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INXN - Q1 2013 Interxion Holding NV Earnings Conference Call

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Interxion 1Q 2013 earnings conference call. (Operator Instructions). I must advise you that this conference is being recorded today on Wednesday, the 8th of May, 2013.

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

Jim Huseby - *Interxion Holding NV - VP IR*

Thank you, Tracy. Hello, everybody, and welcome to Interxion's first 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 are again providing a slide deck. The slides are 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 that we will be making today are forward-looking in nature and involves risks and uncertainties. Actual results may vary significantly from those statements and may be affected by the risks we identify 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 these measures to the most directly comparable IFRS measures in today's press release, which is posted on our Investor Relations page at investors.interxion.com.

We 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/interxion, and Twitter at 'at sign' Interxion. We encourage you to follow us on those sites, as well.

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 Holding NV - Vice Chairman and CEO*

Thank you, Jim, and welcome, everyone, to our first quarter earnings call. Again, as Jim mentioned at the beginning of the call, we've prepared a slide deck to accompany our prepared remarks, and we encourage you to download the deck and follow along, as Josh and I will refer to these slides during our comments. So, if you will, please, turn to slide four.

I'd like to begin by highlighting Interxion's performance in the first quarter of 2013. Once again, Interxion produced another quarter of solid financial and operational results.

From a financial perspective, when compared to the first quarter of 2012, we delivered double-digit revenue growth, again all organic, and even higher adjusted EBITDA growth, once again, reflecting the operating leverage in our business model. Bookings were solid, and our industry load churn was consistent with our expectations.

On the operational side, we have continued to expand the space available in our data centers in response to customer demand, adding space in markets while maintaining utilization rates at consistent levels. Our announced but uncompleted construction project remains on track from a schedule and cost standpoint.

We continue to see demand across all of our target market segments, but especially in the managed services or cloud provider segment, which now contributes about 23% of our recurring revenue.

In our opinion, the outlook for the European data center market remains healthy, and Interxion is well positioned for continued growth and future success as we continue to build customer value and derive shareholder returns from the business.

Please turn to slide five.

Let's look at the first quarter's financial performance in a little more detail. Revenue for the first quarter exceeded EUR74 million, which is an increase of 13% from Q1 2012 and a 2% increase when compared to the fourth quarter of 2012.

Recurring revenue was EUR71 million, which is up 14%, year over year, and 3% sequentially, and accounted for 95% of total revenues. Year over year recurring revenue growth continued to be stronger in the Big 4 countries, growing nearly twice as fast as in the Rest of Europe.

On a sequential basis, ARPU was down slightly in the quarter, and Josh will review this in more detail later in this presentation.

Despite customers continuing to have extended decision-making timeframe, demand remains healthy. The pricing environment is consistent with previous quarters, as is our sales pipeline.

Adjusted EBITDA was EUR31.7 million in the first quarter, which is a 16% year-over-year increase, which outpaced revenue growth due to the operating leverage in our business model.

Adjusted EBITDA margin was 42.6% in the first quarter, which is 110 basis points better than the first quarter of 2012.

Please turn to slide six.

In the first quarter of 2013, Interxion added 4,100 square meters of equipped space in four markets. We also installed 800 square meters of revenue-generating space during the quarter. This amount was consistent with our targets and our quarterly average for the past two years, excluding the two record installations that we had in the second half of 2012.

Revenue-generating space ended the quarter at 57,000 square meters, resulting in a utilization rate of 73%, which is consistent with our utilization target of around 75%.

Please turn to slide seven.

In the first quarter of 2013, we completed the phase builds of three of the new data centers which we opened in 2012. We added the final 400 square meters in London 2. We added the final 600 square meters in Madrid 2. And we added the final 7,200 (sic -- should be 2,700; see correction later in presentation) square meters in Paris 7. In addition, in response to the strong demand that we've experienced in Frankfurt, we also added 600 square meters in our Frankfurt 6 data center. Total equipped space at the end of the first quarter was 78,100 square meters.

We also ended the quarter with 79 megawatts of customer-available power. Our new site in Copenhagen has already opened in the second quarter, on schedule, and Stockholm 2.1 is on schedule to open this quarter, as well, on schedule.

Please turn to slide eight.

We continue to execute well against our strategy of building resilient communities of interest which are at the heart of the digital economy, and we do so by focusing our sales and marketing efforts against specific target market segments.

We're able to attract magnetic customers and their communities of interest members because of the value they receive from our leadership in connectivity and customer service.

Our customers also clearly value our Pan-European coverage, which delivers access to over 75% of Europe's GDP, which is demonstrated by the growing number of customers who contract with us in multiple data centers and multiple countries.

Multiple-country customers now account for over 50% of revenues in the first quarter, and customers in five or more countries accounted for over 30% of the revenue in the first quarter.

As you may recall, during 2012, we told you that we were revamping our sales and marketing organizations. This effort included a resizing of those teams, as well as creating a better alignment of the sales, marketing, and support organizations with our market segmentation strategy. This program culminated with the restructuring of our national and major accounts teams towards the end of last year.

