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Q2 2016 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Thank you for standing by, and welcome to the Interxion Second Quarter 2016 Results Call. At this time, all participants are in a listen-only mode. There will be a presentation, followed by a question-and-answer session. [Operator Instructions] I must advise you this conference is being recorded today, Wednesday, 3rd of August 2016.

I would now like to hand the conference over to your speaker today, Jim Huseby. Please go ahead, sir.

Jim Huseby
Vice President-Investor Relations

Thank you, operator. Hello, everybody, and welcome to Interxion's second quarter 2016 earnings conference call. I am joined by David Ruberg, Interxion's Vice Chairman and CEO; Josh Joshi, Interxion's CFO; and Giuliano Di Vitantonio, Interxion's Chief Marketing and Strategy Officer.

To accompany our prepared remarks, we have developed a slide deck, which is available on the Investor Relations page of our website at investors.interxion.com. We encourage you to download these slides to use during this call, if you've not already done so.

Before we get started, I'd like to remind everyone that some of the statements we will be making today are forward-looking in nature and involve risks and uncertainties. Actual results may vary significantly from these statements and may be affected by the risks we identified in today's press release and those identified in our filings with the SEC. We assume no obligation and do not intend to update or comment on forward-looking statements made on this call. In addition, we will provide non-IFRS measures on today's conference call. We provide a reconciliation of those measures to the most directly comparable IFRS measure in today's press release, which is posted on our Investor Relations page at investors.interxion.com.

We would like to also remind you that we post information about Interxion on our website at www.interxion.com and on social media sites such as LinkedIn and Twitter. We encourage you to check these sites for the most current available information. Following our prepared remarks, we will be taking questions.

And now, I'm pleased to hand the call over to Interxion's CEO, David Ruberg. David?

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

Thank you, Jim, and welcome to Interxion's second quarter 2016 earnings call.

Please turn to slide four. During the second quarter 2016, Interxion continued to post solid financial and operational results. We again produced steady, consistent growth with operational excellence and continued financial discipline. Cloud remains the biggest demand driver in our business, with cloud platform providers continuing to expand across Europe. These cloud platform providers come to Interxion because of, one, our proven ability to deliver highly connected data center space on time; two, the excellence with which we operate these facilities; and three, our ability to support their go-to-market strategy.

European enterprises remain on the same path towards the cloud as U.S. firms, and these enterprises are now beginning to move beyond the initial experimentation phase. We will discuss this in more detail later on in the call.

In the second quarter, Interxion continued its trend of profitable growth combined with margin expansion. Total revenues increased 9% year-over-year and 2% sequentially, while recurring revenue grew over 10% year-over-year and 2% sequentially. Adjusted EBITDA increased 13% year-over-year and 3% sequentially, while adjusted EBITDA margin expanded to 45.5%, an increase of 150 basis points versus the second quarter of last year.

In the second quarter, we continue to expand in Germany, with additional phases opening in both Frankfurt and Düsseldorf. And as announced on last quarter's call, we opened our second data center in Copenhagen in April. Also, as mentioned on last quarter's call, we raised €155 million of new capital from a bond tap in April. This additional capital strengthens our ability to meet the demand that continues to come from the cloud platform providers and others.

Please turn to slide five. I would be brief on this slide, but I'd like to highlight the growth in our adjusted EBITDA margins, a 150 basis point increase over the past year, driven primarily by improvements in our gross margin. These are the types of durable margin improvements that reflect the operating leverage of our business model, as well as the result of our operational excellence.

Please turn to slide six. Operating metrics were once again solid in the second quarter, reflecting our disciplined approach, embodied by a very steady utilization rate over the past year. We added a total of 2,600 square meters of new capacity in the quarter, while installing 1,200 square meters. With respect to other key metrics, bookings in the quarter were strong and broad-based in nature, covering many of our geographies and industry segments.

During the second quarter, we continue to see normal sales processes prior to the UK's Brexit vote. And since the vote, these deals continued to follow the normal sales process and do not seem to be impacted by the vote. As a result, our sales pipeline remains strong. Pricing in the quarter remains steady. Our revenue churn was again low and consistent with our historical annual range of between 0.5% and 0.75% per month on average.

Please turn to slide seven. During the second quarter, we completed three expansions, including the first phase of Copenhagen 2 and two subsequent phases in Germany. The second phases of Frankfurt 10 and Düsseldorf 2. I have spoken before about our strong position in Frankfurt, and we continue to experience strong growth in that market, while Düsseldorf gets comparatively less attention. However, we have experienced a solid uptick in demand at Düsseldorf since last year, as evidenced by the three expansions we've opened since last year of second quarter. Each of our German campuses is the most densely connected data center campus in its respective market, each are offering over 100 carriers and ISPs. The combination of Frankfurt and Düsseldorf allows us to more effectively access the world's fourth largest GDP, and the largest in Europe.

