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NextDC (ASX:NXT) - SHORT

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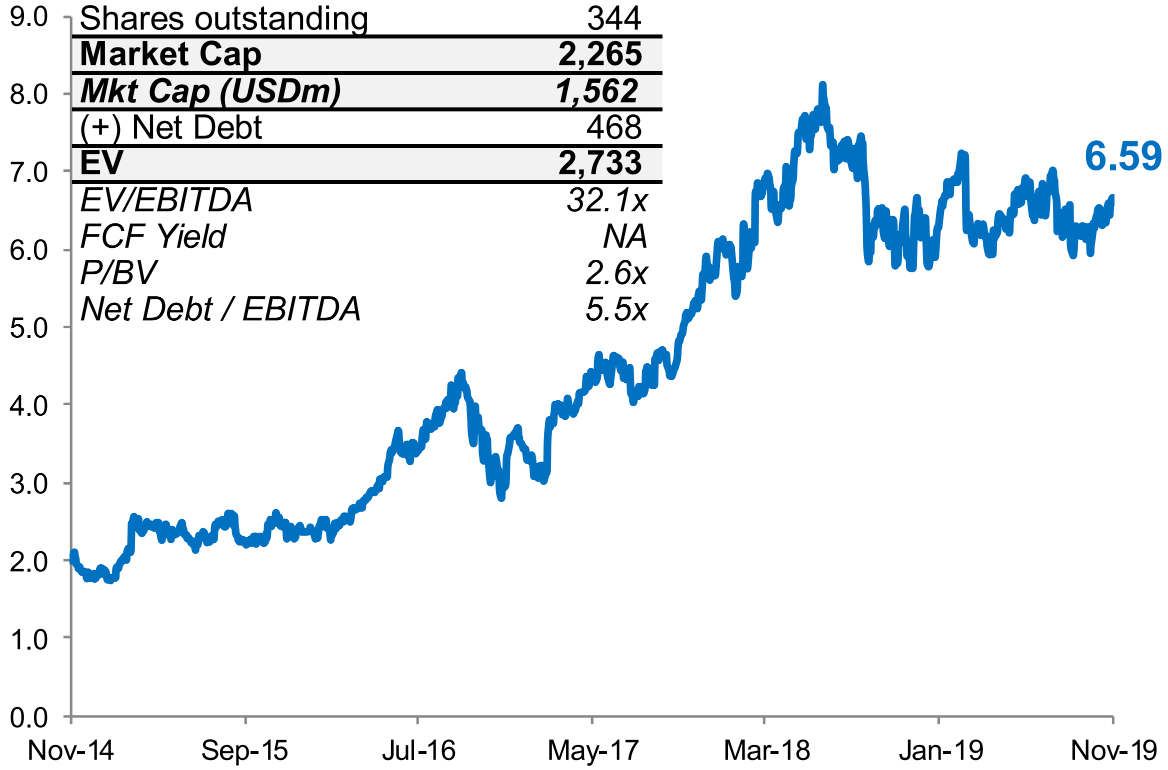
Company Overview

- **NextDC (“NXT” or “the Company”) is an owner-operator of carrier-neutral data centres in Australia**
- Since floatation in 2010 NXT has raised a combined $1.5 billion of debt and equity
- As of FY2019, NXT operated 58 MW of built capacity across 9 data centres, with plans to triple this by 2022

AUD$m	
Share Price (AUD$)	6.59
Shares outstanding	344
Market Cap	**2,265**
Mkt Cap (USDm)	***1,562***
(+) Net Debt	468
EV	**2,733**
EV/EBITDA	*32.1x*
FCF Yield	*NA*
P/BV	*2.6x*
Net Debt / EBITDA	*5.5x*