We began to see the benefits from these efforts in 2012 while building our communities of interest, and we expect these benefits to continue in 2013.

In the first quarter, we also again demonstrated our ability to attract new customers, adding over 60 new logos while increasing market share with existing customers. We saw continued growth across all of our segments, but the managed services or cloud services provider segment, in particular, was strong and accounted for 23% of our revenues in the first quarter. I'll speak more about the impact cloud is having on our business in a few minutes.

With that, I would now like to turn the all over to Josh.

Josh Joshi - *Interxion Holding NV - CFO*

Great. Thank you, David, and welcome to everybody on the phone and on line. As usual, I'd like to start by discussing the Group results, follow that with some additional color on our two geographic reporting segments, followed by a discussion of our capital expenditures, and then to review the balance sheet.

Please turn to slide 10.

Our first quarter results reflect consistent quarterly execution and a solid start to 2013. During the quarter, we saw steady growth in total revenue, recurring revenue, and adjusted EBITDA, together with year-over-year margin expansion, despite the negative impact of foreign exchange headwinds. In addition, we continued to improve our cost of capital and returns.

Total revenue, all organic, in the first quarter was EUR74.4 million, up 13% compared to the first quarter last year, and up 2% sequentially. On a constant currency basis, total revenue was up 13% year over year, and 3% sequentially.

Recurring revenue made up 95% of our total revenue for the quarter at EUR71.0 million, up 14% from the same time last year and up 3% sequentially.

Foreign exchange adversely impacted recurring revenue by about EUR0.6 million sequentially. Absent the foreign exchange movement, recurring revenue was consistent with our expectations.

Non-recurring revenue was EUR3.4 million, in the middle of our expected EUR3 million to EUR4 million quarterly range, though 3% lower than last year and 12% lower than the fourth quarter of 2012.

Recurring monthly ARPUs were down sequentially by a little over 1.5% in the quarter. There were two elements at work here. The major of the sequential decline can be attributed to the foreign currency headwinds I've already talked about. Although it's difficult to forecast currency movements, we don't see these headwinds changing for the foreseeable future.

Another factor in the quarter was residual ARPU dilution arising from significant customer deployments. If you remember, over the last three quarters, the Company has installed nearly 8,500 square meters of revenue-generating space, which represents about 15% of total revenue-generating space at the end of the quarter.

On prior calls, I've explained how large increases in revenue-generating space can dilute the overall average ARPU due to new customer deployments, typically starting with lower initial recurring ARPUs.

Now, as we look forward into the remainder of the year, we would expect these customers to increase their power capacity and energy utilization and so contribute to growth in recurring ARPUs. However, the timing of these power capacity and energy utilization increases is not something we can control. Taking this into account, and excluding other factors like currency, I would expect recurring ARPUs to trend modestly upward over the next several quarters.

Moving down the income statement, cost of sales in the first quarter was EUR29.6 million, up 12% over the same quarter last year, and up 2% sequentially.

Gross profit was EUR44.8 million, an increase of 14% year over year, and 2% sequentially, and gross margins were essentially flat due to the usual seasonality in the business at the start of the year.

Sales and marketing costs were EUR5.5 million in the quarter, up 13% over the same quarter last year, and flat sequentially. As a percentage of total revenue, sales and marketing costs were 7.4% in the quarter and within the 7% to 8% range that we've spoken about previously.

Other G&A costs remained well controlled at EUR7.6 million, or 10% of total revenue. These costs were up 7% year over year and 5% sequentially.

Adjusted EBITDA was EUR31.7 million, an increase of 16% year over year and 2% sequentially. Adjusted EBITDA margin in the first quarter was up 110 basis points year over year, overcoming the expansion drag that typically accompanies a significant increase in equipped space.

Sequentially, adjusted EBITDA margins were, as expected, slightly down, due largely to the annual seasonality in the business for the first quarter in the year.

Just as an aside, the seasonality is normally driven by two opposing elements. First, cold winters tend to reduce the amount of power used for cooling, but this benefit is usually more than offset by the second element, being annual rises in core costs, such as property costs or annual maintenance contracts, which generally kick in during the first quarter.

Depreciation and amortization were EUR14.0 million, a 7% sequential increase, and a 45% year over year. These non-cash expenses have risen for the past four quarters, as our new facilities have become operational and the year-over-year increase matches the increase in gross cost of data center assets held on the balance sheet.

We booked EUR6.5 million of net finance expense in the quarter, significantly higher, both sequentially and year-over-year. However, as in previous quarters, net finance expense was adversely impacted -- was impacted by capitalized borrowing costs.

Underlying interest expense, before capitalization, did increase in the quarter, as we started to recognize interest expense on the Paris 7 capital lease and the Paris 3 and 5 and the Amsterdam 6 mortgages.

Now, the incremental impact of the underlying interest expense was about EUR0.3 million in the first quarter. All things being equal, I'd expect the underlying net finance expense to settle at this level for the second half.

We booked income tax expense of EUR3.3 million in the first quarter, resulting in an effective book tax rate of 32%. The cash tax rate in the quarter was 4%, the first quarter being a seasonally low cash tax quarter. On an LTM basis, our cash tax rate was 12%.

