A	D=C/A×100%
流动资产	1	4,561.30	4,561.30	0.00	0.00
非流动资产 PP&E	2	16,728.50	16,861.72	133.22	0.80
其中：固定资产	3	8,944.64	9,077.86	133.22	1.49
无形资产	4	62.81	62.81	RMB 90.8M	0.00
长期待摊费用	5	7,677.73	7,677.73	0.00	0.00
递延所得税资产		Long-term Deferred Expenses	43.32	RMB 76.8M	0.00
其他非流动资产		(leasehold improvement)			
资产总计	**8**	**21,289.80**	**21,423.02**	**133.22**	**0.63**
流动负债	9	12,233.11	12,233.11	0.00	0.00
非流动负债	10	3,216.28	3,216.28	0.00	0.00
负债合计	**11**	**15,449.39**	**15,449.39**	**0.00**	**0.00**
净资产	**12**	**5,840.41**	**5,973.63**	**133.22**	**2.28**

Source: Assets Sales and Material Assets Restructuring Report, September 8, 2017

Records show that Weiteng Network held an IDC license and carried the assets on its balance sheet (and was the lessee for the building). This directly contradicts the Company's explanation that the acquired entities we identified in our Report only held title to either a license or assets (but not both).

SAIC filings state that GDS acquired Weiteng Network, which owns and operates the GZ2 data center, for only RMB 72 million, not RMB 234 million as the Company claims in its SEC filings. That Weiteng Network held both an IDC license and the assets on its balance sheet supports our investment opinion that the Company inflated the purchase price of the acquired asset.

SZ5

In June 2017, GDS supposedly purchased Shenzhen Yaode Data Services ("Shenzhen Yaode"), which operates a Shenzhen datacenter ("SZ5"), for RMB 312 million from a "third party." As discussed in our Report, publicly available SAIC filings in China indicate that the actual purchase price of the transaction was only RMB 500,000, not RMB 312 million as the Company stated in its SEC filings.

If the Guggenheim analyst note is to be believed, the purchase price in the SAIC filings was only reflective of the cost of purchasing an IDC license, and the assets were held at another entity.

But GDS admitted in its 20-F that Shenzhen Yaode did not have such a license.

> **Acquisition of SZ5**
>
> In June 2017, we consummated an acquisition of all the equity interests in a target group from a third party for an aggregate contingent purchase price of RMB312.0 million (US$48.0 million), subject to adjustment, if any, pursuant to the terms and conditions of the equity purchase agreement. The target group owns SZ5 in Shenzhen, China. As of the date of the acquisition, the data center had just commenced its operations. The company operating the data center has been authorized by GDS Beijing to provide IDC services under GDS Beijing's IDC license.

Source: GDS FY 2017 20-F, p. 54

A search of the MIIT database confirms that Shenzhen Yaode possessed no such license.

MIIT Database Shows Shenzhen Yaode Do Not Own IDC Permit

Source: MIIT Website

In our view, this evidence debunks the narrative that the purchase price in the SAIC filings reflected only the cost of the licenses. Evidence for one acquisition, GZ2, shows that the acquired entity held both an IDC license and the related PP&E. In the case of another, Shenzhen Yaode (SZ5), by the Company's own admission the acquired entity possessed no such license in the first place.

2. **Area in Service and Utilization of a Flagship Data Center**.

In our Report, we tested the Company's claims in a market where it purports to be strongest. GDS claims that its Guangzhou 1 data center ("GZ1") fully occupies the entire service area of the G6 data center building in the Guangzhou Innovation Park. GDS claims that 100% of the space in the G6 building is "committed" and 94% is currently utilized, making it one of GDS's flagship data centers in one of GDS's strongest markets.

Yet we spoke with two different independent companies which claim to be operating data centers (including installing and leasing cabinets) in the same building. One operator, GZIDC told us it leased out 1.5 floors of the G6 building and operated at ~60% utilization. GZIDC followed up our inquiry by sending a quote offering to rent us a significant amount of space in the very same data center GDS claims to exclusively operate at 94% utilization. GZIDC also, at our request, sent us pictures of **rows of empty cabinets in the G6 building**.

The Company's Response on this point was evasive and ambiguous. GDS stated that it is currently "receiving revenue for 94% of the total committed space of GZ1 from these two customers, which is in line with the Company's definition of 'area utilized.'" GDS said that two operators referenced in the Report are leasing the capacity from one of the above customers.

First, the Company's Response suggests that its definition of utilization is somehow different from a common sense understanding of the term. The Company does not dispute that there is empty floor space in the G6 building or that another operator is in the market offering to rent out a material amount of cabinet space. We think it is too cute by half for the Company to claim, as they now appear to do, that such space is utilized, even though it contains empty cabinets without servers. What is the point of disclosing occupancy metrics to the market if the Company can claim empty rows of cabinets as utilized space?

