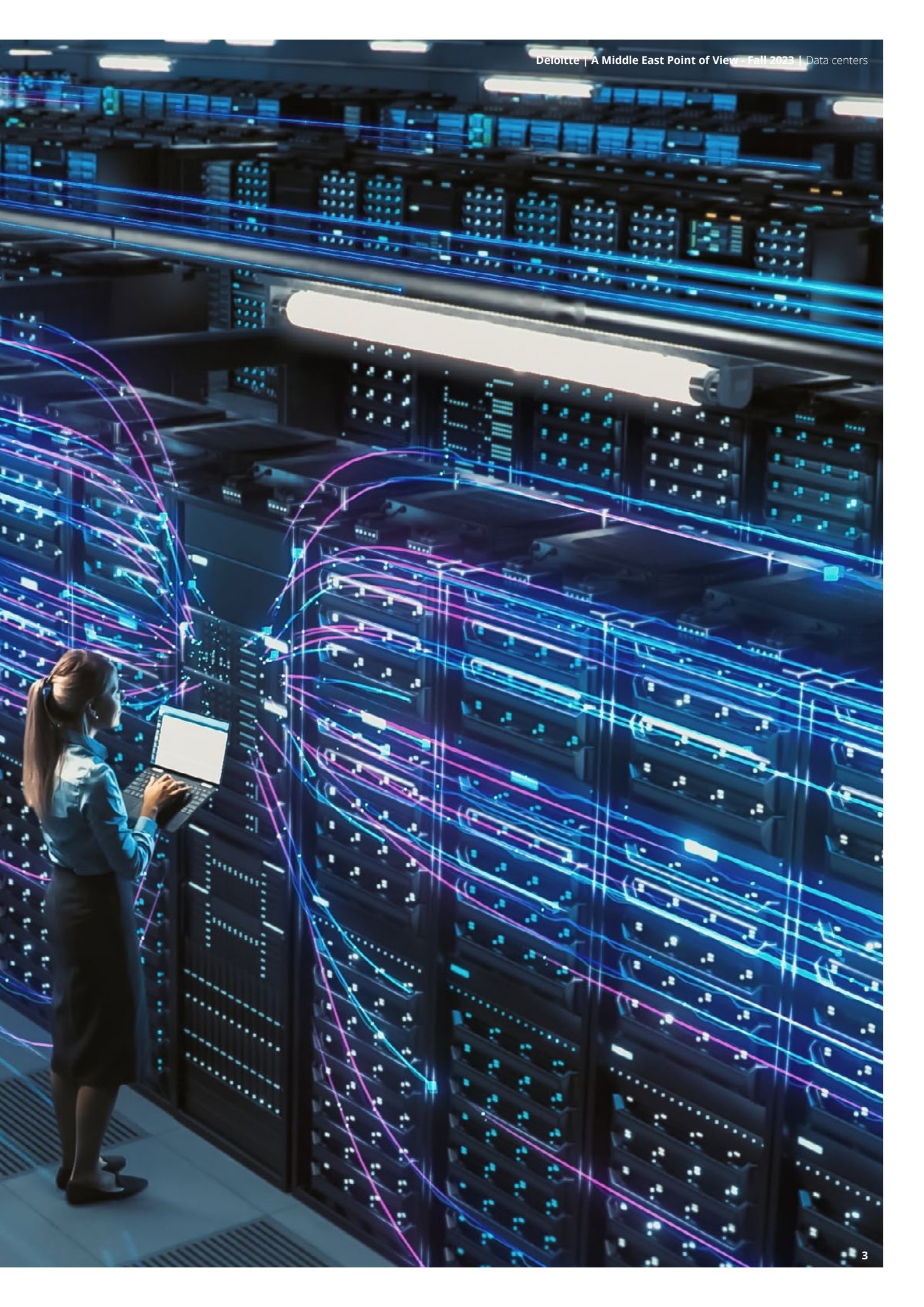


A photograph of a data center aisle. The aisle is filled with rows of server racks. The racks are illuminated with a blue glow, and there are many glowing blue lines of light, likely representing fiber optic cables, crisscrossing the scene. The perspective is from a low angle, looking down the aisle.

# Navigating the financial labyrinth of data center colocation and capacity services



In the rapidly evolving digital landscape, data centers have emerged as technological linchpins, with organizations increasingly relying on these powerhouses to drive operations and innovation. Yet, it's not just the operational aspects that demand attention; delving into the financial intricacies associated with data center services is becoming equally crucial. Such insights play a pivotal role in shaping financial reporting, strategic planning, and investment decisions, ensuring that businesses align their strategies with fiscal prudence and long-term objectives. Within this dynamic arena, two distinctive models of data center services have carved niches for themselves: data center colocation services and avant-garde data center capacity services.