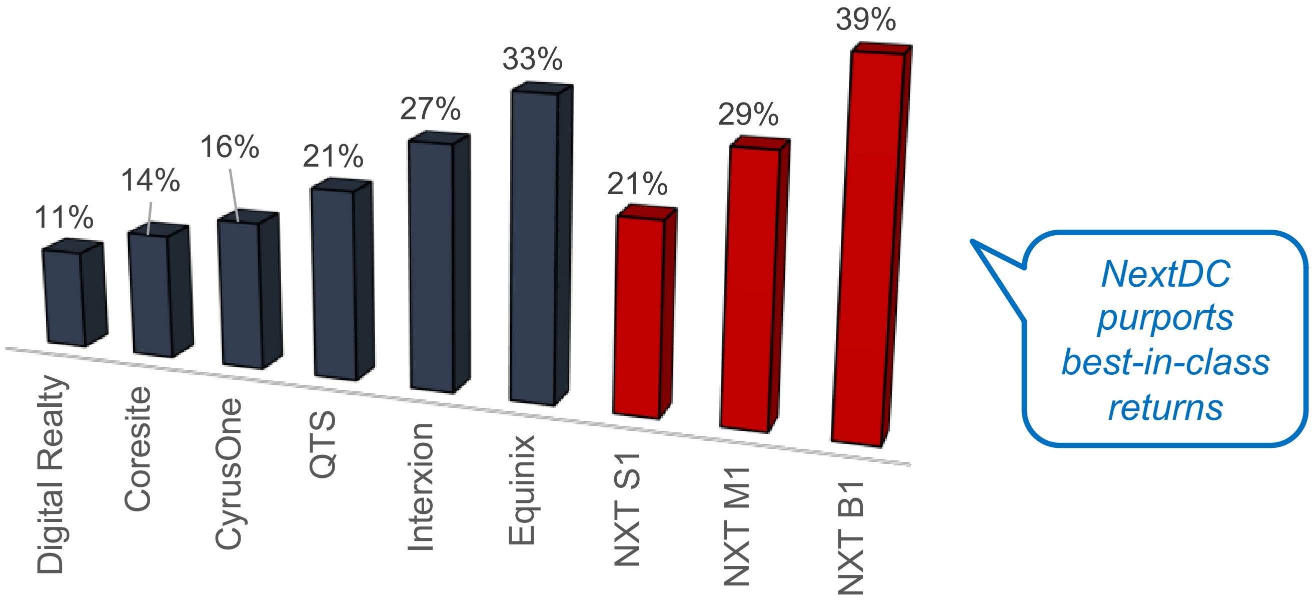
Financial Summary

AUD$m	Jun-16	Jun-17	Jun-18	Jun-19
Revenue	**93**	**124**	**162**	**179**
% growth		*33%*	*31%*	*11%*
Gross profit	84	107	134	146
Underlying EBITDA	**28**	**49**	**63**	**85**
% margin	*30%*	*40%*	*39%*	*47%*
Net Finance exp.	(8)	(13)	(20)	(45)
Net Profit	2	10	(7)	(10)
CFFO	**23**	**47**	**33**	**39**
FCF	**(66)**	**(102)**	**(322)**	**(475)**
Net Debt	(26)	30	(114)	468
Tang. Book Value	317	400	874	853

Investor *Perceptions* Underpin NXT's Premium Trading Multiple

1) **Best-in-Class Operator** - NXT purports to offer a high-end product at a premium price point.
2) **Strong Leasing Track Record** – NXT's "committed utilisation" has kept pace with build out.
3) **Industry-Leading Financial Returns** - NXT reports a return on capital as high as 39% at its first-generation centres.

EBITDA Return on Capital:



Peer Trading Multiples

	Mkt Cap ($USDbn)	EV/EBITDA FY2019
Equinix	45.1	18.2x
Digital Realty	24.3	17.6x
Interxion	6.2	19.6x
Coresite	4.2	15.7x
QTS	2.8	14.8x
Peer average		***17.2x***
Next DC	**1.6**	**32.1x**

*Investors rationalise that if NXT can achieve comparable performance at its new data centres it has the **potential to grow quickly and generate strong cash flow within a few years**.*

- Reality 1: **NXT is operating in a competitive market with its data centres in second-best locations**
- Data Centres in general have high level of homogeneity. Experts describe NXT as a "price taker"
- NXT's data centres in Sydney are located further from the CBD / Airport than retail rivals *Equinix* and *Global Switch*

Management Claims:

"We're not selling widgets. Where the data center is located is critically important....we are not a price-led company. We are an operation centers-of-excellence level organization..And we are a premium price. "

- Craig Scroggie, CEO

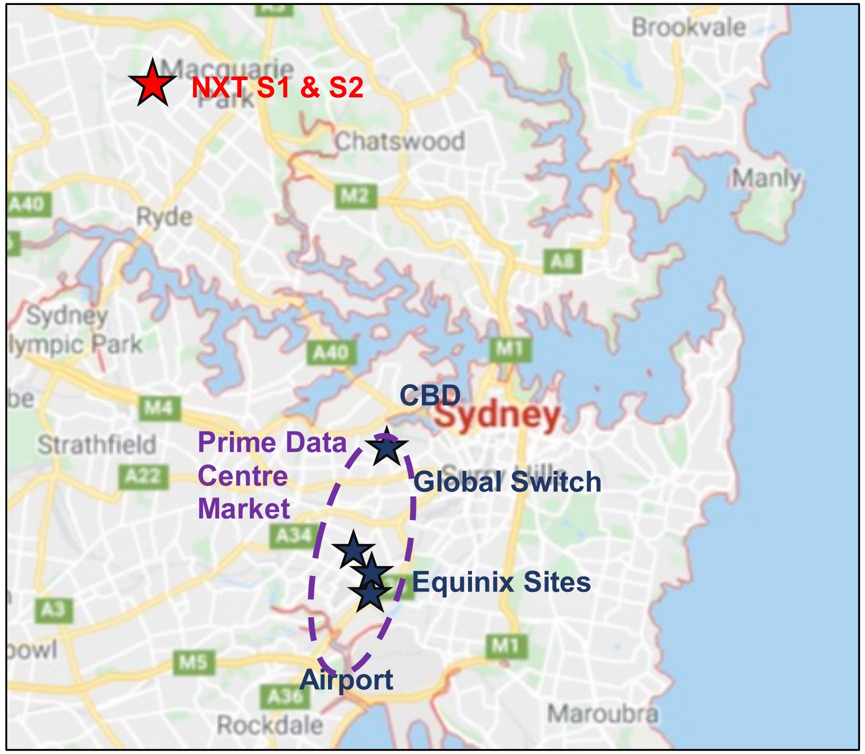
Sell-side Claims

"DCs have an above average level of homogeneity and therefore we believe NXT is closer to a price taker than a price maker"

- Credit Suisse

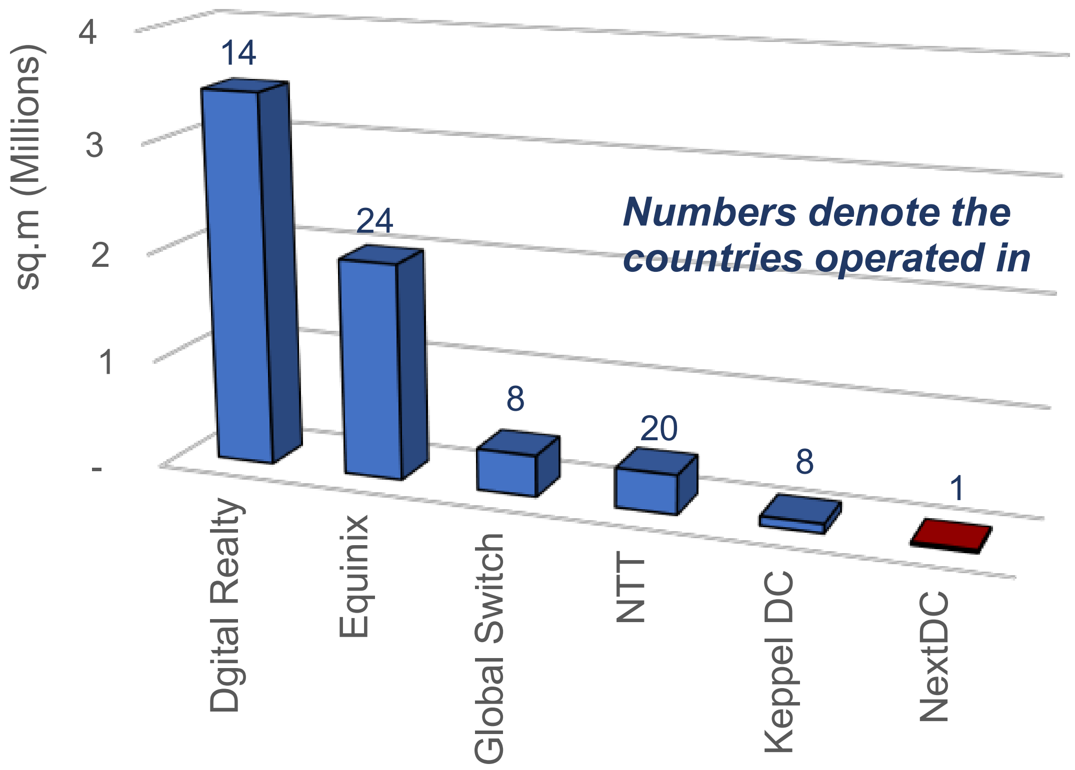
"There is a high level of competition between NextDC, Equinix, and a number of other players in the retail market" ***- GLG Network***