Second, the admitted arrangement seems to undermine GDS's purported position in the data center value chain. GZIDC and Big One, the two data center operators we contacted, both said that they installed the racks, provided value added services, and built their portion of the data center themselves. GZIDC still advertises the G6 data center as one of its self-developed data centers on its website. Both GZIDC and Big One also have licenses to operate data centers, according to the MIIT database.

Big One Owns Cross Provincial IDC Permit

Source: [MIIT Website]

GZIDC Owns IDC Permit in Guangdong Province

Source: http://www.miit.cc/telecom-search/

GZIDC told us that they lease empty space from China Mobile and put cabinets in the G6 building. If GDS's value proposition is to lease the empty space to China Mobile so that China Mobile could rent the empty space to other data center operators, who install the racks themselves, provide valued added services and operate under their own license, we question whether the Company is providing as much value to the process as the market believes. It also raises the question of whether GDS could generate its reported 2,858 MSR (monthly revenue per square meter in RMB) with this business model.

We investigated the GZ1 data center, but the Company also owns the GZ2 data center in the same innovation park. According to Big One's marketing presentation, GZ1 and GZ2 have a similar floor plan and service area. GDS says both buildings have close to the same utilizable area (6,521 vs 6,131 square meters).

GZ2 was built by SNT, the previous owner of Weiteng Network. In a Restructuring Report issued by SNT prior to its sale of the asset, SNT stated that GZ2 was fully completed, operational and fully utilized as of October 2016, prior to its acquisition by GDS. SNT even forecasted Weiteng Network's sales expense to be zero because it was fully occupied by one customer, China Mobile.

①销售费用预测

近几年维腾网络销售费用为零，主要是维腾网络提供的产品和服务是华南新材料创新园G3栋定制机房的运营，已全部交付客户使用，唯一的客户是中国移动通信集团广东有限公司广州分公司，使用方为百度。故未来销售费用预测为零。

① Forecasted Sales Expense
In recent years, the sales expense of Weiteng Network is zero because the products and services provided by Weiteng Network, which are the operations at G3 data center in the Guangzhou Innovation Park, were fully delivered to customer. The only customer is China Mobile Communications Guangdong Limited Company, Guangzhou Branch, and the end user is Baidu. Therefore, the forecasted sales expense is zero.

Source: *Assets Sales and Material Assets Restructuring Report*, *September 8, 2017*

SNT reported that Weiteng Network generated RMB 31.9 million of revenues in the first half of 2017. SNT also forecasted that the data center would generate only RMB 31.9 million of revenues in the second half of the year, confirming that the facility was already fully operational and fully leased to China Mobile. GZ2 has a service area of 6,131 sqm, which means it generated RMB 868 of monthly revenue per square meter, 68% less than reported the Company's reported blended MSR.

Weiteng Network (GZ2) Generated Low MSR

RMB'000	
Reported Revenue 1H 2017	31,935
Forecasted Revenue 2H 2017	31,935
Reported Service Area (sqm)	6,131
MSR (Monthly Revenue/Sqm/RMB)	868
Reported MSR Q2 17	2,750
Difference	***-68%***

Source: *Assets Sales and Material Assets Restructuring Report*, *September 8, 2017*

Based on SNT's disclosures of the data center next door, the revenues appear to be much lower than the Company's reported blended MSR. Obviously, pricing is variable across geographic jurisdictions, but this revenue comparison suggests that the Company's value proposition is considerably worse than commonly understood, which we would expect if other data center operators are the customers of GDS's customers.

Interestingly, this could explain why GDS's margins are well below its peers. GDS guides that its margins will increase as its portfolio matures, which in turn encourages a higher valuation in anticipation of future growth.

Exhibit 32: Datacenters – Adjusted EBITDA Margins

REITs	1Q16A	2Q16A	3Q16A	4Q16A	1Q17A	2Q17A	3Q17A	4Q17A	1Q18A	TTM Average
COR	52.4%	53.2%	51.5%	54.9%	56.0%	55.0%	53.0%	54.6%	56.2%	54.7%
DLR	58.3%	57.7%	56.2%	54.1%	58.7%	58.1%	57.7%	58.6%	60.6%	58.7%
CONE	53.2%	53.6%	50.8%	53.1%	54.1%	54.4%	54.7%	57.7%	55.7%	55.6%
QTS	45.4%	46.2%	45.7%	45.9%	45.6%	45.7%	46.5%	48.4%	47.8%	47.1%
EQIX	45.1%	46.7%	45.4%	46.3%	45.0%	47.8%	47.8%	47.1%	47.7%	47.6%
Non REITs										
INXN	45.0%	45.5%	45.9%	44.6%	45.1%	45.0%	45.1%	45.5%	44.6%	45.0%
NEXTDC	33.7%	33.7%	42.6%	42.6%	40.6%	40.6%	47.3%	47.3%	NA	43.9%
GDS	25.3%	20.0%	26.2%	29.5%	35.4%	29.7%	31.5%	30.6%	32.2%	31.0%
SWCH	-	-	-	-	52.8%	50.8%	50.9%	51.4%	48.0%	50.3%

