

Sell CoreSite

Real Estate,
Healthcare and
Gaming Group



November 13, 2013



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Agenda

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- 2. External Analysis**
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Real Estate Primer



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Real Estate Primer

- Real estate investments are categorized as:
 - **Hard** real estate (physical assets)
 - **Soft** real estate (investment trusts, ETFs, shares in real estate companies)
- Real Estate Investment Trusts (REIT) are companies that operate real estate on behalf of public unitholders and **have** to distribute 90% of annual profits
 - Types: Residential, Office, Industrial, Technology, Healthcare, Retail

Debt to Gross Book Value	Shows level of debt financing for assets
Dividend Yield	Annual dividend income to investors as a percentage of the current unit price
Capitalization Rate	Ratio of Net Income to its capital cost
NAV	Appraise Assets on books, apply cap rate and subtract liabilities
Funds from Operations (FFO)	Net Income + RE Depreciation - Gains on Sale
Adjusted Funds from Operations (AFFO)	FFO - CapEx (often the closest metric to cash flow)

External Analysis



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External Analysis

REITs are driven by Macroeconomic factors

- Real estate performance is closely linked to property prices and events in the macroeconomy like financial crisis and talk of rising interests rates
- Unemployment and disposable income also affect the industry
- Post-crisis real estate was in shambles but is in a state of recovery



External Analysis

Falling Vacancy Rates & Higher Rents

- REIT profitability is based on two factors:

Vacancy/Occupancy Rate	Rent Price
How much of the property is utilized now and is generating rent?	How much is the owner charging for rent?

- As the economy recovers, there has been a trend of lower vacancy rates and higher rents across major U.S. cities (CoreSite's geography)
- The trends indicate an increasing demand for property, especially in the residential, office, and **data center** markets
 - Profitable trends have resulted in a large increase in competition, especially in wholesale data centers

Industry Analysis



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Industry Analysis

Data Centers at a Glance

- Data centers house computer systems, communications, and storage
- Typically include backup power supplies, cooling systems, security, etc.
- Large companies and governments manage a lot of data and employ data centers to save costs; a large center uses as much electricity as a small town
- Demand for data centers continues to grow as global data volumes increase

Types of Data Centers:

Colocation Data Centers	Wholesale Data Centers
<ul style="list-style-type: none">▪ Clients rent smaller SF▪ 2-3x more expensive than wholesale solutions	<ul style="list-style-type: none">▪ Clients rent much larger square footage, often occupying multiple floors▪ Cost effective solution for very large companies/governments

Internal Analysis



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Internal Analysis

Company Overview

Description

- CoreSite Realty Corporation engages in the ownership, acquisition, construction, and management of data centers
- The company's portfolio includes 14 data center locations in eight major communication markets in North America

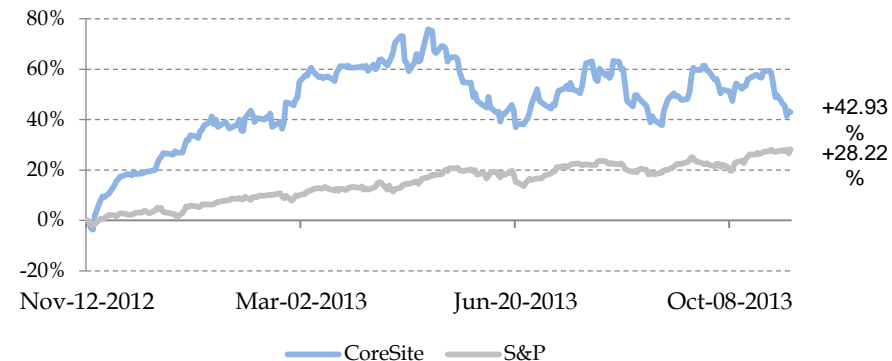
Geographic Breakdown



Key Statistics

Equity Value	\$680.3M
Enterprise Value	\$1,322.2M
EBITDA	\$94.9M
Current Price	\$31.13
% of 52 Week High	81%
52 Week High	\$38.57
52 Week Low	\$20.50