Net profit for the first quarter was EUR7.0 million, 23% higher than last quarter, but 20% lower than last year's first quarter, due primarily to the completion of our expansion projects and the coincident increase in depreciation and financing costs.

Earnings per share during the quarter was EUR0.10 on 69.1 million diluted shares compared to EUR0.13 in the first quarter last year and EUR0.08 last quarter.

Now, let's take a closer look by geography.

Please turn to slide 11.

Once again, there's a clear difference between the growth rates in our two reporting segments. The Big 4 segment continues to show much stronger growth, 16% year over year, and 3% sequentially, while our Rest of Europe segment grew at 9% year over year and 1% sequentially.

While the Rest of Europe growth rate is well below the long-term expected potential of this part of our business, the growth is a solid performance, given the macro headwinds.

Revenue in the Big 4 was EUR46.6 million or 63% of the Company's quarterly total. Recurring revenue in our Big 4 markets was particularly strong, growing on a constant-currency basis 17% year over year and 5% sequentially.

Adjusted EBITDA in the Big 4 was EUR25.2 million, with margins at 54%, up 50 basis points from the first quarter 2012, and up 40 basis points from last quarter. Demand continues to be healthy in the Big 4 markets, and we expect to announce further expansion in these markets in the near future.

Revenue in the Rest of Europe segment was EUR27.8 million, up 9% year over year and 1% sequentially. On a constant-currency basis, recurring revenue was up 2% sequentially. Adjusted EBITDA was EUR14.5 million, with margins that continue to be solid at 52.0%, consistent with the level that we've experienced since the beginning of last year.

Certain markets in the Rest of Europe continue to show strength. Sweden remains very strong, and now that we've added some much-needed capacity, Spain saw solid growth in the quarter.

We continue to invest selectively in the Rest of Europe segment, based on visible customer demand. However, because we size our expansions to the market opportunity, individual projects in the Rest of Europe tend to be smaller in scale than projects in the Big 4 markets.

Looking at adjusted EBITDA margin development a little closer, we've seen demand in the Big 4 markets lead to continued margin expansion, despite the strong headwind from expansion drag in the last year.

Meanwhile, adjusted EBITDA margins in the Rest of Europe have been relatively stable over the last several quarters in the 52%-plus region.

Moving to slide 12, let's discuss capital expenditures. Capital expenditures, including intangibles, as seen on the left-hand chart, total EUR32.8 million during the first quarter, with EUR28.8 million of that devoted to expansion capital, and EUR2.1 million to maintenance and other CapEx.

We have made demand-driven investments across our footprint, with 63% of this quarter's capital expenditures going to the Big 4 markets and 34% to the Rest of Europe. Our approach has not changed for many years. We continue to make capital allocation decisions focused on securing the best possible returns, and constantly seek to improve our flexibility and reduce the cost of our capital.

Please turn to slide 13, where I will discuss our balance sheet and cash.

Summarizing the movement in cash during the first quarter, Interxion generated EUR23.6 million from operations, after absorbing about EUR7 million in working capital, which is generally lumpy, quarter on quarter. We also raised EUR11.2 million from financing activities, paid EUR10 million in cash interest, and invested EUR32.8 million in capital expenditures during the quarter. This left cash and cash equivalents of EUR60.5 million at quarter end, down from EUR68.7 million at year end.

The only significant difference in our borrowings are the two mortgages in Paris which were completed during the quarter. Together with the Amsterdam mortgage completed last quarter, mortgages now total EUR20 million at a blended cash cost of under 3.5%.

I view these transactions as small, but important, steps in optimizing both our cost of capital and the structure of our balance sheet, as senior notes remain in place, and the revolving credit facility continues to be undrawn.

Leverage ratios were essentially unchanged in the quarter. With gross leverage ratio at 2.5 times, and net leverage at 2 times, we remain well capitalized, fully funded, with no near-term maturities, plenty of headroom, and a decreasing cost of capital.

Please turn to slide 14.

I wanted to conclude my prepared remarks by spending a few minutes on the power of our business model to generate solid financial returns. We've shown similar slides in the past to illustrate the returns generated by our data centers in a given period, and other slides to show the operating leverage we enjoy from our business model. This version marries the two and highlights what I think are a number of Interxion's compelling attributes.

In the top panel of the slide, we show certain metrics for the entire data center footprint that as in operation at the end of 2009. Now, at that time, we ran 26 data centers, some big, some small, some with first phase openings as far back as 1998.

We had invested a total of EUR355 million of development and maintenance CapEx in those 26 data centers by the end of 2009, which resulted in 54,800 square meters of equipped space. Now this space generated EUR172 million of revenue in that year, and we ended the period with 70% utilization. Gross profit was EUR97 million for a margin of 56%.

In that year, we spent EUR13 million on maintenance CapEx. As a result, we generated annual data center cash returns of EUR84 million, or 24% return on our cumulative investment. We think this represented a compelling return.

In the bottom panel, we present the same key metrics for the same 26 data centers, but now for the last 12 month period. Since 2009, we've continued to progressively allocated capital in phases to these data centers to support customer demand. The cumulative investment now stands at EUR494 million, and resulting in 60,700 square meters of equipped space.

