

FOCUS: Data Centres as an Asset Class

Roger Aitken examines the growth of data centres as an emerging asset class, dynamic aspects of the sector and prospects for institutional investor recognition.

Wallace Wormley, Editor

Data Centres are facilities used to house computer systems and associated components, such as telecommunications and storage systems. They generally include backup power supplies, redundant data communications connections, environmental controls (e.g. air conditioning, fire suppression) and security devices.

While investing in data centres by institutions might not readily be considered as an asset class, the latest currents at play in the space appear to be creating a confluence of factors that points to greater interest in the sector. Data centres are really at the exotic end of investing in real estate but with a technical twist.

Andrew Harrington, co-founder of AHV Associates LLP (AHV), an M&A and capital raising advisory firm based in London, commented on how real the concept of data centres is as an asset class today: "Ownership of data centres is regarded as an asset class within the property sector because of the bond-like investment returns and mission critical services it provides," he states.

The sector has attracted the attentions of property investors such as the Reuben

Brothers, who have owned Global Switch, one of the leading specialists in designing, building and operating data centres, since early 2007. As a 'specialized area' within the property sector, Harrington acknowledges that while most property investors may not currently feel comfortable with data centres, he contends that this "could well change in the future."

Growth Potential

In terms of hard numbers, data centres have continued to attract significant levels of investment, with more than US\$15bn (c. €11.75bn) committed to global data centres in the past 14 months. International strategies are also being pursued with a broad range of finance and investment approaches (see: www.datacentres.com).

Operators are choosing from a range of options open to them including bonds, private equity, and IPOs, although constraints remain and for unlisted companies. There are funds tracking the sector from firms such as Pinder Fry & Benjamin, who have different funds targeted to private and institutional investors.

Driving the sector are a number of macro trends including dramatic broadband penetration in offices and homes, especially in the U.S. For example, the amount of bandwidth in most homes in the U.S. has risen from 1.5Mbits to around 20Mbits in less than a decade. The more bandwidth that finds its way to end points, the more data ends up being moved to data centres.

Peter Hopper, co-founder of investment bank DH Capital, notes an increasing "wave of commerce" making its way to the Internet. For instance, 'Cyber Monday' (the Monday after Thanksgiving) saw online sales in the U.S. up 14% in 2009 over the year before, compared to 'Black Friday' (the Friday that Christmas sales season begin after Thanksgiving) that were flat between 2008 and 2009.

Furthermore, a sample statistic from Nielsen Online indicated that total U.S. video screens served up on the web was +8.7% between February and March 2009. This type of growth leads to "huge demand for bandwidth from data centre infrastructures to serve all these increasing needs," added New York-based Hopper.

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Data Centre Index Tracks Sector

Research by AHV also reveals that public companies engaged in the data centre sector have outperformed the major indices like the FTSE100 and the Dow Jones Industrial Average and have continued to prosper. The firm developed a specific 'Data Centre Index' last year, comprising a basket of some twenty or so listed companies in the sector.

Market performance on a 12-month basis through April 2010 has been impressive in comparison with major indices and the general media sector (see Table 1). The AHV Data Centre Monthly Index was up +104.1% over that 12-month period, where several stocks were in rude health and shot up more than 200% (see Table 2 overleaf).

AHV has created a capitalisation-weighted index of large, quoted companies that are directly involved in the data centre sector. Specifically, this index consists of the large data centre companies listed in the above table, and large, quoted companies from around the world whose performance is directly related to the data centre industry.

Amid growing sector interest, an international forum gathered in London in December 2009 ('3rd International Finance & Investment Forum for Data Centres') for discussions and an exchange of ideas between investors, private equity firms and lawyers. Organised by BroadGroup Consulting, which publishes AHV's index in its monthly Data Centre News, the event attracted over 100 market participants specialising in the sector.

Key topics included: market demand & drivers; financing expansion; M&A possibilities;

IPOs; data centre location opportunities; internationalisation in data centre expansion; REITs; emerging markets and risk factors.

The "emergence of data centres as a new asset class" was discussed. It was well-timed as a just a few days prior to the forum, news had broken of plans to develop one of world's largest data centres - a 250,000 square meter data storage facility in Lockerbie, Scotland. Alongside it would be a "sustainable village" suitable for companies working in the web-commerce and IT sectors, with a range of land uses on the edge of Lockerbie in Dumfries & Galloway.

