

# Hostopia.com Inc.

## (H-T, C\$6.00)

May 23, 2007

### *Poised, Positioned, and Ready to Succeed*

**INITIATING COVERAGE:** *SECTOR OUTPERFORM*





*Target Price: C\$8.50*

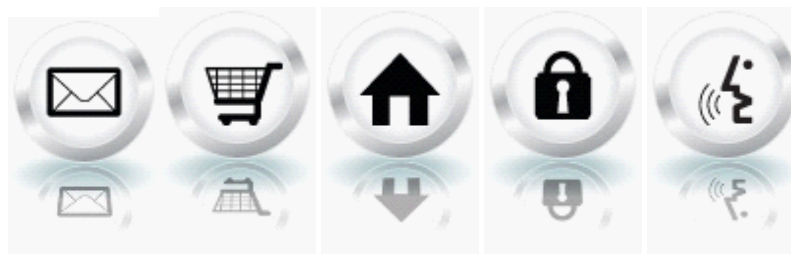
*Risk: MODERATE*

**Investment Brief:** We are initiating coverage on Hostopia with a Sector Outperform rating and C\$8.50 target. 2007-1012 forecast revenue growth at 22% (cagr) is driven by end market growth forecast at 15%, greater penetration of existing users and conservatively forecast new client wins. Hostopia is well-positioned with low-cost, award-winning programming capabilities and marquee client lists in N. America (Verizon, Covad, Bell, TELUS, Rogers) and now Europe (British Telecom, BT Ireland, Perlico). Hostopia boasts a proven 80% success rate on RFPs that represent over half its revenues. New product/service launches are poised to accelerate end user growth with legacy and new clients.

**We believe investors discount the significance of recent wins and view the overhang of insider sales post the six month IPO lock-up as a short term negative.**

**We believe, revenue traction from British Telecom (BT) and other recent wins over the next 2-3 quarters should materially change investor expectations and in turn Hostopia's valuation. We believe insider sales are limited and an opportunity to increase liquidity.**

-  **Poised** – The end market for webhosting is forecast to grow at 15% per annum.
-  **Positioned** – Marquee clients ensure sales access while a long term relationship with Geeks for Less (GFL) in the Ukraine secures low cost, award winning programming. Competitive intensity for client's end users strengthens Hostopia's wholesale model.
-  **Repeat** – History supports execution strength and shareholder focus. Management successfully built and sold Internet Direct, an independent ISP, for \$200M in 1999.
-  Hostopia trades at 5x's forward EV/EBITDA vs. peers at 12x/8x's 2007/08. Current cash/share is \$2.69 with 5 year FCF forecast at \$2.43/share. Our \$9.05 DCF is based on an 11.5% discount rate and 4.25x EBITDA terminal valuation (or 1.7% terminal growth rate).



Source: [www.Hostopia.com](http://www.Hostopia.com)

Please see pages 36 - 39 for full rating structures, important disclosures, risk parameters and disclaimers.

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## EXECUTIVE SUMMARY

<b>Target Price</b>	<b>\$8.50</b>
Current Price	\$6.00
Return	42%
52-Week High / Low	\$6.80 / \$5.50
Shares O/S	11 million (basic)
	11.3 million (F/D)
Market Cap(FD)	\$68 million
Enterprise Value	\$41 million
Cash&ST Invst.	\$27 million
Total Debt	NA
Daily Volume	
(3-month average)	7,099
President and CEO	Colin Campbell
Company Website	

[www.hostopia.com](http://www.hostopia.com)

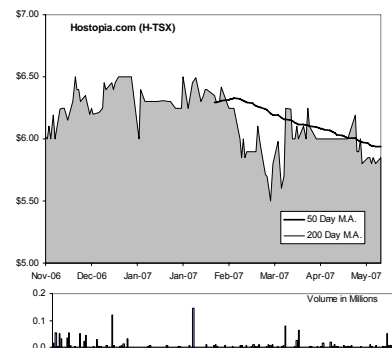
**Revisions, Date of Record-**  
 Target: \$8.50 – May 23, 2007 –  
 Initiating Coverage  
 Rating: Sector Outperform –  
 Initiating Coverage

<b>Risk Profile</b>	<b>Moderate</b>
Forecast Risk	Moderate
Financial Risk	Moderate
Valuation Risk	Moderate

### Company Profile –

Hostopia provides wholesale webhosting services (including website creation/maintenance; managed e-mail accounts; e-commerce applications; hosting; data transfer, etc.) to telcos, ISPs, domain registrars and web hosting companies, which in turn resell these services under their own brands to small and medium sized businesses. Hostopia operates in the U.S., Canada and the UK. Hostopia also serves end-users directly through its subsidiary BlueGenesis. Customers include BCE; TELUS; BT.

### Price Performance



Source: Bloomberg

## Poised, Positioned, and Ready to Succeed

2007-1012 forecast revenue growth at 22%(cagr) builds from our end market growth forecast at 15%, greater penetration of existing users and conservatively forecast new client wins. Revenue traction from recent wins should build momentum and recognition. Furthermore, new product/service launches are poised to accelerate client wins, subscriber growth and support/supplement ARPU. Hostopia is well-positioned with low-cost, award-winning programming capabilities and marquee client lists in North America and now Europe.

**Poised** – Hostopia targets the top 1000 global telecom providers and boasts an 80% success rate on RFPs that have built a marquee client list. Simply aging current account penetration to 9.5% penetration, a level typically hit within 3 years, would support EPS/CFPS of \$0.40/\$0.87 and a target price of \$11.17. Four new product initiatives should accelerate end user growth & ARPUs over the next 12 months. The marquee British Telecom (BT) win is key to attack the fragmented, higher growth European market. The related near term financial hit is a small investment to expand in the 2<sup>nd</sup> largest market. We believe the significance of the BT win & last quarter’s migration of 370k email accounts have been missed.

**Positioned** – A long term relationship with GFL in the Ukraine ensures critical access to low-cost, award winning programming. Marquee clients in North America & now the U.K. ensure further reference wins in the two largest markets. Hostopia’s strengths are evident in its ~ 12% share of Canadian market with Bell; TELUS; MTS AllStream & Rogers as key accounts. IDEARC (a spin off of Verizon), Covad; Time Warner Telecom & Register.com represent marquee U.S. accounts where Hostopia has a 2% market share.

**Repeat** – Management successfully built & sold Internet Direct, an Independent ISP, for \$200M million in 1999. The same strategy, execution and discipline are evident in Hostopia. The disciplined approach has controlled growth, minimized capital and maximized ROIC, at 27% before the IPO. We cannot overstress the importance of management. History and current indicators are positive.

**IPO signaled commitment to accelerate** – We compare Hostopia to Q9 Networks, where Q9’s decision to finally spend its war chest on new facilities signaled accelerating demand & robust industry economics. Hostopia’s \$27M of net cash is committed to pursue attractive opportunities in N.America & Europe.

**Acquisition potential** - Acquisitions should add value given the fragmented nature of targets that are increasingly challenged by clients looking for bundled applications. The recent acquisition of Nexthaus fits the prototype acquisition with Hostopia able to sell Nexthaus’ wireless synching software on a standalone or bundled basis to new and existing clients.

**Financial Objectives** – Five year CAGR revenue/EBITDA growth at 22%/29% targeting revenue/EBITDA of \$60M/\$18M & EPS/CFPS of US\$0.66/\$1.34.

**Valuation** – Hostopia is trading at 5x’s forward EV/EBITDA vs. peers at 12x/8x’s 2007/08. Current cash/share is \$2.69 with 5 year FCF forecast at \$2.43/share. Our DCF is \$9.05 based on an 11.5% discount rate and 4.25x EBITDA terminal valuation.