LTM revenues grew to EUR260 million, representing a same-store sales CAGR of 14%. The utilization rate increased 10 percentage points to 80%, as customers ramped up deployments into the expanded space.

At the same time, gross profit margins expanded 800 basis points to 64%. Maintenance CapEx was EUR9 million in the LTM period, and the resulting annual cash return nearly doubled to EUR158 million, representing a 32% return on the cumulative investment at the end of the first quarter. This is an 800 basis points improvement versus 2009.

We believe our ability to increase returns in this way during a period of protracted macroeconomic headwinds demonstrates the power of the Interxion business model across four key fronts.

One -- we're able to consistently grow revenue in our existing space, as customers are both attracted to and thrive within our communities or interest.

Two -- we are able to drive up utilization by thoughtfully deploying capital, in phases, against these customers' needs.

Three -- we are able to expand gross margins due to our operating leverage and pricing power.

And lastly, four -- this enables us to generate attractive and increasing cash returns from our data centers to drive value for our stakeholders.

Our approach as we go forward is to maintain this same discipline in execution and focus on returns as we continue to invest to meet the growing demand for our services.

And with that, I'd like to turn the call back over to David. David?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Thank you, Josh. Please turn to slide 16.

As Josh just illustrated, our communities of interest continue to be powerful value creators for both Interxion, our customers, and our stakeholders, and at the core of our communities are our magnetic customers. These are customers who attract other customers to co-locate within the data center in order to benefit from trading with the magnetic and the community of interest members that sit around them.

As these communities grow, the network effect increases their value and the communities strengthen their position as a source of long-term competitive advantage and also act as a barrier to entry against new data center operators.

The connectivity providers within our connectivity hubs have historically acted as a foundational magnet to enable those communities to form for those communities that require rapid application response times. Today, our connectivity hubs are providing optimal connectivity capabilities and options, whether fixed-line or mobile, for the successful deployment of cloud platforms that we can deliver -- so that we can deliver the required end-user experience in terms of response time.

This, in turn, strengthens our cloud hubs and is driving significant growth in our managed service provider segment, as we add the on and off ramps, the edge caching, on the pure-play cloud platforms within our cloud hubs. It is the combined strength in our connectivity and cloud hubs that is increasingly making Interxion the location of choice for the deployment of response-time-sensitive hybrid cloud application.

The example shown on this slide depicts how an enterprise deploying a real-time hybrid cloud application leverages trading relationships with other community members, as well as benefiting from access to cloud hub capabilities, in this case, infrastructure as a service or software as a service or specialist cloud enablers.

It also depicts how the application accesses multiple sources of connectivity, fixed line and mobile, in order to access their third-party applications via our connectivity hub capabilities and, ultimately, to quickly and reliably present the results to the end user, anywhere, anytime.

It is our investment in sales and marketing that is enabling us to target the right applications in our chosen segments to build our communities of interest, adding value both to our customers and, ultimately, to our investors.

Our sales teams are doing a good job of maintaining deal discipline, pursuing the right application with the right customers in our target segments, which results in the right mix of business in the terms of size, power, power density, and community growth.

We believe these communities will become more and more important as a differentiator of Interxion, and as a source of value for our clients and shareholders in the coming years.

Please turn to slide 17.

I will close my remarks with a couple of comments on our outlook. We are off to a good start in 2013, executing well in spite of both currency and macro headwinds. We have, again, produced solid results. Our pipeline -- sales pipeline is in line with our expectation, and industry demand fundamentals remain strong.

We have completed five construction projects so far this year, and have one more scheduled to open before the end of the second quarter. And, as Josh already mentioned, we expect to announce more shortly.

Consequently, we are 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 EUR307 million to EUR322 million. We expect adjusted EBITDA to be in the range EUR130 million to EUR140 million, and we expect to invest between EUR130 and EUR150 million in capital expenditures this year.

I would like to thank, again, all of our employees in all of our countries for staying focused on our customers and continuing to deliver strong results. I would also like to thank our shareholders and bondholders for their continued support.

And before I had this back to the operator, I've been notified that I misspoke one number. I indicated that we had concluding installing -- bring on line 7,200 square meters in Paris in the quarter. It's 2,700 square meters.

So, with that, operator, can you please read out the instructions to register questions from the floor?

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions). The first question on the line comes from the line of Tim Horan. Please ask your question.

Tim Horan - *Oppenheimer & Co. - Analyst*

Thanks, guys. Great quarter. Can you talk a little bit about how much capacity you think you can handle per year in terms of adding capacity? And what you'd like to see in terms of demand out there? I guess Equinix said they were seeing extremely strong demand in Europe. Would that kind of change your thinking on adding capacity?

And then, second, I know the target is for 75% utilization, but it sounds like some of your legacy stuff is operating at a higher utilization. Can you talk about, maybe, over time what that utilization can go to?

Thanks.