But Lockerbie Data Centres' massive proposal is just one of a number of such data storage proposals on the horizon in Britain. Scotland has the attractions that its ambient temperatures are cooler than in south of the UK and the benefit from a major global cable - between the U.S. and Europe - running through the country.

Lerwick in the Shetlands is also set to become the UK's most northerly cloud computing data centre with a 10,000 sq ft facility that will be powered entirely by renewable energy.

Further afield, in Australia Global Switch has unveiled plans for an application to the

New South Wales Department of Planning for a A\$200m ((34,000 sq m) in Sydney called 'Sydney 2' - adjacent to its existing data centre in the inner-city Sydney suburb of Ultimo. And, as recently as 12 May 2010, Cincinnati Bell Inc. announced that it would finance the acquisition of seven data centres operated by Texas-based Cyrus One for US\$525m from Boston-based private equity firm Abry Partners.

"The demand for data housing is growing at a substantial rate - as demonstrated by the success of our existing Sydney facility," Global Switch executive chairman, John Corcoran, said in a statement.

Survey Highlights Significant European Growth

According to a survey conducted in 2009 by CBRE, the global real estate specialists, at least 34 new and generally wholesale data centre schemes were expected come on stream by 2012 in Europe*, totalling 6.2 million (m) sq ft at a projected capital amount of c.€8.1bn. By contrast, in the five major European data centre locations (countries) around 6.9m sq ft of space exists today. (*CBRE's survey was based on publicly announced schemes over a two-month period).

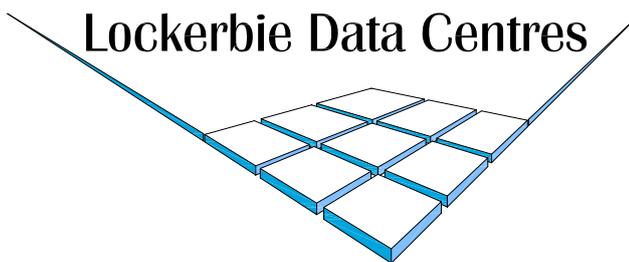
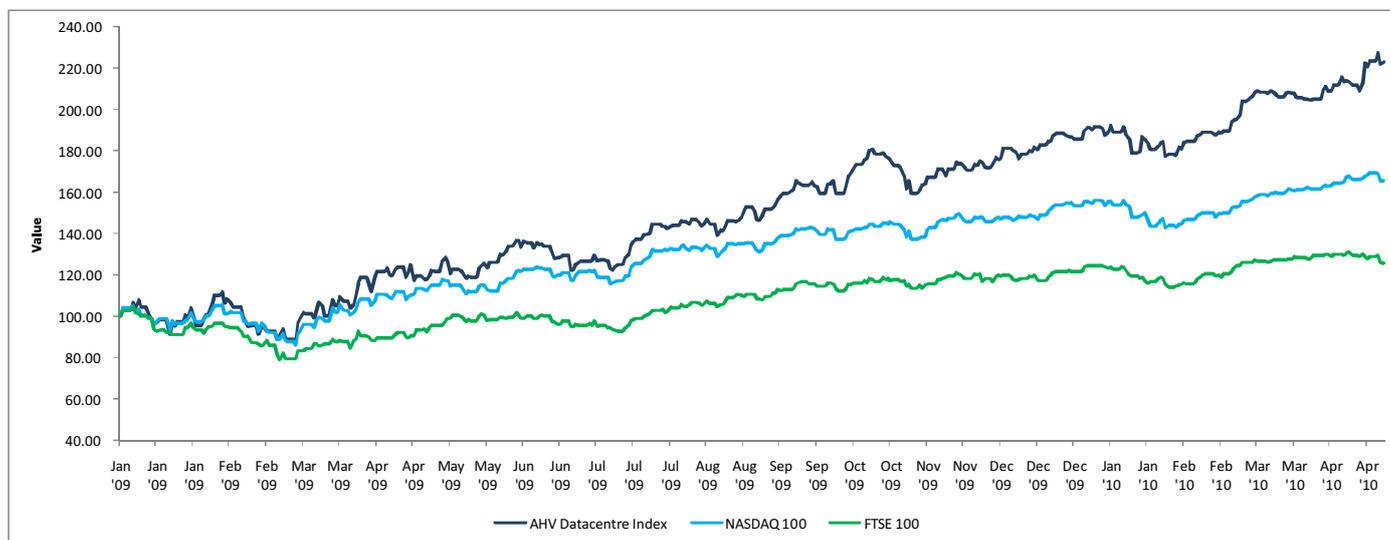