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## INVESTMENT THESIS

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Hostopia's business strategy focuses on providing value-added web services on a wholesale basis to customers drawn from the top 1,000 global telecom providers. These are typically telecom service providers looking to access Hostopia's award-winning design expertise and networking capabilities to launch turnkey web site solutions for small and medium sized enterprises (SMEs). Hostopia's network, data centres and software design capabilities enable ready solutions with ongoing operating costs typically 30%+ below in-house standards experienced by its marquee clients. Clients indicate savings are a factor but access to Hostopia's ongoing development and support are also critical. Surveyed clients recognize that Hostopia is an informed and recognized expert in web service development while it is not typically a core expertise of telecom providers. Hostopia's industry position in European and American leaves clients confident that Hostopia will be at the forefront software development given its window on the key markets.

Hostopia's drive to build scale and broaden its product suite will serve to increase its value proposition as scale ensures efficiencies, development upgrades at least in line with market (fast follower is good enough) and comprehensive solutions. Hostopia further stands out for its focus on the wholesale without channel conflicts and/or diverse interests.

We believe incumbents are increasingly motivated to consider outsourcing to wholesale providers. The intense competition and pricing pressures on web hosting leave the incumbents looking for guaranteed access to new applications as a competitive tool to acquire new users and retain existing subscribers. The incumbents are increasingly motivated to use services such as web hosting as a retention tool to protect access revenues. We believe the migration of 370,000 email accounts for an existing client foreshadows Hostopia's potential to adapt its SME focused products to the increasingly sophisticated/demand residential users.

We believe the shares offer very limited downside considering that Hostopia is trading at 5x's forward EV/EBITDA versus peers at 12x/8x's 2007/08 and our DCF at \$9.05 based on an 11.5% discount rate and 4 times EBITDA terminal valuation. Furthermore, the shares should see support considering the current cash balance per share is \$2.69 and our 5 year FCF forecast at \$2.43/share. Looking to the upside, we believe 2-3 year targets in excess of \$20 are not unreasonable.

Below, we examine growth from existing clients and overall market growth. We then look at Hostopia's sensitivity to higher ARPU assumptions considering the company's potential to supplement ARPU through new applications.

- 1. Maturation of existing clients.** Management has indicated that penetration of client end users typically builds to more than 10% of addressable end users within the first 2-3 years of signing a new account. Excluding BT, Hostopia's end user penetration at the end of FY2007 was 6.5%. We estimate that penetration at the end of FY08 will be 6.6% (with 329k end users) after adding roughly 1 million target end users from BT. We estimate Hostopia's existing base should expand (conservatively) to approx. 475k within 3 years at a forecasted penetration level of 9.5%. This would imply EPS and CFPS at \$0.40 and \$0.87, respectively and arguably a 36 month target of \$11.17. Overleaf, we highlight the EPS/CFPS sensitivities to penetration levels using 50% incremental margins. Our three year target would increase to approx. \$13.69, if penetration reaches 12% in 3 years. For perspective, Hostopia targets 1 million end users over 5 years based on organic and acquired growth versus our forecast 670 users in 2012.

Sensitivity of Penetration (5M addressable end users)				
Penetration	End		Target	
	users (k)	EPS	CFPS	Price (Cdn\$)
6.6%	329	\$0.26	\$0.51	\$8.50
9.5%	475	\$0.40	\$0.87	\$11.17
10.0%	500	\$0.76	\$0.88	\$11.41
12.0%	600	\$0.91	\$1.06	\$13.69
15.0%	750	\$1.14	\$1.33	\$17.12

2. **Market Growth.** Growing the addressable end user base at 15% per annum over the next 3 years, in line with aggregate market forecasts would add roughly 247k subscribers, annual revenues of \$22M and EBITDA of \$11M (based on a 50% incremental margin). Market growth would thereby be expected to add roughly \$5 - \$7 per share based on 6-8 times EBITDA.

Sensitivity of addressable end users base growth				
Penetration	End		Target	
	users (k)	EPS	CFPS	Price (Cdn\$)
6.6%	329	\$0.26	\$0.51	\$8.50
9.5%	722	\$1.10	\$1.36	\$16.49
10.0%	760	\$1.16	\$1.43	\$17.35
12.0%	913	\$1.39	\$1.72	\$20.82
15.0%	1141	\$1.74	\$2.15	\$26.03

3. **Raising ARPU.** We are looking for 2012 ARPU at \$94 ahead \$2 from FY2007 based on new application ARPU contributions exceeding pressures on legacy services. Adding \$10 to our annual ARPU objective would support a 2010 ARPU target of \$102 versus our current target of \$92 in line with the reported fiscal 2007 results. Our DCF valuation would move ahead \$1.50 per share based on the positive ARPU adjustment. ARPU enhancing applications will likely be internally developed and externally acquired.

## Positives

### 1. Senior management's expertise and reputations present a critical advantage highlighted by contacted clients.

It is critical to assess managements' strategic foresight, execution capabilities, networking reach and shareholder commitment. The best testimony is typically past performance. Hostopia's senior management has been involved in the North American ISP industry for over a decade and both understands and just as importantly is known to understand the web hosting requirements of ISPs. Bill and Colin(current CEO) Campbell, co-founded Hostopia after founding iDirect, Canada's fourth largest internet service provider prior to its sale. Paul Engels, the Vice President and Chief Marketing Officer, for Hostopia worked with the brothers at InternetDirect. Together, they built InternetDirect into a \$20M revenue company with 150k subscribers. Management's value commitment supported the sale of InternetDirect for Cdn\$200M in 1999. We note management's involvement in building and selling TUCOWs in 1998 for USD\$30M. Bill Campbell was awarded the Entrepreneur of the Year for 2005 by Ernst and Young.

*We believe that management took the tough but, in our opinion appropriate, path of completing its initial public offering at a lower valuation to gain access to funds.* We further note that management cancelled the initially proposed \$5.4M (0.9M shares) allotment of prorated secondary sales to ensure that the company benefited from the funds. Management signed a 6 month restriction against insider sales which expired at the beginning of May 2007. We believe the end of the restricted sale period continues to be an overhang on the shares. In our opinion, increased liquidity in the shares should be positively received. The current overhang considers the indication by former Chairman, John Nemanic, that he intends to reduce his stake as he rebalances his personal portfolio. As an affiliate, sales by the former Chairman are restricted to 100k shares per month and require a form 144 Filing.

While the shares are flat since the IPO at Cdn\$6, we believe management moved the IPO along ahead of the BT announcement; a deal that would have become increasingly certain through the issue process and one that management would expect to positively impact the shares. We note that there are approx. 810,320 options held internally with an average exercise price of \$3.59, of which 675,000 are in the money with 382,000 expiring at May 31, 2007. We expect that 400k to 500k of these internally held options could be exercised in the near term. Some portion of these shares may be sold to the public.

**Management drives its strategy, tactics and execution to maximize returns.**

The company's business model has been carefully crafted and executed to maximize ROIC. The wholesale model minimizes sales and marketing expenses while the secured outsource relationship with GFL provides a long-term efficient and effective software design pipeline. Invested capital to date is a modest \$31 million with \$3 million in net plant and equipment. The four data sites are largely a variable cost with additional capacity readily available to Hostopia. The ROIC was 26.5% for 2006. With the recent IPO raising the invested capital from \$8.5 million to \$31 million and considering expansion driven expenditures, we forecast ROIC of 4.8% for 2007 (34% excluding the impact of the cash and equity raised through the IPO). We forecast that ROIC will build back towards 6.4% and 8.1% for 2008 and 2009. We have found Management quite adept and pleased to compare its ROIC model with other telecom providers in the low single digits. Management deliberately minimizes its invested capital and has positioned itself as a wholesale provider to lower customer acquisition costs relative to those experienced by direct end user telecom providers.

