

Interland

(INLD)

“Potential Short”

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- Despite being one of the largest companies in web hosting (through acquisitions), Interland is growing in reverse and is not yet profitable.
- Strategies:
 1. growth-by-acquisition (has rarely worked well in tech industry)
 2. competing on price rather than service with its dedicated servers (most lucrative and fastest growing sector of web hosting).
- Management led MicronPC to rapidly declining share of PC market and eventually out of that industry altogether.

- Led by Joel Kocher, who served as CEO of MicronPC beginning in 1999.
- In the midst of a sales drop, this trend accelerated drastically after Kocher arrived.
- He led them out of the PC business altogether in 2001 when they bought out a web hosting company (Interland) and sold the PC portion of the combined company.
- Taking the Interland name, he has led them to a “growth-by-acquisitions” strategy in low-end (non corporate) web hosting.

An Aside

Web Hosting

Vs.

Dedicated Servers

Financial Matters

- For the 39 weeks ended 5/31/03, revenues rose 7% to \$79.3M. Net **loss** from continuing operations totaled **\$82.9 million** vs. an **income** of **\$11.1 million**.
- Interland is lowering prices and losing customers at the same time. The only growth they have comes from "growth by acquisition".
- This is **not** a sustainable process because there just aren't many large companies left to buy.
- The web hosting industry has become one in nearly perfect competition with no barriers to entry. Any mom-and-pop can lease a server and host sites, and prices have come to a point where Interland is not competitive in the market in which they compete ("low-end" - personal and small business web hosting).

Timeline of Acquisitions

Acquired HostPro, Micron Internet Services, and Lightrealm

1999

Acquired Worldwide International Publishing Corporation

2000

Sold non-hosting business assets. Acquired Web host Interland, Inc. And Interliant, Inc.

2001

Acquired CommuniTech.Net, Dialtone Internet, Inc., iINNERHOST, Trellix, and the small-business shared and dedicated Web hosting assets of AT&T

2002

Acquired Hostcentric

2003

Personal Experience ...

- Interland bought 2 companies Ben had previously had wonderful experiences with as a customer: Dialtone and Innerhost.
- As soon as these were bought by Interland, service and reliability went downhill very quickly.
- One thing Interland does when buying a company is they relocate the servers to their own network infrastructure.
- The best points of Dialtone and Innerhost were their great networks and network management. These characteristics disappeared immediately as the network was moved and the network administrators were laid off in favor of Interland's own people.

Personal Experience ...

- Interland also bought 3 companies with whom Ben had negative experiences with as a customer: Interliant (Sage Networks), Communitech, and Hostcentric.
- Even many of those previously satisfied with these companies have now begun complaining about the "new management" of Interland in web hosting forums and chatrooms across the Internet.

They Said It

A current employee:

“Admittedly, Interland has had problems in the past with customer relations. I think we are in the process of focusing all of our efforts into this concept now that the buying is done.”

They Said It

A former employee:

“They don’t keep hardly anyone from the companies they buy. These are the people who have built relationships with the customer base they are paying good money for, and they just throw these people away. As a result, those relationships are also thrown away and they don’t end up with the clients they paid good money for. These clients move on to either the companies these former employees end up with, or to companies with better reputations that they learn about on the Internet.”

They Said It

A former customer:

“After doing any research at all, I’d be surprised if anyone would do business with Interland. They’ve basically ruined every company that I used to enjoy working with in the hosting industry. Luckily, there are more great companies starting every year in this industry, who are more reliable and charge much better prices than Interland for shared hosting.”

Organic Growth Phase is beginning?

- "The completion of the integration phase achieves a primary goal of Interland's strategy: the creation of a large integrated hosting business, at scale...
- ...This accomplishment now enables the company to concentrate on the execution of its organic growth strategies, including reducing churn through customer-focused improvements in its infrastructure, processes and systems...
- ...Organic growth in the core hosting business will be driven by the company's renewed focus on improving the Interland customer experience."

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Shared Webhosting Revenue

Quarter	Revenue*	(Organic)
Q1 2003	\$17.1 million	\$17.1 million
Q2 2003	\$16.0 million	\$16.0 million
Q3 2003	\$15.6 million	\$15.6 million
Q4 2003	\$16.5 million*	\$14.7 million

*includes acquisition of Hostcentric

Q3 2003 to Q4 2003

Growth w/ acquisition: +0.9 million, annual rate: 25.2%

Organic Growth: -0.9 million, annual rate: **-25.2%**

Dedicated Server Revenue

Quarter	Revenue*	(Organic)
Q1 2003	\$9.6 million	\$9.6 million
Q2 2003	\$9.2 million	\$9.2 million
Q3 2003	\$9.2 million	\$9.2 million
Q4 2003	\$9.3 million*	\$8.3 million

*includes acquisition of Hostcentric

Q3 2003 to Q4 2003

Growth w/ acquisition: +0.1 million, annual rate: 4.4%

Organic Growth: -0.9 million, annual rate: **-45.3%**

Total Company Revenue

Quarter	Revenue*	(Organic)
Q1 2003	\$27.3 million	\$27.3 million
Q2 2003	\$26.1 million	\$26.1 million
Q3 2003	\$25.9 million	\$25.9 million
Q4 2003	\$27.3 million*	\$24.1 million

*includes acquisition of Hostcentric

Fiscal Q3 2003 to Q4 2003

Growth w/ acquisition: +1.4 million, annual rate: 24.4%

Organic Growth: -1.8 million, annual rate: -30.8%

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Current Market Observations...

- The entire (dedicated and shared) hosting market's revenue is still growing at 22%* per year. Interland is managing to organically grow at a negative rate.

- *Source: **Web Hosting and Managed Services 2002-2007** by Insight Research

Current Market Observations...

- Interland recently reduced their low-end dedicated servers from a price of \$225 per month to \$99 a month in an effort to gain marketshare in the fastest growing segment of web hosting.
- A well-known competitor (Rackshack, now called EV1Servers) with a much better reputation than Interland has long provided great service at this \$99 price point.
- So far, Interland's switch seems to have only attracted customers who were previously paying \$225 to start paying \$99.

Current Market Observations...

- In the past months, Interland has reduced the price even further: from \$99 to \$89, and then from \$89 to \$79.
- With another large company just recently announcing \$49 dedicated servers (Server4You.com), it is clear that the low-end dedicated server market in which Interland competes is in a state of falling prices.

Current Market Observations...

- The price of low-end shared hosting has also gone into a state of free-fall.
- Interland starts at \$16.99 a month, for basically the same plan that many newer hosting companies charge \$5.00 a month.
- As current customers find out about the competition, they are drawn away from Interland and despite millions of dollars spent on advertising, there is a net outflow from Interland's servers at a time when the market is still growing.

Short Interest

- watch the short interest...
- has jumped from 3% to 5.5% in the past month...
- might like that to be a little lower?

In Conclusion

- Interland is poorly managed
- Unsustainable growth through acquisition
- Provides poor service
- Negative organic growth
- Possible short