



Co-location modularised

DC Two (ASX:DC2) is a Perth-based data hosting infrastructure service provider offering cloud-computing services through tiered colocation space. Recently, DC2 has operationalised a large ISO-certified facility. It is also in the process of applying for Tier III accreditation for its state-of-the-art Bibra Lake facility. Once achieved, DC2 will become the only data hosting vendor in Western Australia that operates its own Tier III data centre facility and ISO 27001 ISMS accredited cloud platform. These certifications will allow the company to engage with relatively high-budget enterprises.

The company enjoys relationship with a network of 40+ channel partners having substantial customer-base. Through constant engagement with these related entities to bundle networking and communication services with cloud and hosting solutions, DC2 is well positioned to take advantage of upselling opportunities

Lower cost modular data centres will drive growth

DC2 has designed an innovative modular data centre solution. It leverages renewable energy to offer cost efficient data hosting solution for high computing needs i.e. crypto mining etc. With the advent of low latency applications and virtual work requirements, these modules are expected to support exponential growth for DC2.

Valuation range of A\$0.46 – 0.79 per share

We value DC2 at A\$0.46 per share base case and A\$0.79 per share optimistic case, using a composite of DCF and relative valuation. Our assumptions are based on operationalisation of higher-tiered large data centre and greater traction within low-cost modular centres. Execution remains the biggest risk.

Year to June (AUD)	2020A	2021A	2022f	2023f	2024f
Sales (mn)	1.86	1.74	1.97	4.70	8.54
EBITDA (mn)	0.01	(3.11)	(2.08)	(1.50)	0.87
Net Profit (mn)	(0.21)	(3.56)	(2.66)	(2.04)	0.13
EBIT Margin (%)	0.8%	NM	NM	NM	10.2%
ROA (%)	NM	NM	NM	NM	1.5%
EPS	(0.12)	(0.07)	(0.04)	(0.02)	0.00
DPS	NM	NM	NM	NM	NM
EV/Sales	NM	4.9x	6.7x	3.2x	1.8x
EV/EBITDA	NM	NM	NM	NM	17.2x
P/E	NM	NM	NM	NM	104.8x

Source: Company, Pitt Street Research

Share Price: A\$0.15

ASX: DC2

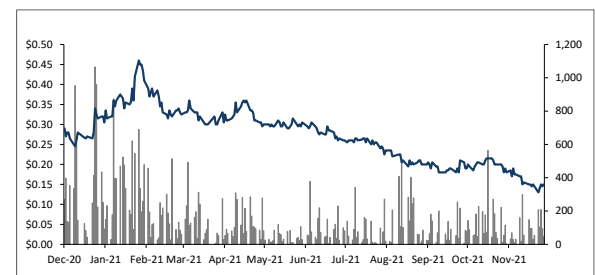
Sector: Technology

14 December 2021

Market cap. (A\$ m)	11.3
# shares outstanding (m)	75.2
# shares fully diluted (m)	90.3
Market cap full. dil. (A\$ m)	13.5
Free float	55.8%
52-week high/low (A\$)	0.50 / 0.13
Avg. 12M daily volume ('1000)	155.2
Website	www.dctwo.com.au

Source: Company, Pitt Street Research

Share price (A\$) and avg. daily volume (k, r.h.s.)



Source: Thomson, Pitt Street Research

Valuation metrics	
DCF valuation range (A\$)	0.58 – 1.02
Relative valuation (A\$)	0.34 – 0.55
Blended valuation (A\$)	0.46 – 0.79

Source: Pitt Street Research

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DC2 has two data centres in Western Australia – Bibra Lake and Osborne Park.

Once approved, DC2 will be the only company in Western Australia with its own ISO 27001 and Tier III accreditation

Modular data centres are locally operated and offers significant cost advantage

DC Two in Nutshell

Established in 2012, DC Two Limited (ASX:DC2) is a Perth-based data storage infrastructure service and cloud solutions provider. Its main portfolio of data centre solutions include data hosting, colocations, miner hosting, and modular data centre services. DC2 also offers a boutique of cloud solutions, such as disaster recovery, software-as-a-service (SaaS), cyber-as-a service (CaaS), private cloud, hybrid cloud, desktop-as-a-service (DaaS), voice-over-internet protocol (VoIP), virtual desktop services, etc.

Innovative and best-in-class centres offer scalability

DC2 offers a vertically integrated portfolio of data-hosting infrastructure and cloud services, with the aim of becoming the only provider in Western Australia with their own Tier III accredited data centre and ISO 27001 ISMS accredited cloud platform. This ISO27001 certified state-of-the-art centre offers multi-tenant cloud platform and is expected to expand DC2's hosting capacity from 34 racks currently to ~400 racks. With the industry average revenue per rack being A\$1,600 per month for co-location and increasing to A\$50,000+ for full cloud racks, this expansion supports exponential growth.

DC2's innovative, high density, transportable and scalable modular data centre solutions—DC Modular business unit—leverages renewable energy to offer cost efficient infrastructure-as-a-service (IaaS) solutions for high computing needs. These modules are pre-fabricated and offer competitive rates, thereby proving to be beneficial even for smaller enterprises.

Dedicated software arm offers significant growth potential

One of the defining features of DC2 that sets it apart from other data hosting infrastructure providers is the integrated cloud solutions. DC2's cloud automation software facilitates faster communications, data sovereignty and security. In addition, the dedicated software team at DC2 is engaged in developing software tools, which complement its cloud solutions – i.e. platforms and tools that bridge the technological gap within the cloud and data centre space. Once commercialized, DC Soft – the in-house software development unit – is expected to lead to potential gains.

Revenues are recurring; channel partners ensuring wider base

The increasing trend of remote working, adoption of edge computing and data privacy concerns have heightened the need for localised data hosting. Consequently, customers often enter into long-term service contracts with their colocation vendors. This provides DC2 with an opportunity for recurring revenues. The company deploys a subscription-based approach to charge customers for using the racks and other allied services. Additionally, with 40+ managed service providers (MSP) as channel partners, DC2 have expanded sales focus to ensure a network of diverse and loyal customers.

DC2 is highly undervalued due to current limited operations

We think that the main reason for the apparent undervaluation of DC2 is its limited rack capacity and restricted offerings. We look for a re-rating in the medium-term once Tier III accreditation is achieved for the Bibra Lake facility and multiple modular data centres become operational. Over the long-term period, commercialisation of the software suit will provide significant value-accretion.



Investment Case: Key reasons to look at DC Two

I. Unique combination of colocation and cloud solutions

DC2 provides a unique proposition of multi-tenant colocation solutions and cloud-services platform through its locally-managed data centre infrastructure and in-house technical team. This helps DC2 acquire an edge against the competition (which does not provide integrated solutions). DC2 has recently introduced a new facility – The Bibra Lake data centre. With ISO27001 certification (first certified facility for DC2) and soon-to-be-achieved Tier III accreditation, Bibra Lake facility is expected to support exponential revenue growth for DC2.

II. Modular data centres provides scalability to operations

DC2 has designed and developed a unique ‘containerized’ data centre that can be put right next to a power source. These modular, transportable, high-performance and high-density data centres do not require significant additional infrastructure. Due to their small size, they can be accommodated anywhere. This helps in making sure that the operations highly scalable and expandable to other regions / geographies with minimal cost.

III. Commercialization of DC Soft will be a game changer

DC2 is developing an integrated and automated software platform for tailor-made service offerings. The aim is to make a single platform that has all the necessary tools for customers to integrate their cloud-based needs. This is expected to be ready for commercial usage in 2022, which will then further re-rate DC2 stock.

IV. Vertical expansion supplements current operations

The Bibra Lake data centre is expected to push DC2 higher up the value-chain, in terms of quality and quantum of clients. With new racks and accreditation (a prerequisite), DC2 can now serve high-value customers, i.e. large enterprises, which was missing earlier. Considering the fact that the company has extensive experience in working with local companies, offers integrated solution and has a well-established network of channel partners, we believe DC2 has a significant potential to expand its coverage within high-end paying customers.

V. “Go-to-market” strategy provides multiple sales avenues

DC2 has extensive channel partnerships that are responsible for ~70% of its total revenue. This go-to-market strategy allows DC2 to double its sales efforts by utilizing the existing and potential client network of managed service providers (MSP). DC2 has been consistently engaging more channel partners to reach a variety of high-end customers. We believe that as the brand and product visibility increase, investor interest will likely follow.

VI. One of the best value data infrastructure service providers

We believe that DC2’s current valuation does not accurately reflect its growth potential. DC2 is one of the least expensive investment opportunities within the high-growth colocation and cloud technology industry. The partnership with related industry players to bundle networking and communication solutions with cloud and hosting services provide DC2 with significant market expansion opportunities. The possibility of revenue growth owing to expansion in the infrastructure capacity and upcoming commercialization of DC Soft tools will aid re-rating in medium-to-long term period.

Growing brand visibility will drive investor interest

Current valuation does not reflect DC2’s full growth potential

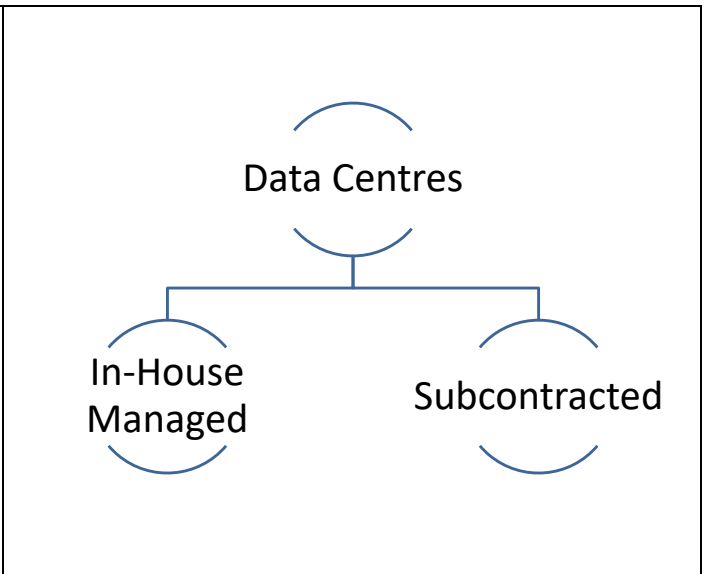


One-stop-shop for colocation and cloud services

Since its inception in 2012, DC2 has primarily been a mid-market data centre infrastructure developer. Along with its boutique of cloud services, it has been focussing on localised data hosting services. Until recently, it had only one facility with ~38 racks that had a total of ~160KW of power capability. With the recent operationalisation of the Bibra Lake facility – a state-of-the-art data centre – DC2 aims to make a giant leap into the big world of colocation. DC2 has invested in a couple of more data centre facilities and, along with the integrated cloud services, is expected to become a one-stop solution for all the data hosting requirements of the local enterprises.

