Final Transcript

InterCall

Contents

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Corporate Participants

David Ruberg

Interxion – Vice Chairman & CEO

Josh Joshi

Interxion – CFO

Jim Huseby

Interxion – Vice President, Investor Relations

Presentation

Operator

Thank you for standing by and welcome to the Interxion Q3 '13 Conference Call. At this time all participants are in a listen-only mode. There will be a presentation followed by a question and answer session at which time, if you wish to ask a question, you will need to press * and 1 on your telephone. I must advise you this conference is being recorded today, Wednesday, 6th November 2013. And I would now like to hand the conference over to your speaker today, Mr Jim Huseby. Please go ahead, sir.

Jim Huseby – *Interxion – Vice President, Investor Relations*

Thank you, Jenny. Hello everyone and welcome to Interxion's Third Quarter 2013 Earnings Conference Call. Today, you'll be hearing from David Ruberg, Interxion's Vice Chairman and CEO and Josh Joshi, the company's CFO. To accompany our prepared remarks we're again providing a slide deck. Those slides are available on the Investor Relations page of our website at investors.interxion.com. We encourage you to download these slides for use during the call, if you've not already done so.

Before we get started I'd like to remind everyone that some of the statements that 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 on 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 these 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. I would also like to remind you that we post important information about Interxion on our website at www.interxion.com. We encourage you to check our website for the most current available information. We also post information on social media sites such as Facebook at facebook.com/interaction and Twitter at @interxion. We encourage you to follow us on these sites, as well. As usual, 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 Ruberg – *Interxion – Vice Chairman & CEO*

Thank you, Jim, and welcome to our third quarter earnings call. Please turn to slide four of the presentation. Interxion produced another quarter of solid growth based on consistent execution of our Communities of Interest marketing strategy. Financial and operating results in the third quarter were consistent with our expectations and saw solid year-over-year improvement. Our revenue growth, all organic, was again in double digits on a consolidated basis, with our recurring revenues growing 16% year-over-year in our Big 4 reporting segment.

In the third quarter, we again demonstrated the operating leverage in our business model, with adjusted EBITDA margins up 230 basis points, which means we again grew adjusted EBITDA faster than revenues. Adjusting other KPIs: sales pipeline, they remained robust; bookings, they were in line with our expectations; pricing, remains consistent with what we have seen in the last few quarters; ARPU, developed in line with our expectations; and churn remains at industry low and was consistent with our historical range of between 0.5% and 0.75% per month on average.

In addition, we completed the refinancing of our debt, which allowed us to significantly reduce our borrowing costs, extend maturities, while providing us with additional financial flexibility. We continue to execute well on the operational front, servicing customer demand from our carrier-rich and cloud-neutral data centres. We opened a small expansion of Vienna early in the third quarter and our other announced construction projects remain on schedule.

During the third quarter, we installed 900 square metres of revenue-generating space, which increased our utilisation rate to 75%. We saw demand from all of our target market segments, with particular strength from cloud platform providers. We believe the outlook for our industry, the European carrier-neutral colocation industry, remains healthy and that Interxion is well-positioned for continued growth and success as we deliver value to our customers and drive shareholder returns from the business. I will come back and address this topic in more detail at the end of our prepared remarks.

Please turn to slide five. Let's take a look at our third quarter financial performance in a little more detail. Revenue for the quarter exceeded €78 million, an increase of 11% from third quarter 2012 and a 2% increase versus second quarter 2013. Recurring revenue was nearly €74 million, which is up 13% year-over-year and 2% sequentially and accounted for 94% of total revenues. Adjusted EBITDA was €33.7 million in the third quarter, growing into 17% year-over-year and 3% sequentially. Adjusted EBITDA margin again expanded, reaching 43.1%, which is a 230 basis point improvement from the third quarter of 2012.

Please turn to slide six. With regard to operational highlights, Interxion ended the third quarter with 79,300 square metres of equipped space, which is up 14% year-over-year. We installed 900 square metres in the quarter, reaching 59,100 square metres of revenue generating space. Utilisation increased to 75% in the quarter, a level consistent with our targets. As an aside, our utilisation rate has been between 70% and 76% every quarter since 2009, even during the rapid organic expansion of equipped space in 2012. We believe that this is indicative of our disciplined expansion approach that matches our builds to customer demand, minimises expansion drag and maximises our risk-adjusted returns.

Please turn to slide seven. Our only scheduled opening for the third quarter was 400 square metres at Vienna 1.4, which came in on time and on budget. Frankfurt remains a strong market for Interxion. Last month, we announced a new 800 square metre data centre called Frankfurt 9, which is scheduled to open in the first quarter of 2014. We also are building out phases one and two of Frankfurt 8, which is a 3,600 square metre facility. Phase one, 900 square metres, is scheduled to open in the first half of 2014 and a second 900 square metres is scheduled to open in the second half. Demand for our services in Frankfurt is not isolated to any one source but rather comes from all of our targeted segments. We see continued strength in the growing Frankfurt campus, Cloud Hub, as our customers deploy cloud infrastructure that delivers a high-quality end-user experience enabled by the right connectivity partners. This, in turn, is facilitating media and financial customer adoption of cloud services. To serve all of this new traffic, carriers continued to add capacity within the data centres to service the growth and to join our Cloud

Hubs, offering cloud and managed services to the communities. We ended the quarter with 81 megawatts of customer available power and a total of 114 megawatts of maximum available power within our current and announced data centres.