TABLE 1: Data Centre Market Performance



Source: Data Centre Index, May 2010, AHV Associates LLP/BroadGroup.

Accessing The Asset Class

While the vast bulk of investors may find the sector "too specialised" for a direct property investment, according to AHV's Harrington, they could have access to the asset class via the quoted sector through a range listed stocks shown in Table 2.

CBRE and GVA Grimley. As a long-term investment in a fully let data centre with contracts spanning multiple years, this provides a recurring stream of income.

The best ones have blue-chip clients residing in them and the applications are typically "mission critical" (e.g. from proximity

TABLE 2: Data Centre Market Performance Tracker

Company Name	Exchange	Ticker	PE Ratio	Last Close	PERFORMANCE			Jan 2009 to Date
					1 - Month	1 - Quarter	1 - Year	
Telecity	LSE	TCY.L	22.36	409.00	-3.54%	4.28%	54.92%	132.06%
Equinix	NASDAQ	EQIX	53.84	100.65	3.40%	4.59%	43.31%	92.45%
Rackspace	NYSE	RAX	66.89	17.95	-4.16%	-1.48%	95.32%	226.96%
Savvis	NASDAQ	SVVS	N.A.	17.58	6.55%	11.69%	54.48%	203.63%
Iomart	LSE	IOM.L	642.86	47.32	-4.92%	5.16%	27.03%	85.57%
Terremark	NASDAQ	TMRK	N.A.	7.17	2.28%	-12.35%	84.32%	93.78%
Internap	NASDAQ	INAP	N.A.	5.79	3.39%	30.11%	108.27%	127.95%
Digital Realty Trust	NYSE	DLR	90.37	58.70	8.30%	23.37%	68.87%	100.34%
DuPont Fabros	NYSE	DFT	55.61	22.17	2.69%	33.88%	162.06%	1098.38%
Navisite	NASDAQ	NAVI	N.A.	2.95	14.79%	0.34%	676.32%	767.65%
Macquarie Telecom	ASX	MAQ.AX	10.92	4.95	-5.71%	-2.94%	160.53%	395.00%
EU Networks	SGX	H23.SI	N.A.	0.02	100.00%	100.00%	0.00%	100.00%
Cogent	NASDAQ	CCOI	29.40	10.19	-2.11%	-6.68%	20.73%	56.29%
COLT	LSE	COLT.L	12.26	124.40	-2.12%	0.40%	31.64%	123.14%
CSF Group	LSE	CSFG.L	N.A.	65.00	3.17%	-	-	-
NetApp	NASDAQ	NTAP	37.80	34.67	6.55%	19.02%	89.45%	175.38%
Akamai	NASDAQ	AKAM	32.29	38.83	23.58%	57.21%	76.34%	163.61%
Emulex	NYSE	ELX	29.25	11.75	-11.52%	4.54%	12.23%	80.77%
VMWare	NYSE	VMW	121.12	61.64	15.65%	35.74%	136.35%	176.16%
SGI	NASDAQ	SGI	N.A.	9.86	-7.76%	23.10%	116.23%	165.77%
Limelight Networks	NASDAQ	LLNW	N.A.	4.02	9.84%	14.86%	-17.96%	70.34%
Citrix	NASDAQ	CTXS	32.26	47.03	-0.93%	13.19%	64.84%	105.55%
EMC	NYSE	EMC	26.39	19.01	5.38%	14.04%	51.72%	84.38%
AHV Datacentre Index				222.59	8.82%	23.07%	81.66%	122.59%

Source: Data Centre Index, May 2010, AHV Associates LLP/BroadGroup.