Figure 1: Data Centres provides racks for computer servers

Figure 2: Data Centres are either managed in-house or are outsourced



Source: Pitt Street Research

Source: Frost & Sullivan and Pitt Street Research

Modular data centres offers cost effective data hosting infrastructure solution for high-powered edge computing

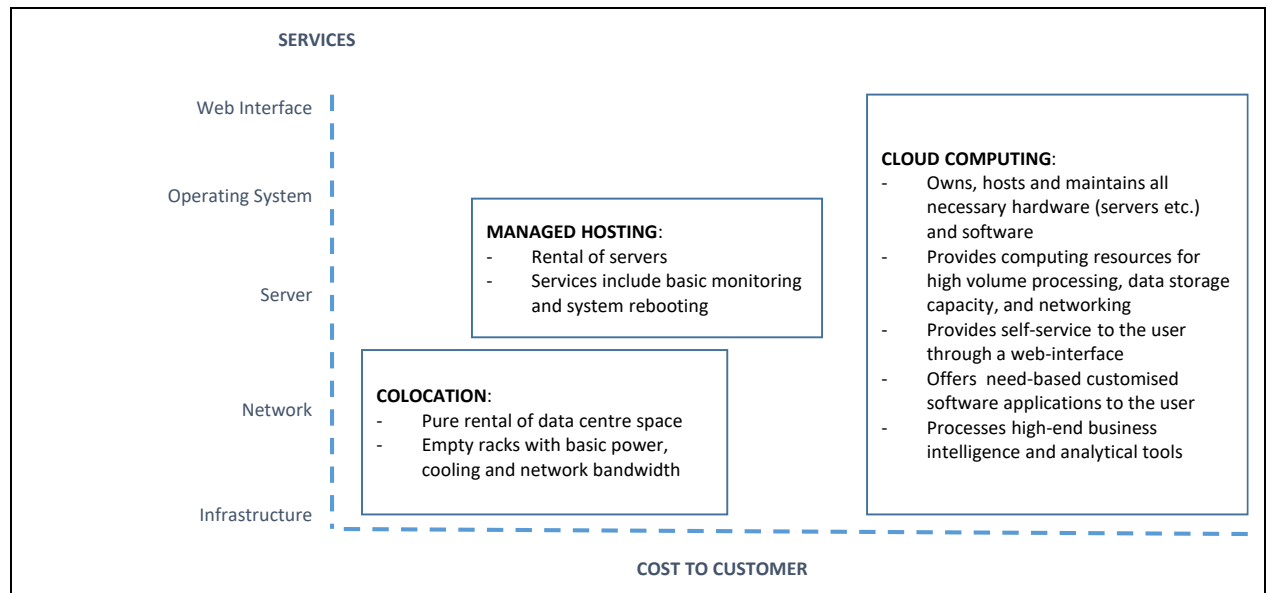
Full boutique of Colocation and Cloud Solutions

Colocation Infrastructure Services

These services provide infrastructure ‘racks’ to third parties for servers and other IT network equipment. The servers and other equipment from different companies are ‘co-located’ under one roof. The equipment is accommodated and maintained (maintenance is optional) by the data centre infrastructure provider. The biggest feature of a colocation service provider is to ensure continuity of operations and data security.



Figure 3: Data Centre Services



Source: Pitt Street Research

DC2 offers this multi-tenant infrastructure service to small and medium enterprises. The complete portfolio of infrastructure services includes data storage, data backup, disaster recovery, software licensing and infrastructure management, hosted through self-managed data centres.

The company provides facilities that are controlled, connected, locally accessed and self-managed. In addition, the management offers a predicted pricing mechanism providing lower operational costs to regional corporations. Along with that DC2 provides additional benefits:

- **Flexibility** in operational parameters for customers: Customers can rent out an entire rack or only a part of the rack with varied power density.
- Through its enhanced measures, DC2 provides complete **data security**.
- **Hybrid centres:** DC2 has a standardized facility and runs both ground and cloud IT services.

Bibra Lake: A state-of-the-art data centre

Situated in the outskirts of Perth city, Bibra Lake is an ISO27001 Information Security Management System (ISMS) accredited facility. With a total potential of 3MW power capacity and ~400 racks (currently STAGE I configuration; 1MW power capacity), this has now become the new base of operations for DC2.

This centre has the facility to provide a power density range of 3KW to 30 KW per rack, supporting the varying demand of enterprises. DC2 has never intended to be an 'only colocation' data centre service provider. Though Bibra Lake is a fixed data centre, the incremental rack capacity supports providing value-added fixed colocation services to existing and potential customers.

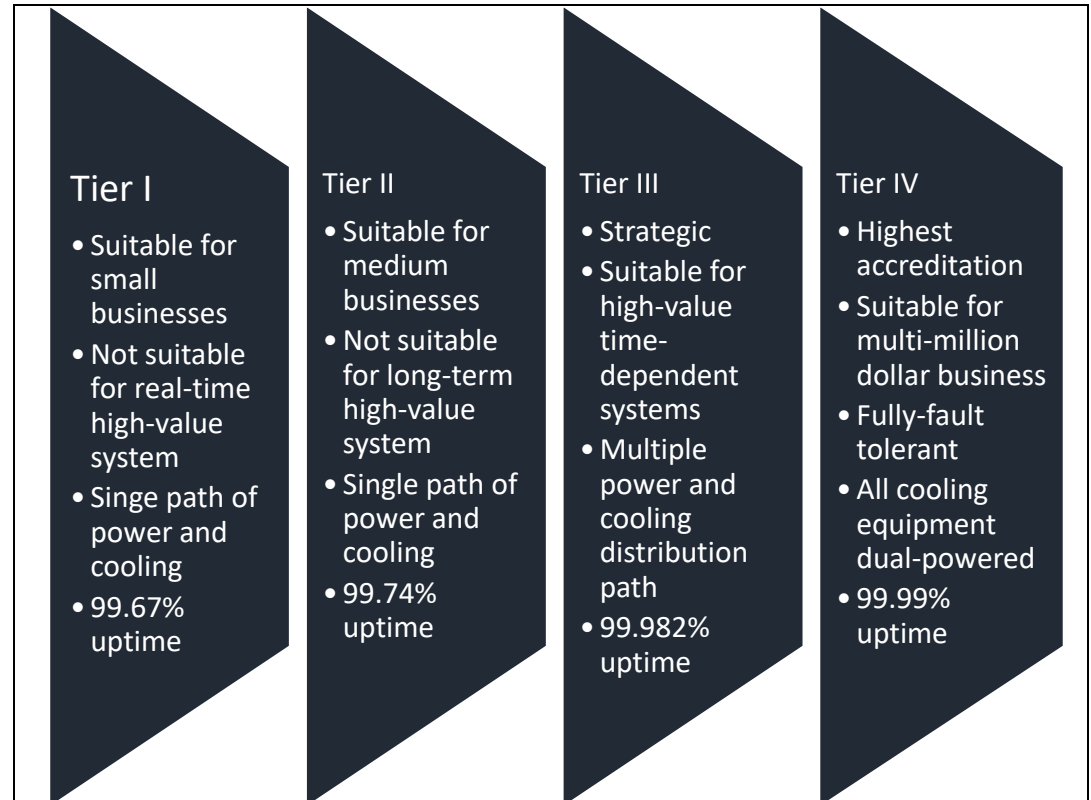
DC2 is currently in the process of re-applying for a Tier III accreditation for this facility. It was design accredited Tier III by the previous tenant. DC2 has completed majority of the required civil and electric work and have applied for Tier III accreditation with Uptime Institute, the world's leading authority to certify data centres.

State-of-the-art Bibra Lake facility, with its ISO and Tier III accreditation, is expected to attract large corporates in the region



Once fully accredited, DC2 is set to become the *only organisation with its own multi-tenant ISO 27001 accredited cloud platform and a Tier III data centre operating in the region of Western Australia.*

Figure 4: Uptime Institute's Data centre Tier Standard



Source: Uptime and Pitt Street Research

Accreditation is important to move up the customer-level curve

The quality of a data centre is based on the level at which it operates (Figure 4). These tier levels are used by the enterprises to identify the complexity and redundancy of the data centre infrastructure. The various levels of a data centre are as follows (Source: HP Enterprises):

- **Tier I** data centres have single path for power and cooling and a few backup components. It has an expected uptime of 99.671%.
- **Tier II** data centre have single path for power and cooling and some redundant and backup components. It has an expected uptime of 99.741%.
- **Tier III** data centre have multiple paths for power and cooling and systems in place to update and maintain it without taking it offline. It has an expected uptime of 99.982%.
- **Tier IV** data centre is built to be completely fault tolerant and has redundancy for every component. It has an expected uptime of 99.995%.

For any large enterprises to select a data hosting infrastructure, a minimum of Tier III accreditation is required to maintain data sovereignty and service continuity. Through its flagship Bibra Lake facility, DC2 aims to move up the curve – from servicing small-to-mid market enterprises (spending A\$1-3k per month) to attracting bigger enterprises with higher paying capacity (A\$10-20k



per month). This is aimed at increasing the operational viability and will also expand profitability (though value-added services).

Other Data Centre Facilities

DC2 has invested in several facilities (one of the sites is self-managed while remaining are a part of other facilities) through which it provides its colocation services.

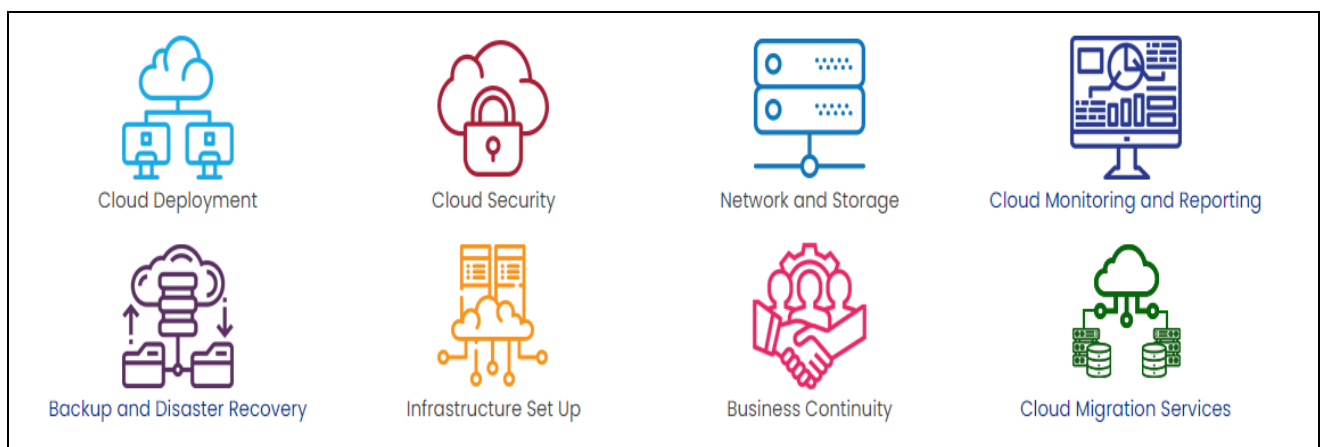
- Osborne Park centre: The Tier II data centre facility is located centrally, ~6km from the Perth Central Business District. It is predominantly dedicated to serve the small-to-medium businesses. With ~40 racks and a total power capability of 1MVA, it provides point-to-point connection to satellite landing station. However, given its relatively lower tier status, this facility is unable to serve big enterprise customers.
- Secure data facility at Darwin and Vocus Perth IX data centres are DC2's points of presence (POP) locations. Darwin facility is home to DC2's presence in the Northern territory. The Vocus Perth centre is a high density facility used for storing servers and other networking equipment.

Cloud and Data Management Services

What are cloud services?

Cloud computing for any business is all about on-demand availability of IT resources, data storage and computing power, without any active management of the same. The main purpose of these services is to provide access to system-specific or shared data from anywhere and on any device over the internet. This is technically doable by storing data in well-connected data centres rather than local on-premises servers. These services include data storage, backup solutions, web-based e-mail services, hosted office suites, document collaboration services, database processing, managed technical support services etc. Cloud solutions are designed in a way that they are highly scalable and available at a relatively optimal cost. Since the assets are managed by a third party, the cost for businesses is restricted.