Please turn to slide eight. We remain focused on executing against a strategy of building resilient, value-enhancing communities of interest in our data centres. In order to do so, we continue investing in our facilities, training our sales force, adding marketing segment expertise, developing relationships with current potential future magnetic customers and refining our customer service offerings. We believe that our multi-tiered, go-to-market model has the right structure and scale in order to successfully deliver against our strategy. In the third quarter, we further strengthened the communities that we have formed around our magnetic customers in each of our target segments, adding more than 50 new customer logos. We feel that this demonstrates the competitive differentiation of our communities of interest and their potential to become increasingly powerful organic growth engines due to the network effect that develops over time.

Just as in the second quarter, we saw a particularly strong performance in the managed service or cloud providers segment as these customers continue to invest in the infrastructure that will enable enterprises to make the transition to hybrid cloud solutions. End customer adoption of hybrid cloud solutions, benefiting from what we have called access to on and off ramps to the cloud, continue at a rate consistent with what we saw in the previous quarter. We are now also seeing the expertise, the tools and the process and procedures being developed and deployed to help customers more easily move to the cloud. As we look into 2014, which appears will bring a better economic environment, we expect that this migration will continue to be a source of sustained, long-term demand across all of our targeted segments. I'd now like to turn the call over to Josh.

Josh Joshi – *Interxion – CFO*

Thank you, David, and welcome to everybody on the phone and online. As usual, I'd like to start by discussing the group results, follow that with some additional colour on our two geographic reporting segments. I'll then discuss our capital expenditures and review the balance sheet. I will also spend a few minutes providing some insight on ARPU development. Please turn to slide ten. Once again, Interxion experienced continued quarterly growth through solid execution. We saw sequential growth in total revenue, recurring revenue and adjusted EBITDA, with expanding adjusted EBITDA margins due to the operating leverage of our business model. During the quarter, recurring ARPUs grew modestly from the second quarter as did our utilisation. Total revenue in the third quarter was €78.1 million, up 11% organically, compared to the third quarter 2012 and up 2% sequentially. On a constant currency basis, total revenue was up 12% on a year-over-year basis, while currency had no impact sequentially. Recurring revenue in the third quarter remained at 94% of total at €73.7 million, a 13% year-over-year increase and 2% sequential increase. On a constant currency basis, recurring revenue was up 15% year-over-year and 2% sequentially. Non-recurring revenue was €4.3 million in the third quarter, slightly ahead of our typical quarterly range, though down 18% from last year's record third quarter.

Churn in the quarter was consistent with our historical range of between 0.5% and 0.75% a month on average. Our recurring monthly ARPUs were modestly higher sequentially, in line with our expectations, due mostly to the expected increases in power and energy, offset a little by some geographic dilution. I'll talk a little more about the drivers for ARPU development in a few minutes. Cost of sales was well controlled in the third quarter, despite the seasonal power cost increase that we usually experience during this quarter. Cost of sales was €31.9 million, up 8% over the third quarter last year and 2% higher than the second quarter of 2013.

Gross profit was €46.2 million, an increase of 13% year-over-year and 2% sequentially, with gross margins at 59.2%, up 90 basis points from the third quarter last year. Sales and marketing costs remain at about €5.5 million for the fourth consecutive quarter. We're able to allocate these costs over a rising revenue base, resulting in the cost ratio being at the bottom of the 7% to 8% of revenue range that we've spoken about previously. Other G&A costs were essentially flat sequentially at just under €7.1 million and down 2% year-over-year. Adjusted EBITDA was €33.7 million, an increase of 17% year-over-year and 3% sequentially. Adjusted EBITDA margin, at 43.1% in the third quarter, was up a strong 230 basis points year-over-year and 30 basis points sequentially.

Moving to slide 11. Depreciation and amortisation was €15.2 million, a 38% increase year-over-year and a 2% sequential increase. As I noted last quarter, the year-over-year increase in these non-cash expenses relates to our new facilities that became operational over the past year and is consistent with the increase in the gross cost of data centre assets held on the balance sheet. As we previewed last quarter, the €38.1 million finance cost includes a €31 million of onetime costs incurred as a result of the refinancing completed on 3rd July this year. Excluding these one-off costs, finance expense was €7.1 million in the third quarter, which was an increase year-over-year. This reflects the significant capitalised borrowing costs booked during the data centre construction in last year's third quarter, in line with our IFRS requirements.

In the third quarter we reported a €4.1 million tax credit which was caused by the one-off refinancing costs incurred in the quarter. Without these costs, the effective book tax rate for the third quarter would have been 30%. On the same basis, the LTM cash tax rate was 15%. Since the beginning of 2012, our LTM cash tax rate has been slowly but steadily creeping up and as we've highlighted on previous calls, all things being equal, we expect this trend to continue over the next two years or so as we utilise our tax yield.

Net loss was €16.5 million in the third quarter 2013 compared with a net profit of €8.6 million in the third quarter of 2012 and a net profit of €6.6 million in the second quarter of 2013. The one-off refinancing costs of €31 million, after taking into account the tax impact, have turned the quarter into a loss. Loss per share was €0.24 on 69.5 million diluted shares. The underlying earnings per share, adjusting for these one-time effects, was plus €0.10 compared to €0.10 in the third quarter last year and €0.09 last quarter, on the same basis. We've provided a chart in the appendix to the presentation which sets out a number of the moving parts for you.