In addition to these markets – two markets in Germany, we also have experienced an uptick in demand in Copenhagen. Obviously, Denmark is a much smaller market than Germany, but the cloud platform players' move to the edge, combined with growing local enterprise demand, has resulted in an increase in demand. We opened the first expansion phase in Copenhagen in April of 2016, and today, we're announcing another square – 600 square meter expansion, the second of three phases at Copenhagen 2. The space is scheduled to come online in Q1 of 2017 and is completely sold. We have an active build schedule underway with over 7,000 square meters of new capacity scheduled to open over the second half of 2016 and another 2,800 square meters scheduled throughout 2017.

Please turn to slide eight. In Q2, our communities of Interest continue to expand across the board, as we had a very healthy quarter from a booking standpoint with a very good mix of large-sized, medium-sized and small-sized deals. More than 90% of bookings came from existing customers, and we added over 60 new customers. Once again, we experienced strong demand in the cloud provider segment, underpinned by a growing sales pipeline across multiple countries, as the leading infrastructure vendors continue to expand their footprint in Europe. As we mentioned before, the cloud growth is not only coming from the hyperscale providers, but also local cloud providers that have had launched any relationships with Interxion.

The managed service providers are enabling access to these cloud platforms, showed excellent momentum in Q2 in six different countries, with wins in Netherlands, Germany, France, Sweden, Denmark and Belgium. The largest systems integrators are continuing their evolution. The consolidation of their legacy deployments is offset by new projects, as they continue to shift their business model to the cloud, and they enable the digital transformation of enterprises. For instance, our expansion in Copenhagen is to meet the needs of a system integrator that is supporting the functions of a prominent bank. It was a strong quarter for digital media as well, with several expansions by existing customers who are spreading their deployments into new locations, in line with the growing trend of pushing the infrastructure closer to the end users. We also saw new deployments by content delivery networks as this segment is undergoing a rapid evolution, with new products and services being rolled out as well as new players coming into the market.

Within the Enterprise segment, we're seeing strength in the consumer retail sub-segment. In the financial services sector, we are seeing early indications that a few institutions may diversify their infrastructure as a result of Brexit by adding PoPs in mainland Europe. Finally in the Connectivity segment, momentum is picking in Marseille, following the official announcement in Q2 of two submarine cables, AAE-1 and SEA-ME-WE 5 landing exclusively in our facilities at Marseille. We now have over 90 carriers in the facility, up from about 50 carriers, when we acquired it less than two years ago.

I would now like to turn the call over to Josh.

Josh Joshi
Chief Financial Officer

Great. Thank you, David, and welcome to everybody on the phone and online. I'd like to start by discussing the group's second quarter results, and then provide some additional color on our two geographic reporting segments. I'll follow that with some commentary on capital expenditures, cash flow and the balance sheet, and as usual, finish with a few comments on returns.

So, starting with the income statement. Please turn to slide 10. Interxion delivered another quarter of profitable growth based on solid execution and disciplined expansion. Total revenue in the second quarter was €104 million, up 9% compared to the second quarter of 2015, and up 2% sequentially. On a constant currency basis, total revenue was up 10% year-over-year and 2%, sequentially. Recurring revenue in the second quarter increased to €99.3 million, a 10% year-over-year increase and a 2% sequential increase. Non-recurring revenue was €4.7 million in line with our expectations. This level is slightly lower than the first quarter and down from the prior year. Recurring ARPU increased to €409 in the quarter. But looking forward, I fully expect that recurring ARPUs will decrease in the second half given the increased impact to foreign currency and also as new installations kick in.

Turning to costs. Cost of sales was €39.6 million in the second quarter, up 5% from the second quarter of last year and up 1% from the prior quarter. Gross profit was €64.4 million, an increase of 2% sequentially and 11% year-over-year, with gross profit margins at 61.9%, improving 140 basis points year-on-year and 30 basis points sequentially. There was a strong margin performance in the quarter, benefiting from the operating leverage of our business model, coupled with continued efficiencies in our data center operations.

Sales and marketing costs were €7.3 million in the first quarter of 2016. In the second quarter of 2016, an increase of 1% year-over-year and a decrease of 6% sequentially, which is primarily timing related. We expect to continue to invest in our strategic marketing organization, as we further develop and expand our communities of interest. Sales and marketing spend this quarter at 7% of revenue is at the low end but still within our expected range this year of between 7% and 8% of revenue. Other general and administration costs were €9.7 million, up 14% year-over-year and 5% sequentially. Overall, other G&A costs were at 9.4% of revenue, slightly higher than expected due to timing differences on professional fees.

Adjusted EBITDA was €47.3 million, an increase of 13% year-over-year and 3% higher sequentially. Adjusted EBITDA margin increased to 45.5% in the second quarter of 2016, 150 basis point improvement over the same period of last year and a 50 basis point increase from the first quarter. With a strong increase in adjusted EBITDA this quarter, Interxion has continued its long track record of profitable financial execution.