Figure 5: Various Cloud Services as offered by MSPs



Source: Pitt Street Research



Specific cloud management services

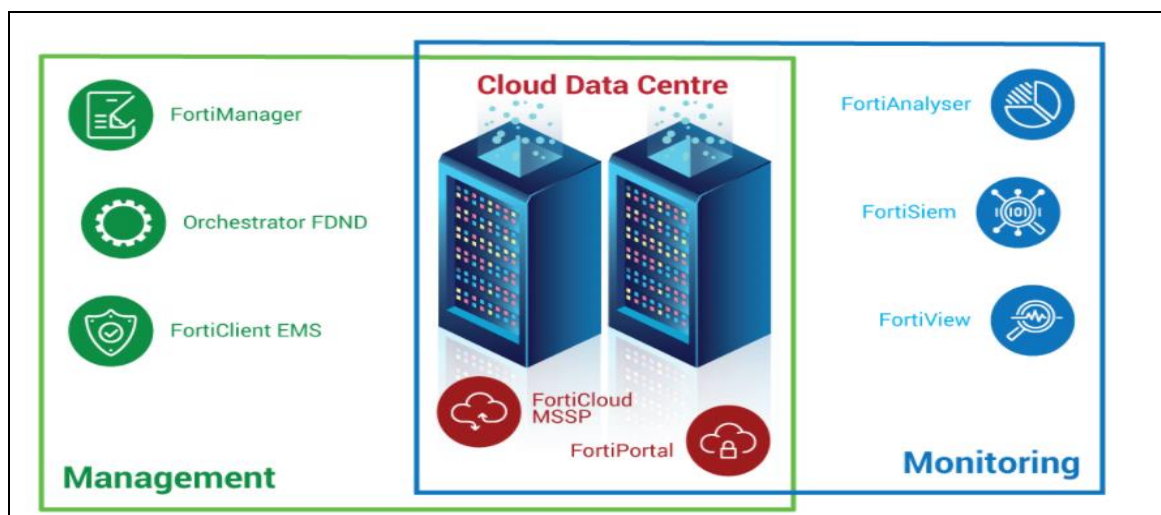
Through its dedicated self-managed data centre facilities, DC2 complements its clients with a variety of cloud-managed services. These solutions provide complete management of the customers' cloud resources. As a managed service provider (MSP), the ultimate aim for DC2 is to support the enterprises in managing data with optimal security, provide operational continuity and develop an efficient environment for on-demand access to resources (Figure 5). Through its boutique of services, DC2 offers a combination of software licenses, automation tools, compliance set-ups and people with technical know-how.

DC2 offers customised solutions from its highly secure data centres in and around Perth's central business district. The on-demand computing services do away with the necessity of managing the IT infrastructure. This therefore allows businesses to concentrate on their core operations. The combination of private cloud, public cloud and hybrid cloud services makes DC2 one of the most optimal partners.

As an MSP, DC2 provides a host of cloud solutions:

- **Private Cloud:** DC2's private cloud solution can be located anywhere in Australia and hence is highly scalable for enterprises. This is supported by a locally-present technical team that ensures data security and business continuity.
- **Public Cloud:** Through its multi-tenant environment DC2 offers a pay-as-you-grow scalability option for public cloud service clients. The company provides flexibility to enterprises at a reduced cost and also offers storage space, depending on the requirement and capability to scale operations. DC offers tools that allow seamless integration with other cloud service platforms, such as Amazon's AWS and Microsoft's Azure.
- **Security-as-a-Service:** *Partnering with Fortinet*, a US-based cybersecurity solution provider, DC2 offers a complete package to keep the client's data secure and maintain continuity in operations (Figure 6). Based on monthly fee model, DC2 provides monitoring and security management of devices and systems. The most common services include managed firewalls, virtual private network, vulnerability scanning, disturbance detection and anti-virus services.

Figure 6: Security Protocol as provided by DC Two

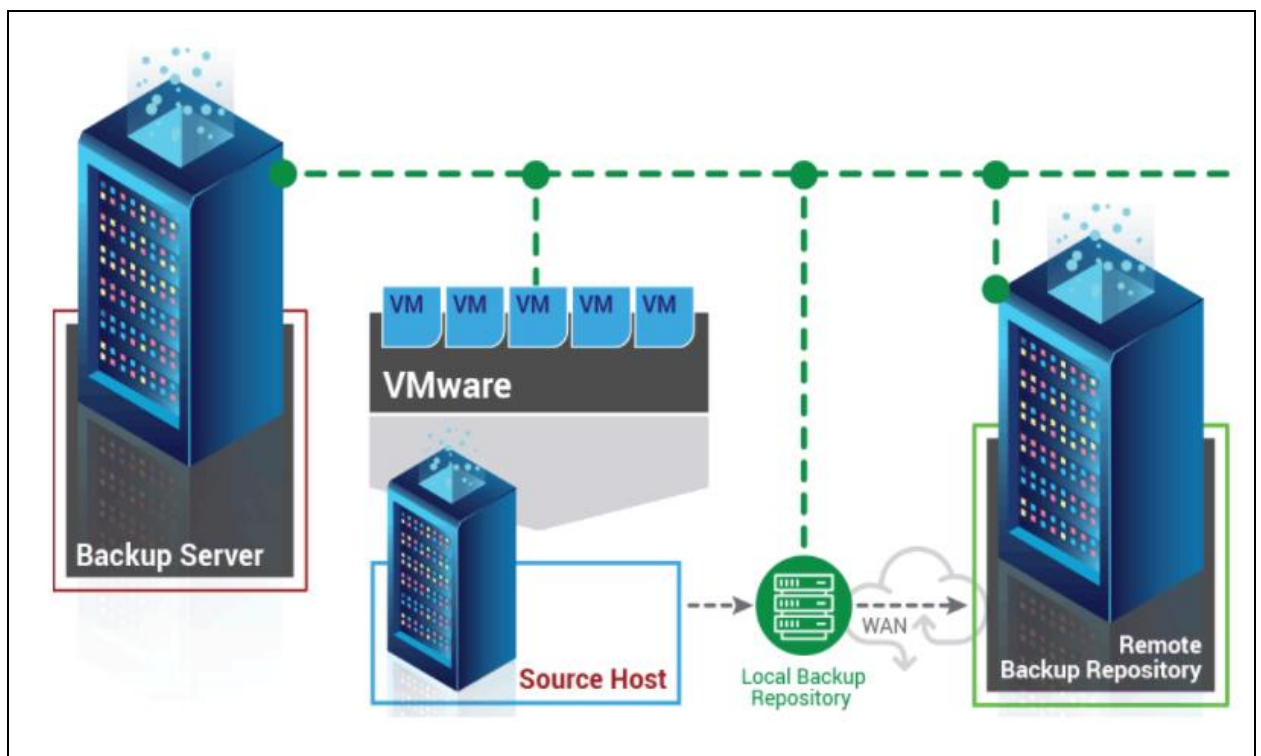


Source: Company



- **Disaster Recovery-as-a-Service:** A spectrum of disaster recovery solutions allow DC2 to support businesses in accessing data all the time. DC2 offers *Veeam Cloud Connect*—a built-in modern back-up technology—that provides locally-based replication solution. DC2 has ‘onsite’ kiosks that can be used to upload the backup relatively quickly (Figure 7). The DC2 team monitors and repairs any network issue remotely. *Data Transfer Kiosks* is one of the unique offerings that makes DC2 different from its peers. All transfer is done remotely and in real-time, thus reducing the security risk.

Figure 7: Disaster Recovery Protocol as provided by DC Two



Source: Company

- **Virtual Desktop-as-a-Service:** Leveraging its integrated solutions, DC2 now provides clients with the option to work from anywhere through the virtual desktop service. Riding on integration within multiple operating systems, DC2 customers can access desktops remotely on any device, thereby attaining complete freedom to access data from anywhere. The company’s Standard and True Virtual Desktop Infrastructure (VDI) solutions eliminate the need for on-premises servers or high-powered computing. In addition, through the MyDaaS (part of desktop-as-a-service), DC2 also offers a simplified solution of virtual desktop to clients. With its new cost-per-usage model, DC2 can charge clients on the number of end-desktops every month, allowing customers to have a flexible workforce without the constraints of a physical office.



Vertically integrated solutions are value-accretive

The boutique of integrated solutions that DC2 offers is quickly becoming a differentiation factor, prompting many customers to prefer DC2 over other competitors. DC2 differs from other private cloud vendors who do not offer software solutions / licensed products that complement the services. DC2 is an ideal vendor for hybrid cloud data centre services due to following reasons:

- DC2 mainly operates in the mid-market, where most of the service providers lack an in-house technical support team. Customer support services often take a back seat for mid-market data centre developers. **DC2, on the other hand, is one of the few fully integrated infrastructure service providers** covering all the aspects of data hosting and cloud computing supply chain. It serves as a supplement/ replacement for in-house cloud IT teams for clients resulting in resource optimization for everyone.
- While the big data centre suppliers do not serve everybody. They often charge extra elevated prices for support functions. In comparison *DC2 offers predictable pricing* for a portfolio of services. The higher the content of the portfolio, the higher the charge. This **subscription-based model** supports clients to pick and choose the service offerings. In contrast to this, pricing by most of the service providers is highly opaque.
- **Cost-per-usage model:** Since DC2 has no minimum usage charge at the back-end, data centres services are also charged accordingly — pay-as-per-usage.
- Data security is of paramount importance for any colocation or cloud management service provider. DC2, with in-house technical team, puts security at the forefront. Multi-tenancy can often pose security and privacy risks. However, DC2 has a **dedicated team to look after this – the team is involved in quick-response and complete disaster recovery.**
- Transparency and control: Since the delivery of dynamic, cloud-based infrastructure, platform and application services doesn't occur in a vacuum, it is imperative that enterprises choose a reliable partner, like DC2.



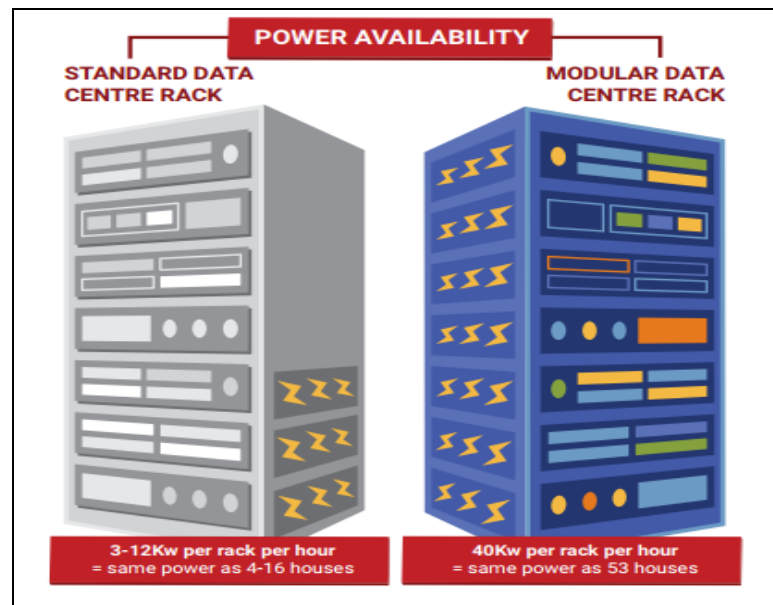
Modular data centres are unique and cost efficient

What is a modular data centre?

Technically, modular data centres are regional / localised data centres that are non-tiered. The main purpose of these data centres is to provide ultra-high powered data hosting infrastructure for high-performance computing requirements (Figure 8).

These centres offer complete integration of power supply, distribution systems, cooling system cabinets, etc. The factory-fitted modules are pre-tested and the whole-package field installation results in rapid deployment. They offer ready-made solutions to establishments with edge computing needs, also called crypto miners. Since modular data centres follow the pre-fabrication construction process, the site expansion timeframe is limited.

Figure 8: Modular data centres are ultra-high powered



Source: Company

Apart from being energy-efficient, these modules also help reduce the number of people required on site during the construction/deployment phase. This feature resulted in an increased traction for such data centres, especially amidst the restrictions that were imposed due to the pandemic. The module is expected to provide incremental opportunities to the vendors.