Josh Joshi - *Interxion Holding NV - CFO*

Yes, let me -- thanks, Tim. This is Josh. Let me deal with the utilization first. The -- what we're doing is we're bringing on our data centers in a phased basis to meet customer demand. And the underlying data centers that I talked about were, effectively, as we've developed them over the last three years, they've gone to 80%, and we think -- and we've spoken about before -- that we think full data centers run at around 85% utilization.

We -- from an organic perspective, we target 75% utilization, plus or minus 2 or 3 points, and if you look over the last several quarters, that's exactly where you're going to see our numbers are heading. And the reason why we do that is so our customers, as they grow with us, they have visible runway to grow, and so it's a mixture of growth.

David?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

The demand that we see, and I think Josh covered this reasonably well, if you look at our Big 4, and you look at the Rest of Europe, the demand that we see in the Big 4 is, I guess you could categorize it as strong. Demand in the Rest of Europe is reasonable.

So, I can't give any more color than that. The economies in the Rest of Europe, as everybody knows, are not as healthy as the Big 4.

But I think, as Josh also indicated, this, we believe is a temporary situation. We believe there's tremendous potential in the other seven countries that we're in. The margins remain healthy, and we invest on a selective basis, and the returns are very good.

So, we are quite comfortable where we sit today, and, as the economies recover, we will be there to participate in that growth.

Tim Horan - *Oppenheimer & Co. - Analyst*

Thank you.

Operator

Thank you. Your next question comes from the line of Jonathan Schildkraut of Evercore. Please ask your question.

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Jonathan Schildkraut - *Evercore Partners - Analyst*

Great. Thank you for taking the questions. I guess I have two questions. The first is on the macro environment. You highlighted it in your release and on the call, and I just want to get an understanding of whether there's a deterioration in the macro environment or it's still kind of stubbornly bad?

And, in particular, I was wondering if you were changing your approach to the market, given the macro environment, or if you'd seen any increase in competitive, particularly around pricing? And, as a sub question there, as we look at the Rest of Europe, where we understand the environment's not quite as good, one question I have is whether churn has changed in those markets or if it's just a matter of generating new demand?

And then I have a follow-up question just on your notes. Thanks.

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Hello, Jonathan, thank you for eight questions.

The first one is, on the Big 4, we actually believe that we have seen somewhat of a response, favorable response, in one of the major countries, which is France, as they deal with the political environment there. The rest of it is you used the word stubbornly resistant. Nothing, I believe, has changed in the last couple of quarters, except that we do see a little more enthusiasm for investment in France. That has not translated, yet, into the pipeline, but we see much more activity in terms of people talking to us about potentially investing.

Jonathan Schildkraut - *Evercore Partners - Analyst*

But not getting worse?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

No. No, sir. Not getting worse, okay?

Josh Joshi - *Interxion Holding NV - CFO*

Yes, and I think that, as we look at the changes, you talked about the impact of pricing and churn. Picking both of those up, pricing has been consistent over the last several quarters, and the churn, Jonathan, I think we talk about it being industry low. We experience, on average, monthly churn of around 0.5% to 0.75%, and that's exactly the range that we've seen over the last several quarters. And so -- on an average basis. So, again, those indicators aren't going in the wrong direction, either.

Jonathan Schildkraut - *Evercore Partners - Analyst*

Great. Josh, if I can ask a question about the notes, you brought that up in your prepared remarks. I think you're paying 9.5% on those notes right now. I believe there was a rate cut from the ECB recently. Have you thought about maybe what rate you could get in a current market environment? And then, could you just remind us what the call premium on those notes are, for next year? Thanks.

Josh Joshi - *Interxion Holding NV - CFO*

The call premium, from memory, is 104.75, and they're callable in February, as you know.

Look, Jonathan, I'm not going to disagree with you. I think that the coupon on this is high, and we continue to look for opportunities to improve our cash returns. We've not made any determination, as yet, but doing some kind of refinancing certainly looks like to be a very good opportunity at some point in the future. And we think there are great opportunities to lower the cost of capital, and also to save real debt servicing costs.

We'll continue to be opportunistic in terms of lowering the overall cost of capital, and I'd refer you to the mortgages, as well, that we've been looking at. So, I think that there is an opportunity there. The bonds are trading well and pricing well, and we'll look at that on an opportunistic basis.

Jonathan Schildkraut - *Evercore Partners - Analyst*

Thank you.

Operator

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

Jonathan Atkin - *RBC Capital Markets - Analyst*

Yes. I was interested in the growth in revenue-generating space, up year on year, but the sequential growth was a little bit slower, and I wonder if you could just remind us if there's a seasonal factor related here -- related to installs or customer decision cycles?

And then, wondered if you had any just kind of top-level commentary about your sales backlog?

Josh Joshi - *Interxion Holding NV - CFO*

Yes, Jonathan, on the revenue-generating space, I think we talked about it last quarter in Q4 and in 3Q that we had some significant installations, and so they were uncharacteristic records, if you like. I think that the underlying revenue-generating space, as we see it in this first quarter is typical of what we see, in average, over the several quarters, over the history, and it is just lumpy.

There is, in fact, no seasonality to this. This is just lumpy based on customer buying cycles.