Source: RBC Capital Markets Report, "Datacenter Download," June 29, 2018

But if our findings are at all indicative of wider practices at GDS, then we think GDS's lower margins have as much to do with its lower value offering than the stage of its growth. In which case, investors have little reason to expect these margins to increase significantly in the future.

According to Citi's analyst note, GDS claimed that such subleasing to other operators accounted for less than 1% of the Company's total area in service. But based on our conversations with Big One and GZIDC, if they are subleasing at least two and half floors of the GZ1 data center, then this alone would be 3,260.5 square meters, which is already more than 1% of the Company's total reported area in service of 103,475 square meters.

Subleasing Area > 1% Area in Service

sqm

Total area in service Q1 18	103,475
GZ1 service area	6,521
Service area per floor	1,304
# of floor occupied by GZIDC & Big One	2.5
Subleasing area	3,261
% of subleasing	***3%***

Source: GDS Public Filings, Presentations, Citi Note on GDS, 8-2-2018

We focused our due diligence on the GZ1 data center because it made a good case study to test the Company's claims. It was a mature asset, it was not under construction (meaning empty space could not be accounted for by expanding capacity), it was in a market where the Company claims to have greater than 50% of the market share, and the data center had high reported utilization (94%) and commitment (100%). GDS does not own the building, they lease it. If in this one example, we found substantial proportion of data center space effective sub-leased to other licensed operators, what are the odds that this is the only instance?

Ultimately, we continued to view the GZ1 example as a canary in the coal mine, and we think the Company's Response raises more questions than answers regarding its utilization metrics, subleasing arrangements, reported MSRs and its place in the data center value chain.

3. Serial Capital Raising and Crushing Debts for Offshore Cash?

In our Report, we highlighted that since its IPO, GDS has been a serial capital raiser, issuing equity and debt despite ample cash on its balance sheet. GDS claims to need such money to grow. Yet GDS discloses that it keeps over 65% of its cash balance off-shore (and only 24% of its total cash in RMB), where it would be essentially useless if the purpose of raising such cash was to buy and build data centers in China. We asked why does a business that operates <u>exclusively</u> in China keep 65% of its cash off-shore? Why does GDS borrow at interest rates up to 9.7% in China, only to have most of its cash sit in foreign currencies earning less than 0.6% interest?

In GDS's response, it claimed that it can only remit monies from offshore to onshore as approved by the PRC State Administration of Foreign Exchange ("SAFE"). GDS claims that it holds its cash offshore until such time as there is a specific need, and the onshore capital injection is completed.

First, if the Company did not **need the cash** which now sits idly off-shore earning less than 0.6% interest, then why did it dilute shareholders to issue equity or incur crushing levels of debt to raise such cash in the first place? As of Q1 2018, GDS's interest costs exceed its gross profits. If the Company only repatriates cash when it needs it, then why not wait until such time (or even close to such time) to raise such funds? Investors should remember that in June 2018, the Company raised an additional $250 million through convertible notes. If the Company did not need the cash it already held off-shore, then why issue more debt?

GDS only operates in China. It claims to keep a massive cash balance off-shore until such time as it needs cash in the PRC. But why would the Company ever need such a large balance off-shore to begin with? Other than making interest payments on off-shore debt, why would it need such material amounts of cash in locations and currencies where it does not operate? As we noted in our Report, we believe that off-shore cash is convenient for insiders siphoning off money in undisclosed related party acquisitions, but essentially useless for a business that operates exclusively in China.

Second, the Company's explanation seems non-sensical from a cash management standpoint. The Company admits that it borrows heavily on-shore in the PRC, at interest rates up to 9.7%. If the Company did not need the cash that sits idly off-shore, why not repatriate it to refinance or pay off its more expensive on-shore debt?

Third, the Company's explanation contradicts the intuitive understanding of capital flows into and out of the PRC. By reputation, Chinese bureaucrats happily allow off-shore money into China but instill strict capital controls to prevent money from leaving the country.