Let's take a closer look by geography. Please turn to slide 12. In the Big 4, total revenues grew 11% year-over-year, 13% on constant currency basis and 1% sequentially, while adjusted EBITDA grew 19% year-over-year and 2% sequentially as margins continue to expand. Adjusted EBITDA margin reached 54.5%, up another 50 basis points in the quarter and 330 basis points year-over-year. Revenues for the Big 4 represents 62% of the company's total, in line with what we've seen over the past several quarters. Recurring revenue in the Big 4 continue to show strong growth, up 16% year-over-year, up 18% at constant currency. We experienced strong margin growth in the Big 4 over the past year with over two-thirds of the incremental revenue flowing through to adjusted EBITDA. We generated this growth over a period where we also opened three new data centres in a total of 11,500 square metres of equipped space.

Revenue in the Rest of Europe segment was €29.3 million, up 10% year-over-year and a strong 4% sequentially. Recurring revenue growth was 9% year-over-year, 10% on a constant currency basis, while non-recurring revenue grew by 19%. Adjusted EBITDA was €14.9 million, with margins of 51% impacted slightly by the revenue mix as a result of higher levels of lower-margin non-recurring revenue. Levels of activity in the rest of Europe segment vary across markets, with Stockholm again showing strength. As David mentioned earlier, we completed the Vienna expansion, adding 400 square metres in that market during the quarter.

Moving to slide 13. Let's discuss our capital expenditures. Capital expenditures, including intangibles, as seen on the left-hand chart, totalled €26.5 million during the third quarter, with €25 million of that devoted to expansion capital and €1.5 million to maintenance and other capex. We continue to invest more heavily in the Big 4 markets, with €17.6 million or two-thirds invested in the Big 4 in the third quarter. Most of the remaining capital expenditures were invested in the Rest of Europe markets. Year-to-date, we've invested over €88 million in capital expenditure. With our two recently announced Frankfurt projects, plus other projects that are in the pre-announcement phase, we expect to accelerate our capital investments for expansion in the fourth quarter, all in support of customer demand, but we will remain within our guidance.

Please turn to slide 14. Before I speak about the balance sheet itself, I'd like to review the refinancing that closed on 3rd July. As we stated on the last few earnings calls, reducing our cost of capital is a key strategic focus for Interxion and we have done that through our debt refinancing. Over the last few quarters, the company has extended debt maturities with about 94% of debt maturing in 2018 or beyond and we've improved our financial flexibility. The bond refinancing was NPV positive, with interest savings of over €5 million annually despite a €65 million or more than 25% increase in principal. As mentioned earlier, the cost to retire the old bonds was approximately €31 million and was all expensed this quarter. This includes a premium on the old bonds of about €26.5 million, together with a non-cash write-off of about €4.5 million of unamortised financing costs relating to the old revolver and bond. Our RCF was expanded to €100 million, bringing down the interest rate and adding additional relationship banks. The RCF, by the way, remains undrawn.

Summarising the movement in actual cash during the quarter, Interxion generated €32 million from operations. We paid €12.6 million in net cash interest and taxes and invested €26.5 million in capital expenditures that I talked about on the prior slide. We raised €31.3 million from financing activities, predominantly from the incremental cash from the refinancing. This left cash and cash equivalents of €84 million at the quarter end. Borrowings at the end of the quarter were €363 million, made up mostly of the 6% notes along with €46 million of mortgages and capital leases. Gross leverage ratios remain low at 2.9 times adjusted EBITDA and net leverage at 2.2 times adjusted EBITDA, both of which ticked down about one-tenth of a turn during the quarter. I'm pleased with our efforts to improve our balance sheet thus far. Our balance sheet provides us with significant financial flexibility, an attractive maturity profile and a decreasing cost of capital.

Let's move to slide 15. The charts on this slide may be familiar to some of you as we discussed something similar on an earnings call last year. As I said a few moments ago, we saw a modest increase of just over €1 in recurring ARPU this quarter. Interxion customers primarily pay us for space, power and energy. These components of revenue develop differently over time depending on the nature of the customer deployments and the development of customer IT workloads. The top chart looks at recurring ARPU for an illustrative customer. Customers initially contract for space and some modest power reservation and then, as their IT workloads increase over time, energy consumption increases as do power reservation fees.

As a result, the recurring ARPU of a customer installation typically starts low and increases over time as the chart illustrates. When you have significant installations and build-outs, as we have had this last year, ARPUs can get diluted. By that, I mean a higher proportion of our revenue generating space is at an earlier stage along the development timeline. The important thing is that we see ARPU grow over time, in particular for space used by high power density customers who end up with a much higher proportion of the green in their ARPU metrics. Now, the lower chart looks at recurring revenue within a data centre and the contribution of the core revenue components over time. What's interesting is that long after a data centre maybe full from a space perspective there will still be a revenue growth opportunity from higher power and energy consumption associated with growth in customer IT workloads.