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

And, Jonathan, in terms of the -- you used the word "backlog," but I think you were referring to pipeline -- no, the pipeline remains healthy and we pay very much attention to the aging of the pipeline and the cleansing of the pipeline to make sure that we're not carrying potential opportunities that have really expired. And, again, it's consistent with what we've seen and I can only reinforce, we've seen a little uptick in the enthusiasm in France, but other than that, it's consistent with what we've seen the last couple of quarters.

Jonathan Atkin - *RBC Capital Markets - Analyst*

And then, David, you did mention in your prepared remarks strength in the Frankfurt market, and wondered what's driving that, because that does seem to be a little bit in contrast with what certain competitors have indicated their trend is?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

I think one of the competitive advantages that we have in the Frankfurt market is we do have the DE-CIX, the core node in our data center. And I -- we are experiencing as the Asian carriers are looking to expand their footprint, we are the logical landing point for that.

So, we've seen a pickup in that. We've seen a pickup in the cross-connect activity that's associated with that.

So, it's been a very fortunate revenue opportunity and growth opportunity for us, Jon.

Jonathan Atkin - *RBC Capital Markets - Analyst*

And then final question, for Josh. On slide 14 the maintenance CapEx number seems to have declined, and this is for the same cadre of data centers, and I wondered if there's anything in particular that drove that? So, if you can give (inaudible).

Josh Joshi - *Interxion Holding NV - CFO*

Yes, I know. There's nothing in particular. We are very focused on maintaining our data centers. Remember, we spend actually a significant amount within the income statement on the maintenance of our data centers, over time.

And so, there's nothing to infer from that. The maintenance level, from a long-term perspective, at around 5%, on average, of revenues, and we're in that range across both of those periods.

Jonathan Atkin - *RBC Capital Markets - Analyst*

Thank you.

Operator

Thank you. Your next question comes from the line of Prasad Borra. Please ask your question.

S.K. Prasad Borra - *Goldman Sachs & Co. - Analyst*

Thanks for taking my questions. A couple, if I may.

Firstly, on interconnect fees, what kind of revenue opportunity do you see from interconnect? Equinix does talk a lot about it, and TeleCity is also discussing that opportunity in a bit of detail. So, if you could discuss that opportunity.

And secondly, on the ARPU trends, yes, capacity is increasing and ARPU is modestly declining, but if you look on a more constant capacity basis, how is ARPU trending? Are you able to increase prices across the market?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

All right. Again, thank you for your questions. I'll answer the first one. At the present time, our focus has been primarily to interconnect these people and to interconnect them based on a non-recurring basis. We're in the fundamental business of interconnecting people.

The industry seems to be expecting different orientation toward that, and so we are looking at that, but I think our -- my answer to your question in terms of what percentage of the revenue it would be, it would be approximately what Equinix looks -- what Equinix gets and what TeleCity gets.

And I think that's in the range of 4% to 7%. So, I think we would -- we're in a very competitive situation when it comes to interconnection and cross-connection. I think it would be the same amount.

Okay?

S.K. Prasad Borra - *Goldman Sachs & Co. - Analyst*

Okay.

Josh Joshi - *Interxion Holding NV - CFO*

And, Prasad, thanks for the question on ARPUs. The ARPUs in our business are influenced by a number of different elements, and I've talked about them on the call and before. We're talking about geography, space, power, and energy utilization and, obviously, currency.

And it also depends on how much incremental space we're selling at any particular time. I think if you look at slide 14 and you look at the development over the last three years, the ARPUs of those 26 data centers in that period of time went up 18%.

And we talked about same-store growth in the prior quarter of 3%, which is relatively consistent with what we experienced, and I think as we go forward, as -- the thing that we don't have control over is how customers will bring on the incremental energy, incremental power capacity. But we do expect modest increases in ARPUs progressively over the several quarters going forward.

S.K. Prasad Borra - *Goldman Sachs & Co. - Analyst*

Okay, thank you.

Operator

Thank you. Your next question is from the line of Maurice Patrick, Barclays. Please ask your question.

Maurice Patrick - *Barclays - Analyst*

Good morning, guys -- afternoon, rather. A quick question for you on return on capital employed. So, Josh, you talk about slide 14 where you talk about the 30% cash return you make on the cumulative investments. I guess offsetting that inside the income statement you have EBIT that's down year on year due to higher depreciation, a function of actually investing in higher capacity.

So, how -- the first question is, how do you think about, long term returns in that respect? How high can your cash return go, longer term, from a long-term (inaudible) level of about 30%?

And I think your ROCE, if you calculate your ROCE, it comes out at around 10%. So, how do you think about that? Thank you.

Josh Joshi - *Interxion Holding NV - CFO*

Yes, thanks, Maurice. The -- there are two perspectives on this. First, what we're focused on is building our data centers to meet the demand that we see, and, therefore, to manage the capital that we deploy.

And you can see that our cash ROGIC for the first quarter was 13%, and that was consistent with where it was last year. And I think in periods of expansion, which is coming back to your question on ROCE, which is -- and I'm not sure about the figure being at 10%, but at that level, the way that you just calculated is not something that I look at. I tend to look at cash ROGIC. I think that that's also impacted by the significant expansions that we've talked about over the last year.