**2. Growth to date Highlights Strong Execution, Merits of Marquee Client Strategy.**

*Acquisition of new customers and high penetration among end-users are key growth drivers.*

For the past five years, Hostopia's strategy has been to drive organic growth by improving its services while expanding its base of customers and more importantly its base of end-users. Hostopia's customer base has registered a CAGR of 14%, from 197 in FY02 to 335 in FY07 while its target end user base has grown at 52% to reach 4 million (58% CAGR with BT and end-user base of 5 million). Over the five years, revenues have grown at a CAGR of 54% from \$3.2 million to \$22.5 million. The higher revenue growth relative to customer growth reflects wins at larger accounts and the growth of end users at established accounts. Looking ahead, tracking customer growth is questionable given the disparity in customer sizes and Hostopia's moves to cull certain smaller accounts as it wins larger accounts. In FY2007, Hostopia signed contracts with 16 new customers during 2Q07, added 14 in 3Q07 and 12 in Q4/07 to finish FY07 with 335 customers. However, on a net customer basis, Hostopia increased its customer base by only one for the year. Targeting large and established telcos and ISPs in the U.S. and Canada has minimized customer acquisition costs and accelerated growth in its end-user base. Winning large contracts with companies such as British Telecom lowers COA costs and brings efficiencies of scale for development costs. Our forecast 19% CAGR in end users from FY07 to FY12 could be realized by end market growth and penetration gains from existing clients.

*The company's web of Marquee clients started in Canada, moved to the U.S. and has now crossed to Europe.* Hostopia targets the top 1,000 global telecom providers. The company has third party validation to show that it has been successful with 80% of its responses to RFPs. Revenues from these RFP wins represent more than half of overall revenues. We were pleased to note last quarter's addition of marquee customers; BT Ireland; Perlico (Republic of Ireland), MTS/AllStream and Time Warner Telecom. Gaining sponsorship by critical telecom providers has proven itself to be a successful strategy to penetrate markets. This reminds us of the Assante Wealth Management strategy to build its base of professional athletes by signing marquee stars as reference accounts. Hostopia is by far the largest wholesale provider in the Canadian market with an estimated market share of ~12% while its clients in total contribute roughly 90% of the

country's telecom marketplace. Hostopia is estimated to have ~2% of the U.S. market where the largest provider is estimated to have a 5% share. We look for Hostopia to significantly expand its U.S. end user presence by migrating end users at Hostopia's clients, through further wholesale wins and acquisitions.

In November 2006, Hostopia signed a two year contract with BT, after completing a successful pilot. The contract gives Hostopia a chance to migrate a large number of BT's SME customer accounts onto its own platform. We believe BT's recently launched promotions focused on the SME market reflects aggressive ambitions to increase its share of the SME web hosting market where it is estimated that BT has 4% of SME end users. While investors are aware of BT's roughly 34k to 40k end users lined up to migrate onto Hostopia's platform, we believe investors remain largely unaware of BT's aggressive plans to gain market share and drive its end user base onto value added services such as those provided by Hostopia. With success, the potential exists that BT subscribers could advance towards 200k over the next 18-24 months. This would represent an increase of 77% measured against Hostopia's current end user base of 260k. The fragmented nature of the supplier and user markets increases the marketing value of marquee clients, such as BT, as a key differentiator.

### 3. Sustainable Product Advantage.

**Hostopia's contract with GFL allows Hostopia to significantly reduce costs.** From 2003 onwards, Hostopia began using outsourced services from GFL in areas such as software programming, technical support and project management. GFL is a Canadian registered firm with a facility in the Ukraine. GFL provides Hostopia with a very significant cost advantage with Ukraine programmers in some cases at roughly 1/8<sup>th</sup> the cost of a N. American equivalent. We estimate that GFL costs roughly US\$600 to US\$1,000 for an average of roughly US\$800 on an all in basis. High end N. American programmers can enter six digit territory for compensation. In addition to the savings, GFL costs are more variable than they would be with a full time, in-house N. American equivalent. The contract charges Hostopia on a per contractor equivalent basis ranging from \$388/month to \$280/month. Hostopia has also entered into a template purchase agreement with GFL with prices ranging from \$140/500 templates to \$110/500 templates.

Hostopia's top management (Colin & Bill Campbell) own 50% of the Ukraine-based GFL. Recent Hostopia chairman, John Nemanic (who owns over 12% of Hostopia's shares outstanding) also owns 25% of GFL. While the cost savings are a huge advantage, design and development capabilities are a game-stopper. On this front, GFL has consistently developed award winning applications that have been integral part of Hostopia's ability to build its Marquee client list. GFL has clearly established itself for its differentiated product while Hostopia's financials reveal the cost-effectiveness of its arrangement. The relationship with GFL is grounded in common ownership while it is governed by a long term pricing contract. Wholesale clients consider GFL an in-house development source another differentiator against competitors who may be reliant on independent, outsourced development work.

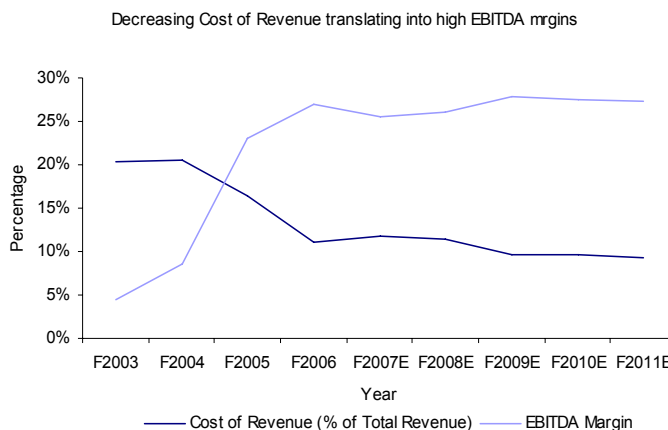
**In-house R&D, proprietary delivery platform and high operating leverage gives Hostopia an added advantage.** Over the years, Hostopia's proprietary application delivery platform and web services (built in-house) have been the foundation of the company. As Hostopia has grown, its costs on a per end user basis have declined thereby increasing Hostopia's scale efficiencies. Hostopia leases data centre facilities in Ontario, Canada & Florida, U.S. leaving these costs as a success driven variable consideration. Management has indicated that there are no constraints on adding data center capacity to meet demand in N. America or Europe.

**Hostopia's technology expertise gives it an advantage over its peers.** Early Hostopia clients such as TELUS indicated that Hostopia's hybrid Windows and UNIX clustered delivery platform was a strong selling point given the sensitivity of migrating end users onto the Hostopia platform.

#### 4. Business Model Yields Low Financial Risk, Leading ROICs.

Hostopia's business model works on monthly subscription fees from customers over contracts ranging from one year to five years. The recurring revenue (96% of total) from these existing customers gives management greater clarity on forecasts and financial stability. Hostopia's scalable business model drives lower is clearly evidenced by the increasing profitability shown since F2004. Hostopia's automated application delivery platform (ADP) gives it the ability to add more customers without significant ongoing or upfront costs. Hostopia's cost of revenue as a percentage of sales dropped from 21% in FY04 to 13% in FY07, while EBITDA margins improved from 8% to 23% during the same period (note EBITDA margins were 27% in FY06, before increased cost related to BT migration, etc.). We expect EBITDA margins to return to the mid twenties in coming quarters as expenses to migrate BT customers are offset by increased revenue.

Hostopia's return on invested capital for FY06 was 26.5%. We calculate FY07 ROIC at 4.8% or 34% excluding the impact of the company's IPO. We expect ROIC to build over the next 5 years to mid teens as the IPO proceeds are productively redeployed.