Sydney Data Centre Market



- Reality 2: **NXT is a small-scale operator competing against much larger peers**
- Data centre industry exhibits major economies of scale.
- Competitors *Equinix* and *Digital Realty* are a magnitude of times larger than NXT
- Competitors are able to provide a global service, catering to businesses operating in multiple regions

Global Data Centre Footprint (sq.m)



*"we had to become more global for our customer base. Our customers are all doing business in multiple regions ….**Everything in this business is about size…**Operating at scale is crucial to compete in this business"*

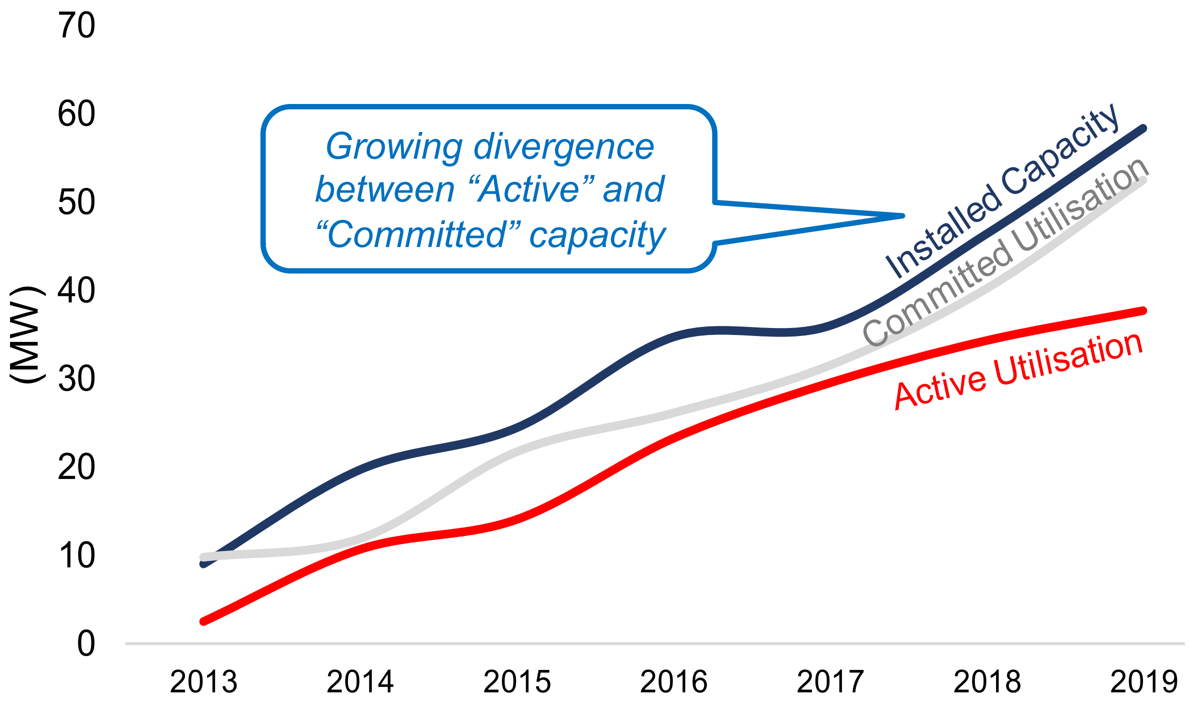
- Andy Power, CFO Digital Realty

"being able to target businesses operating in multiple regions is a strong selling point…I'm surprised that [NextDC] haven't done that"