But stepping back from all of that, and how do we think about it, going forward? The key here is, I think, looking at where EBITDA margins can go, how this business develops in an environment which is in cash harvest mode, if you like? And in that environment, I think that the returns available to shareholders are significant, and to some extent, that was what I was trying to show on slide 14.

And I think that the growth -- there is substantive growth available on cash ROGIC from where we are at current levels, over time.

Maurice Patrick - *Barclays - Analyst*

And that 32% relates to the -- I think it was the 30% to 40% IRR number you gave on the last conference call. Is that the same definition?

Josh Joshi - *Interxion Holding NV - CFO*

Yes, that's at the same -- that's at the same level, correct.

Maurice Patrick - *Barclays - Analyst*

Perfect. All right, perfect. Thank you so much.

Operator

Thank you. Your next question comes from the line of Gray Powell of Wells Fargo. Please ask your question.

Gray Powell - *Wells Fargo Securities - Analyst*

Great, thanks. I just had a couple.

So, we're definitely glad to hear the commentary on ARPU trends for the rest of the year. Along these lines, can you give us a sense as to how long it takes customers or it takes new customers to reach core Company ARPU levels? And then, just the average ARPU that a new customer starts off at, on day one?

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Thank you for your question. That is a -- there's no consistent answer to that, but I can give you -- it ranges depending on application. One customer that installed in the fourth quarter will take and took, let's say, 100-square meters. Their installation process is going to take them one year. So, in the one year that it will take them to install their equipment and configure their equipment and to test their equipment, they will -- and they are at 1 to 1.5 kilowatts per square meter. They will need next to no power, except on a test basis.

So, they bought the entire, say, 100 square meters for the one year in advance of when they intend to turn it on so they can lay out the configuration. So, that's an indication of someone that will put in that space an application that will need next to now power for the first year.

Then over the next two or three years, as we've talked to them, they had their standard configuration. They have their cabinets in place, and then they will grow the power consumption each year and the cooling consumption as that application grows with the demand of their own customers.

So, that's just one example.

Gray Powell - *Wells Fargo Securities - Analyst*

Got it. That's helpful.

And then, I thought slide 14 was particularly interesting. If you look at it, it appears that you're generating about an 80% incremental margin as utilization increases. Should we think about that as just the contribution margin as you lease out recently launched facilities? And then, just in terms of the flow-through to EBITDA, is there anything else that we should think about?

Josh Joshi - *Interxion Holding NV - CFO*

Yes, that's a really good question. The -- fundamentally, the logic is sound, partly because if you think about the percentage of revenues that represents energy costs, that tends to be around 15%, and that's a direct cost as customers tend to grow their business, but the rest of the operating leverage in our business model comes from pretty fixed costs.

There are stepped rises, over time, as we develop into a data center. So, you're going to find certain periods where the 80% incremental margin doesn't necessarily work, but I think it's a good yardstick.

Gray Powell - *Wells Fargo Securities - Analyst*

Got it. Okay. Thank you very much.

Operator

Thank you. The next question comes from the line of Michael Rollins of Citigroup. Please ask your question.

Michael Rollins - *Citi - Analyst*

Hi. Good morning and thanks for taking my questions. I had two questions for you.

First, have you done a deeper dive into whether it makes sense for you guys to offer cloud and compute type services, or whether you're very satisfied staying with your core strategy of just continuing to stick with the co-location, the power, the interconnectivity, and fuel the communities of interest that you have?

The second question I had was if you look at the revenue guidance range, of EUR307 million to EUR322 million, it's a pretty wide range of growth rates. On the low end, it's a deceleration in revenue growth. On the high end, it's an acceleration of revenue growth.

Can you just help us understand, maybe, the puts and takes as you're moving through the year? What scenarios get you towards the higher end versus the lower end? And just help us think through some of those sensitivities?

Thanks.

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Yes, I was so -- thanks, Mike. I was so fascinated by your second question. I'm going to answer the first one, which was --

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Josh Joshi - *Interxion Holding NV - CFO*

The cloud.

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Oh, okay. Okay. The simple answer to your question is, we are very happy staying where we are, but I'm not sure that I would categorize it the way you did. We don't sell just power, space, and security. We sell a solution, and the solution that we sell is focused on bringing together these communities of interest and working with our customers and our potential customers, to help them understand, for us to help -- for us to understand and for them to understand the benefit of getting the right customer mix sitting in the data center next to them, connected in the right fashion and in the right way.

So, when people look at our business and they say, why don't you move up to the managed services business, what don't you do this, why don't you do that? If you look at what we truly do, this is not just power, space, security, and security and the rest of that, this is a marketing -- well-thought-out marketing approach to help them come into a data center, attract the right people, understand who their trading partners are, understand how they create value or want to create value, and help them migrate to that.

So, what we really sell is an understanding of what their business is and how we can facilitate that.

And now I'll turn the tough question over to Josh.

Josh Joshi - *Interxion Holding NV - CFO*

Well, I think the first thing I'd say is actually I think, Mike, that we have a tight range. It's plus or minus 2.5% around the midpoint. And, as we thought about the range, and our approach, really has been to think about all the different factors that would be puts and takes in this. So, foreign currency is one of them. As you -- as I've talked about before, we've got the space and the power and the energy consumption, and we make judgments on that, and that can change.