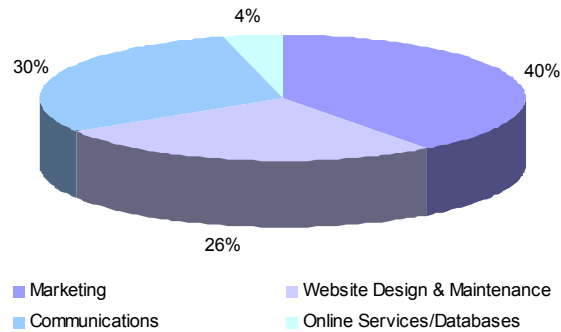
Source: Company filings and Haywood Estimates

#### 5. Strong Market Growth Projections.

The Yankee Group estimated that the U.S. web hosting industry for SMEs was around \$4.4B in December, 2005 and forecast to reach \$5.6B by 2009. Hostopia's growth within our forecasts will be largely driven by the approximately 40% of the total 22 million SMEs in the U.S. without a website. Beyond new end user growth, Hostopia is positioned to realize growth by pushing ahead penetration with the existing customers' end user base of approximately 4M (excluding BT) where Hostopia's penetration rate is a low 6.5%. BT adds another 1M addressable end users for Hostopia.

In 2004, U.S. businesses had online spending of \$31.5B, of which 26% or approximately \$8B was spent on website design and maintenance. With roughly one fourth of total online spending derived from website design, web adoption by the 40% of total U.S. SMEs do not have websites should sustain growth over our forecast horizon.

Allocation of \$31.5 bn of online spending in 2004



Source: Borrell Associates, 2005

## 6. Depth of Client Relations

**Bundled service offerings, provide flexible end-to-end solutions beyond the reach of small providers.** Hostopia's client relationships extend to end user account set-up services, sales/marketing and technical support services. Hostopia's ability to migrate clients' end user accounts onto its application delivery platform provides clients the opportunity to develop stickier/deeper end-user relationships by reducing churn while building incremental revenues without additional capital requirements. Hostopia gives clients the ability to offer their end-user user friendly (key for SMEs), proprietary solutions to help them create and manage websites on their own. These bundled and easy-to-use web services are Hostopia's key differentiators.

Some of the advantages that customers have by outsourcing web hosting services to Hostopia are:

- **Significantly lower setup time:** Hostopia's project management and technical support staff help customers through the setup process so that the web hosting service gets up and running in a few weeks. Our discussions with customers highlighted Hostopia's strong customer service record.
- **Low initial setup costs:** Hostopia's online and automated delivery platform enables customers to offer web hosting services to SMEs with minimal capital outlays and typically lower operating costs.
- **Wholesale model ensures focus, avoids channel conflict.** Hostopia's strategy to be a wholesaler without channel conflict was a consideration by clients who were reluctant to buy products from competitors.

## **Risks**

### **1. Revenue Concentration.**

Hostopia's total number of customers at the end of FY07 was 335 however approx. 63% of total revenue came from just 20 customers and approx. 29.3% from only three customers (Bell Canada accounted for nearly 11% of FY07 revenues). Such high revenue concentration may negatively impact Hostopia's growth prospects as it clearly would experience a material setback should it lose any of its larger customers.

### **2. Pricing pressures at retail could work back to the wholesale level.**

Initially, web hosting players relied on server size, server speed and storage space to price their products. However, the huge decreases in bandwidth & data center costs have shifted competitor tactics to pricing. Pricing pressures on service providers will in turn put pressure on Hostopia's wholesale products and services. Hostopia will need to offset these pricing pressures with new applications and service enhancements.

For better perspective on the pricing pressures, hosting packages at roughly \$20/month a decade ago are now available well below \$10/month with significantly greater services, storage and bandwidth. Hostopia's strategy has been to maintain pricing by significantly enhancing capabilities and adding services. Hostopia's margins have increased over the period through efficiency gains and savings on its leased storage and bandwidth costs. As storage and bandwidth cost declines abate, Hostopia will need to rely on new services/capabilities to support pricing while development efficiencies enable profitability gains.

### **3. Successful adoption by BT**

Marquee clients can work for you or against. It is critical that Hostopia successfully migrate BT's clients onto its platform. The next 3-6 months are critical to measure Hostopia's success. We expect Hostopia to be successful based on its past performance and detailed planning. However, the demands of moving BT's current subscriber base of roughly 34K to 40K plus new subscribers is a significant consideration. As noted, BT subscribers could advance towards 200k over the next 18-24 months. This would represent a 77% increase measured against Hostopia's current end user base of 260k.

### **4. Deployment of Cash**

Hostopia has \$27 million of net cash on its balance sheet following the company's \$25 million initial public offering. We believe management will exercise full discipline pursuing acquisitions and expansion using the proceeds. Management indicated that \$20 million of the proceeds are targeted for the acquisition of technology and customers with \$5 million available for international market expansion.

### **5. The 800lbs. Gorillas - Google and Yahoo**

The potential entry of companies like Google and Yahoo into the web hosting market is an inherent risk not only to Hostopia but also to the entire industry. Web giants such as Google and Yahoo always have the firepower to disrupt the web economy with their end user base and internal capabilities. Fortunately, Hostopia is buffered by its non-consumer focus. Should the web giants make successful inroads into the SME marketplace it would put greater pressure on the incumbents to secure leading edge applications. This should add to Hostopia's value proposition. Looking for opportunities, we believe that investors should consider Hostopia's potential to adapt its SME application suite to the residential market where web hosting

capabilities are expected to take on greater importance. We expect telecom service providers to consider adding applications to repatriate the residential interface from separate portals. We believe Hostopia's migration of 370,000 email accounts during Q407 reflected success in adapting a SME product to a residential application.

## **6. Reliability Risk**

Hostopia's service delivery is critical with stringent service level agreements (SLAs) the norm across the industry. Hostopia's track record, network topology, built-in redundancy and safeguards suggest risk is minimal but it should be noted. We believe the challenge of delivery service beyond SLAs is an opportunity for companies with scale to consolidate the fragmented industry.

## **7. Immature termination of contracts with GFL, TELUS**

Hostopia signed contracts with TELUS for bandwidth and data center facilities in 2001 and GFL for software programming and technical support in 2003. The relationship with TELUS is well grounded in history, reciprocal business and TELUS's stake in Hostopia. We see no reason for a change in the existing relationship between the two parties. Both TELUS and Hostopia gain from their business relationship before considering TELUS' stake in Hostopia. The relationship with GFL has clearly been a significant positive benefit to Hostopia. GFL's reliance on Hostopia revenues and the two companies common ownership would suggest minimal risk of an early termination. The contract with GFL was renegotiated in July 2005 with the term renewable every 12 months; with pricing set with an automatic inflation adjustment.

## **8. Currency Fluctuation Risk**

Hostopia generated approximately 43% of its total revenues for FY07 from Canada. With Hostopia reporting in U.S. dollars, a drop in the value of the Canadian dollar vis-à-vis the U.S. dollar would hurt revenues. The Canadian dollar has appreciated against the U.S. dollar by as much as 13% during the last three years. Hostopia doesn't manage exchange rate risk using financial instruments. We note that Hostopia has been shifting its revenue segmentation, with Canada contributing 43% of total revenues at FY07 down from 48% in FY06. We forecast Canada will represent 39% of total revenues by the end of FY08.

## FINANCIALS

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### ***Fiscal 2007***

#### **Q4 FY07 Results**

Q4 FY07 revenues increased 15% on a y/y basis from \$5.1M to \$5.9M. Web hosting and applications revenue increased to \$5.6M from \$4.9M (14% y/y), representing 95% of the total revenue. During the quarter, Hostopia added a total of 12k end users to reach total end users of 260k; up 5.7% q/q and 23.5% y/y. EBITDA for the quarter was \$1.3M down -12% compared to last year, as the company ramps up overheads (staffing, etc.) to deal with the increased end users expected over the next two quarters as BT comes on-stream. As a result, EBITDA margins declined to 22% in Q4 FY07 compared to 29% the same period a year ago, but improved from 20.3% last quarter. Diluted EPS was \$0.05. Cash equivalents were reported at \$27.3M (\$2.45/share) up from the \$25.7M (\$2.32/share) at the end of the IPO quarter (Q3/07). Management maintained earlier guidance for FY08 revenue growth of 18% to 22%.