Now moving to slide 16. I imagine it's a familiar slide by now but I wanted to refer to it again as the company has now delivered 28 quarters or seven full years of sequential, organic revenue and adjusted EBITDA growth, coupled with significant margin expansion. Interxion has an unrivalled track record of successful execution in all kinds of market conditions and is positioning itself to take advantage of the significant profitable growth opportunity still yet ahead of us as we compete and win in our vibrant industry. And with that, I would like to turn the call back over to David.

David Ruberg – *Interxion – Vice Chairman & CEO*

Thank you, Josh. Please turn to slide 18. I'd like to conclude our prepared remarks by sharing my thoughts with you on the situation in the European carrier-neutral colocation industry. I've heard from many of you a number of concerns regarding the industry's prospects given the economic outlook and other factors. I thought I would address those head-on today. I think the carrier-neutral colocation industry is in very good shape, with strong fundamentals to underpin continued growth and profitability. From my perspective, I think about industry's resilience and Interxion's own prospects for that matter, across four main categories as depicted on slide 18: demand drivers, barriers to entry, switching cost and pricing power. And I would like to discuss each one of them.

Demand. Demand is being supported by three different factors. One is IP traffic growth. Well, it has been growing at a decent rate over the last few years and is projected to continue to grow at this rate through 2017. Another factor which impacts demand is general business growth. Our industry growth is dependent upon both general economic conditions and growth in data centre outsourcing. We all know that the European economic performance has been weak for the last four years but is expected to improve starting in 2014. As for the outsourced portion of the data centre space, it is forecast to grow meaningfully in the period 2014 to 2017. And the last factor impacting demand is cloud migration. This is a huge opportunity that businesses are now starting to understand. We are still in the early adopter phase but migration is poised for growth as the early adopters have now demonstrated successes, the barriers to migration are coming down, issues about privacy and security are being dealt with and the provisioning of access to the cloud is improving. Global cloud computing revenue is expected to grow at a 31% CAGR from 2013 to 2016.

Next, barriers to entry. Barriers to entry to the carrier-neutral colocation business are just high as ever, especially in Europe and, by the way, barriers for successful entry are even higher. Even if new entrants can overcome challenges such as funding, location, permitting, planning, energy supply, they still face the toughest barrier of all, developing the products and services attracting the magnets that allow the new entrant to build the communities of interest that the customers seek for the response time sensitive applications for their mission-critical applications. And then you have to develop and retain the people that are needed to meet the expectations of these customers every day. I believe our long history in key markets, high carrier density, operational excellence and well-developed communities of interest represent a sustainable competitive advantage in this regard.

Switching costs: they remain high. Customers develop long-term partnerships with their data centre providers as a key supplier with whom they make substantial investments. Making a switch may mean taking a risk on unproven track record of performance and reliability, loss of access to the right communities of interest, potentially significant cash costs and operational complexity. For the vast majority of our customers it's just not worth the risk to switch, which is proven by our very low churn rates.

Pricing power. Pricing is generally rational in the markets we serve and has been so for some time. We are focused on uniquely adding value to each of our target segments by supporting applications that are response time sensitive and for which connectivity, community and access to cloud platforms is critical. These are mission-critical applications for our customers. As our communities of interest continue to grow, become even more magnetic and add additional value to our customers, we expect our pricing power to be enhanced over time. Based on these factors, I believe that Interxion and the European carrier-neutral colocation industry are well-positioned to continue their track records of growth, strong profitability and increasing cash generation.

Please turn to slide 19. We are again reaffirming our previously announced full year financial guidance and to be specific, for the full year 2013, we're expecting revenue to be in the range of €307 million to €322 million. We expect adjusted EBITDA to be in the range of €130 million to €140 million, and we expect to invest between €130 million and €150 million in capital expenditures this year. I would like to thank again all of our employees and all of our companies for staying focused on our customers and continuing to deliver strong results. With all of the noise in the marketplace today it is even more important that we stay focused. I would also like to thank our shareholders and bondholders for their continued support through these turbulent times. 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 from the call?

Questions and Answers

Operator

Thank you, sir. And as a reminder, if you wish to ask a question, please press * and 1 and telephone and wait for your name to be announced. If you wish to cancel your request, please press the # key. And your first question today comes from Gray Powell from Wells Fargo. Please ask your question.

Gray Powell – *Wells Fargo*

Hi, thanks for taking the questions. I just have a couple. So there was a lot of capacity added in Europe in 2012, obviously. 2013 looks more like a normal year and it appears that 2014 is tracking that way too. How should we think about utilisation rates and the overall pricing environment in your regions over the next 12 months?

David Ruberg – *Interxion – Vice Chairman & CEO*

Good morning. If, in fact, your assertions are correct and we, I believe, concur with that, we would expect that the pricing will firm and we will go back to an opportunity to raise prices in the coming years.

Gray Powell – *Wells Fargo*

Got it. And then you also alluded to the potential of macro recovery and obviously we've seen the organic growth improve in Q3 versus Q2. I'm just wondering, do you see the rest of Europe growing at a similar pace to that of your Big 4 markets at some point over the next few quarters?

David Ruberg – *Interxion – Vice Chairman & CEO*

That's a very good question and that's a question everybody would like an answer to. I can't answer that question. I can tell you that we have begun to see in all of our markets through the eyes of the systems integrator renewed interest and the systems integrators confirm this in terms of their sales pipeline, in even some of the weakest economies, as people are beginning to look to the future and look to the opportunity to take advantage of the benefits of the cloud for them. So how that will play out and what rate, I don't have any better crystal ball than you do but the interest is developing.