- GLG Network

- Reality 3: **There is a growing divide between NXT's "billing capacity" and "committed capacity"**
- "Committed Utilisation" has kept pace with build out program, standing at 90% of installed capacity as of FY2019.
- "Active Utilisation" – i.e. the space on which NXT is actually receiving revenues – has plateaued in recent years, growing just 10% in 2019

Utilisation Rate



KPI Summary

	Jun-16	Jun-17	Jun-18	Jun-19
Data centres	5	5	7	9
Installed Capacity	34.7	36.0	46.4	58.4
% growth	*42%*	*4%*	*29%*	*26%*
Contracted utilisation	26.1	31.5	40.2	52.5
% growth	*20%*	*21%*	*28%*	*31%*
% installed capacity	***75%***	***88%***	***87%***	***90%***
Active utilisation	23.2	29.5	34.3	37.7
% growth		*27%*	*16%*	*10%*
% installed capacity	***67%***	***82%***	***74%***	***65%***

New Commitments are taking more than 12 months to come online

- Reality 4: **NXT's leasing activity is predicated on discounts provided to its largest customer**
- NXT's largest customer accounts for 31% of its revenues[(1)]
- Company disclosures reveal that space was historically leased to this customer at $2-$2.5[(2)] per MW on a wholesale basis. Based on this pricing, the largest customer may account for as much as 56% of NXT's leased capacity

NXT Largest Customer Utilisation

$AUDm	FY2015	FY2016	FY2017	FY2018
Largest Customer revenues	17.0	24.4	37.9	44.4
% of revenues from largest customer	29%	27%	32%	29%
Largest Customer Rate ($/MW)	2.5	2.5	2.5	2.5
MW occupied by largest customer	**6.8**	**9.8**	**15.2**	**17.8**
Average utilised capacity	12.3	18.6	26.4	31.9
% capacity occ. by largest customer	**55%**	**52%**	**58%**	**56%**

A great way to fill space but is this a viable business model?

"there's a lot of incentive if someone comes a long and says hey we'll take half this building off your hands at this rate, which might be almost a cost of capital type rate" ***- GLG Network***

(1) As of 2018. In FY2019 NXT disclose that its two largest customers accounted for 36% of revenues but do not provide a breakdown.

(2) This is corroborated by sell side analysts who estimate the Company's wholesale pricing at approximately $2-2.5m/MW.

- Reality 5: **A number of NXT's key customers appear to be related parties**

- NXT leases capacity to a number of entities connected to its founder and major shareholder *Bevan Slattery*. These include ASX listed companies *Superloop* and *Megaport* as well as a number of their subsidiaries. NXT recently announced that *Superloop* had signed as the cornerstone tenant at its new data centre in Perth.
- Other current / former related party customers include Morgans[(1)] and Tech Mahindra [(2)]

NXT's Chief Accounting Officer is the former CFO of Superloop

NXT Related Customers

Customer	Relation
Megaport	*Founded by Bevan Slattery*
Superloop	*Founded by Bevan Slattery*
BigAir	*Subsidiary of Superloop*
APEXN	*Subsidiary of Superloop*
Morgans	*Advisor and related to Former Executives*
Tech Mahindra	*Shared Chairman pre 2015*

Circular Revenue streams with Superloop

NEXTDC taps in to 9,000km cable thanks to Superloop deal

Written on the 13 November 2018 by Business News Australia

Data centre operator NEXTDC (ASX: NXT) is set to benefit from higher speeds thanks to a deal with Superloop (ASX: SLC) that will see it plug into consortium INDIGO's 9,000km international fibre cable project.