#### **FY07 Results**

For the year, Hostopia reported total revenue growth of \$22.5M or 25.1% on end user growth of 23.5% over FY06. Increased ramp up costs, stock option costs and IPO related costs lowered margins to 22.6% on the year down from 27% for FY06. Consequently, EBITDA at \$5.1M showed modest growth at 4.8% on a y/y basis. The additional expenses are clearly evident with only 5.1% of every incremental revenue dollar on the year making it to the EBITDA line. We expect better measures in 2008 with revenue and EBITDA growth forecast at 22% and 27%, implying incremental revenue to EBITDA flow-through of 28%. On a geographical basis, revenue from the U.S. ended FY07 at 55% (52% in FY06) of the total revenue, whereas Canada contributed 43% in FY07 (48% in FY06) of total revenue. The UK accounted for 2% of the total at FY07.

### ***Longer Term Expectations***

#### **Outlook 2008, 5 year CAGR.**

We forecast that FY08 revenues will grow 22% to \$27.5M against FY07's \$22.5M. We expect end users to reach 329k by end of FY08, from 260k in FY07. Our forecasts call for EBITDA margins to improve modestly to 23.5% in FY08 from 22.6% in FY07. We forecast 5 year revenue and EBITDA growth of 22% and 29% on a CAGR basis, and estimate EBITDA margins will average 29% over the 5 year period. Below, we summarize the outlook for the three key operating regions.

#### **U.S.**

We are expecting FY08 revenue from the U.S. to increase 13% y/y to \$13.9M. We are forecasting U.S. end users to reach 161k in FY08 from our estimate of 140k in FY07; or net adds of 21k. Over the past couple years, the penetration rate for Hostopia in the SME market in the U.S. has increased marginally as new client wins dilute penetration gains from prior clients. We expect the trend to continue for the next few years as Hostopia signs new contracts and existing customers migrate end users to Hostopia's platform. Longer term, we estimate U.S. revenues to grow at a 5 year CAGR of 16%.

## CANADA

We see revenue from Canada growing to \$11M (or 13.6% y/y) in FY08 on our estimate of 128k end users (representing net adds of 13.5k for the year). We estimate that Hostopia's penetration into Canada's SME market was approx. 6.8% in FY07. With the Canadian web hosting market client penetration relatively mature and the overall market smaller in scale, we believe Canada will lag the other two regions, in terms of net adds in FY08. However, we expect growth will be driven by up-selling existing contracts with customers. Longer term, we estimate Canada revenues to grow at a 5 yr CAGR of 15% in line with market growth expectations.

## UK

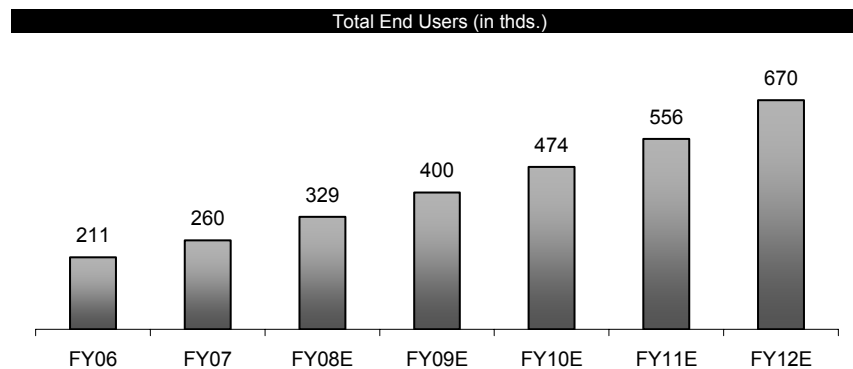
Hostopia's move into the U.K. market became official with its November BT contract. Following the contract and extensive trials, Hostopia's platform was launched in April 2007 for new SME clients to BT. The second phase now currently underway sees the migration of BT's existing SME clients onto Hostopia's platform over the next two quarters. As such, we expect associated web hosting revenues from the UK to be on an aggressive upward swing for the next few quarters. We forecast revenue from the UK will reach \$2.5M in FY08 from \$368k in FY07. We estimate UK end users to reach 39.9k by FY08, as the BT migration is expected to take approx. 6 to 12 months. Long term, we estimate UK revenues to grow at a 5 yr CAGR of 108% given its embryonic starting point.

We have assumed business mix will remain constant at 96% and 4% for web hosting and services revenue, respectively, across all three regions.

<b>Financials Summary (US\$'000)</b>	<b>F2006</b>	<b>F2007</b>	<b>F2008E</b>	<b>F2009E</b>	<b>F2010E</b>	<b>F2011E</b>	<b>F2012E</b>
<b>Total revenues</b>	<b>17,957</b>	<b>22,470</b>	<b>27,507</b>	<b>34,845</b>	<b>41,747</b>	<b>49,456</b>	<b>59,913</b>
- <i>y/y growth</i>	26%	25%	22%	27%	20%	18%	21%
<b>Total cost of revenues</b>	<b>2,003</b>	<b>2,921</b>	<b>3,522</b>	<b>4,523</b>	<b>5,455</b>	<b>6,399</b>	<b>7,705</b>
Gross profit	15,954	19,549	23,985	30,322	36,292	43,057	52,208
Gross Margin	88.8%	87.0%	87.2%	87.0%	86.9%	87.1%	87.1%
<b>Operating expenses:</b>							
Sales and marketing	3,899	4,776	5,753	6,674	8,009	9,290	11,055
Research and development	2,108	3,069	3,836	4,795	5,754	6,905	8,286
Project management	1,393	1,716	1,995	2,514	3,142	3,613	4,155
Technical support	2,259	3,006	3,673	4,224	4,858	5,538	6,313
General and administration	1,451	1,907	2,265	2,696	3,100	3,596	4,207
Amortization:	1,796	2,600	2,857	4,288	5,398	6,536	7,914
<b>Total operating expenses</b>	<b>12,905</b>	<b>17,074</b>	<b>20,380</b>	<b>25,190</b>	<b>30,261</b>	<b>35,478</b>	<b>41,931</b>
<b>Net Income (Loss)</b>	<b>2,003</b>	<b>1,863</b>	<b>3,075</b>	<b>4,068</b>	<b>4,738</b>	<b>5,863</b>	<b>7,768</b>
Net income (loss) per share:							
Basic	0.47	0.31	0.27	0.35	0.41	0.51	0.68
Diluted	0.28	0.24	0.26	0.35	0.40	0.50	0.66
Cash flow per share:							
Basic	0.92	0.54	0.52	0.73	0.88	1.08	1.36
Diluted	0.55	0.47	0.51	0.71	0.87	1.06	1.34
<b>EBITDA</b>	<b>4,845</b>	<b>5,076</b>	<b>6,462</b>	<b>9,419</b>	<b>11,430</b>	<b>14,115</b>	<b>18,191</b>

## Tracking End User, ARPU

We are estimating total end users to reach 329k at the end of FY08, up 26% over 2007. We conservatively estimate end users to grow at a 5yr CAGR of 21% to reach 670k by FY2012. The table below highlights the 5 year trend. We are very aware that Hostopia is pursuing a path with higher volumes and lower ARPU. The addition of 370,000 email accounts during the most recent quarter raises the issue of how Hostopia will report its end users and ARPU. We believe the large email based added on the quarter will bring monthly revenues of roughly \$0.14 to \$0.15. These type of e-mail accounts will likely be excluded from the end user count while their revenues may or may not be included in end user ARPU depending on the level of disclosure adopted by Hostopia.