'Behind the meter' data centres are unique

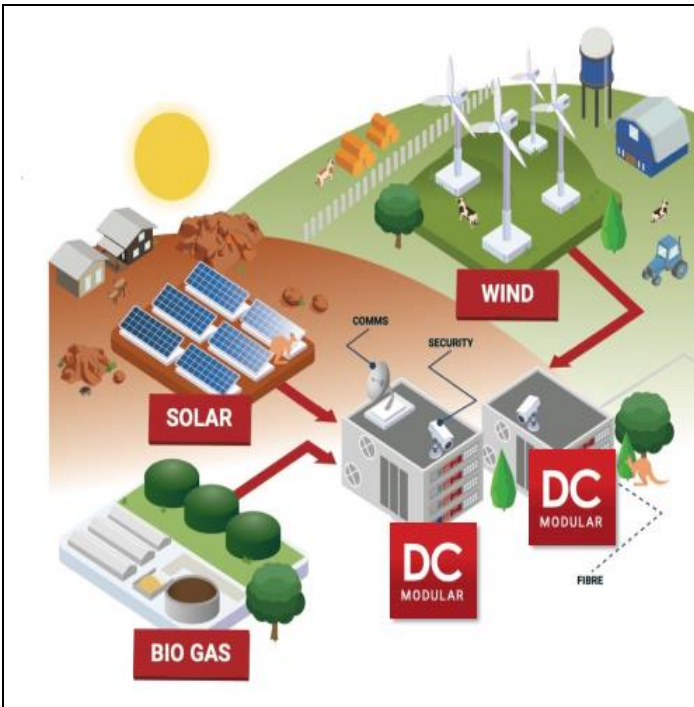
Launched in March 2021 DC2's regional modular data centres are the first-of-its-kind in Australia. Developed in-house, these high density, transportable and containerized data centres are economical, have a high-margin and are easy-to-deploy. The modules are based on durable ISO standard sea containers and non-rugged insulated variants. DC2 has exclusively designed these solutions in a way that the modules can easily be integrated with third-party renewable energy sources, namely wind, solar, biomass energy, across regional and low-cost semi-urban remote locations (Figure 9). These are of a very high density with ~40kw per rack for all the racks.

Modular data centres offers cost effective data hosting infrastructure solutions for high-powered edge computing

DC2's modular data centres are located at places where renewable energy power source is available. These centres provides ultra-low operational costs for end-customers and also manages ecological impact



Figure 9: A prototype of DC2 modular data centre



Source: Company

Figure 10: One of DC2's active regional modular data centre



Source: Company

DC Modular data centre business unit designs and constructs modules (MINI-PODs) that include (Figure 11):

- Individual power distribution units (PDU) powering the server devices;
- Remotely controlled monitoring systems that manage the entire environment of the modular centres.

These are 'fit-for-purpose' and locally deployed modules that only require a power source and data connectivity. The modules offer plug-and-play solutions for end-users. Being placed right at the green- powered source, these modules offer ultra-low costs, which makes them an efficient option for budget-constraint enterprises as well.

Direct-to-market model makes it a high-margin proposition

Contrary to its colocation solutions, DC2 does not follow a 'partner first' model for regional modular data centre services. Being pioneers of this concept, DC2 takes it directly to market, saving on the partner commission. This translates into a relatively higher margin for the company.

The main cost for DC2 in building these modules is that of power supply. The company enters into a long-term power purchase agreement with the supplier and can simply mask the cost and raise an invoice for the client based on usage. This implies very high margins (30-40%) from a recurring revenue stream.

PdUs are integrated with the central management portal to ensure better monitoring

Modular data centres can be scaled up very easily. Even though it requires capital inflow, the payback period is limited



Figure 11: Various SECTIONS of a modular data centre and their utility

MINI-POD	Power Distribution Unit (PDU)	Room Controller	DC Portal
<ul style="list-style-type: none"> - Can house 4 racks, each with up to 4 PDUs in each rack - A maximum of 16 PDUs per MINI-POD - Each module can provide cooling for ~160KW of power, i.e. 40KW in each rack - Able to connect with satellite or fibre internet connection - Security features includes door locks, cameras, motion sensors and alarms - Designed to integrate with 3rd party power source like wind, solar or bio mass 	<ul style="list-style-type: none"> - Very high power capability of 63 amp single-phase (15KW) - Remote web interface - Access unit to remotely cycle power on each device - Alerts warnings, and messages - Can be a standalone product or integrate with room controller 	<ul style="list-style-type: none"> - Remote web interface - Multiple PDU integration - Have Temperature sensors, humidity sensors and electrical frequency controllers 	<ul style="list-style-type: none"> - Views all PDUs and room controllers from one room

Source: Company and Pitt Street Research

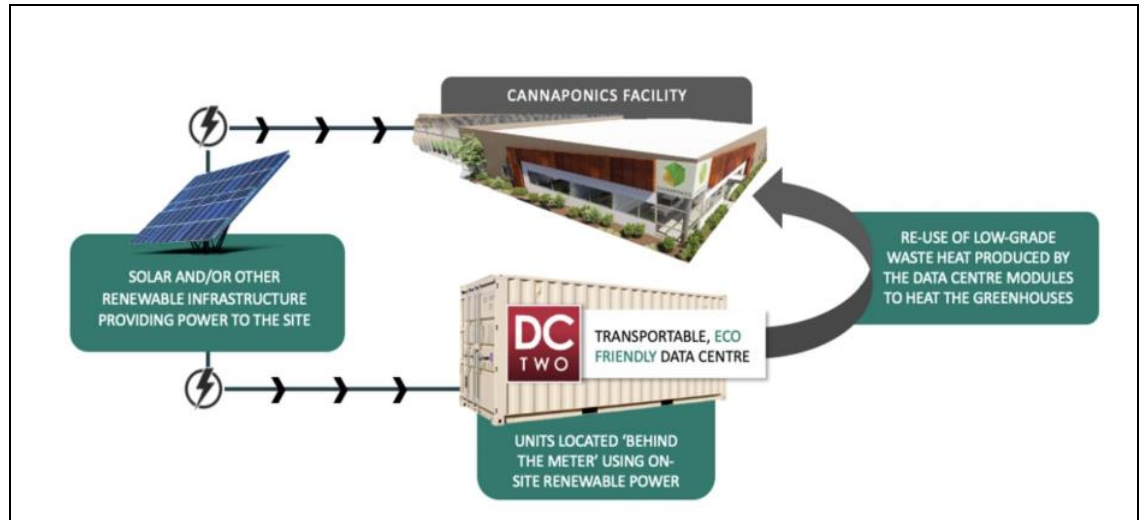
Current portfolio of regional modular data centres is expanding rapidly and can be scaled up further

- Currently, DC2 has a modular data centre in the **mid-west** region. It is an onsite module within an existing wind farm with a power capacity of 2MW by the end of 2021. DC2 has deployed the first 160KW module under a fixed term agreement with a cryptocurrency miner for a period of 5 years. This is a first such facility in Australia which is being promoted for high performance super-computing activities.
- DC2 is also building up a new facility at an existing biomass site located in **Victoria**. Within the framework of a non-binding MoU, DC2 is preparing a land access and power purchase agreement for this facility. With energy being supplied from a waste storage capacity nearby, this latest module will have an initial power capacity of 1.4MW – which can be extended up to 5 MW. While DC2 offers/rents complete racks to the end customers, DC2 is also exploring the commercial viability of offering standalone units to customers here.
- DC2 has signed a non-binding memorandum of understanding (MoU) with Cannaponics Limited to establish an additional modular data centre at their cannabis facility. In this, DC2 gets a large-scale facility with a renewable solar energy source to put its modular data centre, providing reduced operational costs for the end-customers. **Situated in Collie** (Figure 12), this facility is currently aiming to be under a binding agreement in the short term, with initial power capacity TBA and the first module is expected to become operational in 2022. This new facility is expected to use a heat-recovery mechanism that will redirect heat from the servers to heat Cannaponics greenhouse systems. DC2’s existing modules, technology and IP is expected to keep the capex low and will be margin-accretive.
- DC2 has been exploring and has already identified numerous other potential power generation sites. The company management is in constant discussion with providers to accelerate future growth.

In the long term, DC2 aims to design, build and provide operational support for third party modular data centres



Figure 12: Upcoming modular data centre at Collie, Western Australia (using heat-recovery system)



Source: Company

These modular modules are able to link with satellite, microwave and fibre connections, providing remote security features

While it is understandable that enterprises engaged in super-computing activities become that target audience for such services, DC2 is expanding its customer base by reaching out to government and other non-government organisations with high data storage requirements, i.e. schools, universities, local government establishments, etc. Considering that DC2's modular data centres can be put up straight at a power source, these modules can be effectively put up anywhere in the world without much investment, especially at the unexploited renewable energy source sites. This makes the **modular data centre business unit a highly scalable proposition**. DC2 is expected to achieve accelerated growth into the local, regional and edge capacity data hosting market through these differential and scalable modular data centres.

Regional modular centres have limited-to-no regional competition

DC2 has the first-mover advantage in reaping benefits from the advent of modular data centres in Australian region. With internationally competitive power rates, a lot of customer have migrated from other countries to DC2's mid-west modular facility. The DC2 modular data centre has an operational advantage over most of the other relatively bigger infrastructure players in the market. Most of the relatively bigger infrastructure data hosting service in the Australian data centre sub-industry only offers data centre rack colocation as their primary offering with a different pricing model, which is neither value-accretive nor relatively cost-competitive.



Modular data centre provides strong ESG proposition to DC2

The sustainability strategy of DC2 covers generating lower carbon footprints, being socially responsible with infrastructure spending and practicing stringent governance policies. DC2 aims to integrate the principles of sustainability into management systems. Given its region-specific infrastructure-heavy operations, the key theme remains economic and environmental sustainability.

DC2 has been developing a robust mechanism of placing these regional modular centres at the energy sources, i.e. wind and solar. This is a practical and impactful way to protect the environment while fostering economic and social development of the region. The fact that the company has incorporated these principles in business operations is an indication of management's commitment towards social development through sustainable solutions.