Trading History (LTM)



Internal Analysis

Two Industry Product Offerings

Wholesale (Not CoreSite)

- A dedicated suite to an entire building, with dedicated power/cooling infrastructure, under long term leases (5-15 years)
- Rental rates vary with power usage depended and availability of low-cost electrical power
- Tenants include enterprises, colocation/managed hosting/managed services providers and network carriers

Retail Colocation (CoreSite)

- Product sold in smaller increments such as individual cabinets or cages with shorter lease durations (1-5 years)
- Interconnection services are provided, and customers demand a greater degree of support
- Differentiating factors include proximity to company offices, key personnel, and network density

Internal Analysis

Industry Trends

Colocation and Wholesale Lines are Blurring

- While data center providers are generally divided between wholesale and retail colocation, customers don't see the space between these two categories
 - Needs are being assessed with respect to power density, security and the flexibility to expand
- Retail brokers are seeing retail deals moving up to wholesale, retail colocation providers are landing larger contracts
 - Colocation pricing in most markets is typically 2x-3x higher than wholesale pricing, and wholesale providers are increasingly stealing market share
- While CoreSite is protected against loss of clients requiring low latency, high power density, the rest of the contracts are likely to see pricing pressure as price-sensitive users seek more affordable options

Internal Analysis

Industry Trends

Large Customers Building Own Data Centers

- With much of the data needs resulting from large organizations such as Facebook, Twitter and LinkedIn, companies are looking to build their own data centers (or switch to wholesale prices)
 - *“Facebook will build a massive data center in Altoona, Iowa. [The company] confirmed its plans to invest \$299.5 million. [The] 476,000 square foot building will be the world’s longest data center, providing the company with a digital beachhead in the middle of the U.S.”*
 - *“Microsoft [invested] \$15 billion in data centers that now house more than 1 million servers. It has **construction projects underway in at least five locations across the globe**, from Singapore to Des Moines. And now Microsoft has also become **the biggest customer in the market for turn-key “wholesale” data centers.**”*

CoreSite Sell Presentation

Industry Trends

Supply Outstripping Demand

- Silicon Valley has been the softest data center market in the country; Facebook is shopping to sublease it's wholesale space at very aggressive prices; while it's contracts don't expire in the next 3-5 years, this is increasing competition in an already oversupplied market
 - 29% of CoreSite's revenues come from San Francisco Bay area
- Similar problems are in the Northern Virginia market; significant pricing pressures are expected
 - 19% of CoreSite's revenues come from Northern Virginia
- While YoY Northern Virginia pricing has held up relatively well (down 3.4%), Silicon Valley took a greater hit (6.4%)
 - Relative to the overall market decline of 5.8%

Valuation



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Valuation

Benchmarking

Company	Market Valuation		LTM Financial Statistics			LTM Margins		Growth	
	Market Cap	TEV	Revenue	FFO	AFFO	FFO (%)	AFFO (%)	Hist 1 - yr	Est. 1 - yr
CoreSite Realty Corp.	\$ 810	\$ 868	\$ 229	\$ 88	\$ 87	38.6%	38.1%	13.0%	10.0%
CyrusOne Inc.	\$ 435	\$ 525	\$ 221	\$ 53	\$ 54	24.1%	24.5%	0.0%	0.0%
Digital Realty Trust, Inc.	5,880	8,960	1,357	570	433	42.0%	31.9%	6.8%	7.0%
DuPont Fabros Technology, Inc.	1,490	2,139	332	128	123	38.5%	36.9%	66.7%	25.0%
Average						34.9%	31.1%	24.5%	10.7%
Median						38.5%	31.9%	6.8%	7.0%

Coresite has comparable margins to peers, significantly above the closest comparable (CyrusOne). Dividend growth has been impressive however may be slowing down.