Depreciation, amortization, and impairment expense was €22 million, an increase of 12% year-over-year and 3% sequentially, consistent with the increase in depreciable asset base driven by our investments in data center expansion. The second quarter net finance expense was €10.1 million, 28% higher than last year's second quarter and 28% higher sequentially. The year-over-year and sequential increases were primarily due to the payment of interest on the additional bond issue early in the quarter.

The second quarter income tax charge was €4.2 million, which represents an effective tax rate of 32%. On an LTM basis, the cash tax rate was approximately 18%, which shows an increase on the prior quarter. As we look forward, we would expect our cash tax rate for the full year 2016 to be at around 18% to 20%. And over the next few years, we expect our LTM cash tax rate to continue to trend towards the effective tax rate levels.

Adjusted net profit in the quarter was €9 million compared to €8.3 million in the same quarter last year and €10 million in the first quarter, with a sequential decline, due to the additional interest as a result of the bond tap. Adjusted diluted earnings per share was €0.13 compared to €0.12 in the second quarter last year and €0.14 in the first quarter. The adjusted net profit and adjusted earnings per share calculations are affected by the impact of M&A transaction items in 2015, capitalized interest and the tax effect of these items. We've provided a full reconciliation of these puts and takes in the appendix to the presentation.

Now, let's take a closer look by reporting segment. Please turn to slide 11. The momentum in our largest geographic reporting segment continued, as revenue in the Big 4 was €66.4 million, up 10% year-over-year and 1% sequentially. The Big 4 accounted for approximately 64% of the company's quarterly total. On a constant currency basis, we saw strong recurring revenue growth in our Big 4 markets of 13% year-over-year and 3% sequentially. Germany, both Frankfurt and Düsseldorf, continue to shine with the Netherlands and France particularly, Marseille, also making strong contributions this quarter. Adjusted EBITDA in the Big 4 was €37 million, with strong margins at 55.8%, higher than both the second quarter last year and sequentially.

Revenue in the Rest of Europe segment was €37.6 million, up 7% year-over-year and 3% sequentially. On a constant currency basis, recurring revenue growth was 9% year-over-year and 2% sequentially. Adjusted EBITDA at €21.6 million was up 12% year-over-year and flat sequentially, with margins of 57.3%; up year-over-year and down sequentially, impacted by a higher proportion of lower-margin non-recurring revenue in the quarter.

Our Rest of Europe segment also enjoyed another solid quarter performance with Austria, Denmark and Sweden, all performing well in the quarter. This segment continue to report outstanding margins, reflecting our leading position in most of these markets. Our Rest of Europe segment is very well-positioned to capture future demand, particularly as cloud expands in further ways across Europe.

Moving to slide 12, let's discuss our capital expenditures. Capital expenditures, including intangibles totaled €62.6 million during the second quarter, of which the vast majority, €56.3 million, was discretionary investments in expansion and upgrades to meet customer requirements. Our approach has not changed. We continue to be disciplined in the deployment of capital and allocate it based on customer demand. It should be no surprise therefore that the majority of our investment is currently focused on the Big 4, with nearly 70% of our total capital expenditure in the quarter being invested in our Big 4 markets.

We've seen an increase in the momentum of our quarterly CapEx over the last four years, and this is driven by demand across multiple markets and the corresponding build activity to support this demand. It's worth reiterating that we are not building anything speculatively. For example, as David already mentioned, our last expansion of Copenhagen 2 is fully pre-sold with precisely the type of local customer partnership that we seek to nurture in our community. Capital expenditures for Copenhagen 2.2 are included within our capital guidance for 2016, and which remains at €200 million to €220 million. Our consistent utilization rates speaks to our ability to closely match our supply with projected customer demand market-by-market. And more than half of our 2016 expansion CapEx is being spent in support of customer requirements.

Please turn to slide 13. Interxion ended the quarter with €193.5 million in cash and cash equivalents, up from €44.6 million at the end of the first quarter. Cash generated from operations in the quarter totaled €39.3 million. We invested €62.6 million in capital expenditure and paid €3.5 million in cash interest and taxes. As reported in the last earnings call, in April, the company raised €155 million in net proceeds from a bond tap of our existing senior notes maturing in 2020. The bonds were issued at 104.5%, providing an implicit interest rate for the new money at approximately 4.8%. In addition, we also obtained a mortgage on our Vienna campus that we purchased a year ago, with mortgage loan proceeds of approximately €15 million, and it entered into an €18 million finance lease for our Amsterdam 8 data center.

Balance sheet ratios again remained strong, with gross leverage at 4.0 times LTM adjusted EBITDA, and net leverage at 3.0 times. Cash ROGIC or cash return on gross invested capital is 11%. Our blended cost of debt at the end of the second quarter was 5.8%. With the cash on hand, the strong cash generation of our data center assets and access to the €100 million revolving credit facility, we continue to have the financial flexibility to fund and funding to execute our expansion program and to secure long-term sustainable returns.