Source: Company reports, Haywood estimates

We note the sensitivity of our end users estimate to our 3 year DCF valuation below:

Sensitivity of Penetration (5M addressable end users)					
Penetration	End users (k)	EPS	CFPS	Target Price (Cdn\$)	
6.6%	329	\$0.26	\$0.51	\$8.50	
9.5%	475	\$0.40	\$0.87	\$11.17	
10.0%	500	\$0.77	\$1.04	\$13.46	
12.0%	600	\$0.92	\$1.25	\$16.15	
15.0%	750	\$1.15	\$1.57	\$20.19	

## VALUATION

### Discounted Cash Flow

Our DCF uses a discount rate of 11.5% (comparable with the discount rate we use for Peer I Networks and Q9 Networks – operators of IT infrastructures which host hardware like Hostopia's). We use a terminal year multiple of 4.25x on terminal year EBITDA of \$18M, representing a 5 year CAGR of 29%. The terminal multiple equates to a conservative terminal growth rate of 1.7%. Our DCF valuation gives us a current value for Hostopia of Cdn\$8.03, growing to Cdn\$9.05 in 12 months. Our model forecasts capital expenditure intensity moving to 10% of sales.

Discounted Cash Flow Analysis	2007	2008	2009	2010	2011	2012	CAGR 07 - 12
Revenue (\$)	22,470	27,507	34,845	41,747	49,456	59,913	22%
Revenue Growth	25.1%	22.4%	26.7%	19.8%	18.5%	21.1%	
EBITDA (\$)	5,076	6,462	9,419	11,430	14,115	18,191	29%
EBITDA Growth	4.8%	27.3%	45.8%	21.3%	23.5%	28.9%	
EBITDA Margin	22.6%	23.5%	27.0%	27.4%	28.5%	30.4%	
Amortization (\$)	(2,601)	(2,857)	(4,288)	(5,398)	(6,536)	(7,914)	
EBIT (\$)	2,475	3,605	5,132	6,031	7,579	10,278	
Less Taxes (\$)	(1,128)	(1,885)	(2,493)	(2,904)	(3,593)	(4,761)	
Plus Amortization (\$)	2,601	2,857	4,288	5,398	6,536	7,914	
Less Capital Expenditures (\$)	(1,600)	(5,823)	(4,530)	(5,010)	(4,946)	(5,991)	30.2%
Capital Intensity	7.1%	21.2%	13.0%	12.0%	10.0%	10.0%	
Unlevered Free Cash Flow (\$)	2,348	(1,246)	2,396	3,516	5,576	7,439	
PV of Unlevered FCFs (\$)	2,348	(1,224)	2,110	2,777	3,950	4,726	
<b>Valuation Assumptions:</b>							
Discount Rate	11.5%						
Terminal Multiple	4.25						
DCF Implied Valuations	EV/EBITDA	2007	18.1	2008	14.8	2009	11.4
Terminal FCF Multiple	FCF	2010	12.0				
<b>Valuation Analysis:</b>							
		Current	1-Yr Target	2-Yr Target	3-Yr Target		
Total PV of FCFs (\$)		14,688	13,760	16,864	15,878		
Terminal Value (\$)		77,313	77,313	77,313	77,313		
PV of Terminal Value (\$)		49,122	54,771	61,069	68,092		
Net (debt) cash position		27,849	26,873	29,757	33,804		
Total Value (\$)		91,659	95,403	107,690	117,774		
DCF Value/Share (US\$)		\$7.23	\$8.15	\$9.20	\$10.07		
DCF Value/Share (Cdn\$)		\$8.03	\$9.05	\$10.22	\$11.17		

Below, we show the sensitivity of our DCF valuation to discount rates and Terminal multiples/growth rates. Our most conservative assumptions give a target DCF valuation of Cdn\$8.29.

Hostopia DCF Sensitivity Analysis							
		Discount Rate					
		10.5%	11.0%	11.5%	12.0%	12.5%	
Terminal	3.75x	8.60	8.52	8.44	8.36	8.29	0.5% Terminal
Multiple	4.00x	8.91	8.83	8.75	8.66	8.58	1.2% Growth
	4.25x	9.23	9.14	9.05	8.96	8.88	1.7%
	4.50x	9.54	9.45	9.36	9.27	9.18	2.2%
	4.75x	9.86	9.76	9.66	9.57	9.47	2.7%

*Alternatively, value investors should consider that Hostopia currently has \$2.65 per share in cash while FCF forecast over the next 5 years is expected to add a further \$2.50 per share.*

## Relative Valuation

Hostopia currently trades at 6x/5x FY07/08 EV/EBITDA, while the comparable group of web hosting companies trade at 12x/8x FY07/08 EV/EBITDA. We note that Hostopia's FY 2007 ended on March 31<sup>st</sup>. Our \$8.50 target has Hostopia trading at 11x/8x FY08/09 EV/EBITDA compared to Capital IQ's consensus targets for Hostopia's peers that generate a median target valuation at 9x/7x's FY 2008/09 EV/EBITDA. We note that our 22% forecast 5 year revenue CAGR for Hostopia compares with the consensus 15% for its peers. We are holding back additional upside potential for evidence of Hostopia's success with BT and further new contract wins.

Webhosting	Ticker	Trdg	Mkt.	Price	Pot.	% of 52 week	P/E				EV/Revenue				EV/EBITDA				LTM EBITDA		1YR Growth (LTM)		1YR Growth (FWD)	
							Rating	Cur	Cap(Min)	17-May-07	Target	Return	Low	High	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	FY07E	FY08E	Margin	REV
Internet Business Group plc	AIM:IBG	NR	GBP	22	0.29	NA	NA	126%	74%	NMF	NMF	NMF	NA	NA	NA	NA	NA	NA	9.8%	112	150	49	NMF	
Group NBT plc	AIM:NBT	NR	GBP	66	3.95	3.12	-7%	299%	98%	37.2	27.9	2.7	1.9	2.5	1.7	14.0	9.1	13.0	8.5	26.0%	34	52	63	34
Pipex Communications plc	AIM:PXK	NR	GBP	287	0.12	0.15	25%	150%	67%	12.0	12.0	0.8	0.8	1.0	0.9	10.7	8.2	13.0	10.0	7.4%	121	36	36	36
Visual Sciences, Inc.	WSSI	NR	USD	226	11.12	17.42	57%	116%	67%	15.4	12.2	2.4	1.9	3.8	3.1	10.6	8.1	16.8	12.9	16.3%	56	8	31	158
Website Pros, Inc.	WSPI	NR	USD	147	8.44	12.67	50%	108%	68%	15.3	12.6	1.5	1.2	2.5	2.1	10.6	7.4	18.0	12.5	13.5%	35	104	36	NMF
Web.com, Inc.	WWWV	NR	USD	82	4.88	8.00	64%	139%	75%	97.6	14.4	1.3	1.1	2.2	2.0	21.0	7.9	36.9	13.8	NMF	NMF	NMF	11	NMF
Vocus Inc.	VOCS	NR	USD	406	23.40	25.50	9%	195%	86%	54.4	41.1	6.7	5.3	7.3	5.8	45.2	29.4	49.6	32.3	12.2%	48	NMF	39	108
Hostopia.com Inc.	TSX:H	NR	CAD	63	5.71	8.50	49%	104%	84%	21.4	19.7	1.4	1.2	2.7	2.2	6.3	4.9	11.8	9.3	35.8%	25	27	22	27
								<b>Mean</b>		<b>38.7x</b>	<b>20.0x</b>	<b>2.6x</b>	<b>2.0x</b>	<b>3.2x</b>	<b>2.6x</b>	<b>18.7x</b>	<b>11.7x</b>	<b>24.5x</b>	<b>15.0x</b>	<b>14.2%</b>	<b>68%</b>	<b>70%</b>	<b>38%</b>	<b>84%</b>
								<b>Median</b>		<b>26.3x</b>	<b>13.5x</b>	<b>1.9x</b>	<b>1.5x</b>	<b>2.5x</b>	<b>2.0x</b>	<b>12.3x</b>	<b>8.2x</b>	<b>17.4x</b>	<b>12.7x</b>	<b>12.9%</b>	<b>52%</b>	<b>52%</b>	<b>36%</b>	<b>72%</b>
<b>Related Technology</b>																								
Q9 Networks Inc.	TSX:Q	OP	CAD	285	13.80	17.00	23%	145%	95%	NMF	43.1	4.1	3.3	5.2	4.3	14.8	10.1	19.1	13.0	27%	19	5	22	17
Peer 1 Network Enterprises, Inc.	TSXV:PIX	OP	CAD	84	1.30	1.75	35%	260%	81%	39.3	19.7	1.3	1.1	1.6	1.4	4.8	3.9	6.1	5.0	23%	86	86	16	45
Radiant Communications Corp.	TSXV:RCN	OP	CAD	13	1.15	1.70	48%	192%	82%	14.4	11.5	0.5	0.5	0.8	0.7	7.0	6.3	10.8	9.7	5%	10	NMF	NMF	NMF
SAVVIS Inc.	SVVS	NR	USD	2,667	50.58	51.69	2%	222%	95%	NMF	NMF	3.5	3.0	3.5	3.0	17.7	13.1	18.1	13.4	18%	15	58	8	32
Internap Network Services Corp.	INAP	NR	USD	749	15.32	23.00	50%	170%	72%	43.8	23.9	2.9	2.4	4.5	3.7	18.9	12.3	29.1	19.0	14%	21	107	30	NMF
Equinix Inc.	EQIX	NR	USD	2,471	78.26	100.81	29%	172%	85%	NMF	NMF	7.1	5.8	9.1	7.3	18.7	14.1	23.8	18.0	35%	29	39	26	36
								<b>Mean</b>		<b>32.5x</b>	<b>24.6x</b>	<b>3.2x</b>	<b>2.7x</b>	<b>4.1x</b>	<b>3.4x</b>	<b>13.7x</b>	<b>10.0x</b>	<b>17.8x</b>	<b>13.0x</b>	<b>20.3%</b>	<b>30%</b>	<b>59%</b>	<b>21%</b>	<b>33%</b>
								<b>Median</b>		<b>39.3x</b>	<b>21.8x</b>	<b>3.2x</b>	<b>2.7x</b>	<b>4.0x</b>	<b>3.4x</b>	<b>16.3x</b>	<b>11.2x</b>	<b>18.6x</b>	<b>13.2x</b>	<b>20.2%</b>	<b>20%</b>	<b>58%</b>	<b>22%</b>	<b>34%</b>