4. Mounting Balance of Unbilled Receivables.

In our Report, we flagged that in FY 2017, GDS reported that "unbilled receivables" comprised **70% of its accounts receivables and 16% of total sales**. It is a significant red flag, given that GDS's proportion of unbilled receivables has almost doubled since its IPO. To our knowledge, no other publicly traded IDC comp discloses such material balances of unbilled receivables in the ordinary course of business, making GDS a significant outlier. In our opinion, this mounting balance corroborates other evidence of overstated revenues, because such unbilled receivables are more difficult to audit and verify.

In its Response, GDS stated that the higher proportion of "unbilled accounts receivable reflect[s] the shift in GDS' customer profile to large cloud customers, primarily major Chinese internet companies."

But this does not explain why GDS appears to be an outlier among publicly listed IDC providers. Other IDC providers, such as 21Vianet (NASDAQ: VNET), also provide data center services to major Chinese internet companies, yet do not report such a material balance of unbilled receivables. VNET's customers include, iQIYI (Baidu), Eleme (Alibaba), Qunar (Baidu) and Tencent.

Search Engine/ Portal	Rich Media	eCommerce	Social Networking
Damai	iQIYI	Meituan	Tencent
Fang	Chineseall	Eleme	Qunar
Baixing	Mgtv	Jiuxian	Renren
58	Kuwo	Lashou	Jiayuan

Source: VNET 20-F, page 51

VNET even disclosed in a March 2018 conference call that it "strengthened [its] cooperation with both **AliCloud and Tencent Cloud** by building out direct fiber lines between certain 21Vianet data centers and those of **Alibaba and Tencent**." We doubt that GDS's mounting balance of unbilled receivables since its IPO can be explained by its relationship with big Chinese Internet companies when VNET operates the same business with many of the same customers and reports no such material balance.

5. **Mounting Balance of Payables**.

In our Report, we also highlighted that since going public, the Company's reported days payable outstanding have ballooned from 205 to 470 days. To put that in context, if GDS's financials are true, on average it takes the Company almost 16 months to pay its suppliers. This strains credulity.

GDS's response on this point was that the way GDS calculates payables, it includes capital expenditures in the denominator, which make its payables appear more reasonable. But any calculation can be made to appear more reasonable if the Company simply changes the variables to make it appear more reasonable.

If GDS wants to add capex to its payables calculation, then this should be done for the other IDC providers as well. In our view, calculated by the same, generally accepted methodology, GDS's payables appeared highly unusual both on an absolute but especially on a relative basis.

VALUATION

We suspect that many investors who bought into the GDS narrative are investing by analogy. Google and Amazon have been amazing stocks for the past decade. If Baidu and Alibaba are the Google and Amazon of China, investors buy BIDU and BABA in the hopes that as China grows, so will its leading internet companies. The same likely holds true for GDS. TMT investors made fantastic returns investing in U.S. data center providers Equinix (EQIX) and Interxion (INXN). So the same investors (or the ones who missed out on EQIX and INXN) look for the Chinese analogue, in the hopes that GDS will be positioned to take advantage of anticipated capital expenditures from China's growing internet companies.

But just because some company is likely going to become a premier data center operator in China, does not necessarily mean that it will be GDS. Our investment thesis purposely eschewed a discussion about the broader data center market in China because even if the industry grows, shareholders will not benefit if they invest in the wrong management team.

Investors fond of analogies should consider VNET, which is listed in the U.S. and like GDS, operates carrier-neutral data centers exclusively in China. VNET is subject to the same disclosure requirements as GDS, has a similar customer profile and largely operates a similar business.

Analysts justify GDS's nosebleed valuation because of its supposedly robust growth. Setting aside the evidence presented in our Report suggesting such growth is illusory, investors should ask themselves why GDS can report such strong growth figures when its closest analogue, VNET, is supposedly shrinking? Shouldn't VNET and GDS be subject to the same secular forces in the PRC data center market?

VNET is also beset by corporate governance concerns, highlighted by market commentator Trinity Research in a 121-page report detailing evidence of overstated utilization and certain undisclosed related party transactions. VNET trades at 8.7x EV/2018 EBITDA, which the market considers an appropriate multiple for a U.S.-listed operator of carrier-neutral data centers in China with significant corporate governance concerns.

GDS, even at today's price, continues to be an expensive stock of a Company laden with debt. In our valuation, we applied a forward multiple of 20x EBITDA, which is hardly cheap. We apply a corporate governance discount to our valuation, which we continue to believe is appropriate given GDS's boiler plate Response, the contradictory statements apparently given to sell side analysts, and its complete failure to meaningfully address most of the evidence presented in our Report. We stand by our investment opinion.

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