Please, turn to slide 14. Now, this slide is familiar to most of you, and it shows the returns from our 30 fully built-out data centers. This group consists of 30 data centers and 70,500 square meters of equipped space at 82% utilization. These fully built-out data centers delivered €312 million of revenue in the last 12 months, growing 6% year-over-year. Revenue growth came from price escalators, as well as increased energy and power, and of course, cross connects. These fully built-out data centers also delivered 66% gross profit margins and generated nearly €200 million in discretionary cash flow to the business.

The 24% annual cash return that we're achieving on these investments, evidences the strong underlying operating leverage and prudent capital allocation, which is driving attractive, and we think, industry-leading returns from our data center assets. This quarter, we delivered our 39th consecutive quarter of sequential organic growth in both revenue and adjusted EBITDA. That's nearly 10 years uninterrupted history of consistent financial execution. Our approach remains focused to secure long-term and attractive cash returns in a disciplined and measured manner.

And now, with that, I'd like to return the call back to David.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

Thank you, Josh. Please turn to slide 16. In previous calls, we talked about the pattern of cloud adoption and the time lag between U.S. and Europe. As adoption continues to unfold on both sides of the Atlantic, we are learning more about the similarities and the differences between the two. And we continually refined our views for adoption in Europe, as a consequence. It's important to look separately at the trends for the magnets i.e. the cloud platforms, and the drones i.e. the enterprises and their enablers, because the former almost entirely coming from the United States, while the latter will consist of a mix of global enterprises and smaller local players in Europe.

Let's start by looking at the magnets. Large cloud providers are in the midst of a global, multi-wave cloud rollout that increasingly relies on third-party data center providers for a couple of reasons. The first reason is the fact that the topology of cloud deployments is becoming more distributed with each new wave of the rollout, as a larger percent of the capacities, push closer to the end users. This is the move-to-the-edge trend that we have spoken about on prior calls. While being a global trend, the move-to-the-edge is more pronounced in Europe because of the national boundaries, language differences and data sovereignty regulations are additional considerations favoring a distributed architecture, which is likely to result in more spread out and smaller compute nodes in Europe than in the United States.

The second driver is time-to-market for cloud providers. As cloud adoption grows globally, meeting end-user demand in a timely fashion is critical to gaining a competitive advantage. The expansions in the third-party data centers enables the providers to meet early demand in high-quality and highly connected facilities, while relying on specialized providers to build and equip the required capacity in a timely fashion. This is particularly true in a distributed topology. While the time-to-market consideration applies globally, we're seeing signs that the political and economic uncertainty in Europe may create an additional motivation for cloud providers to partner with data center providers to timely procure the required capacity in specific countries.

Carrier-neutral data centers have always been the obvious choice for the network nodes of the cloud providers as density of connectivity is the main selection criteria. For compute nodes, proximity to the main Internet hubs wasn't a primary concern in the early days, but is now becoming a consideration in response to the performance requirements of specific workloads that are migrating to the cloud. As a result, cloud providers are often seeking to contract for compute nodes and network nodes at the same time, which enhances the value for the proposition of highly connected data centers.

Now, if we look at the enterprise side of the equation, those who are drawn to the magnets, we are looking at a totally truly different set of considerations, because the demand will come from a mix of global and local customers. The portion of the demand coming from global enterprises, with a presence in Europe, will probably be amongst the earliest, in terms of enterprise deployments. These early adopters are likely to be large American corporations that have sizeable IT budgets and have already deployed in the United States. Therefore, we closely monitor the enterprise market in the U.S. to gain early insights on how the data center architecture for hybrid cloud is panning out.

When it comes specifically to European enterprise drones, we base our views on our experience and how enterprises adopt new technology in Europe, as well as economic forecast for the various countries, in which we operate. Europeans, generally, have a more considerate and thorough approach in new technology adoption than the Americans. A new project typically suggests of a comprehensive business case, with a detailed analysis of the expected return on investment, as well as a careful consideration of all the pros and cons, major risk factors and risk-mitigating strategies. Cloud adoption makes no exception to these patterns, and cloud adoption is actually scrutinized even more because of its significant impact on IT within enterprises. There are, of course, regional variations, because corporate cultures differ by country and European IT departments are generally more process-oriented.

Within Europe, the UK, the Netherlands and the Nordics have a more similar approach to U.S., and it's no coincidence that these three regions lead the way in cloud adoption in Europe, but they're still relatively cautious compared to the American organizations. For all of these reasons and more, European enterprises are taking more measured approach to cloud and are relying more heavily on technology partners, such as managed service providers and systems integrators to help them with this migration. This requires a different approach to market-making than that what we're seeing elsewhere.

In Europe, we are seeing more success in working with those who enable enterprises to migrate to the cloud. In particular, the local managed service providers are those playing a critical role in shaping access to the cloud, because they're providing the average enterprise with a Point of Presence and close proximity to the cloud on ramps, without requiring extension of their own enterprise network. They're effectively acting as demand aggregators for the first phase of colocation adoption for cloud access by enterprises. These players typically specialize in providing access to one or more cloud platforms and are focused on one country or one region, as an example, the Nordics, and we're having very good traction with them, thanks to our partnership with cloud providers and our granular go-to-market model at the country level.