Source: CapitalIQ, Haywood securities

## COMPANY OVERVIEW

### Overview

Hostopia targets the top 1,000 telecom service providers globally. Hostopia provides wholesale website design and maintenance services to telecommunication carriers, cable operators, internet service providers (ISPs), domain registrars and web hosting service providers in Canada, the U.S. and the UK. Hostopia's customers include Bell Canada, COLT Telecommunications, Covad Communications Company, Register.com, Rogers Communications Inc, Aliant, Talk Talk, dotCanada and, most recently, British Telecom; BT Ireland; Time Warner Telecom and MTS AllStream. Hostopia also provides web services directly to end users through its wholly-owned subsidiary, BlueGenesis. However, it should be stressed that over 95% of Hostopia's revenue is generated through its wholesale distribution channel. We do not expect Hostopia to significantly increase its direct sales given the channel conflicts that would arise. Web services include:

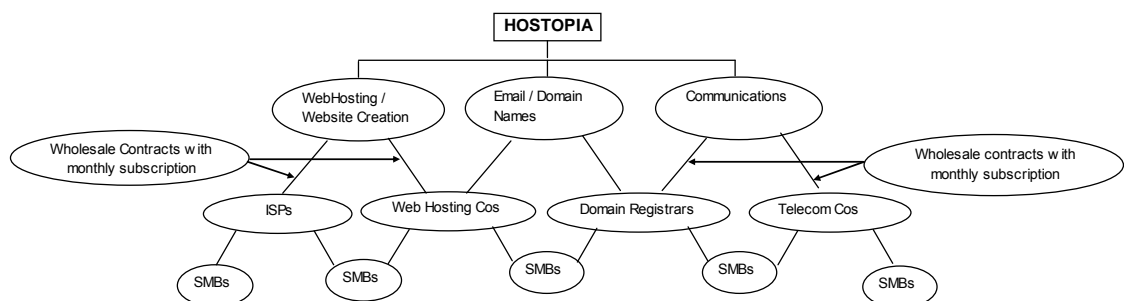
- Website creation and maintenance applications
- Managed e-mail with virus and spam protection
- E-commerce application
- Website hosting and data transfer

Hostopia enters into wholesale contracts with telecom providers for web service suites which are resold to SMEs under private label brands. Hostopia also provides after sales and support services to customers end-users. The company recently started a standalone division, Website Experts, to market its web hosting services. Website Experts will operate under a referral model where they end-to-end solutions to its customers' end-users and under the private label model where services are determined by the customer.

Hostopia reports revenue under recurring web hosting and application services; and other services, which includes onetime setup fees, amortized over the life of the contracts. The recurring web hosting revenue segment represents approximately 96% of revenues.

### Business Model

Contracts with customers range from one to five years, with monthly subscription to Hostopia's services. Below is a diagrammatic representation of Hostopia's business model:



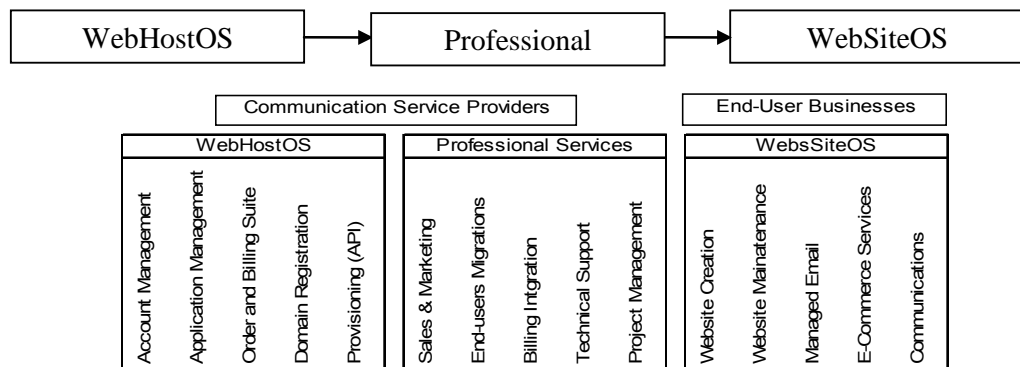
## Proprietary Software Delivery Platform

Beyond software applications, Hostopia offers technology, infrastructure, and support services. Its value proposition is based on saving customers time to market while lowering upfront and ongoing costs. From our discussions, clients look for Hostopia to deliver bundled service near but not necessarily at the front of industry advancements. Hostopia’s web-based suites are developed for the SME market with typical end users with 1-25 employees who have varied degrees of technical expertise. The software is designed for use by relatively unsophisticated users while allowing custom web design by SMEs who may contract technical assistance in developing their website.

## Scalable Business Model with High Operating Leverage

Hostopia’s application delivery platform is based on proprietary software that allows them to increase their end user reach without significant additional design and development expenses. Hostopia’s high operating leverage has been shown to investors with EBITDA margins moving from 8% in FY04 to 27% in FY06 as the cost of revenues as a percentage of revenues dropped from 21% to 11% for the same period. Though the recent IPO distraction and efforts to sign the marquee UK account, BT, has recently caused EBITDA margins to retreat, we expect management will be able to meet their stated objective of returning EBITDA margins to mid twenties levels in the medium term.

The diagram below represents the delivery model of Hostopia:



WebHostOS and Professional Services include web services and after-sales services to customers to help manage web hosting services for end-users. Customers use Hostopia’s proprietary web-based tool WebHostOS to manage billing, viewing customer information retrieval and to add new customers. The software allows clients to select specific features including the use of its web template library for client end-users through the WebSiteOS control panel.