**Switching lanes: Transitioning from colocation to data center capacity for future-proof infrastructure**

**Data center colocation services: A tangible asset approach**

Data center colocation typically offers clients control over dedicated floor space, where they can house their hardware, servers, and storage. This model emphasizes the provision of physical space, power, cooling, and connectivity, allowing clients to manage their equipment directly while benefiting from the data center's infrastructure. The colocation model represents a tangible asset approach, focusing on the physical attributes of the service and giving clients a significant degree of control over their dedicated space.




**Data center capacity services: The integrated paradigm**

On the contrary, data center capacity services present a contrasting paradigm, emphasizing integrated services over dedicated physical space. In this model, the focus shifts towards the seamless provision of specialized space, resilient power, cooling, network connectivity, and

security. The capacity services approach intertwines these components, forming an interdependent and harmonious service that aligns with the client's operational needs. Here, the emphasis on integrated services offers a holistic solution, with each component significantly influencing and reinforcing the others, to create a cohesive, value-driven offering.

**Evolving organizational preferences**

Technically, the distinction between these models is increasingly being scrutinized by organizations exploring optimal solutions for their digital infrastructure needs. While colocation services offer tangible control and dedicated space, the integrated nature of capacity services brings forth a synergistic amalgamation of essential components. This shift towards a service-oriented approach represents a new frontier in data center solutions, with its potential impact and practicality yet to be fully explored and understood by many organizations.

IFRS 16 Leases	VS	IFRS 15 Revenue from customer contracts
		
Data center colocation	VS	Data center capacity
Client recognizes a right-of-use asset and a corresponding lease liability Data center recognizes lease variables	<b>Asset recognition</b>	It is a service arrangement rather than involving an asset Data center capitalizes assets utilized in service provision
Lease of data center white space Client will bring, install, and manage its own hardware including servers, racks, and allied infrastructure	<b>Contract</b>	Provision of data center capacity Integrated services include specialized space, cooling, and allied environment
Data center recognizes income evenly over lease term	<b>Revenue</b>	Recognized as services are rendered to the customer
Fixed periodic lease payments	<b>Payments</b>	Variable – based on utilized capacity
Against leasing a data center white space	<b>Consideration</b>	Against provision of integrated data center services

## IFRS evolution: Redefining balance sheets as capacity services challenge colocation norm

### Financial implications: An IFRS perspective

At its core, data center colocation service offers companies the luxury of dedicated space to house their hardware, granting them autonomy over equipment and operations, while providing the benefits of enhanced security, power, and connectivity. This leasing arrangement, viewed through the accounting lens of IFRS 16, casts intriguing shadows on the client's balance sheet, revealing the intricacies of asset and liability management. Conversely, the capacity services model, under the aegis of IFRS 15, refrains from direct balance sheet implications, focusing instead on the recognition of revenue over the contract period. For clients, this translates to a lighter balance sheet, potentially enhancing financial ratios and offering a degree of agility in financial reporting and strategic planning.

### A win-win move: Data center capacity services - Boosting agility for providers and clients alike

#### Strategic choices for data center companies

For data center companies, navigating this strategic crossroads is laden with challenges and opportunities. Their core competency lies in operating extensive, state-of-the-art facilities for clients who prefer to remain unencumbered by the complexities of managing data centers. Yet, the vast majority of their primary assets—data centers—are entangled in lease arrangements, creating a financial tableau that demands careful navigation.

#### Emergence of a new model

The introduction of data center capacity services offers a paradigm shift, presenting an alternative to the tangible ties and balance sheet implications of asset-specific leasing. With its inherent flexibility and adaptability, this model aligns seamlessly with the dynamic needs of clients, casting a

variant financial shadow that may intrigue and sway stakeholders, lenders, and investors.

### The future beckons: Colocation to capacity - A strategic leap forward in data center dynamics

#### Dynamics and choices: A strategic interplay

The nuanced interplay between these models elucidates divergent dynamics and strategic choices for both clients and providers. Colocation services resonate with clients who value autonomy and control, while capacity services cater to those seeking seamless, integrated solutions without the balance sheet encumbrances. The resultant choice can significantly alter the financial narratives and strategic trajectories of both data center companies and their clients. In this intricate dance, lenders and investors scrutinize the evolving financial landscapes, evaluating creditworthiness and risk through the prisms of these models. The choice between asset-centric and service-centric models can shape the financial dialogue, influencing lending terms, investment decisions, and the overall financial health and strategic positioning of the parties involved.

In conclusion, traversing the labyrinth of data center colocation and capacity services unveils a rich tapestry of insights, considerations, and strategic inflection points. The nuanced financial and operational threads woven into these models guide the steps of clients, providers, lenders, and investors. The choice, far from being inscribed in stone, is etched in the evolving narrative of the industry, with the informed and strategic decisions of its participants shaping the contours of the future. ●

By **Zeeshan Abbasi**, Partner, Risk Advisory, Accounting & Reporting, Deloitte Middle East

The nuanced interplay between these models elucidates divergent dynamics and strategic choices for both clients and providers. Colocation services resonate with clients who value autonomy and control, while capacity services cater to those seeking seamless, integrated solutions without the balance sheet encumbrances.