Larger systems integrators are working with enterprises in broader digital transformation initiatives, of which hybrid cloud is a critical component, and will pave the way to a more thorough architecting of enterprising networks. This represents the next wave of joint opportunities for us, which we will deliver larger deployments but will take a bit longer to materialize. Once these initiatives gain traction, we expect enterprises in Europe to become more autonomous in managing their own cloud architectures, in line with what's happening with their larger counterparts in United States. This is the aspect of the adoption that we will have the largest lag between U.S. and Europe because of the size and risk aversion gap.

So, please turn to slide 17. In this context, our strategy remains consistent as we focus on the three phases that will create the communities of interest and maximize the return on the invested capital. One, capture the platforms with the highest magnetic potential; two, create a community of interest with MSPs and systems integrators; three, expand the community of interest with direct enterprise deployments. As discussed throughout this section, the first phase is rapidly ramping up in Europe, with a life of about two years to the U.S. The second phase is particularly relevant to Europe and will possibly happen faster here than in the U.S. The third phase lies further behind in Europe than in U.S., and will continue to monitor both adoption in the U.S., and know-how deployment in Europe in order to estimate the ramp up more accurately.

Based on the available market data, we estimate that current cloud adoption is almost three times larger in the United States than it is currently in Europe, and it is growing at roughly twice the pace in the United States. On the other hand, historical patterns of IT spend indicate that the total demand in Europe will eventually be approximately two-thirds of the U.S. demand, which leads to a promising long-term outlook for our industry in Europe. Since the cloud adoption is more gradual in Europe, growth comes at a more moderate pace, and each way, it tends to last longer.

The other important consideration in studying the European market is the fragmented nature of the economic landscape. Different parts of Europe are growing at different rates, and one can establish a very direct correlation between economic growth and the pace of new technological adoption, which leads to staggered ways of adoption across Europe. Higher growth countries are also those, where CIOs are more inclined to use third-party providers to mitigate the risks associated with economic uncertainty, rather than reducing their IT investments, which gives us some degree of confidence that Brexit may represent a potential upside for our industry. As we continue to gain deeper knowledge of how the migration to hybrid cloud is happening, we are increasingly confident we are building the right assets, we are targeting the right customers in the right locations to gain market share in Europe and drive very healthy returns to our investors.

Please turn to slide 18. Today, we are reaffirming our previously announced full year financial guidance for revenue, adjusted EBITDA and capital expenditures. To be specific, for the full year 2016, we're expecting revenue to be in the range of €416 million to €431 million, we expect adjusted EBITDA to be in the range of €185 million to €195 million, and we expect to invest between €200 million and €220 million in capital expenditures this year.

Before we turn the call over to Q&A, I would again like to thank all of our employees in all of our countries for remaining focused on our customers, for executing against our business plan, and for continuing to deliver strong results. I would also like to thank our shareholders and bondholders for their continued support of interaction.

Now, let me hand the call back to the operator to begin the question-and-answer segment. Operator, can you please read out the instructions to register questions for the call?

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] The first question comes from the line of Michael Rollins. Please ask your question.

Michael I. Rollins
Citigroup Global Markets, Inc. (Broker)

Q

Thanks, and good morning. In the past, you've mentioned, I think, a few times how much capacity was pre-sold when you would turn up the facilities or the expansion. Can you give us an update on that? And then more broadly, on the backlog that we're seeing for future business? Thank you.

Josh Joshi
Chief Financial Officer

A

Hi, Mike, it's Josh. Thanks for the question. As we build based on the demand that we see – and one of the things that I said in our prepared remarks was that the CapEx that we are deploying in 2016, that's about greater than 50% supported by customer commitments. And so that's, I think, a very strong position that we had last quarter, and we continue to have this quarter.

Michael I. Rollins
Citigroup Global Markets, Inc. (Broker)

Q

And then if you could you give us some thoughts strategically on [indiscernible] (36:15) that you see for a global footprint and your interest in participating in that type of opportunity? Thank you.

Josh Joshi
Chief Financial Officer

A

All right. We've been relatively specific about this in the past, and nothing has really changed. And, again, a global platform certainly would bring us certain advantages, but as we'd indicated time and time again, our current footprint is not constraining our growth or our future at the present time.

Michael I. Rollins
Citigroup Global Markets, Inc. (Broker)

Q

Thanks very much.

Operator: Thank you. Your next question comes from the line of Colby Synesael. Please ask your question.

Colby Synesael
Cowen and Company

Q

Great. Thank you. Well, I was hoping you can give us an update on cross connects, the percentage of revenue they represent today, maybe how many you have to the extent you can provide that, and also your thoughts on potentially looking to monetize the base opposed to just charging for new cross connects. And then also, you mentioned in Copenhagen. I believe, it was Copenhagen that you've pre-leased 600 square meters. Was that all to one customer, or was that across a pretty diverse group? And I guess, what I'm getting at there is, are you seeing a greater opportunity to provide, for the lack of better description, wholesale-like solutions? And do you see that as a growing opportunity in the European market, considering there's really not a lot of wholesale providers with scalps, if you will, across the European landscape? Thanks.

