2023 Mid-Year Results Briefing

Thank you for joining us today.

Key Highlights

Let's begin with the Key Highlights on page two of our presentation.

Digital Core REIT announced a distribution of 1.92 U.S. cents for the first half of 2023, in line with the second half of 2022. We expect to pay the distribution on 28 September to unitholders of record as of 4 August.

The cash flows underpinning this distribution are generated by our portfolio of mission-critical facilities that support the underlying businesses of the world's leading technology service providers. Despite a somewhat challenging macroeconomic environment, these service providers continue to enable global digital transformation, and they are rapidly adapting to a momentous technology platform shift.

Artificial intelligence has quickly become a buzzword, and everyone wants a piece of the action. Within the data centre sector, however, the action is matching the hype. Data centre absorption reached a new record high in the second quarter, driven in part by several sizable artificial intelligence requirements. Supply remains constrained across most core global data centre markets while demand has accelerated, driving continued improvement in pricing. We believe we are well positioned to benefit from this platform shift, given our existing presence in core data centre markets along with our unparalleled Sponsor acquisition pipeline.

We have exercised caution on external growth to date, opting to preserve liquidity and manage leverage in the current macro environment, but we did take the opportunity during the first half to invest $2 million to buy more of our own portfolio at a deep discount to intrinsic value, repurchasing 4.6 million units at an average price of just over $0.46 per unit and generating roughly 40 basis points of DPU accretion while keeping leverage essentially flat. Including the purchase of the 25% interest in the Frankfurt facility and the buyback we executed at the tail end of last year, since December of 2022, we have generated approximately 400 basis points of accretion on total investments of roughly $160 million.

We ended the first half of the year just below our 35%-40% target leverage range while 72% of our debt is hedged against rising interest rates.

Customer Bankruptcy

Let's turn to our portfolio update on page three.

As you know, our second-largest customer, representing approximately 22% of annualised rent, filed for bankruptcy in June. The customer currently occupies 100% of two shell & core facilities in Los Angeles; 100% of three shell & core facilities in Silicon Valley; and 1.5 megawatts, or 4%, of a fully-fitted facility in Frankfurt.

The customer remained current on its rent through the month of May and has paid rent for the month of July. They have not yet paid rent for the month of June, although we expect to collect June rent in full as an administrative expense claim through the bankruptcy process. Under U.S. bankruptcy law, the customer must continue to pay rent throughout the bankruptcy process, unless and until they reject a lease.

In the days immediately following the bankruptcy filing in early June, the customer rejected a handful of lease agreements with other providers for facilities that were either completely or almost completely unoccupied. To date, they have neither accepted nor rejected any of their lease agreements with us.

The customer has publicly disclosed that they are running a sale process to find a buyer for their business. Preliminary bids were due last week, and the winning bid is scheduled to be selected over the coming weeks.

One nuance to point out here is that prospective buyers have the ability to bid on the entire business or just select assets. Consequently, although it may have seemed intuitive that any leases that were going to be rejected would have been rejected prior to the preliminary bid deadline, the reality is that the winning bidder – or the future owners of the business – will be able to make the ultimate determination as to which leases are accepted or rejected.

In the press release announcing the customer bankruptcy, we disclosed that if 100% of the annual revenue from this customer were to be eliminated, our DPU would be roughly cut in half. We believe the worst-case scenario is highly unlikely, as these assets are concentrated in core markets, in-place rents are below market, and we would be well-equipped to step into direct agreements with the end-user colocation customers.

However, it's probably not realistic to expect that we will emerge completely unscathed, either. We do not have perfect visibility into the process, but as represented by the color-coding under the customer footprint table at the upper left on page three of our presentation, we believe the L.A. facilities are most at risk of lease rejection. The customer has up to 120 days from the date of its bankruptcy filing on 4 June to determine whether to accept or reject its lease agreements, although we hope and expect that we should reach resolution over the next several weeks.

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Sustainable Growth

Let's turn to page four to discuss the path forward.

As you can see from the chart on the right, there has been a healthy flow of data centre investment activity over the past several months. Cap rates for fully fitted facilities have begun to widen out, although investor demand for data centres remains robust, particularly for platform plays and shell & core facilities.

There are nuances to each of the transactions represented on this chart. At the high end of the range, the Sponsor recently contributed an asset in suburban Chicago to a joint venture at a six-handle – although this was a fully-fitted facility in a secondary sub-market facing intermediate-term customer churn and sharply higher property taxes.

Conversely, the going-in yield on the Toronto transaction was just a shade over 3%. However, this was a network-dense portfolio that was just 75% occupied and is expected to stabilise in the mid-to-high fours over the next several years. The truth – and the weighted average – is probably somewhere in between, particularly for shell & core facilities.

Keep in mind that the Fed has raised rates by 500 basis points over the past 16 months. Against that backdrop, it stands to reason that cap rates will edge higher.

However, we continue to see a very healthy bid for data centres in the private market, as evidenced by the real-time comps in the middle of the chart on page four. In addition, data centre fundamentals are continuing to tighten, with a rapidly strengthening tailwind from artificial intelligence workloads. The acceleration in demand coupled with limited supply is driving greater embedded rent growth, serving to partially offset the impact of cap rate expansion on data centre valuations. Consequently, although we do expect to see valuer cap rates edge higher, we remain comfortable with our leverage profile and covenant compliance.

Finally, there's a silver lining to modest cap rate expansion. The widening spread provides greater opportunity to structure accretive transactions. We still need to reach resolution on the customer bankruptcy, but we are confident in our prospects and the resiliency of our business, and we are looking forward to the day when we can go back on offense and capitalise on our industry-leading acquisition pipeline to create value for unitholders.