

REPORT REPRINT

QTS Realty Trust expands to capitalize on increasing demand for hybrid IT outsourcing

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THE 451 TAKE

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CONTEXT

Overland Park, Kansas-based QTS is a real estate investment trust (REIT) that was formally established as a stand-alone entity with the purchase of the Atlanta-Suwanee mega datacenter in 2005. The company owns, develops and operates enterprise-class, carrier-neutral, secure, compliant multi-tenant datacenters focused on wholesale, retail, hybrid cloud and managed services. Its 25 datacenters are located in 10 of the top 25 global markets (including Amsterdam, London, Hong Kong, Sydney and Toronto, in addition to its US sites) and consist of roughly 5.3 million gross square feet of data-center space, supporting more than 1,000 customers worldwide. Overall capacity utilization for all of the sites was 88% as of Q2 2016.

QTS EASTERN US FACILITIES

Property	Year Acquired (1)	Gross Square Feet (2)	Raised Floor (4)	Total	% Occupied (7)	Annualized Rent (8)	Available Utility Power (MW) (9)	% Of Global Annualized Rent
Atlanta -Metro, GA	2006	968,695	452,986	821,365	94.10%	\$90,118,528	72	26.01%
Suwanee, GA	2005	369,822	185,422	301,247	81.30%	\$56,471,954	36	16.30%
Richmond, VA	2010	1,318,353	167,309	397,256	88.10%	\$35,510,868	110	10.25%
Jersey City, NJ	2006	122,448	31,503	87,612	97.10%	\$11,680,023	7	3.37%
Princeton, NJ	2014	553,930	58,157	171,791	100%	\$ 9,702,840	22	2.80%
Piscataway, NJ	2016	360,000	88,820	194,982	76.20%	\$ 8,914,718	111	2.57%
Total Globally:		5,250,927	1,283,941	2,548,972	88.00%	\$346,467,230	550	100.00%
Total of East Coast:		3,693,248	984,197	1,974,253		\$212,398,931	358	61.30%

*Source: QTS Form 8-K 7/26/16

QTS EAST COAST MARKETS

ATLANTA

The Atlanta-Suwanee (a northern suburb) and Atlanta-Metro facilities, purchased in 2005 and 2006, respectively, are considered by the company to be best-in-class mega datacenters. Combined, they offer more than 1.3 million gross square feet. Annualized revenue from this market represents 69% of the total Eastern US revenue and 42% of total global revenue. The Suwanee location provides infrastructure for all of the QTS core datacenter services (the 3Cs): custom datacenter, colocation and cloud services. It hosts QTS's largest customers, and this location serves as the national operations service center. The Atlanta-Metro datacenter is the second-largest in the QTS portfolio and recently achieved LEED Gold Certification for phase two of the facility. Both of these facilities have multiple carriers and IP providers, diverse SONET access, and fiber and QTS Metro Connect Service to 56 Marietta.

RICHMOND, VIRGINIA

The Richmond, Virginia facility (210 acres) purchased in 2010 is also a best-in-class mega datacenter, the building was originally a new Motorola Semiconductor Fab that QTS purchased for a fraction of the cost to build it (classic QTS strategy). This facility is the largest in the QTS portfolio and was developed specifically to support government datacenter consolidation and initiatives, as well as enterprise datacenter customers and commercial colocation and managed services. It also serves as a mixed-use building and has plenty of office space, raised floor and power with two on-site substations that deliver 110MVA and have the ability to ramp up to 220MVA. As with all of the mega datacenters in the QTS portfolio, this one offers multiple carrier-neutral options for local and regional fiber and internet connectivity choices, including three distinct paths to Ashburn and Culpepper, Virginia.

ASHBURN AND DULLES, VIRGINIA

QTS has roughly 29,000 operating square feet of space in Dulles. This facility caters to very compliance-driven enterprises such as healthcare and financial verticals, as well as federal agencies that must comply with a number of federal IT standards.

HARRISONBURG, VIRGINIA

This facility has 10,000 square feet of raised floor with the ability to expand to 100,000 square feet. It was designed to meet or exceed the Uptime Institute's (a division of The 451 Group) Tier III datacenter classification. It is 50 miles outside of Washington DC's nuclear risk zone, outside of a 500-year flood plain, away from heavy traffic patterns and has minimal risk of natural disasters. It has 40MW of critical power available on-site that can be upgraded.

JERSEY CITY, NEW JERSEY

The Jersey City facility overlooks the Hudson River and is just six miles from Manhattan. Given its proximity to New York, it sees strong demand from the financial services vertical. It is a carrier-neutral facility with multiple options for connectivity. QTS Metro Connect Service is available here and provides connectivity to 111 8th Ave. This is one of QTS's smaller datacenter locations with just 31,500 square feet of 18-inch raised floor. Capacity utilization is currently 97.1% at this facility.