Michael I. Rollins
Citigroup Global Markets, Inc. (Broker)

Q

Thanks, Colby. I'll – let me take the cross-connect question, then I'll hand over to David. Percentage of cross connects in terms of recurring cross-connect revenue to total revenue is around 3% in the quarter. I think, that continues to grow within our business. As we've talked about before, it's going to take us a couple of years, maybe longer to fully ramp up, as we're progressing on half way going forward in terms of new recurring cross connects coming online as well as going back, and looking at our existing base, which we haven't fully started yet. I think, as you look forward over the next past two years, perhaps a little bit longer, I'd expect, as a percentage of revenue, cross connects to trend up towards something like 5% over that time scale.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

As far as the question of wholesale, I don't want to get into a name-calling conversation. Yes, it is for one customer, but that customer, who is a systems integrator, who's supporting a bank, came to us not because we're providing space and power, but because we're providing connectivity, our already established community of interest. And many of the partners that the bank is looking for are our customers as well. So, the margins were quite good, and it allowed us to continue developing our relationship with a multinational systems integrator. We got the right customer, we got the right margins, and they came to us for the right reason.

Colby Synesael
Cowen and Company

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Matthew Heinz. Please, ask your question.

Matthew Heinz
Stifel, Nicolaus & Co., Inc.

Q

Thanks. Good morning. David, I appreciate the detailed breakdown you've provided on the European cloud landscape. That was very helpful. I was particularly interested in the piece about U.S enterprise coming over to Europe to expand their reach. I guess, I've always thought of that as a hard to reach area or bookings channel for Interxion, given your lack of U.S presence. But could you talk about the kind of RFP activity from, I guess, the multinational U.S. enterprise that's moving abroad?

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

Yes. And I'm going to let – I'm going to hand this over quickly to Giuliano. But keep in mind, although we don't have a presence in the United States, where we provide service, we do have a strong partner base, one of which got acquired, but one of which is a very – is doing quite well. And there are a number of agents and reps that support them and ourselves as well. So, we certainly don't have access as if we had for providing services, so – but we have been very active in the last couple of years, developed relationships with people that can help us bring these type of customers. Giuliano?

Giuliano di Vitantonio
Chief Marketing & Strategy Officer

A

Yeah. I'll just echo that. So, American enterprise are becoming more and more like cloud providers. They are looking for partners in Europe, and we are becoming increasingly visible to them through our channels in U.S. So it's a [indiscernible] (41:23)

Matthew Heinz
Stifel, Nicolaus & Co., Inc.

Q

Okay. Thank you. And then as a follow-on to Colby's question on interconnection, I was hoping you could provide some context on the trends in some of your more mature and high-density markets. I guess, what sort of growth you're seeing in the number of cross connects at a Frankfurt or an AMS campus? And whether that is still kind of mostly cloud to carrier, or are you seeing more MSP enterprise to cloud connections at this point?

Giuliano di Vitantonio
Chief Marketing & Strategy Officer

A

So, typically in the past year, across the board, we've seen an increase of 50% of cross connect that we sell on a recurring revenue basis. And that we've seen a big uptake by digital media companies, primarily, enterprise as well, but digital media company and cloud provider connecting to the connectivity provider. That's the biggest driver of growth for cloud cross-connect.

Matthew Heinz
Stifel, Nicolaus & Co., Inc.

Q

Okay. I just want to make sure, I heard that right, 50%.

Giuliano di Vitantonio
Chief Marketing & Strategy Officer

A

Yes.

Matthew Heinz
Stifel, Nicolaus & Co., Inc.

Q

Growth in cross connects? Okay. Thank you very much.

Operator: Thank you. Your next question comes from the line of James Breen. Please ask your question.

Jim D. Breen
William Blair & Co. LLC

Q

Thanks for taking the question. Just a couple. I guess, first, for Josh. Can you just talk about some of the puts and takes? You've mentioned ARPU coming down a little bit in the back half because of deployment. Can you just talk about that relative to the deployment and the FX impact, and then how you think about utilization around that as well? And then more strategically, signing up a single customer for a large base in the U.S. market, we're always concerned that, that customer gets large enough and then builds their own facility. Maybe, Dave, can you talk about some of the restrictions, or because of the dynamics of the European market, why you feel like that's not as likely a scenario there, as it would be in the U.S.? Thanks.

Josh Joshi
Chief Financial Officer

A

Thanks, Jim. This is Josh. I'll go on the ARPU question first and hand over to David. As I said on the call, it was up to – at around €409. I expect it to go down in the remainder of the year. We're not going to specifics. Probably there are two components to that. Foreign exchange is one, and obviously, the expansions, the sort of usual dilutions that we've talked about on many occasions before on new installations. And so, both of those will have an impact on our offers in the second half of the year. David?