Josh Joshi – *Interxion – CFO*

Yes, I'd agree with that, David. And what I would add is that in many of our Rest of Europe markets we are well-positioned to take advantage of that and the opportunities that are there because in many of them, in terms of the carrier-rich and carrier-neutral operators, we're one of the very few people in those markets that have the operational excellence to deliver and so it's a significant opportunity for us going forward.

Gray Powell – *Wells Fargo*

Understood. Thank you very much.

David Ruberg – *Interxion – Vice Chairman & CEO*

You're welcome.

Operator

Sorry, your next question comes from David Barden from the Bank of America. Please ask your question.

David Barden – *Bank of America - Merrill Lynch*

Hey, good morning guys or afternoon. First question, Josh, just on the MRR trajectory, I know we have this conversation a lot these quarters and I know you added that slide. I think that there was a purpose to that which is to say that we might have seen, maybe, just €1 of MRR improvement quarter-over-quarter now but the expectation is that we should kind of see… I think, the implication is that we should see that kind of level of growth or better as we start to evolve up that curve. If you could kind of help shape that conversation a little bit on MRR through fourth quarter and into early next year, that'd be helpful.

The second would be just for a level set to help people understand the difference between power reservation and energy consumption in your model and how you monetise those two things differently. I think it would be helpful to level set on that. And then just the last piece on capital investment, you know, you were saying that you are expecting a step up in unannounced projects. In order to get to the low end it would mean that you do have to have a pretty significant step-up in capex, around €42 million or so. And I just wanted to make sure I just sure that we're kind of definitely on track for that and if we are, should we be anticipating that this is space that's going to be monetisable in Q1 or Q2 or is it more of a back half of 2014 investment? That'd be kind of helpful to understand the next year growth curve. Thanks.

Josh Joshi – *Interxion – CFO*

Okay thanks, David. This is Josh. Three relatively complex questions. I'll try and take each one in turn. Dealing with your MRR or recurring ARPU perspective, I think, you know, it's a good question. I wanted to spend time on the call to cover an important perspective, which is that different customers and different deployments follow different schedules in terms of a customer's deployment of power reservation or energy consumption. And that's a mix in terms of, you know the complexity of their deployments and also the IT workloads that they bring on board. And so looking at each one separately, a customer puts its deployment into our space and deploys square metres and then they will purchase a small amount of power reservation fees and, you know, it would be in kilowatts per square metre. And then as the customers IT workloads increase, their energy consumption increases. And they're two separate components of the invoice.

The power reservation fee is a recurring fee that we charge based on how much power they reserve for themselves, like a cooling reservation. And then the energy consumption is like a regular metered bill, billed in arrears. But the revenue development is that the energy consumption is based on the IT workloads and that will grow as the customer actually uses the data and increases its IT workloads within its computing cabinets. As they get to a certain point, the customer will then come back and probably ask for increased power reservation fees. And we try, we work very closely with our customers as best as we can so that we are ready for them. When they want to increase power and consumer energy, we'll be ready for them and they contract extra with us and then that increases.

But converse, as you will try to look forward and think, well, okay, how are ARPUs going to develop over time, then that's a little bit more difficult because customers will develop that at their own pace, so it'll be slower. I remember a couple of quarters ago David talking about the Swiss business taking four quarters to develop ARPUs. So we've had a €1, there or thereabouts, uplift in recurring ARPUs this quarter. It reflects the modest uplift that we were expecting and for the time being, we continue to expect modest growth in ARPUs.

Looking at your capex question, on the one hand, David, we have reaffirmed our guidance and, you know, we've been averaging around €30 million a quarter. And I think as we go into… as we develop the projects that we've announced plus, as I said, we have some unannounced projects. The incremental spend in the fourth quarter will bring us into the range. And I said on our prepared remarks that we would expect to see a little bit of acceleration as we put these projects and they get into the real build mode. But, as we've announced, a number of these projects are actually setting us up for bringing space on in the first half and in Frankfurt, also, in the second half of next year which is, you know, in support of customer demand. So I spoke quite a lot there but thank you for the questions, David.

David Barden – *Bank of America - Merrill Lynch*

Thanks guys.

Operator

Thank you. And your next question comes from James Breen from William Blair. Please ask your question.

Jim Breen – *William Blair & Company*

Thanks for the taking the question. Just on the Rest of Europe, just wondering if you can talk about, you know, what's the growth there; seems to be continuing to be okay, relative for what was it few quarters ago. What do you think is driving the growth there? And then just anymore colour you can offer on the Frankfurt market. A couple of the competitors made comments again that there shouldn't be increased competition there. Is it more segment based and, you know, do you view your product offering there is different from some of the other data centres? Thanks.

David Ruberg – *Interxion – Vice Chairman & CEO*

Hi, thank you for your questions and the first one, which is on the Rest of Europe. Again, as we tried to indicate on slide 18, the health of the economy really does make a difference and as these economies and peoples… the way they feel about their economies is improving, so is the growth. So again, I tried to point out there are three drivers for the demand. It's been very consistent on one of them, which is the IP traffic growth, but that's like a two-cylinder engine. The economic growth is a four-cylinder engine and as it has begun to improve the growth has picked up there and, yes, you're seeing double-digit growth. So I believe that, that will continue. Right, what was the...