PRINCETON, NEW JERSEY

The Princeton campus is 194 acres. The 58,000 square feet of raised floor with 12MW of gross power is currently at 100% of capacity utilization. This campus also has a unique 14.1MW solar field, which supports QTS in its efforts to be a leader in green initiatives.

PISCATAWAY, NEW JERSEY

The most recent addition to the East Coast portfolio is this 360,000-square-foot facility on 38 acres in Piscataway. Only phase one has been completed at this location. It consists of 88,000 square feet of raised floor with 18.2MW of critical load power. Currently, 70% of the available raised floor (56,000 square feet) and 52% of the available critical load power (8.4MW of critical power) is utilized. This facility has 18 carriers offering connectivity services and is a point of presence for the Amsterdam Internet Exchange. The campus also has a rare solar array, which has the ability to produce 2MW of power and complements the Princeton solar arrays.

The QTS purchase of NJ1 in Piscataway at a low cost significantly strengthens its ability to serve Fortune 1000 enterprises in this area. Compared to DuPont Fabros, the site's previous owner, QTS offers more of a mix of wholesale and retail colocation services and fully integrated managed hosting and cloud services customized to client requirements.

QTS intends to expand this facility over time, adding 86,000 square feet and another 8MW of capacity, which will bring the total up to 176,000 square feet and more than 26MW of critical power. QTS estimates this will cost the firm less than \$7m per megawatt, which is well below the average cost to build in the New Jersey/New York market.

STRATEGY

The QTS strategy is to be the owner and operator of what it considers to be carrier-neutral, highly connected, best-in-class mega-scale infrastructure. The firm's goal is to have a low cost basis and a below-market cost to build with significant capacity for phased expansion over time. It prefers to own large blocks of land next to its existing facilities. The firm offers an end-to-end integrated technology services platform focused on delivering hybrid IT services leveraging custom datacenter, colocation and cloud services. It includes serving large hyperscale cloud providers and developing a variety of purpose-built cloud and connectivity offerings. This is combined with high-end security and compliance throughout all of its facilities and flexible offerings that meet customer demand as needed, plus the potential for upselling.

This strategy permits the firm to have a mix of customers fairly balanced across its products with custom datacenter taking 39%, colocation taking 43%, and cloud and managed services taking 18% as of Q2 2016. The company says that more than 50% of its customers choose more than one product.

Given the firm's broad geographic footprint, QTS's customers are in a variety of verticals: technology 38%; consulting 15%; telecommunications 7%; retail 6%; communications 4%; government 4%; banking 3%; healthcare 3%; finance 3%; insurance 1%; manufacturing 1%; and other 15%. Given its purchase of compliance-focused Carpathia Hosting last year, we expect the firm to emphasize its compliance capabilities going forward, so it should see additional strength in the government, healthcare and financial services verticals.

COMPETITION

QTS's competition varies by market and by product because it offers wholesale, retail colocation and cloud/managed services. For wholesale and retail colocation, it vies with firms such as CoreSite, CyrusOne, Digital Realty, DuPont Fabros Technology, IO, RagingWire, Stream Data Centers, T5 Data Centers and Vantage Data Centers. On the cloud services side, it encounters providers such as CenturyLink, Rackspace, zColo and Verizon that target their private cloud services at enterprise customers. The firm's recent acquisition in New Jersey gives it an even bigger presence in that market and should allow it to compete more effectively with firms such as CenturyLink.

Compliant IaaS service providers with Federal Risk and Authorization Management Program (FedRAMP) authorization include Hewlett Packard Enterprise (Helion), IBM (SmartCloud), Lockheed Martin and Microsoft (Azure). In early October, QTS acquired the sole rights to VMware vCloud Government Service (vCGS), a FedRAMP-compliant cloud offering. The vCGS platform, now called QTS Government Cloud, was previously developed in partnership with VMware to deliver cloud services to the federal sector.

SWOT ANALYSIS

STRENGTHS

QTS benefits from its integrated service-delivery platform, extensive datacenter footprint and its range of services, including wholesale space, retail colocation space and cloud and managed services. The hybrid REIT is well positioned to compete in its current markets and is well capitalized.

WEAKNESSES

QTS will need to build its brand in the Chicago and Dallas markets further to reach midmarket and enterprise customers and communicate the advantages of its wholesale, colocation, managed services and cloud offerings targeting potential customers.

OPPORTUNITIES

There is a significant opportunity for QTS to execute on its strategy leveraging its integrated service delivery platform to deliver a broad portfolio of IT services including the development of purpose-built hybrid clouds supporting increasing industry demand.

THREATS

There is tremendous competition in multiple markets, and several of QTS's competitors are in the same markets plus many more, so they may be better able to vie for customers from their larger, more geographically diverse businesses.