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

In terms of your second question, and I'd be too philosophical here, but basically, you have to look at why people come to us. What application do they bring to us, what benefit do we provide? And so, we tried to give you some indication of that, that the applications don't look at them whether they're big, small, whatever, what size, it's the applications they bring to us, because of time to market, our position, our connectivity, our communities of interest. And some of these can be small edge nodes. And as we indicated, some of these can be compute nodes.

And we feel comfortable about this, because not only have we maintained the reason why they come to us, but it enhances itself, as we continue to build these communities. And they are beginning to recognize this by providing us with long-term contracts. So, we are not – as long as we continue to do what we have done for the last couple of years, which is understand what their go-to-market strategy is, augmented with our go-to-market strategy and build the resources that they would have a difficult time doing, because they are not neutral. They will come to us and stay with us.

Jim D. Breen
William Blair & Co. LLC

Q

Great. Thanks.

Operator: Thank you. Your next question comes from the line of Frank Louthan. Please ask your question.

Frank Garreth Louthan
Raymond James & Associates, Inc.

Q

Great. Thank you. Talk to us a little bit about construction cost for the 12 months. Are you seeing any better – any improvement there that are possibly helping yields? And then, how long before we should see in the Marseille property and the activity going on there become a more meaningful contributor to revenue? Talk to us about your prospects there?

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

The construction cost for the last year have been pretty much stable, neither up nor down. As we get larger, we do get better economies of scale, but those are relatively marginal. As far as Marseille, we're moving as fast as we possibly can. It was interesting. The world knew that these two carriers we're going to land there. The world had a pretty good indication that they were going to exclusively land with us. But until the boat showed up and the cables were put online, nobody really did anything. So, that seems to be the nature of wait and see.

But, since then, the momentum has picked up substantially. And I don't know what meaningful contribution in terms of number you have in mind, but one of the benefits that we've seen, which is very difficult for us to notate and to explain is that our consequence of this has brought us carriers that – in Marseille, that are also now looking to pop with us elsewhere not only carriers, but enhanced capability. So, it's had a – not only impact in Marseille, but it's had a radiation impact throughout some of our other campuses. So, to us, it's quite material already.

Frank Garreth Louthan
Raymond James & Associates, Inc.

Q

Okay. Great. Thank you very much.

Operator: Thank you. Your next question comes from the line of Timothy Horan. Please ask your question.

Timothy Horan
Oppenheimer & Co., Inc. (Broker)

Q

Thank you. Dave, not to put words in your mouth, but we are seeing the top kind of cloud providers. Their CapEx has been pretty strong, kind of accelerating on this last year, if you looked at top six or so. When we look at your slide 17, are you kind of saying that you're seeing a kind of more growth and maybe more demand out of those top kind of cloud providers as Phase 1 takes a little bit longer to implement? Or I guess, we're seeing in a lot of the data center providers in the U.S. seeing a lot of that demand. Maybe just talk about what you are seeing from the top six guys? And it does sound like on Phase 2, maybe that adoption is getting pushed out a little bit from what you were thinking, maybe 18 months to two years ago?

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

Okay. I think, we all know that if you look at B2B and B2C, there's probably 20 guys around the world who are spending a lot of capital. I think what we're trying to indicate is that the waves in the United States may have a different contour than they do in Europe. They may be shorter on duration, higher in peak to trough. Europe is more moderate, and so, we're not – from what I can tell, from what I read in the press, and what you analysts write, we're not seeing the distorted quarterly bumps that we see in United States. We're seeing a methodical, moderate approach to rolling out the capital. It is taking place in more countries, as they move the compute nodes to the edge to match where the gross domestic product is for various reasons, data sovereignty, being one of them. It's just a more moderate approach. I don't believe that the cycles are elongated anymore. It's just the contour of the approach is different.

Timothy Horan
Oppenheimer & Co., Inc. (Broker)

Q

Great. And just a quick question on – given all the changes and ownership of data centers in Europe with Equinix and Digital Realty, have you seen Equinix change there, or have you seen any change of competitive dynamics? Is Equinix now starting to more aggressively charge for cross connects or increased prices, or come up with new services? Or any color on that would be great.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

Okay. It's relatively early in the game. Remember, they acquired the asset in January. And there was another acquisition asset last month. It's relatively early, but we have really seen no material change in the behavior of either of those, nor did we expect it. And the flip side of that is we have competed with these assets for years, and we do not believe that the change in ownership of these assets materially significantly changes to competitor dynamics or value of those assets.

Timothy Horan
Oppenheimer & Co., Inc. (Broker)

Q

Thank you.

Operator: Thank you. Your next question comes from the line of Jonathan Atkin. Please ask your question.

Jonathan Atkin
RBC Capital Markets LLC

Q

Yeah. So, the new versus existing mix, the 90-10. You talked about 60 new customers. And I wondered if you could shed any light on – of those new logos, which regions, which verticals any different profile there than in your existing base? And then the second question was around the cloud growth that you're seeing and the incremental cloud absorption within your footprint. I just wondered is that taking place more in the Big 4, or the bigger getting bigger, or is it taking place more in the Rest of Europe?