In addition, some funds have been launched in recent years from firms like Pinder, Fry & Benjamin (PF&B). Through PF&B's Data Centre Fund, the fund aims to profit from the boom in digital data processing and storage, and the shortage of such processing and storage capacity. This fund has committed to investments in four prime data centre projects in the UK, Germany and Switzerland via a joint venture with e-Shelter, an international data centre developer.

There is also the option to purchase a data centre outright or part thereof through real estate specialists in the area such as

hosting for high-frequency trading to exchanges/market venues). Typically these are provided by listed data vendors like Equinix or Savvis, both of which are tracked in AHV's index.

"Technical real estate, like data centres, can be attractive to property investors," adds Harrington. "As a hybrid investment, it has many of the characteristics of traditional property, including long-term contracts and recurring revenues, but with the added bonus of rapid growth prospects given the dynamics of computer, web and telecoms storage needs."

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Relatively Immature Market ... But Fast Developing

Chris Crosby, Senior Vice President of Corporate Development, Digital Realty Trust, Inc., [Ticker: 'DLR'], agrees that as a new asset class the sector is "not well understood" but is emerging significantly.

"The marketplace, which is relatively immature, has traditionally been confined to consultants and engineers," says Crosby. Digital Realty, which is traded on the NYSE and is the largest data centre REIT player globally, has around 14m sq ft. (operating c.3m sq ft and c.11m sq ft as landlord).

For 2009 DLR expected to see the bottom line grow by 25% and it recently became the first company on AHV's data centre index to secure an investment-grade rating. DLR is essentially a provider of data centre infrastructure, acquiring data centres and providing turnkey operations. Crosby's firm boasts a broad client base including the likes of Equinix, Savvis, IBM, Morgan Stanley, Facebook and Yahoo.

Crosby also reveals that DLR continues to witness a "tremendous amount" of demand in the data centre space. "We view it as the infrastructure for the information age," he contends. "And, we are the railroad company, not the railcar company."

Is Institutional Appetite Fully There?

Andrew Jay, CBRE's Head of Technology Practice Group, commenting on whether data centres have become institutionalised as an asset class, says the institutions are "having problems" understanding data centres and in many ways it confuses them.

Jay adds: "They struggle with the link between the real estate owner (i.e. Propco) and operators who run the buildings and have Service Level Agreements (SLAs) between them and cross guarantees (i.e. Opco). As such they don't like it."

"The view of the institutions tends to be far more simplistic. Either they want an Opco or a straightforward real-estate investment that is let for say twenty years."

It's also proving difficult to "educate" some of the institutions and the current market size of the sector is proving an issue too. For certain institutions 6m sq ft is viewed as quite a small market, since many of larger institutions could already be holding in excess of 6m sq ft of real estate space. Consequently some institutions would decline the proposition and "not bother getting involved", he points out.

Noting that demand and supply in the data centre market was at present broadly in "equilibrium" in Europe, Jay outlined

three different models for valuation of such facilities based on: (1) Traditional market comparables, which gives a "very high valuation"; (2) Discounted Cash Flow, a "sensible approach" Jay contended; and, (3) Split Real Estate and Fit Out, where the fit out is amortised over a certain term.

The initial construction work at the Lockerbie development and the opening of Equinix's fifth International Business Exchange (IBX) data centre in Geneva, Switzerland, are recent examples of major capacity expansion in Europe.

Equinix in fact has a US\$1.4bn (c.€1.1bn) 2007-2010 global expansion plan, including a fourth IBX data centre in Zurich in 2010. "Geneva is a very strategic market for Equinix," states Eric Schwartz, president of Equinix in Europe.

He added: "Not only is there growing local demand for high specification data centre services - particularly from the city's financial sector - the city's location between Northern and Southern Europe means it is a key collection of point of Internet networks."

Clearly, places where many telecoms and Internet networks interconnect to exchange traffic will require massive data centre storage, contingency devices and security services as the demand grows exponentially. Watch this space for further developments.



About the Author

Roger Aitken, a former FT trade journalist, is a specialist writer on algorithmic trading, low latency applications across the asset class spectrum (equities, FX, fixed-income and derivatives), incumbent exchanges and MTFs. He has interviewed many leading CEOs and senior executives in both Europe and North America. He also has a credit ratings background, having been Fitch's first European in-house comment writer.
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