Josh Joshi – *Interxion – CFO*

Frankfurt.

David Ruberg – *Interxion – Vice Chairman & CEO*

Okay. We've been asked this question about Frankfurt many, many times and I can't speak for our competitors or their comments. But keep in mind that Frankfurt is in an economy which is probably the strongest economy – economic growth – in Continental Europe. We have a tremendous situation there that we have developed over time in terms of the communities of interest, the magnetic customers, the connectivity. And so the combination of the health in the economy and the positioning and our approach, our magnetic and our communities of interest approach, is paying off. So, and by the way, to be fair to everybody, having one of your competitors have a problem for one or two quarters does not mean that they will continue to have problems there or it's not a healthy environment. So I can't speak for them. I can only speak for us. It is a very good opportunity for us, not only now but as we look into the future.

Jim Breen – *William Blair & Company*

Thanks, and then just with respect to the Rest of Europe and relative to the Big 4 markets, is there any difference in the types of customers that you're seeing signed up there, whether it's your content providers or enterprises, carriers?

David Ruberg – *Interxion – Vice Chairman & CEO*

Yes. Look, every one of these economies is different, all right? And so it's not where we are today, it's where we're going to be five years or ten years from now, which is why we invest in them. If you look at Frankfurt and you look at the UK, look at London, they're more dominated now by the financial services. So it's a question of where all of they are in terms of adoption of what we believe is the dominant factor that we have to deal with which is the migration to cloud and from a dedicated environment to a shared environment. Some are further than others based on economic support from the government, whether it be back taxes, all of these things comprise. So they're all in the different phase of adoption but over time, which is why we focus on GDP, they will all get there.

Jim Breen – *William Blair & Company*

Great, thank you.

Operator

Thank you. Your next question comes from Jonathan Schildkraut from EP. Please ask your question.

Jonathan Schildkraut – *Evercore Partners*

Hello. Thanks for taking the question. A lot of them have been asked and answered but I have been reading a lot about our spiking power costs in Germany and I was wondering if that was having any impact on the business? We see power fluctuation costs. I imagine you guys are locked into some longer-term rates and so just wondering how you manage power fluctuation costs and what kind of flexibility you have as it applies to rolling those through to customers.

David Ruberg – *Interxion – Vice Chairman & CEO*

Thank you. I'm not sure what you mean by spiking cost. I will tell you that the energy costs in Germany are some of the highest in Europe, but not because of the generation costs but because of the surcharges that are put on the cost of energy generation costs in order to support the political initiatives in that country. And there's been a lot of debate before the election, a lot of debate after the election in terms of whether that leads to a competitive situation in Germany. So I don't believe that there's spiking but I do believe that there people are looking to increase and we're anticipating that.

And, yes, that makes for, sometimes, an uncompetitive situation in Germany but we all suffer from that because no one has a competitive advantage or disadvantage unless you're smart about how you buy and even smarter about the PUEs, which are the efficiencies of your data centres. So we spent a lot of time in making sure that we understand the needs of our customers. We make sure about how we buy the energy but, more importantly, we design and build our data centres to be as efficient as they possibly can and, particular, green; and that is important in that country.

Jonathan Schildkraut – *Evercore Partners*

Thank you.

David Ruberg – *Interxion – Vice Chairman & CEO*

You're welcome.

Operator

Thank you. Your next question comes from Michael Rollins from the Citi Investment Research. Please ask your question.

Michael Rollins – *Citigroup Investment Research*

Yes, hi. Thanks for taking the question. I think it was last quarter you talked about one of your top 15 customers that would be reducing their spend with you through the end of the year. I was wondering if you can give us an update in terms of how that affected the third quarter results and, you know, what we should be anticipating for the rest of the year from that event? And then, secondly, if you could talk a little bit more about, you know, what you're doing with your sales force in terms of sizing, focus. That would be great, thanks.

Josh Joshi – *Interxion – CFO*

Hey, Michael, I'll take the top 15 churned customer question and then hand over to David on sales. Going back to what I said at the last quarter, on the last quarter's call, to preview for everybody, we talked about a top 15 customer, about 1% of revenues, that would be out by the end of the year. And, you know, they have continued… their exit through our business has continued in line with expectations, in line with what we'd agreed with them. They're about halfway through this at the end of the quarter and they'll do the rest by the end of the year. And it's a steady migration. David?

David Ruberg – *Interxion – Vice Chairman & CEO*

Mike, if you give me a little latitude, I'd like to answer a little different question than you asked. In terms of the sales, it has to be viewed in the concept of what your go-to-market strategy and what your segmentation strategy is. And so we break this into three. We have the segment leads, so we have the marketing segmentation; we have major accounts; and we have local accounts. And this is a coordinated effort on the part of major accounts and marketing to get the magnetics, to get the leads and then to use the radiation that comes from them to help the local sales people attract the rest. So it's a coordinated approach, not just a try here, try there; takes discipline, takes focus.