Giuliano di Vitantonio
Chief Marketing & Strategy Officer

A

Okay. This is Giuliano. When it comes to the new customers, we've seen logos across all geographies and all segments, pretty evenly spread. When it comes to cloud, we're seeing two things. In terms of the network nodes that originally were just in the Big 4, we're now seeing the network nodes being cascaded to the smaller countries – the second-tier countries, which is typically a prelude to the compute node economy. And in fact, for now, the compute nodes are mainly in the Big 4, but becoming a bit more distributed. And so, we expect that with the next wave, we will see the compute nodes as well in Tier 2 countries. So, if you want this wave expand with network first, followed by compute, and right now, at this specific point in time, is a rollout of network nodes in Tier 2 and additional nodes in Tier 1, Big 4.

Jonathan Atkin
RBC Capital Markets LLC

Q

And then maybe, for Josh. On slide 11, with the EBITA trends in Rest of the Europe, you talked about some of the factors affecting the margin compression. But the absolute amount of the increase was also a little bit muted. And I wondered what some of the factors were there?

Josh Joshi
Chief Financial Officer

A

If you look at the way margins developed in Rest of Europe, we had a couple of things going on. One, we had a strong non-recurring revenue quarter, Jon, and so that depressed the margins because some of those components in non-recurring revenue were low margin. And then, some of the other puts and takes on timing differences in the costs came through and impacted the numbers in terms of the sequential growth. But as I said, in my prepared remarks, I think, if you look at that business, you look at the adjusted EBITDA margin at 57%. That's a very strong margin and reflective of the other long-term potential of that business.

Jonathan Atkin
RBC Capital Markets LLC

Q

Great. Thanks very much.

Operator: Thank you. Your next question comes from the line of Michael Bowen. Please ask your question.

Michael Bowen
Pacific Crest

Q

Okay. Thanks for taking the question. A couple, if I may. I'm sorry if I missed this, but with regard to energy and power, can you just address how that has been trending this quarter? And then secondly, question for you, Dave. I think a couple of quarters ago you had mentioned, one of the constraining factors, which is pretty obvious is that there's some global business that you just can't bid against – or bid for rather. And you had mentioned in one of the earlier answers to a question that – while that was not constraining your ability to grow, can you maybe give us a little bit of an idea as to maybe what that growth possibly could look like if you did have a wider global platform at this point? Thanks.

Josh Joshi
Chief Financial Officer

A

Let me take the energy discussion first, and then I'll come back to David on the other point. As you looked at the energy growth in the business, one of the things that we've seen is an increase absolutely in the consumption of energy by our customers. Obviously, on a per square meter basis in the second quarter, it was slightly lower. But the other thing that was really important was the improvements that we've been continually making in the operational efficiency, particularly the energy efficiency, the way that we run our data centers. And I think that, that showed up in our gross profit margins. And so, we've seen continued improvement in energy consumption from our customers. That's what we would have expected. And it contributed to our top line growth and our revenue per square meter growth. But it also contributed to our margin improvement as well in terms of the energy efficiency.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

And as far as the second half of your question, I know, I'm giving to pontification and lecturing, but that's a question that's speculative in nature. And I think the fundamental issue there of what we could be is really dependent upon the size and footprint of what would support that. And so, I think, you realize that there are too many variables there.

Michael Bowen
Pacific Crest

Q

Okay. Thank you.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

Yup.

Operator: Thank you. Your next question comes from the line of Milan Radia. Please ask your question.

Milan Radia
Jefferies International Ltd.

Q

Great. Thanks very much. Just a question on the submarine termination endpoints, how will they address resilience? So, will they have primary and secondary termination locations other than yours, or what is the kind of general kind of approach that the two cables are taking? And then second question was around the economics of that? I mean, clearly, it's very lucrative for you guys to have those termination points in your data centers. Who's paying who, ultimately, for that kind of termination agreement? Thank you.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

Okay. Milan, keep in mind that many times, when the submarine cables land – they land in a manhole, which is not replicated, and then they go to a power station that has the terminating equipment, which is not replicated, we just have to be fortunate enough to have the terminating equipment, not only in our data center, as well as the data processing equipment to support that. So, many of them have looked at this and are looking at their resiliency in terms of having of access to other cables not replicating the – or replicating a termination point. Okay?

Milan Radia
Jefferies International Ltd.

Q

Got it.

David C. Ruberg
Vice Chairman, President & Chief Executive Officer

A

And as far as who pays who, that's between the consortium members, and the consortium members, and ourselves.

Milan Radia
Jefferies International Ltd.

Q

Fair enough. Thanks very much.

Operator: Thank you. There are no further questions at this time. Please continue.

Jim Huseby
Vice President-Investor Relations

Yes. Well, that concludes our conference call for today. Thank you very much for joining us. We look forward to seeing each of you out on the road once again, and look forward to chatting again in early November for our third quarter results. Thank you very much. This concludes our call.

Operator: Thank you for participating. You may all disconnect.