Valuation

Comparable Trading Multiples

Company	Market Valuation		FFO Growth		EV/EBITDA		Div Yld	Price/FFO		Price/AFFO	
	Mkt Cap	TEV	2013E	2014E	2013E	2014E	Yld (%)	2013E	2014E	2013E	2014E
CoreSite Realty Corp.	\$ 810	\$ 868	17.7%	17.4%	17.4x	14.6x	3.1%	19.0x	16.2x	20.3x	17.1x
Comparables											
CyrusOne Inc.	\$ 435	\$ 525	12.6%	39.1%	16.2x	9.6x	3.4%	16.2x	11.6x	16.8x	12.2x
Digital Realty Trust, Inc.	5,880	8,960	7.7%	10.1%	14.4x	12.6x	5.6%	11.7x	10.7x	15.5x	12.9x
DuPont Fabros Technology, Inc.	1,490	2,139	29.0%	19.1%	13.1x	12.0x	3.9%	14.8x	12.7x	14.3x	11.2x
Average			16.4%	22.8%	14.6x	11.1x	4.3%	14.2x	11.7x	15.5x	12.1x
Median			12.6%	19.1%	14.4x	11.1x	3.9%	14.8x	11.6x	15.5x	12.2x
REIT Sub-Sectors											
Office							3.7%	14.6x	13.6x	20.9x	20.7x
Industrial							4.1%	17.9x	16.3x	25.8x	21.7x
Triple-Net Lease							5.5%	14.7x	13.4x	14.0x	13.1x
Self Storage							2.9%	21.5x	19.6x	22.9x	20.9x
Healthcare							5.5%	15.1x	13.7x	16.3x	14.7x
Average							4.3%	16.8x	15.3x	20.0x	18.2x
Median							4.1%	15.1x	13.7x	20.9x	20.7x

Coresite trades at a premium to both its direct peers as well as various lower-risk REIT sub-sector indices such as Healthcare on P/FFO and P/AFFO multiples.

Valuation

Discounted Cash Flows

Discount Rate on Cash Flows	10.00%
Cap Rate on Terminal Value	8.00%

	2013E	2014E	2015E	2016E	2017E	2018E
Unlevered FCF	74,398	68,527	63,125	84,930	78,216	72,040
Discounted FCF	67,635	56,634	47,427	58,008	48,566	
Sum of 5-Yr Cash Flows	278,270					
PV of Terminal Value	559,136					
Enterprise Value	837,406					
Total Debt Outstanding	166,625					
Total Cash	702					
Equity Value	671,483					
Units Outstanding (000's)	20,555					
Value per Unit	32.67					

	Cap Rate	Discount Rate				
		9.0%	9.5%	10.0%	10.5%	11.0%
	7.0%	\$ 38.37	\$ 37.45	\$ 36.55	\$ 35.68	\$ 34.83
	7.5%	\$ 36.20	\$ 35.33	\$ 34.48	\$ 33.66	\$ 32.85
	8.0%	\$ 34.30	\$ 33.47	\$ 32.67	\$ 31.88	\$ 31.12
	8.5%	\$ 32.62	\$ 31.84	\$ 31.07	\$ 30.32	\$ 29.59
	9.0%	\$ 31.14	\$ 30.38	\$ 29.65	\$ 28.93	\$ 28.23

Intrinsic valuation with key assumptions of an 8.0% cap rate and a 10.0% discount rate give a base valuation of \$32.67, right around the current trading range of the stock.

Risks & Catalysts



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Risks and Catalysts

Risks

Hard to Keep Pace With Technological Change

- Fast paced growth in technology requires data centers to adapt.
- This may be difficult for REITs because change requires lots of capital expenditures

Ten Tenants Make Up 31.9% of Revenue

- The loss of one of the larger tenants is detrimental to CoreSite because the top ten accounts for a large portion of revenue
- Therefore, CoreSite's revenues are also dependent on their tenants' competitive success

Pipeline Realization is Speculative

- Total time required to develop a data center can take as long as 4 years
- During this time, there is no guarantee that the developed asset will produce revenue