I believe that we have sized the organisation correctly. And where we spend our time and effort, as I mentioned before, is we spent a lot of time and effort to make sure that their efforts are focused on who we want, focused on how we go after them, focused on how we develop the process and procedures to facilitate that and focused on how we train our people to do consultative sales, not just to be order takers. So I believe that we have the right approach. You never have it executed 100% correctly and that's where we spend a lot of time to make sure that there are no mishaps as we meet the needs of our customers in helping them to come to us and build the communities of interest which are important to them.

Michael Rollins – *Citigroup Investment Research*

Thanks for that. And can you also just specify the number of quota bearing sales people roughly that you have today or an aspiration in terms of where you may want to get back to over a 12-month period?

David Ruberg – *Interxion – Vice Chairman & CEO*

Do you include me in that number or not?

Michael Rollins – *Citigroup Investment Research*

Are you quota bearing?

David Ruberg – *Interxion – Vice Chairman & CEO*

Look, you better believe it. You guys have a quota on me. I don't deliver, guess what happens to the stock? Look, we have in the sales and marketing organisation, without getting too specific, we have approximately 70-75% of the people in these various functions, okay. And I think we have the scale, the scope and the discipline to do what we want to do. And I think that's been demonstrated by what we've accomplished over the last couple of years.

Michael Rollins – *Citigroup Investment Research*

Thanks.

Operator

Thank you. Your next question comes from Colby Synesael from Cowen. Please ask your question.

Colby Synesael – *Cowen and Company*

Great, thanks, a few of them. First up, just curious going back to the top 15 customer. You mentioned churn was 0.5% to 0.75% and that was within your historical range. I was curious if that takes into account the top 15 customer? Second question, you've been running your…

David Ruberg – *Interxion – Vice Chairman & CEO*

I'm sorry, the answer to that is yes.

Colby Synesael – *Cowen and Company*

Yes, it includes it?

David Ruberg – *Interxion – Vice Chairman & CEO*

Absolutely.

Colby Synesael – *Cowen and Company*

So, I guess, overall churn came down if we were to exclude that?

Josh Joshi – *Interxion – CFO*

Yes, we've had… remember, this top 15 customer is going to figure into and over the course of the second, third and fourth quarter. But, overall, our churn is within the range, 0.5% to 0.75% and it includes this top 15 customer in arriving at those numbers.

Colby Synesael – *Cowen and Company*

Okay. Second question, you've been running your non-recurring a little bit higher than, I think what you'd indicated in the past, it should be. So it's been roughly 6% of revenues. I was curious as we go into the fourth quarter, if you're anticipating that staying at an elevated level? And then the other question I have just has to do with M&A versus buybacks. I mean, your stock is down about 7% year-to-date. I think based on your commentary today you think the business continues to do very well. It seems like that's a great opportunity to potentially get more aggressive in buying back your stock and I want to get your sense on that, especially after you noting how strong the balance sheet is. Thanks.

Josh Joshi – *Interxion – CFO*

Okay. When I talked about it balance sheet, we also talked about the fact that we're always looking at opportunities to improve our cost of capital and looking for the best uses of our discretionary free cash flow. Given the demand environment and I think given the returns that we target and that are available for us in terms of investing in further data centre expansions, we currently plan and expect to use the company's cash flow to expand our capacity. That's where we're focused on to meet, on a targeted basis, to meet the demand that we see as a prime focus. In terms of NRR development, we've said historically that NRR is between €3 million and €4 million per quarter on average. That would be a standard metric for modelling purposes and that characterisation has not changed.

Colby Synesael – *Cowen and Company*

So you think we can get back down to that normalised level in the fourth quarter?

Josh Joshi – *Interxion – CFO*

I'm not trying to give you guidance of where NRR is going to be in the fourth quarter but, from a modelling perspective, I think that that's a good way of modelling it.

Colby Synesael – *Cowen and Company*

Well, I guess, just to be more pointed, you're targeting or tracking towards the lower end of your guidance for the year and I'm just try to get a sense of it. How much of it is expected to come from recurring versus non-recurring since, obviously, there's more value based on the recurring portion and just wanted to make sure that we weren't going to get your guidance based on excessive amount of non-recurring in the fourth quarter.

Josh Joshi – *Interxion – CFO*

We have given our guidance, Colby, and the way that we think about guidance is if we're going to be in or materially out of the range, we would change it. The guidance is on total revenue. That's what we give our guidance on, and that's where we are.

Colby Synesael – *Cowen and Company*

Okay. Thank you.

Operator

Thank you. And your next question comes from Milan Radia from Jefferies. Please ask your question.

Milan Radia – *Jefferies International*

Thanks very much. Yes, a couple questions from me, actually. The first is, I guess some of the volatility that we've seen in recent weeks in the Europeans sort of quoted sector has come down to the assertion that new entrants having some form of material impact, detrimental impact on the business of the retail colo incumbents. And so I guess my question is, is there any discernible sign from what you look at, not just in London but elsewhere in Continental Europe, that the new entrants are either winning business that should've or would've traditionally gone to the retail colo incumbents or decimating pricing on deals or elongating sales cycles to a material extent?

David Ruberg – *Interxion – Vice Chairman & CEO*

No, no, no, Milan. Okay, there's a lot of noise in the industry today and I think a lot of this comes from the United States, not necessarily from Europe. Milan, without getting into a long dissertation, the dynamics here in Europe are different in the United States. It's a whole lot easier for people to perceive that you can get into the colocation business here in the United States than it is in Europe. I don't believe either in the United States or in Europe to spend a whole lot of penetration. I think the line is blurred a little bit but the line between wholesale and retail has not been perforated, it's not been obliterated, it's just there's a lot of noise around it.