DC Soft: A work-in-progress lucrative proposition

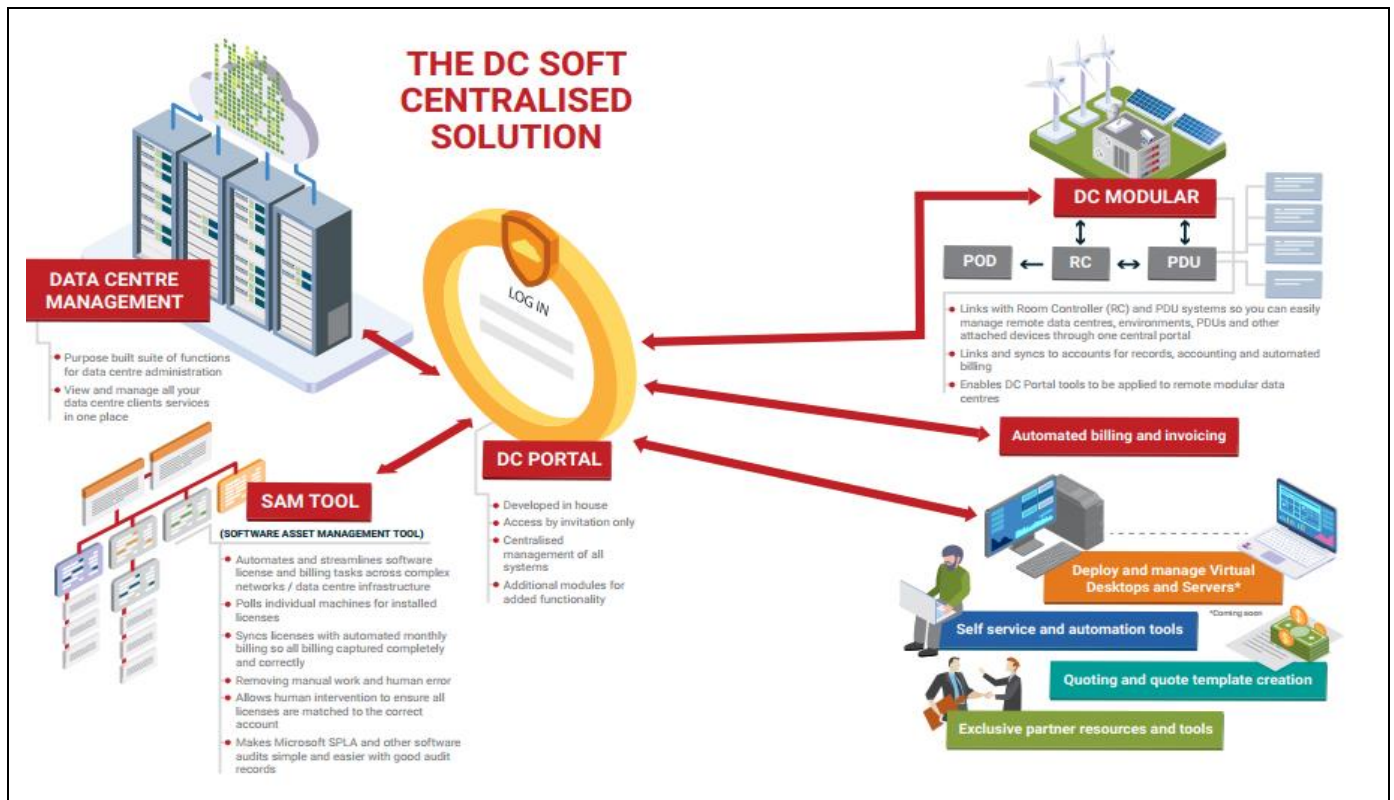
Under the DC Soft business unit, an independent software arm of DC2, the company develops customised tools and platform sites that are mainly aimed at automation and self-servicing existing operations. The resultant tools should be able to manage, maintain and improve the technology required to automate the management of the entire data centre including Tier III, modular and cloud platforms.

The currently available tools, i.e. DC Portal and Software Asset Management (SAM), are aimed at controlling and managing the needs of the business that are yet not mapped by cloud solutions (Figure 13).

- **DC Portal:** A single user interface application that provides the framework and capability to automate and manage various operational services, i.e. tiered account management, internal account books, billing systems etc. It aims to provide a one-stop solution with back end account management and billing capabilities to the entire business.
- **Software Asset Management (SAM):** A suite of tools that manages reporting and recording of software implementation. This suite is deemed necessary for recording licenses of multi-tenant cloud solutions, especially targeting Microsoft Service Provider License Agreement (SPLA) partners.
 - o DC2 aims at partnering with SPLA providers to re-sell the SAM software platform to reduce underreporting of Microsoft's pay-per-use agreement across the industry.



Figure 13: DC Soft business unit is developing digital assets that can be collated under one umbrella product



Source: Company

Software tools are explored for large commercial opportunities

Over the longer-term period, DC2 aims at scaling up this suite of tools as an integrated solution for its customers and for third-party requirements. The solutions will be customised according to each individual user’s requirements and provide the necessary value-add. DC2 ultimately aims to offer its back-end portal for the clients to manage their platform on the front-end.

In the long term, DC2 intends to explore large commercial opportunities with related automated software tools by monetising the products and releasing them to other IT-service providers. As the DC Soft assets mature, they will reach a point where they will become a product in their own right and could provide a substantial revenue stream to other providers. DC2 aims to grow and develop the software arm independently. The various stages of development and future prospects within DC2’s software business unit are as follows:

- Under the current set of offerings, DC2 is targeting Microsoft service providers. The tools are aimed at augmenting right reporting, reducing compliance risk and optimise license utilisation, thereby bringing in operational efficiency for the user. In Australia, the current gross revenue for Microsoft’s SPLA suite is ~A\$150m. It is expected that with correct usage reporting and recording the gross revenue will expand accordingly.
- DC2 has been successfully able to demonstrate its software suit to RHIFE—leading Microsoft SPLA distributor in Australia. As a next step, DC2 is undertaking the final testing of components and checking the readiness of the tool to be implemented within its own cloud platforms.

Currently, no tools exists to manage Microsoft’s pay-per-use SPLA sold widely in Australia. DC2’s SAM aimed at solving that

Additionally, the company has initiated internal discussions with external vendor for beta testing on their sites.

- Future of cloud business is the ability to integrate private and public cloud operations through automated solutions. DC2 aims to incorporate all the features within one product which can be customised according to the user's need. The management believes that it will take them at least 1-2 years to be able to achieve it.
- DC Soft's boutique of ready-to-use tools will be amalgamated with the user's platform; it will help control and manage operations when public cloud takes over private cloud services.

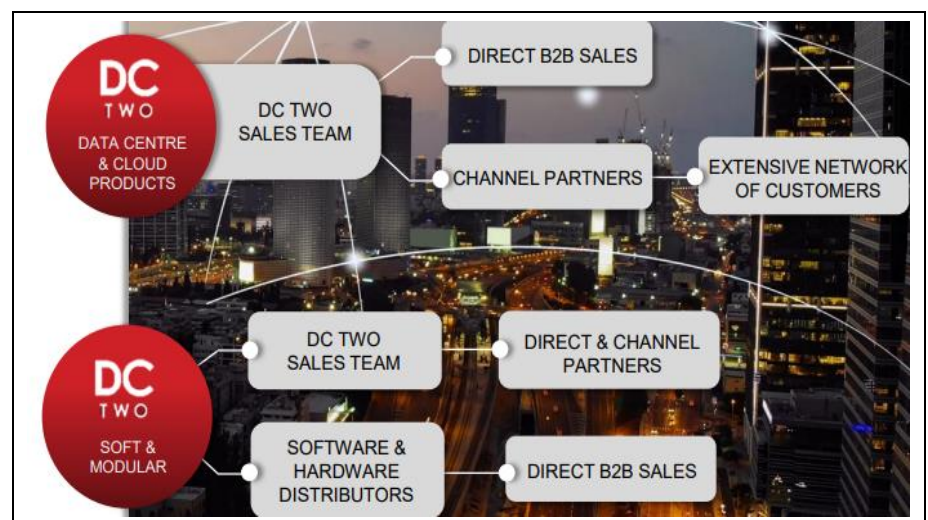
However, DC2 is currently facing a shortage of experienced developers and hence would need a couple of years before these platforms and tools can be productised for larger commercial success.

Presence of Multiple Sales Channel

The DC2 management uses a multi-sales channel strategy to augment a higher sales pitch conversion rate and wider reach (Figure 14). While it maintains a team of dedicated channel partners to amplify the reach to extend customer base across geographies, it also maintains an in-house business development team for making direct business-to-business (B2B) sales pitch.

The rationale for maintaining diverse sales channels is the fact that through the channel partners, it is relatively easier to reach out to the prospective client and make the required sales pitch. However, for the new-age services, such as DC Modular and DC Soft, it makes a better commercial sense to market them directly.

Figure 14: DC2 has multiple avenues to make a sales pitch



Source: Company

Channel Partners

The company's Cloud Services and data centre business units operate through a partner first model, which helps them generate ~70% of the revenue from the partner ecosystem (as of 2020). With 40+ channel partners, DC2 has been able to service 300+ businesses. Through these partners, the company has



The Company management intends to expand the channel partner network and simultaneously venture out into other domestic regions

access to an extensive network of customers across diverse verticals and sizes.

The primary task of these MSPs is to channelize resources, selling and promoting DC2's data hosting infrastructure and cloud services, across Western Australian and Northern Territory markets. They provide a gateway to engage end users and customers with the company's products and services. These partners act as wholesale agents for DC2.

The channel partners, who are mainly IT service vendors, earn a healthy 10-20% commission on channelizing customers to use DC's facilities and cloud service centres. The commission paid out is irrespective of the service to the end customer — colocation, cloud service etc.

Each partner, easily contributes 20-30 customers and becomes the custodian of DC2's brand endorsement. They facilitate the company in serving diverse customers, providing technical support capabilities and reducing customer risk.

On the part of the management, they run exclusive partner-level certification, determined by the sales volume. Across these levels, the management provides access to benefits such as discounts, marketing collaterals, priority access to support staff such as engineers for technical assistance, etc. Classified under diverse levels, these certifications are as follows:

- a. **Authorised Resellers** get entry level discounts and get access to partner program tools and support
- b. **Silver Partners** require sales certification on 1 vendor partner of DC Two. They get 2 lunch & learn workshops per year in addition to higher discounts, large discounts on access to testing and development environment and access to partner program tools and support
- c. **Gold Partners** require sales certification on 2 or more vendor partners of DC Two. They get 4 lunch & learn workshops per year in addition to maximum discounts, free testing and development environment and access to partner program tools and support

DC Two has a dedicated portal for both partners & customers to manage all their accounts as well as services and products in one place.

Direct sales

Even though currently channel partners form the bulk of revenue source for the company, the management is not looking through acquiring any MSP. In fact, for the new service offerings — DC Modular and DC Soft business units — the company management is preferring a direct-to-market approach, given the extent of market opportunities. The management feels that the new services, which will soon become their core offerings, will not be in line with the services provided by the channel partners. This will result in higher margins for the new service lines and ensure a sufficient customer base for legacy services.

Recently, the company management hired several full-time sales people. The company did this to enhance its business development capabilities and streamline and strengthen the sales pitch processes.



Infrastructure-as-a-Service (IaaS) demand is rising

Digitalisation demands expanded infrastructure globally

The increasing trend of remote/hybrid working, remote learning, remote fitness, etc. has accelerated the need for a robust digital infrastructure. Moreover, due to data privacy concerns raised by several governments and end-users, the importance of setting up the digital infrastructure in the home country (where the data has originated) has increased.

The adoption of 5G and other low-latency[^] applications, i.e. streaming IoT, real-time applications etc., will require more edge data centres and fibre networks to give quicker results.

[^]Low-latency is a computer networking environment that is best suited for a process that involves the consumption of a very high volume of data packages and doesn't have too many intervals.

It is mainly requirement to process real-time data, whose relevance perishes the moment it is consumed, i.e. high frequency trading in capital markets, video streaming, virtual meetings, video visit to doctors, online gaming, retail, travel, medical imaging, etc.

The remote work model, along with low-latency applications and technological restrictions, make it imperative that the digital infrastructure running these data packages is closer to the end user

According to the Forbes magazine, the amount of data created and consumed in the last decade (2010-2020) has increased 5000%, i.e. from 1.2t GB to 59t GB. The data consumption is expected to remain high with a 26% CAGR growth over next few years (between 2020 and 2024). The increase in the number of people who work remotely (compared to pre-Covid-19 levels) will further push the requirement for digital infrastructure globally.

In addition, the paradigm shift towards working through cloud computing will only entice more spending on infrastructure. According to Gartner, The worldwide public cloud services expenditure/spend is expected to grow at a CAGR of 17.9% during 2019–2022 to reach US\$397.5bn in 2022, from US\$242.7bn in 2019. According to a study by International Data Corporation (IDC), this expenditure is expected to be US\$500bn in 2023. Within this, IaaS is forecast to grow 34% between 2019 and 2022, which is the highest growth rate across major market segments.