Under the terms announced today, Superloop will provide NEXTDC's data centres in Perth (P1 and P2) and Sydney (S1 and S2) with optical layer connectivity to the subsea cable which connects Australia with Southeast Asian networks.

The service is expected to be ready by the second half of FY19, enabling speeds exceeding 36 terabits per second with significantly lower latency and greater reliability.

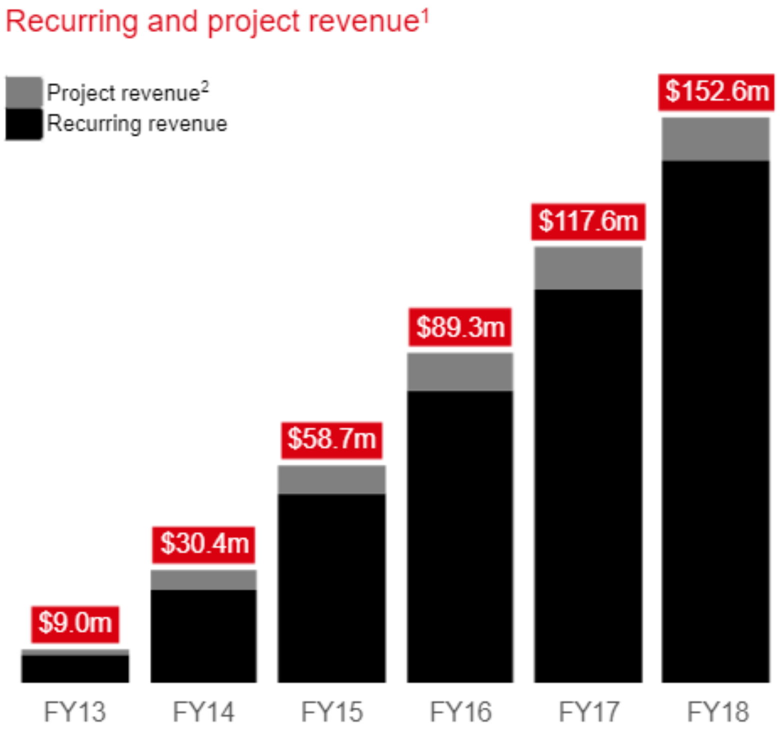
Superloop will also be the inaugural customer at NEXTDC's new world class 20MW P2 Tier IV data centre currently under development in East Perth.

Source: businessnewsaus.com

(1) A blog post from NXT in 2014 stated that Morgans was a tenant at its B1 Brisbane Data Centre

(2) NXT's former chairman (2011-15) Ted Pretty was also chairman for Tech Mahindra's AZNAC operation (2012-15)

- Reality 6: **NXT's EBITDA pre-2019 was boosted 8% by aggressive revenue recognition**
- Project fee revenue is charged for one-off set up costs associated with the onboarding of new customers
- Although fees are charged upfront, associated costs are typically incurred over the course of the contract
- New accounting rules introduced in 2019 revealed NXT had historically recognised project fee revenue as it was charged. This is against industry practice and would have inflated NXT's EBITDA during its initial expansion phase.



AUD$m	FY2018
EBITDA pre accounting change	62.6
Adjustment to project fee revenue	(5.2)
EBITDA post accounting change	57.4
% overstatement	***8%***

Project revenue includes one-off setup costs for new customer fitouts, standard establishment fees for new services, remote hands and other service

- Reality 7: **NXT's recurring capex payments appear to be as much as 6x higher than peers**
- NXT's payments for intangibles equated to 7% of revenues in 2019.
- Although NXT does not provide a breakout of *Maintenance* capex, **recurring** payments at its **stabilised** Brisbane data centre equated to 10% of revenues between 2017 and 2019(1)

B1 Data Centre Brisbane *Stabilised Asset*

AUD$m	Jun-15	Jun-16	Jun-17	Jun-18
Revenue	11	14	15	16
Built Capacity (MW)	2.25	2.25	2.25	2.25
Billing Utilization	78%	93%	93%	92%
Capex		**2**	**1**	**2**

