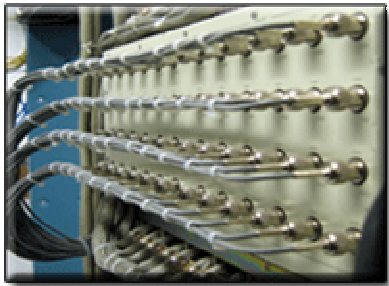


DATA CENTERS

Sustained growth in the sector is accompanied with the likelihood of further acquisitions, mergers and new investment



Valuation & Research Specialists (VRS)

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The Sector: General Information

As the importance of IT operations accelerates, the international Data Center Sector has experienced significant development the past years. Growth is being driven by increasing broadband penetration and the proliferation of bandwidth-intensive services including VoIP, online gaming, streaming video and audio, and IPTV. This is leading to stronger demand for interconnection services, as network service providers, ISPs, and other Internet-dependent businesses require additional connectivity to exchange increasing amounts of network traffic. However, apart from companies related to technology itself as a business, Data Centers play a key role in all business sectors.

From simple computer rooms to the complex growth of information technology and the “dot-com bubble” the previous decade, Data Centers now form an integral part of IT Operations in any business or government organization as they are at the root of the enabling infrastructure for modern technology. The data center value chain goes from shell and core and co-location, to disaster recovery, application hosting and full outsourcing. Data centre business models range from the rack to the floor or an entire building.

The corporate trend of outsourcing data centers can be attributed to the following basic factors:

- Minimization of cost. As IT infrastructures become increasingly complex, the costs of developing an in-house data center requires significant costly investments, while the cost for access to such infrastructure from specialized service providers is considerably less.
- Focus on core business. Many companies that do not run an IT business, would rather invest their resources in improving their business than in data centers, as IT is the driver of the business but not the business itself.
- Lack of space. Service providers can offer a cost-effective solution for the increased space required for IT infrastructure.
- Improved service. Through outsourcing, tight service level agreements ensure a high level of service as a contractual obligation.
- Increased Access. Specialized Data Center providers have years of experience in managing data centers. Companies can benefit from such experience.
- Stable IT environment. Service providers have the resources to face any eventuality and can offer a stable IT environment.

- Business continuity requirements – disaster recovery. New regulation on business continuity – disaster recovery requirements increases the need to outsource data centers.

Currently the sector is characterized by significantly higher demand in the global market than supply, while with a large amount of investments, new entries of data centers, IPOs and a relative merger & acquisition activity, the Data Center sector has received strategic importance during the recent years. Moreover, it also faces significant challenges imposed by demand in power and new regulation for providing environmentally friendly services.

Major Data Centers Firms Internationally

Company Name	Net Space (thous. sq.m.)	Price	Mkt Cap (mn)	P/E Trail.	P/E '08	P/BV '07	P/Sales
EQUINIX INC (in \$)	>3,000	88.39	3,249.82	422.29	107.805	4.54	7.74
COGENT COMMUNICATIONS (in \$)		17.89	851.04	-	-	8.19	6.1
SWITCH & DATA (in \$)		14.78	524.72	76.84	864.706	4.39	4.85
TELECITY GROUP PLC (in GBP)	46.6	245.00	485.33	-	46.79	3.95	5.13

	EQUINIX INC	COGENT COMMUNICATIONS	SWITCH & DATA	TELECITY GROUP PLC
<i>Amounts in mn</i>	(in \$)	(in \$)	(in \$)	(in GBP)
Turnover	419.44	185.66	137.53	97.90
Gross Profit	63.73	30.07	19.42	40.08
EBITDA	109.26	35.72	35.18	18.60
EBIT	9.18	-29.92	9.61	-
EBT	0.3	(31.3)	(0.92)	(7.76)
EAT	(5.2)	(31.3)	(0.79)	(7.82)
Net Fixed Assets	1162.72	245.42	65.95	152.8
Current Assets	426.76	206.23	56.09	73.7
LT Borrowings	1085.76	280.72	56.49	32.59
ST Borrowings	20.39	7.72	3.75	42.62
Shareholders' Equity	814.43	138.8	125.1	150.3

	EQUINIX INC	COGENT COMMUNICATIONS	SWITCH & DATA	TELECITY GROUP PLC
Profit Margin	0.95%	-16.71%	4.24%	-7.99%
Operating Margin	4.54%	-16.11%	8.14%	-2.07%
Return on Assets	0.83%	-4.72%	2.81%	-3.80%
Return on Equity	0.74%	-17.51%	4.98%	-6.71%

Recent Trends in the Sector

Merger & Acquisition Activity

The merger & acquisition trend that surfaced over the past years seems to continue as single facility owners are more prone to sell to larger players. Network equipment, racks and other intelligent metal work is confronting a period where collaboration, application hosting, the emergence of SaaS, future migration to the new edge of the network, and virtualization collectively reveal the more focused needs of data centers for partnerships and services.

It is worth noting the recent acquisition of the Dutch data centre firm Virtu Secure Webservices B.V. from Equinix, Inc. an international carrier-neutral data centre in February 2008. The move follows the 2007 acquisition of European collocation provider IXEurope. Also, in June 2007 property investors Reuben Brothers proceeded with a buy out of Morley Fund Management's 25% stake in the European business of data center company Global Switch, while already holding a 75% stake. Following these acquisitions, Equinix alongside Global Switch will now become the only two global data centre businesses.