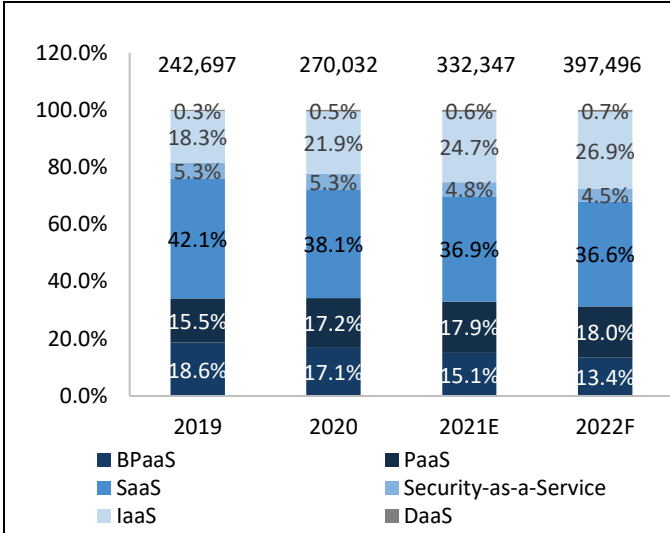
IaaS' contribution to total cloud computing expenditure, which is expected to increase from 18% in 2019 to 27% in 2022. SaaS continues to lead and is expected to contribute 37% by 2022 but is on a decline (42% in 2019). Cloud Platform-as-a Service (PaaS) is the other segment on an increase – expected to grow at a 24% CAGR over 2019-2022, contributing 18% in 2022 to the total expenditure (15.5% in 2019).

In 2020, the top five IaaS providers — Amazon, Microsoft, Alibaba, Google and Huawei — accounted for 80% of the global IaaS market and nearly 90% of all IaaS providers exhibited growth.

Demand for modern-day applications and the amount of workload requires upgraded digital infrastructure



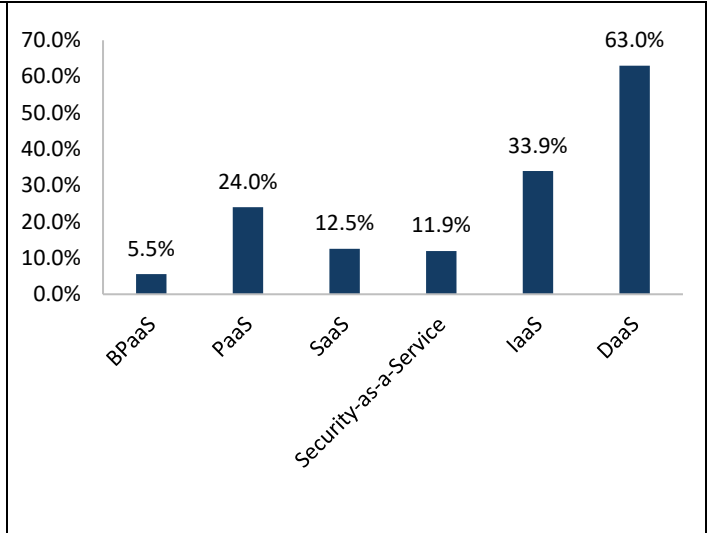
Figure 15: Global public cloud services spending (US\$m)



Note: Updated in April 2021

Source: Gartner and Pitt Street Research

Figure 16: Cloud service CAGR (2019-2022) based on end-services



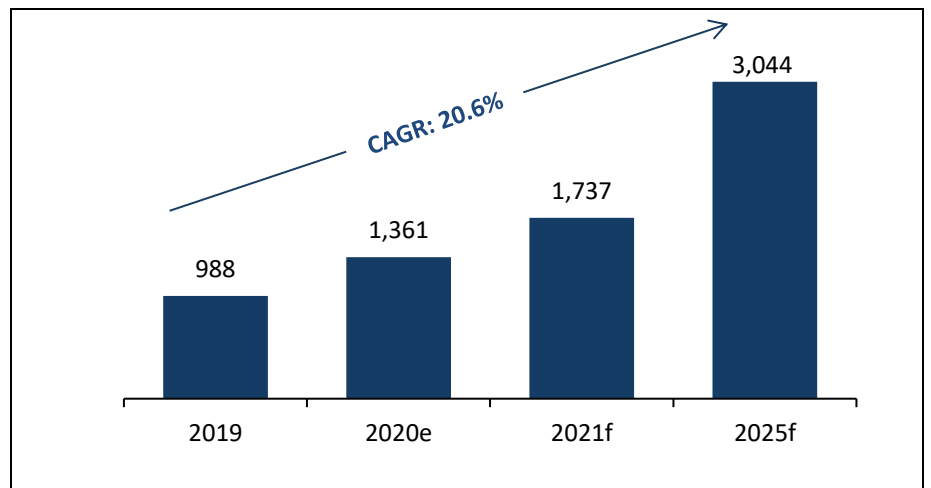
Note: Updated in April 2021

Source: Gartner and Pitt Street Research

The Australian IaaS market is witnessing a pent-up demand post-COVID

According to a BCG report, the public cloud market in Australia is expected to grow from US\$4.7 billion to US\$10.5 billion at a CAGR of 17% between 2018 and 2023. Within the public cloud market of Australia, SaaS is the largest segment with ~70% market share. However, IaaS is expected to remain the fastest growing market.

Figure 17: Growth in Australian Cloud IaaS market (\$m)



Source: Telsyte and Pitt Street Research

According to research and markets, Australian data centre market is expected to grow at a 6% CAGR over 2020-2026

According to Telsyte, an Australia-based emerging technology analysis firm, Australian companies had spent US\$1.36 billion on IaaS in 2020 (+38% YoY to US\$988m spent in 2019), and is expected to cross US\$3bn by 2025 (Figure 17). As of 2020, ~29% Australian companies have already been engaging with third parties to manage their cloud services, as compared to 5% in 2019.



According to Gartner, Australian companies accelerated their commitment to public cloud in 2020 (post-COVID) and are now investing to support new opportunities in 5G, AI and data analytics. Leading companies are adding new regional capabilities to meet the increasing demand.

Within IaaS, the current focus is shifting towards hyper scale infrastructure. Hyper scale IaaS is a computing network that supports massive scalability, utmost performance, and high tolerance ability to handle faults. Telsyte expects hyper-scale IaaS to have ~90% revenue share in Australia by 2025.

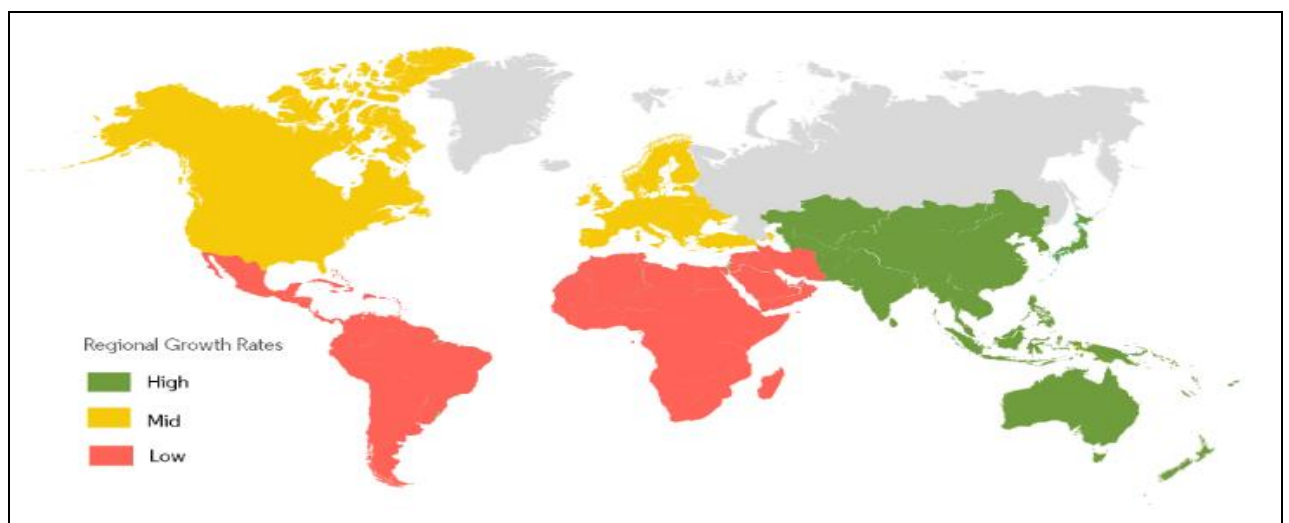
As the number of applications deployed on the public cloud is growing, businesses are using multiple vendors and hybrid clouds.

Modular Data Centre is a concept whose time has come

The post-pandemic acceleration of digitization demands quick deployment and scalability from data centre vendors. This has resulted in the concept of containerised modular data centres – These are data hosting centres that can be deployed at any location with power, an internet connection, and an external chiller.

According to MarketsandMarkets, a market intelligence and advisory firm, the global modular data centre market size is expected to grow from US\$18.4bn in 2020 to US\$37.8bn, at a 5-year CAGR of 15.4%.

Figure 18: Modular Data Centre - Growth Rate by region (2020-2025)



Source: Mordor Intelligence and Pitt Street Research

Countries in the Asia Pacific region, including Australia, are expected to largely benefit from the increasing adoption of modular data centres (Figure 18), as this adoption will help achieve the power capacity required for operating such data centres. The Australian government is also launching significant projects in renewable energy, which further increases the attractiveness of the region. In addition, the increasing adoption of cryptocurrencies and their relatively high storage and power requirements is expected to push the demand for modular data centres upwards in Australia. This is expected to support the exponential growth for DC2 in medium term.



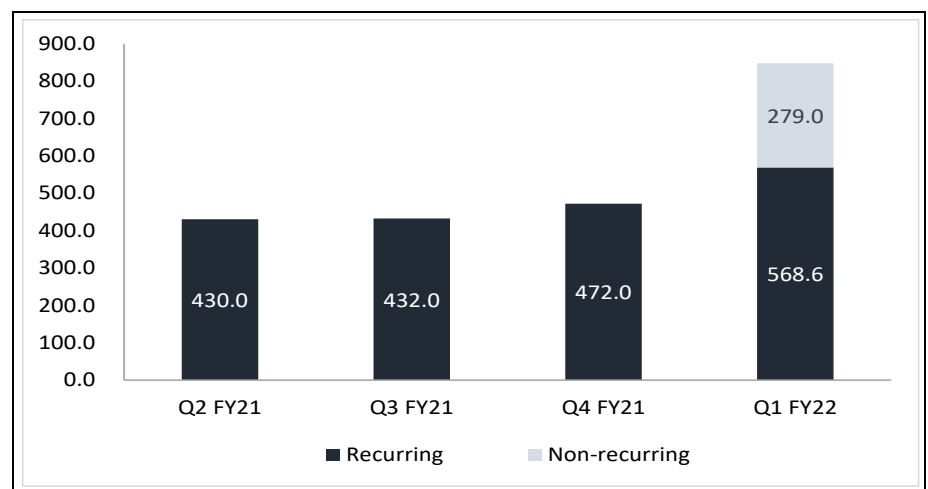
DC2 has a consistent sales profile

Currently, ~90% of the company's revenue is earned through colocation and cloud management services. The company charges monthly subscription fee to the customers using its data hosting infrastructure services. Consequently, bulk of the revenue is recurring and long-term in nature (Figure 19). **Recurring revenue operating model provides stable and predictable cash flows and higher customer life-line value.**

In addition, DC2 also receives additional revenue from the secondary offerings, like telecommunication and networking links, hardware resale and technical services.

For Q1 FY22, DC2 reported 20.5% increase in recurring revenue

Figure 19: DC2 has consistently maintained recurring revenue (A\$'000)



Source: Telsyte and Pitt Street Research

DC2 leverages the potential to upsell. Upon being signed by the client, DC2 can embed itself in the company's networking infrastructure, thereby paving the way for users to opt for add-on managed cloud services. The success of this strategy is evident by 300+ customer base. This supports in mitigating customer retention risk.

FY2022 could prove to be the defining year for DC2

In September 2021, DC2 received binding commitments for a A\$2.5m capital infusion (before costs), completed across two tranches which will aid DC2 in executing expansion of the modular centre portfolio.