So, to answer your three questions, has there been someone that's come along that's had a significant impact? No. Your second question was… the last question was have they distorted pricing? No. Have they had an impact? No. So, again, I want everybody to take a deep breath. There is not a real problem here. There's a lot of noise about this. Guys, if we had two quarters of good GDP growth we'd be having totally different conversations. But from my perspective, as I tried to indicate before, to truly get into this business and succeed in this business, okay, I listed all of the things that are different; we have not seen people be able to breach that line. We've seen a lot of noise but we have not seen a lot of penetration, nor do I expect it.

Milan Radia – *Jefferies International*

Got it. And just one last question, actually, which is just around M&A and I see we're seeing a bunch of tuck-in type deals coming from some of the other players in the segment. You clearly have the resources financially and the management bandwidth to make some of these smaller geographic footprint-type acquisitions. Is there any appetite to do so?

David Ruberg – *Interxion – Vice Chairman & CEO*

Our focus is creating value for our customers and for our shareholders, our stakeholders. We look at all of these things, just like everybody else does. We look at them. We're looking for welldefined data centres, customer bases, people, but at the end of the day, we're looking for assets that can help us generate more cash per share and improve our returns. And if we find one, we'll be in there pitching just like everybody else.

Milan Radia – *Jefferies International*

Okay. Thank you very much.

David Ruberg – *Interxion – Vice Chairman & CEO*

Welcome.

Operator

Thank you. Your next question comes from Jonathan Atkin from RBC Capital Markets. Please ask your question.

Jonathan Atkin – *RBC Capital Markets*

Yes, I had a question about kind of the qualitative nature of capex as we think about, not just the fourth quarter but 2014, and is the preponderance of that going to be kind of same campus expansion or creation of new campuses within your existing metros? And then my second question is around cross connects and how many… just want a ballpark figure of how many cross connects are currently being planned at your data centres?

Josh Joshi – *Interxion – CFO*

Hey, Jonathan, it's Josh. Thinking about capex, you know, our focus has been, as David said, trying to identify opportunities to increase shareholder value and stakeholder value and also targeted on trying to increase the value for our customers. And what we've seen over time is that our customers have value community and the greatest centre of gravity that we see our committees build out tend to be within our existing campuses. And so what we've tried to do is to try and build on our existing campuses and, you know, where we've seen a good thing to build on top of it. Now, Frankfurt is a classic example but we've done the same in Paris and in London and we'll continue to do the same across all of our footprint. Our focus is really trying to identify the community and then to actually develop that community. And, to date, we've seen that we've had most success when doing that in campuses.

David Ruberg – *Interxion – Vice Chairman & CEO*

Jonathan, on your question about cross connects, we have not yet published that number and I don't think today is the day that I'm going to announce it. So, fundamental to our business, we are not in the data centre business. We are in the cross connect. We are in the interconnection business which is why there's a large X in our name and so this is as important to us as anything. By the way, it's just not cross connect in carriers, there's cross connects with cloud providers, there's all kinds of different cross connects. And so, as we sort this out, we will address this in the not-too-distant future.

Josh Joshi – *Interxion – CFO*

Okay, let's have the last question here.

David Ruberg – *Interxion – Vice Chairman & CEO*

So we have time for one more question?

Jim Huseby – *Interxion – Vice President, Investor Relations*

One more question.

Operator

Okay. And that next question comes from Prasad Borra from Goldman Sachs. Please ask your question.

Prasad Borra – *Goldman Sachs*

Thanks for taking my question; just one from my end. In terms of the industry, are macro and execution is still the major challenges for the ones who are in this space or do you think there are any other major trends which you're seeing which would have implications in terms of both pricing and churn going forward?

David Ruberg – *Interxion – Vice Chairman & CEO*

I don't want to turn professorial here but one of the things we look at all the time is Michael Porter's Five Factors. I have seen nothing change, nothing in the last four or five years, other than demand has not developed as people anticipated. But, as I've tried to explain over the last two or three quarters, the demand that people are looking for is the migration from a dedicated platform to a shared platform. And we are beginning to see the interest, the tools, the support, the case studies that demonstrate the benefit and the economic support from the economies doing well and encouraging people to take advantage of these things. So, no, I do not see any fundamental difference. It's unfortunate we've gone through four or five years of economic up and down, start and stop, foot on the gas, foot on the brake. But once this settles down, as I said, if we get a couple of quarters of good growth, GDP growth, I think we'll have totally different conversations. So that's one man's opinion.

Prasad Borra – *Goldman Sachs*

Yes. Thank you. Thanks, David.

David Ruberg – *Interxion – Vice Chairman & CEO*

All right.

Operator

Thank you. Mr Huseby, please continue.

Jim Huseby – *Interxion – Vice President, Investor Relations*

Okay, thank you everybody for joining us on our third quarter earnings conference call. We look forward to seeing you out on the road and we'll look forward to talking to you on our next conference call in the first quarter. Thank you very much.

Operator

That does conclude our conference for today. Thank you for participating. You may all disconnect.