

Rating Action: Moody's assigns first-time (P)Baa3 issuer rating to Global Switch

Global Credit Research - 31 Mar 2011

First-time rating

London, 31 March 2011 -- Moody's Investors Service has today assigned to Global Switch Holdings Limited ("Global Switch", "the company") a provisional (P)Baa3 long-term issuer rating and a provisional (P)Baa3 rating to a proposed EUR500 million senior unsecured bond. The outlook for all assigned ratings is stable. This is the first time Moody's has rated Global Switch, a real estate operating company that owns, acquires, manages and develops data centres with six in Europe, two in Asia Pacific and a ninth under construction in Paris. The company's carrier-neutral data centres offer wholesale, multi-tenanted space on medium- to long-term leases. Global Switch is wholly owned by Aldersgate Investment, an unlisted investment vehicle owned by the Reuben brothers.

Moody's issues provisional ratings in advance of the final closing of a transaction or the sale of securities and these ratings reflect Moody's preliminary credit opinion only. Upon a conclusive review of the final documentation of the bonds and bank facilities and the successful closing of Global Switch's refinancing, Moody's will endeavour to assign definitive ratings. A definitive rating may differ from a provisional rating.

The issuer rating has been assigned on a provisional basis and will be finalized upon (i) receipt of interim reviewed accounts as at 31 December 2010 and these not being materially different from those previously received from the company; and (ii) confirmation that any outstanding shareholder loans post-refinancing were converted into common equity.

The bond rating is also provisional, based on a senior unsecured ranking (and pending confirmation of no secured debt in the group and no encumbered assets), guaranteed by material subsidiaries (effectively the same subsidiaries guaranteeing the company's bank facility), and will be finalized subject to receipt of the final documentation and it not being materially different from the drafts we have reviewed in assigning the provisional rating.

RATINGS RATIONALE

The key strengths that support the (P)Baa3 rating with stable outlook are Global Switch's solid recurring income generated from long-term leases with high occupancy rates of around 93% and a very low tenant churn rate of less than 1% during the calendar year 2010. Furthermore, in Moody's view, the growth in demand for data centre space is likely to continue to exceed growth in supply in the short- to medium-term, thereby supporting rental growth and continued low vacancy rates. The rating is also supported by the company's moderate leverage, as measured by net debt/EBITDA and good fixed charge coverage, measured by EBITDA/gross interest expense + ground rents (note all data is subject to Moody's standard accounting adjustments) that are forecast on a pro-forma basis at FYE 31 March 2011 to be 2.1x and 4.4x respectively. In addition, Global Switch benefits from an adequate liquidity risk profile. The first debt maturity does not occur before 2014 and headroom under its financial covenants is comfortable.

The rating is constrained by Global Switch's relatively small scale compared to its global similarly-rated peer group and the company's limited diversification by location with eight data centres in seven cities, plus one under construction. In addition, revenues are concentrated by tenant with the top ten tenants comprising 52% of annualized rental income and the largest tenant 13%.

Data centres as a property type experienced significant overbuilding in anticipation of demand from dot-com companies, followed by a collapse in the early 2000s. Currently, strong demand from financial services and corporate enterprises for electronic data storage and online services coupled with a lack of data centre construction has created favourable near-term market dynamics for Global Switch. Moody's notes, however, that over the longer term there is the potential for additional competition, as well as structural and technological changes in the data marketplace, which are meaningful credit concerns. The potential threat to the demand for data centre space is likely to emerge from among Global Switch's tenants who may choose to develop and operate their own data centres. Furthermore, potential competition from new entrants, such as power companies; existing players or large volume in-house users who decide to provide space and services to third parties, could eventually shift under-supply.

Nevertheless, there are extensive barriers to entry as data centres are highly capital intensive due to tenants' operational requirements. The construction specifications for data centres include heavy load bearing, fire retardation materials, capacity for peak power requirements, efficient cooling systems, strict security control and system redundancy requirements. However, given the high cost of these specialized buildings, there is limited alternative use that would provide a similar return on investment. Reliability is an important aspect of this asset class and, positively, Global Switch's management reports a strong track record for service reliability in line with the industry standards for Tier 3 facilities, which supports tenant demand for its data centres.

The stable rating outlook reflects Moody's expectation that no significant change occurs in the competitive landscape for the foreseeable future and that the lease-up of Global Switch's new facility in Paris (currently under construction) will be in line with management's forecast. The stable outlook also assumes that adjusted net debt/EBITDA will remain around 3.0x or less, fixed charge cover remains above 3.0x, the development pipeline does not exceed 10% of gross assets, assets remain unencumbered and an adequate liquidity profile is maintained at all times.

The company's relatively small scale compared to its global similarly-rated peer group and limited diversification are constraining factors on the rating. Positive pressure on the rating could arise if the company grows larger and more diverse, with the market and tenant concentrations comprising less than 15% and 10% of GLA (gross lettable area) or revenues respectively, while maintaining its currently high occupancy rates and credit metrics. Conversely, a sustained deterioration of financial metrics with inter alia leverage rising above 3.5x or fixed charge cover falling below 3.0x, a sharp increase in development activity or an inadequate liquidity profile could be negative for the rating.

The principal methodology used in rating Global Switch was Moody's "Global Methodology for REITs and Other Commercial Property Firms", published July 2010. Other methodologies and factors that may have been considered in the process of rating these issuers can also be found on Moody's website.

Global Switch, incorporated in the British Virgin Islands with its corporate offices located in London, reported at fiscal year-ending 31 March 2010 total revenues of GBP221 million and total assets of GBP2.55 billion.

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