AUD$m	2017-18
Incremental Capex	3
Revenues	30
Maintenance capex % of revenues	***10%***

Recurring capex at NXT's stabilized asset equates to c. 10% of revenues

Recurring capex % of Revenues

AUD$m	Maint.	Intang.	Total
Equinix	3%	-	3%
Digital Realty	3%	-	3%
Interxion	3%	2%	5%
Coresite	1%	-	1%
QTS	1%	-	1%
Average	*2%*	*0%*	*3%*
NextDC	***10%***	***7%***	***17%***

*NXT's **recurring capex payments 6x higher than peers** as a % of revenues*

(1) Between 2017 and 2019, NXT spent a combined $3 million of capital expenditure at its Brisbane B1 Data Centre vs cumulative revenues of $30 million.

- Reality 8: **After adjusting for recurring capex payments, NXT's ROIC falls to 6%**
- Stripping out NXT's WIP balance and factoring in recurring capex (assumed at 15% of revenues), the Company's estimated ROIC in 2019 was just 6.1%.
- At this level, NXT will struggle to service its rising debt pile, which as of 2019 stood at 5.4x EBITDA

ROIC Calculation

AUD$m	Jun-18	Jun-19
Revenues		*170*
EBITDA		85
(-) Recurring capex (15% of revenues)		(25)
EBITDA (-) Recurring Capex		**60**
Gross PP&E ex. WIP & APDC Assets	475	804
(+) APDC and RoU Assets	339	339
Adj. Gross PP&E	814	1,142
Average Gross PP&E		**978**
ROIC		**6.1%**

Fixed cost coverage

AUD$m	Jun-17	Jun-18	Jun-19
Interest costs	(19)	(26)	(55)
APAC rent	(13)	(14)	
Finance costs (+) rent	(32)	(40)	(55)
EBITDAR	62	76	85
(-) recurring capex	(19)	(23)	(25)
Adj. EBITDAR	44	53	60
Coverage	***1.4x***	***1.4x***	***1.1x***

Analysts note that low returns are typical in Australia due to high cost of acquiring facilities and pricing pressure due to the supply glut of DC capacity(1)

(1) Source: DBS Data Centre & Cloud insights 2018

Valuation

- Value NXT on a multiple of ***2022 EBITDA (-) recurring capex*** to give credit to NXT's growth prospects but limited free cash flow generation
- Base case assumes active utilisation continues to grow in line with trend and maintenance capex payments stabilise at 10% of revenues(1)
- **A multiple of 17.0x (peer average) gives a downside of -44% (target price $3.69).**

Financial Projections - Base Case

AUD$m	2018A	2019A	2020E	2021E	2022E
Average utilised capacity (MW)	**32**	**36**	**41**	**48**	**55**
% growth	*21%*	*13%*	*15%*	*15%*	*15%*
Av. Revenue per MW	5.1	5.0	5.0	5.0	5.0
Revenue	**162**	**179**	**206**	**237**	**273**
Underlying EBITDA	**63**	**85**	**98**	**113**	**129**
% margin		*47%*	*47%*	*47%*	*47%*
(-) recurring capex			**(21)**	**(24)**	**(27)**
% of revenues			*-10%*	*-10%*	*-10%*
EBITDA (-) recurring capex			**77**	**89**	**102**

Valuation

AUD$m	Trend	Bear	Base	Bull
Assumptions:				
Active utilisation growth	13%	10%	15%	25%
Rec. Capex % of rev.	17%	15%	10%	5%
2022E EBITDA (-) Rec. Capex		**78**	**102**	**149**
Multiple		***15.0x***	***17.0x***	***19.0x***
EV		**1,170**	**1,737**	**2,831**
(-) Net Debt		(468)	(468)	(468)
Market Cap		**702**	**1,269**	**2,363**
Target Price ($AUD)		**2.04**	**3.69**	**6.88**
Dowside		**-69%**	**-44%**	**4%**

(1) Revenue per MW assumed flat at $5 per average MW utilized. EBITDA margins assumed flat at 47%.