And, indeed, as we talked about foreign currency, if the current trends continue, then that'll take about a 1 percentage point out of that growth rate. But, nevertheless our approach is to take that range, and if we are going to be materially outside of that, then we'll talk about it, but otherwise we'll reaffirm our guidance. And we believe that the range we're providing is appropriate and takes account of the various puts and takes that I just mentioned.

Michael Rollins - *Citi - Analyst*

Great. Thanks very much.

Operator

Thank you. (Operator Instructions). You have a question from the line of Colby Synesael of Cowen and Company. Please ask your question.

Colby Synesael - *Cowen and Company - Analyst*

Great. I have two.

The first has to do with M&A. Some of your competitors have been ramping up their M&A of late, and just trying to get a sense of how important that is for you guys. I would think that, longer term, that could have some meaningful impacts on the business, particularly recognizing that this is very much akin to a real estate model, somewhat of a land grab, whoever gets there first clearly has an advantage.

Should you be thinking more about M&A today, not for growth in 2013 or maybe even '14, but how that impacts the Company's strategic positioning in years '15 and '16 and beyond? And if you're not going to be more aggressive now, does that ultimately imply that at some point you're more likely to be a seller versus a buyer?

And then my second question has to do with visibility, guidance, ARPU, however you want to describe it, but you mentioned during your prepared remarks that you're expecting modest ARPU increases through the course of the year, which suggests, then, that you're expecting fairly consistent, I would think, square meters to come online through the course of the year.

I'm just wondering if you can talk about linearity, recognizing that you do have very good visibility, certainly more than a quarter out, even though you only give us guidance for one -- for the full year? And then kind of tying that back to you missed expectations for the first quarter, even though I'm sure what you actually put up was probably what you were expecting. Maybe giving us a little bit more color on how you expect the year to trend out would be helpful.

Thanks.

David Ruberg - *Interxion Holding NV - Vice Chairman and CEO*

Okay. Well, thank you for your questions. I'll take the first one. First of all, it's not that we don't look at M&A. We regularly look at the M&A opportunities and I think we see most of the same opportunities that our competitors do.

We may look at it is a little differently, in terms of how we go about it. To date, we've found that there's superior returns associated with organic growth, because we've been unable to find an asset that when we looked at it had the right customer, the right product, okay, and, more importantly, the projected returns.

So, in terms of being first mover, second mover, as we outlined in today's presentation, we think we have the right strategy to create value for our stakeholders. Our organic growth strategy is delivering attractive top-line growth, and we're expanding margins and strong returns on capital.

Again, we consistently look at these opportunities, and if we find one, we'll be a participant, but I do not believe that what we've seen so far has put us in a position which in any way, shape, or form diminishes our opportunity to grow in the future.

And, in terms of the second half of that question, we are constantly looking at ways that we can create long-term shareholder value returns for our shareholders. And if the right opportunity, one way or another, comes up, we'll participate in it.

Josh Joshi - *Interxion Holding NV - CFO*

Yes, thanks, David, and I think it's just another capital allocation question, isn't it, in terms of where the best returns are in the businesses. We see them.

In terms of your second question, Colby, yes, I did make the comment about the modest growth in ARPU. I would also -- it's worth reminding you, actually, that last quarter we also talked about a significant customer that was purchasing power directly, and is a multi-site customer, but at one of its largest installations.

So, that has an impact on ARPU, because we won't see the energy growth of that, but as we think about our visibility, yes, we do have visibility going forward, and I spoke earlier about the revenue-generating space can come on in relatively lumpy. That's just the nature of the beast, but, overall, as we look at it on a year-over-year basis, I think we can be very consistent about the way that we determine how we think we're going to grow.

As far as the guidance and the granularity around that goes, I think that at the beginning of the year our approach is to provide a revenue range. It's relatively tight, as I said before. And that's been our philosophy since we started providing guidance a couple of years ago.

And that revenue range is based on that visibility, and if we think that that visibility changes materially, we'll update that range. But beyond that, that's where we are.

And we'll be in the range.

Colby Synesael - *Cowen and Company - Analyst*

So, Josh, I mean, I guess what you're saying, then, is that there is no significant ramp, whether it's in Q3 or 4, that you're anticipating right now. It should be fairly consistent, fairly linear, both in terms of square meters added, ARPU, revenue growth, really, for the year?

Josh Joshi - *Interxion Holding NV - CFO*

Well, specifically what I said is I think that the ARPUs are going to grow modestly and reasonably well, and I think that we're going to see sequential revenue growth. But beyond that, I don't think I've added particularly more color.

Colby Synesael - *Cowen and Company - Analyst*

Okay, thank you.

Operator

Thank you. (Operator Instructions).

Jim Huseby - *Interxion Holding NV - VP IR*

Thank you. Thank you, operator. I think that concludes our call for the day, and thank you, everybody, for joining us on our first quarter earnings conference call. We'll talk to you again in three months. You can sign off now.

Operator

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