Small Pool of Tenants

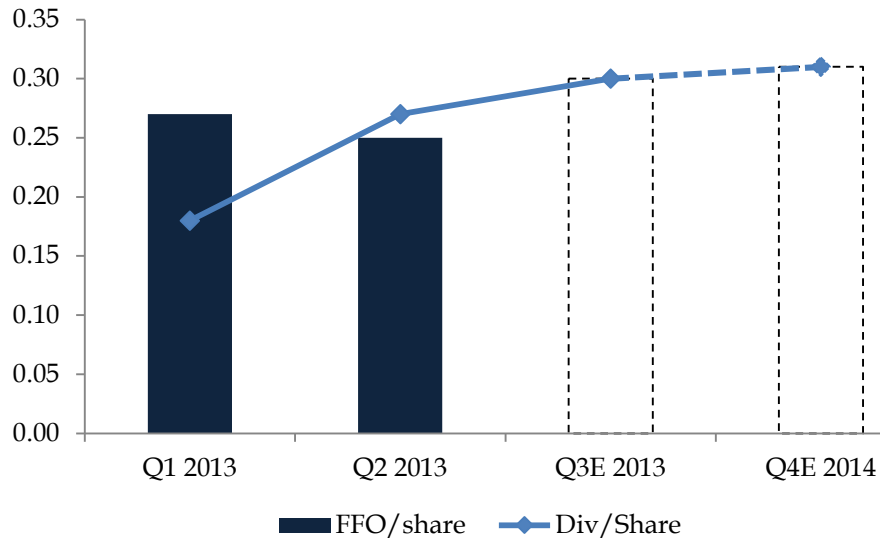
- Unlike other REITs, data centers cater solely to technology companies
- Tenant pool is very small, finding new tenants or negotiating economically feasible deals may be difficult

Risks and Catalysts

Catalysts

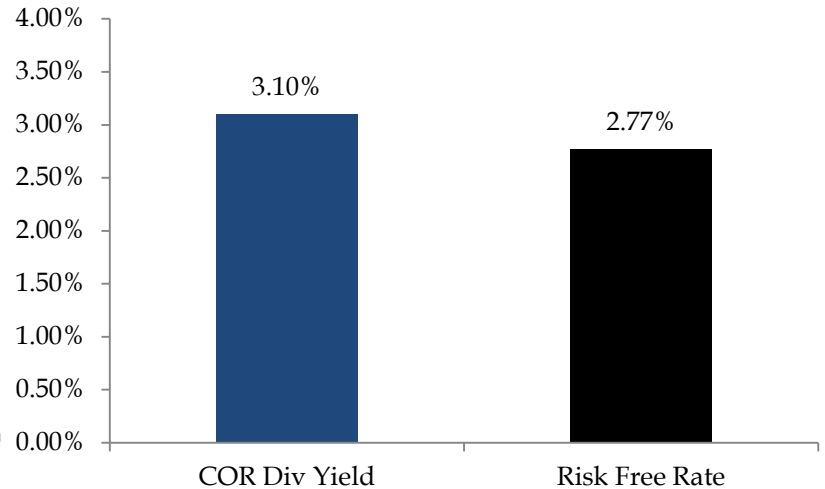
No Growth in Dividend

- Current dividend: \$0.27/share
- Projected next quarter FFO/share: \$0.30
- Is there room for growth given FFO projections?



Interest Rate Increase

- A small 0.33% increase on the 10-year yield could theoretically punish COR's stock price



Summary of Thesis

1. Competitive advantage of superior location is becoming less important
2. Macroeconomic outlook, possibility of rising rates unfavourable
3. Lines between colocation and wholesale centers are blurring
4. Customers looking to build their own datacenters
5. Oversupply of space in some markets leading to sub-leasing
6. CoreSite is trading at a premium to its comparable peer group
7. Technological change in data gives low visibility into future revenues
8. Significant exposure to a small group of tenants
9. Realization of high occupancy for developments in pipeline is speculative
10. Dividend growth could be slowing significantly

Recommendation:

Sell Shares of Coresite at \$30.80



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