The emergence of global data centre players through an alliance system or through acquisitions underlines industry confidence in the sector and also the increasingly strategic importance of data centers. Some providers believe that there is nothing to be gained from acquiring existing Data Center companies as all valuations are high – but others believe that consolidation in the sector is inevitable. In this context, consolidation of the highly fragmented European market is likely to continue in 2008, with some of the acquirers likely to be from outside the region, and not solely American.

Data Center Expansions

Apart from mergers & acquisitions current players are also focusing on expanding their facilities in response to specific customer demand although investment is increasing significantly.

Recently Galileo Connect, a UK based company specializing in pre-designed modular data centers, announced a GBP540m global expansion in London, Paris, Singapore, Canberra and Sydney, while IBM has announced that it will undertake an \$86 million expansion of a greenish data center in Boulder, Colo. The company will add 80,000 square feet to a 225,000-square-foot facility, using energy-efficient lighting and heating.

It is worth noting that according to a recent research study by Digital Realty Trust Inc., a leading owner and manager of corporate and Internet gateway datacenters, 2008 will see a wave of datacenter expansions. The study was based on a recently completed survey of senior decision makers who are either directly responsible for datacenters or influence significant decisions related to datacenter operations. According to the study, 86 percent of respondents stated that they will definitely/probably expand their number of datacenters in the next 12 months, indicating an active phase of datacenter development during the second half of 2008 and first half of 2009.

“Green” Data Centers

The need to balance high IT infrastructure against social and corporate responsibility to reduce carbon footprints / emissions has already begun to affect the Data Center Sector. Currently, the Data Centre industry has serious power and cooling issues to face as technology usage is still rising with no indication of this trend reversing. Specifically, new applications demand more and more power, and in the financial industry storage requirements in the wake of MiFID amongst others, are putting an ever increasing strain on corporate Data Centers, but at the same time the Data Centre industry must somehow reduce its overall power consumption.

The environmental challenge for data centers is also reinforced by the risk that Data Centers will not have sufficient Power and Cooling capacity to meet the demands of high density equipment in the future. Today more than 50% of the power supplying a typical data center goes to the Power and Cooling systems and

not to the IT loads so there is room for improvement in this area.

New regulation on the issue has also been introduced as an EU code of conduct (best practice) for Data Centers has already been drafted from the end of 2007 and aims at minimizing energy consumption of data centers, while currently the U.S. Environmental Protection Agency (EPA) and the U.S. Department of Energy (DOE) have initiated a joint national data center energy efficiency information program.

However the issue of reducing power consumption in an efficient way can benefit the market and may even be good for the third party data center industry, as in their effort to decrease power consumption, businesses and public sector organizations are increasingly moving such IT facilities out of their offices and into separate purpose-built Data Centers where the equipment is maintained under optimum conditions. A clear indication of the market's turn towards "greener" activities is the construction of the world's first green powered Data Farm in Scotland by Internet Villages International. The Data Farm will consist of approximately 20 Data Centers with 3mn sq.ft. of data storage and is expected to achieve significant carbon reductions and major cost savings, while according to the company several Fortune 500 multi-national companies have already expressed interest in the Data Farm.

Challenges & Risks

One of the main challenges in the international Data Center Sector, apart from the 'power & cooling' issue, is of course the rise in property costs and available space, with space in city centers being the key issue. In general, Data Centers now face a more challenging environment. They need to find more space and ensure that the cost of the building conversion provides an economic return.

Moreover, many providers are facing the challenge of high-density computing leading to a requirement for blade servers and high-density server clusters. To accommodate such servers, providers will either have to upgrade their facilities or amend their existing applications, including using additional space for this purpose.

Finally, there do remain concerns of over-supply and comparisons to another 'dot com bubble' as US investors pump up valuations and property investors become re-acquainted with Data Centers. Currently however Data Centers are presenting

very strong fundamentals.

Future Outlook

Sustained growth is predicted for the market, with the likelihood of further acquisitions, mergers and new investment. As demand outweighs supply, due to an increasingly shortage of space, further investment in the business sector is required. In this context, prices are likely to rise, as evidenced now in the US and Europe. Opportunities do exist for new entrants in the market, particularly in Europe, which represents around one-third of the global telecom market.

Positive future growth in the sector is also indicated from the fact that investment is not just coming from traditional sources but from property investors and REITs (real estate investment trusts) as well. The Pinder Fry and Benjamin data center investment fund is an example of such alternative forms of investments. Moreover, apart from traditional sources of demand in the sector, such as banks and systems integrators, public investments are also becoming an increasingly important area as the public sector looks to cut costs, outsource and manage its growing data burden.

Historically, outsourced locations were often of a poor quality, and data centre issues were usually considered low priority. However, Data centre managers can also no longer insist on being close to their offices, and there will be more demand outside city centers and a migration from the major markets to areas such as Central and Eastern Europe, the upcoming North Africa region and India, as these economies mature and new technology drive demand for hosted services, such as the adoption of broadband, internet and content services.

Furthermore, future growth will be dependent on the ability of Data Centers to gain access to new sites which are suitable for new facilities. The providers that have existing land banks will have a strong advantage, while the main constraint on future demand will be the supply of suitable Data Center space.

Notes

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