First tranche of 8.8m shares already placed to institutional investors, at A\$0.15, on October 5, 2021. Second tranche of ~7.9m shares has also been recently placed to institutional investors at \$0.15 and approved by shareholders on 26 November, 2021.

Potential revenue per rack ranges from A\$1,600 per month for pure colocation rack to A\$50,000 for full cloud racks

The management also highlighted that its mid-west data centre capacity is expected to reach 2MW by end-CY2021 (600KW by end-October 2021). Further, the company has initiated migration procedure for existing cloud customers into the Bibra Lake facility while the first rack sales of the facility have also been executed. These are strong initial steps that the company has taken towards business expansion.

With the onset of newer modular data centres, limited future capex requirement for Bibra lake facility, market share expansion across Western



Australia and Northern territory and extension into other geographies, DC2 is expected to achieve exponential revenue growth—53.5% CAGR over 2021-2027 (Figure 20).

Figure 20: DC2 is expected to report exponential revenue growth over 2021-2027

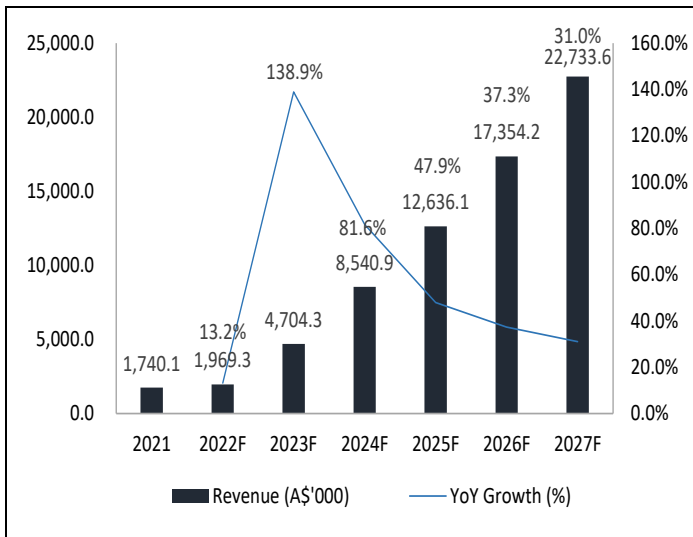
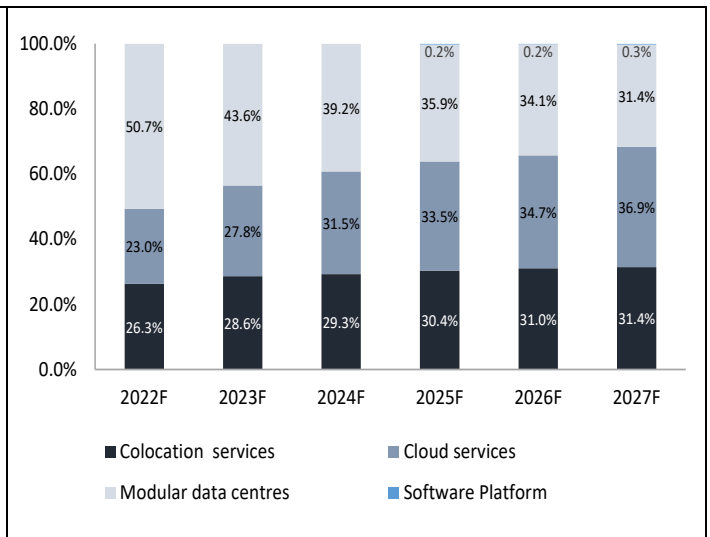


Figure 21: Cloud and modular data centre units will lead revenue growth



Source: Pitt Street Research

Source: Pitt Street Research

Capital raising provide necessary financial strength to drive future investment in business expansion, product innovation, sales and marketing

Strong balance sheet to facilitate expansion

With the successful completion of the IPO on 10 November 2020, the company raised gross proceeds of A\$5.5m, through the issuance of 27.5m ordinary shares. Following this IPO, DC2 is able to execute its business expansion plans.

Notably, the company has reduced its debt. We believe this provides DC2 further room for incurring capital expansion without worrying much about meeting financial obligations.

Operational breakeven not very far away

Though the company has been witnessing consistent top-line for the past few years, it is yet to achieve operational breakeven. This is primarily due to limited operations and relatively higher expenses in the wake of development cost and higher channel partner commissions. We believe that as DC2 achieves market expansion, the operating expenses will subside in the medium term. As a result, we estimate that the company will become operating positive by FY2024 (Figure 22).

Figure 22: Profitability profile of DC2

Margins (%)	2021	2022	2023	2024	2025	2026	2027
EBITDA margin	NM	NM	NM	10.2%	34.5%	49.1%	59.9%
EBIT margin	NM	NM	NM	2.7%	27.0%	44.1%	56.9%
Profit margin	NM	NM	NM	1.5%	19.1%	31.1%	40.4%

Source: Pitt Street research



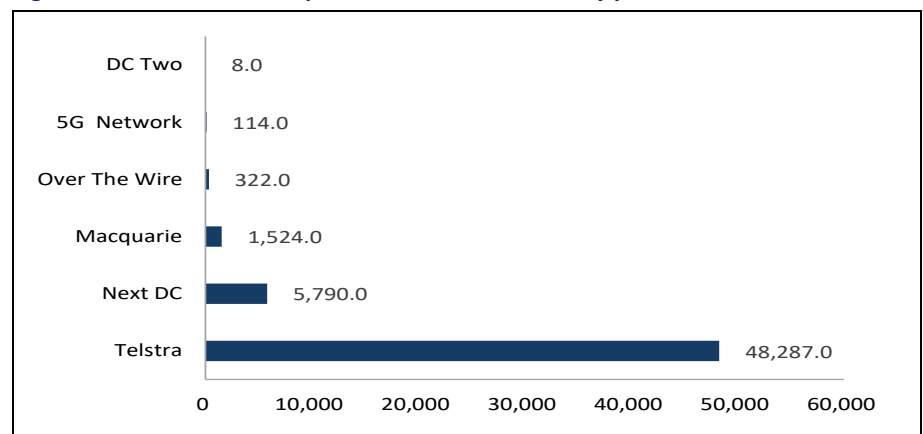
Competitive Landscape

DC2 faces intense competition from regional and global players

DC2 competes with both domestic and international cloud services vendors and data hosting infrastructure service providers. In Australia, the industry is highly fragmented and becoming increasingly competitive. We believe DC2 faces competition from the following regional players:

- **5G network (ASX:5GN):** 5G Network provides data networks, data centres, cloud and managed services to support the Australian ICT industry. They also have presence in New Zealand, US, Singapore and Japan. They have 5 data centres which are built on Tier 3 N+2 design.
- **Macquarie Telecom Group (ASX:MAQ):** Macquarie Telecom Group (ASX:MAQ). The Macquarie Telecom Group provides voice and mobile services, cloud hosting services, cybersecurity and Tier III data centres with a focus on SD-WAN and SD-LAN technologies. Its target customers are medium and large companies as well as the government.
- **NEXTDC (ASX:NXT):** NEXT DC offers data centre outsourcing solutions, connectivity services and infrastructure management software. It is an independent data centre operator with 9 data centres and a network of Tier III and Tier IV facilities in the Australian market. It provides colocation services to local and international organisations. It has partnerships with >730 clouds, networks and IT service providers.
- **Over the Wire (ASX: OTW):** Over the Wire provides tailored Data Networks and Internet, Voice, Hosting, Security & Managed Services in Australia and New Zealand. They also have a partner program to expand their reach in the market.
- **Telstra (ASX:TLS):** Telstra provides services in areas such as networks, security, mobility, unified communications, colocation, cloud and Internet of Things (IoT). It has 58 data centres in 12 countries across Asia, Australia, US and Europe.
- **Equinix (Nasdaq:EQIX):** Equinix is a data centre and colocation infrastructure provider with 230 data centres in 26 countries across 5 continents. It also provides interconnection solutions, edge services, business and digital ecosystems and expert consulting and support. It has partnerships with >3,000 cloud and IT service providers.

Figure 23: DC2's market capitalisation* relative to key peers



Note: *As of 19 November 2021

Source: Refinitiv and Pitt Street Research



Apart from the regionally diversified and established players, there are certain global players that operate in Australia and have a well-established infrastructure

- **NTT Communications** (TSE:9432). NTT Communications provides information and communications technology (ICT) solutions – such as cloud services, network solutions, managed security, voice and video communication and application services. The data centres are connected to a Global Fibre Optic Network, to which helps ensure seamless connectivity worldwide. NTT has a global network in >190 countries.
- **Digital Realty** (NYSE:DLR). Digital Realty provides data centre, colocation and interconnection services in 24 countries across 6 continents. It has >290 data centres globally.
- **Fujitsu** (TSE:6702). Fujitsu provides technology solutions such as multi-cloud services (IaaS, PaaS, SaaS, etc.), outsourcing services (data centres, ICT managed services etc.), business application services, managed infrastructure services, enterprise and cyber security, digital business solutions (IoT), network services, Artificial Intelligence (AI) solutions, co-creation programs and software. It also offers ubiquitous solutions and device solutions. It has a presence across all the major countries of the Americas, Europe, Africa, Asia and Oceania.
- **Global Switch**. Global Switch owns and operates 13 carrier and cloud-neutral data centres in cities across Europe and the Asia Pacific. It provides IT infrastructure to public and private organisations across these areas, which helps them to connect with telecoms, ISPs and cloud providers and peers.
- **Airtrunk**. The company has data centres to cater to the Asia Pacific market. It has opened Australia's first and largest hyper scale data centres in Western Sydney and Melbourne in addition to data centres in Singapore and Hong Kong and plans to further expand in the Asia Pacific regions such as Japan.

Valuation: DC2 has significant upside potential

To derive DC2's long-term value, we have employed a weighted average valuation methodology. We assigned equal weights to a peer-group-based relative valuation and a DCF calculation.

Peer group valuation suggests DC2 is undervalued

Given that DC2 faces challenge from both domestic and international players, we have considered companies from all economies. Our peer-group consists of ASX listed cloud-based data services, networking and hosting infrastructure service providers as well as global players in the colocation service domain.

While the Australian market is fragmented, there are few firms that pose direct competition to DC2. These include: Next DC (ASX:NXT), Macquarie (ASX:MAQ), Over The Wire (ASX:OTW), 5G Network (ASX:5GN), Telstra (ASX:TLS). All these companies are significantly larger in size but does not provide the complete boutique of integrated services. We believe that DC2, with its portfolio of solutions covering the entire value-chain, should trade a slight premium to the average multiple (Figure 24).



Figure 24: Peer Multiples[^]

Company Name	Ticker	Last reported fiscal	M-Cap	EV / Sales			
			(A\$ m)	2021F	2022F	2023F	2032F
Next DC	NXT.AX	Jun-21	5,790.0	24.0x	20.5x	16.8x	14.0x
Maquarie	MAQ.AX	Jun-21	1,524.0	6.0x	5.6x	4.7x	4.2x
Over The Wire	OTW.AX	Jun-21	322.0	3.2x	2.6x	2.4x	2.2x
5G Network	5GN.AX	Jun-21	114.0	1.2x	1.0x	0.9x	0.8x
Telstra	TLS.AX	Jun-21	48,287.0	3.0x	2.9x	2.9x	2.8x
Equinix Ltd	EQIX.O	Dec-20	98,631.0	14.0x	12.6x	11.7x	10.8x
Average			25,778	8.6x	7.5x	6.6x	5.8x
Median			3,657	4.6x	4.3x	3.8x	3.5x

Note: [^]As of 19 November 2021

Source: Refinitiv and Pitt Street research

To better gauge the performance of DC2, we have also included an international player listed on NASDAQ in our peer list. We have included: Equinix Limited (NASDAQ:EQIX). We have avoided some of the other bigger players, like –NTT Communications (TSE:9432) and Fujitsu (TSE: 6702)—mainly due to their unidirectional service offering. Taking the average FY2023 EV/Sales of 6.6x from the peer-set, and applying a small premium, we arrive at a valuation of A\$0.34 per share in base case, and A\$0.55 per share in our optimistic case (Figure 25).

Figure 25: Peer group valuation: Base case

Equity value determination (A\$' 000 unless specified)	EV / Sales
Sector Average Multiple	6.6x
Discount/ Premium	5.0%
Sales 2023F	4,704.3
Implied EV	32,420
Net debt (cash)	1,867
Minority interest	-
Provisions	-
Equity/Book value	30,554
Diluted Shares (m)	90.3
Implied price (A\$)	0.34
Current price (A\$)	0.15
Upside (%)	125.5%

Source: Pitt Street Research

Bull case

Equity value determination (A\$' 000 unless specified)	EV / Sales
Sector Average Multiple	6.6x
Discount/ Premium	10.0%
Sales 2023F	7,171
Implied EV	51,772
Net debt (cash)	1,686
Minority interest	-
Provisions	-
Equity/Book value	50,086
Diluted Shares (m)	90.3
Implied price (A\$)	0.55
Current price (A\$)	0.15
Upside (%)	269.7%

Driven by the current efforts on expansion of operations, the company has substantial upside potential for re-rating. Markedly, the partnership with related industry players to bundle networking and communication solutions with cloud services should provide DC2 with significant market expansion opportunities.



DCF calculation suggests a substantially higher value

Our DCF model assumes a cost of equity of 12.5% for DC2 (reflecting a 2.5% risk-free rate, a 4.7% market risk premium and a beta of 2.1). Applying this discount rate to our free cash flow projections through FY2032 and using a terminal growth rate of 2.0% yields a value of A\$0.58 per share in base case (Figure 26).

Figure 26: DCF valuation: Base case

DC Two Valuation (A\$ m)	
Enterprise Value	51.2
Net debt (cash)	(0.9)
Minority Interest	-
Other Investments	-
Equity value	52.1
Share outstanding (Diluted)	90.3
Implied price (A\$)	0.58
Current price (A\$)	0.15
Upside (%)	284.2%

Source: Pitt Street Research

Bull case

DC Two Valuation (A\$ m)	
Enterprise Value (A\$ m)	91.2
Net debt (cash) (m)	(1.0)
Minority Interest (m)	-
Other Investments (m)	-
Equity value (m)	92.2
Share outstanding (Diluted)	90.3
Implied price (A\$)	1.02
Current price (A\$)	0.15
Upside (%)	580.9%

Fair value of A\$0.46-0.79 per share

Our base case value of A\$0.46 per share has been derived using a weighted average valuation methodology, which assigns equal weight to our relative valuation and our DCF calculation (Figure 27). Our bull case calculation results in a valuation of A\$0.79 per share. Both the cases imply substantial upside from the current share price.

Figure 27: Weighted average valuation: Base case

Base Case	Weights (%)	Share price (A\$)
DCF	50.0%	0.58
Relative valuation	50.0%	0.34
Composite Value		0.46
Current Price		0.15
Upside/ Downside (%)		204.9%

Source: Pitt Street Research

Bull case

Bull Case	Weights (%)	Share price (A\$)
DCF	50.0%	1.02
Relative valuation	50.0%	0.55
Composite Value		0.79
Current Price		0.15
Upside/ Downside (%)		425.3%

Re-rating DC Two limited

DC2's stock is currently trading below our base case valuation. We see four factors helping to re-rate DC2 into our valuation range:

- Quick success in achieving Tier III accreditation for the Bibra Lake facility;
- Swift expansion of modular data centre portfolio;
- Increased bundling of cloud and hosting services through related industry players;
- Commercialisation and swift deployment of software platform



Risks

The main risks that we see while investing in DC2:

- **Execution risk:** Majority of the future growth for DC2 is expected to come from the newly operationalised Bibra Lake facility and higher traction within modular data centre. Any interruption in expansion of modular centre portfolio, delay in receiving Tier III accreditation for Bibra lake facility and difficulty in commercialising the software platform, will jeopardise the investor sentiments. This remains the key risk to the investment rationale.
- **Economic downturn in focussed industry:** DC2 is expected to generate a significant portion of modular data centre revenue from crypto-miners. Considering that this is a relatively young business with reasonable risk, any economic or fundamental downturns here will hamper DC2's growth potential.
- **Geographical concentration:** Western Australia (WA) region represents 100% of total revenue. This may restrict the growth capacity for DC2 in the WA region as the market becomes competitive. With DC2's latest initiative to expand market presence across the South-East and South West Australian region, the revenue profile should become less skewed.
- **Channel partner concentration:** Majority of the revenue for DC2 (c.70%) comes from the network of channel partners which offers referrals to the company from its customer base. However, DC2's recent efforts to increase direct sales mechanism for the new-age services should help mitigate this risk.
- **Competition:** As the Australian data centre market expands, the larger (regional and foreigner) data centre and cloud computing provider will also increase presence in the region. DC2 will have to counter their financial and technological power to attract customers.



Management Overview

	<p>Justin Thomas Co-Founder and Managing Director</p>	<ul style="list-style-type: none"> Justin is the co-founder of DC Two Limited and has >20 years of experience in the IT industry. Prior to DC Two Limited, he built and sold two start-ups – namely Home Open, which was sold to RP Data in 2007, and the Henderson Data Centre, which was sold in 2013 to Amcom (now Vocus). He is also the founding member of D Coin, a cloud mining platform for cryptocurrencies.
	<p>Mark Dignam Co-Founder and Senior Technician</p>	<ul style="list-style-type: none"> He co-founded DC Two Limited along with Justin Thomas. He has >30 years of experience in the IT industry and has expertise in hardware, software, networking, VOIP, programming, storage, etc. He holds certifications in CCNA and VCP5. Previously he helped in starting the first bulletin board in Western Australia and was the first person in Australia to decode and identify the Michelangelo (a computer virus discovered in 1991, which infected DOS systems)
	<p>Blake Burton Executive Director</p>	<ul style="list-style-type: none"> Blake had been DC Two's non-executive director since its IPO and became an Executive Director in October 2021. Currently, he is the CFO of Attained Group, a managed IT service provider and a Director of Intercast Australia, a bronze and aluminium foundry. In 2011, he co-founded Netorigin, a web hosting company, which became one of the largest privately owned web hosts in Western Australia. He has substantial experience in the IT industry and holds a Bachelors' degree in Commerce from the University of Western Australia
	<p>Shane Wee Non- Executive Chair</p>	<ul style="list-style-type: none"> Shane retired as a founding director of Alto Capital after 28 years in the financial services industry in July 2021 to take on the role of CEO of The Magic Coat for Kids and other opportunities Over the years, he has built close relationships with a number of business leaders in Perth's business community. His focus has always been on building long term relationships with strategic partners and continuously value add to Alto's local network of clients and contacts throughout South East Asia.
	<p>Bradley Goodsell Chief Financial Officer</p>	<ul style="list-style-type: none"> On 4 October 2021, Bradley became the CFO of DC Two Limited. He has 20 years of experience in financial due diligence, systems operations and financial reporting, for both listed and unlisted entities. He holds a Bachelors' degree in Commerce (Hons) and has been a Chartered Accountant for over 25 years

Source: Company and Pitt Street Research



Appendix I – Capital Structure

Class	In million	% of fully diluted	Note
Ordinary shares	75.2	83.2%	
Unlisted options	10.2	11.2%	Wtd. avg. exercise price of 29 cents
Unlisted performance rights	5.0	5.5%	
Fully diluted shares	90.3		

Source: Company

Appendix II - Analyst Qualifications

Marc Kennis, lead analyst on this report, has been covering the Semiconductor sector as an analyst since 1997.

- Marc obtained an MSc in Economics from Tilburg University, Netherlands, in 1996 and a post graduate degree in investment analysis in 2001.
- Since 1996, he has worked for a variety of brokers and banks in the Netherlands, including ING and Rabobank, where his main focus has been on the Technology sector, including the Semiconductor sector.
- After moving to Sydney in 2014, he worked for several Sydney-based brokers before setting up TMT Analytics Pty Ltd, an issuer-sponsored equities research firm.
- In July 2016, with Stuart Roberts, Marc co-founded Pitt Street Research Pty Ltd, which provides issuer-sponsored research on ASX-listed companies across the entire market, including Technology companies.

Cheng Ge is an equity research analyst at Pitt Street Research.

- Cheng obtained a B.Com in Finance and LL.B from University of New South Wales, in 2013. He also completed all three levels of the CFA Program.
- Before joining Pitt Street Research, he worked for several financial services firms in Sydney, where his focus was on financial advice.
- He joined Pitt Street Research in January 2020.



Profit & Loss (A\$'000)	2020	2021	2022F	2023F	2024F	2025F
Sales Revenue	1,856.0	1,740.1	1,969.3	4,704.3	8,540.9	12,636.1
Operating expenses	(1,841.0)	(4,846.7)	(4,049.7)	(6,205.3)	(7,672.1)	(8,282.0)
Adjusted EBITDA	15.0	(3,106.7)	(2,080.4)	(1,501.0)	868.8	4,354.2
Depn & Amort	(229.9)	(539.8)	(492.3)	(470.4)	(640.6)	(947.7)
Adjusted EBIT	(214.9)	(3,646.5)	(2,572.7)	(1,971.5)	228.2	3,406.5
Net Interest	50.0	187.2	196.6	206.4	216.7	227.6
Profit before tax (before exceptional)	(209.0)	(3,555.7)	(2,662.0)	(2,038.3)	184.3	3,448.0
Tax expense	0.0	0.0	0.0	0.0	(55.3)	(1,034.4)
NPAT	(209.0)	(3,555.7)	(2,662.0)	(2,038.3)	129.0	2,413.6
Cash Flow (A\$'000)	2020	2021	2022F	2023F	2024F	2025F
Profit after tax	(209.0)	(3,555.7)	(2,662.0)	(2,038.3)	129.0	2,413.6
Depreciation	229.9	539.8	492.3	470.4	640.6	947.7
Changes in working capital	9.4	593.5	(327.1)	263.7	(479.8)	(168.3)
Other operating activities	(18.5)	1,049.2	196.9	235.2	427.0	379.1
Operating cashflow	11.9	(1,373.2)	(2,299.8)	(1,068.9)	716.8	3,572.1
Payments for exploration and evaluation	(70.1)	(1,405.8)	(1,100.0)	(770.0)	(687.5)	(412.5)
Other investing activities	0.0	(108.5)	0.0	0.0	0.0	0.0
Investing cashflow	(70.1)	(1,514.3)	(1,100.0)	(770.0)	(687.5)	(412.5)
Equity raised (repurchased)	0.0	5,039.0	2,500.0	1,500.0	750.0	0.0
Net proceeds from borrowings	281.4	(126.0)	(126.0)	(126.0)	(126.0)	(126.0)
Other fiNancing activities	0.0	(371.0)	0.0	0.0	0.0	0.0
Net change in cash	223.2	1,654.5	(1,025.8)	(465.0)	653.3	3,033.6
Cash at End Period	237.1	1,891.6	865.8	400.8	1,054.1	4,087.7
Balance Sheet (A\$'000)	2020	2021	2022F	2023F	2024F	2025F
Cash	237.1	1,891.6	865.8	400.8	1,054.1	4,087.7
Total Assets	913.0	7,195.3	7,180.0	7,874.9	8,876.8	11,519.6
Total Liabilities	749.4	4,255.7	4,402.3	5,635.5	5,758.4	5,987.6
Shareholders' Funds	163.7	2,939.7	2,777.7	2,239.4	3,118.4	5,532.0

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