Hostopia’s WebSiteOS control panel is a browser-based application that gives end-users the ability to manage their web sites independently. Applications and tools offered with WebSiteOS include the Database Manager, EasyMail, Log Manager, Template Gallery, and Web Stats applications. As an example, the Database Manager application allows end user to create and manipulate a maximum of two MySQL databases (a multi-threaded, multi-user SQL database management system – owned and sponsored by Swedish company MySQL AB). SQL(Structured Query Language) is a computer language used to create, retrieve, update and delete data from relational database management systems. SQL has been standardized by both ANSI and ISO. Using Hostopia’s WebSiteOS, end-users can directly access their website data stored on Hostopia’s servers and make specific adjustments.

## ***Facilities***

Bandwidth and data center costs are key cost factors. Hostopia buys bandwidth from multiple vendors on a monthly fee basis. It leases data centre facilities at four locations, with three in Toronto and one in Florida. The centres provide high levels of security, power and connectivity redundancy with lease contracts ranging from one to three years. Hostopia first signed a three year contract with TELUS to purchase bandwidth and lease data center facilities in Dec. 2004.

Out of the four North American points of presence, Hostopia's main data center is an 80,000 square ft. 'Intelligent Internet Data Center' facility, with a total capacity of more than 35,000 servers.

## ***License and Other Agreements***

**Patent License Agreement with Web.com** – In July 2006, Hostopia entered into a five year non-exclusive license agreement with Web.com to use two of its patents. Both the patents cover methods for website building and web hosting control panels. Under the agreement, Hostopia agreed to pay Web.com royalty fees equaling 10% of gross U.S. retail revenues multiplied by five. The total of \$0.65M was paid upfront.

**Programming/Support Services Outsourced to GFL** – In 2003, Hostopia entered into a contract with GeeksForLess Inc. (GFL) for services including software programming, technical support and the purchase of web based templates. The contract is based on dedicated contractors working full time for Hostopia in GFL's Ukraine-based facility. Overhead charges range from \$388/month to \$281/month with wage contributions determined every month. As per the contract, costs are subject to increase on an annual basis by the lesser of annual inflation rate in Ukraine or 10%. The contract is renewed annually. Hostopia also buys web templates developed by GFL with prices ranging from \$110 to \$140 per 500 templates.

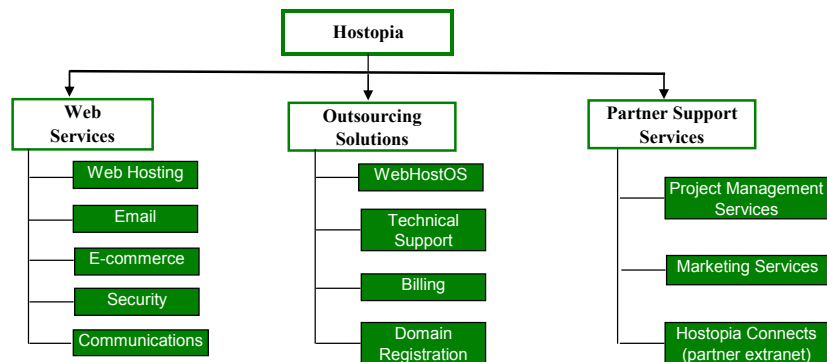
## ***Acquisitions***

Hostopia's five year growth has primarily taken place through the organic route, with only a couple of significant acquisitions in its history. In July 2003, BlueGenesis, a subsidiary of Hostopia, acquired the website hosting assets of Data Centurion Canada Inc for \$0.71M. Another significant acquisition took place in January 2006, when Hostopia acquired the web hosting assets of one of its customers, Fortunecity.com for \$1.3M.

On May 3, 2007 Hostopia acquired Nexthaus Inc. for its mobile device software capabilities. Nexthaus software enables the automated transfer or synching of data between PCs, mobile devices (phones, PDAs) and the web. Hostopia plans to sell the applications throughout its existing customer base and in new markets. Furthermore, GLF has mobile software development capabilities that are already being used to complement Nexthaus and reduce programming costs.

## Products and Services

The value proposition of Hostopia is built on its suite of products and services designed for SMEs. The products and services range from web hosting, email, e-commerce to security, communications, project management services, technical support, billing, domain registration and marketing services. The breadth and quality of Hostopia's product suite has been the critical differentiator measured against competitors who are typically smaller or potentially encumbered by channel conflicts. The products and services can be broadly categorized as follows:



Source: Company Website & EVS Analysis

### 1. **Web Services:** Hostopia is a leading North American web service provider to SMEs. Web services include:

- a) **Web hosting services:** Hostopia offers user friendly but sophisticated applications including managed email with virus & spam protection, sub-domain email services and integrated web hosting and e-commerce services. Hostopia automates the most common end user tasks to lower technical support costs for customers as it balances clients' technical limitations against product demands.

Web hosting involves web site development through WebSiteOS, a browser-based application that helps build e-commerce enabled website. Tools include the EasySite Wizard guide and a template gallery that enables the customers to create a website without HTML knowledge. Hostopia provides access to over 300-industry categorized templates that help the often technically limited SMEs get websites up and running in one sitting.

The completed websites are compatible with the most popular Internet web browsers like Internet Explorer, Netscape, Mozilla and FireFox. These applications have improved the web service offering of Hostopia vis-à-vis its competitors. Hostopia recently started a standalone division, Website Experts to produce customized websites for its customers at lower price points than traditional web design studios.

- b) **Email services:** With most companies offering similar feature-based e-mail services to SME customers, the business is very price sensitive. Hostopia's email service starts from as low as \$1.99 for a 3 e-mail package and moves up to \$1199.99 for a 1000 e-mail package. Hostopia's ability to win new accounts clearly benefits from a history of successfully migrating over two million business-class email users onto its network. This makes Hostopia a highly reliable, highly scalable and economical e-mail service provider. Hostopia offers e-mail services through its Webmail 4.0, EasyMail and AntiSpam & AntiVirus products, which include domain-based email account, state-of-art spam and virus protection combined with features like auto-responders. These applications and the websites are hosted on fully redundant clustered servers that are monitored 24\*7\*365 with calendaring features.

- c) **E-commerce:** Hostopia has three e-commerce applications EasyStoremaker, EasyStoremakerPro and ProStores. Hostopia's e-commerce applications operate on a clustered server environment and are monitored 24\*7\*365. The applications are compatible with the web site creation tools and are offered free with selected plans (bundling EasyStoremaker with its "bronze" plan and EasyStoremaker Pro with its "silver" plan). In addition, Hostopia provides additional features like accepting all international currencies.
  - d) **Communications:** Hostopia has two main applications: EasySite Optimizer, a search engine optimization tool, and EasyLive Chat. With SMEs focusing on improving customer service and reducing the TAT (turnaround time), Hostopia's communication based applications enables the company to differentiate itself from smaller competitors who are challenged to provide the same breadth of applications.
2. **Outsourcing Solutions:** Hostopia's value proposition to date builds on its breadth and strength of its application suite, upfront and ongoing cost savings. However, many clients contacted openly communicated that their own core competencies and focus were not software development and sourcing. These clients acknowledged that Hostopia's focus positions it for both software development and customer service functions. Hostopia's solutions include:
- a) **WebhostOS:** A tool offered by Hostopia that enables automation of hosting business including branding, administrative tasks, customer administration and report generation on real time basis.
  - b) **Domain registration:** Hostopia has partnerships with the leading providers of global domain name registration and internet services like Register.com and Tucows. In addition, Hostopia has its own in-house domain service called "Internet Names for Business", which help its customers to offer their own custom-branded domain registration services.
  - c) **Billing & Technical support:** Hostopia offers professional services for billing and technical support to its customers. Hostopia differs from its competitors in the breadth of applications that are included in its bundled services.
3. **Partner support services:** Hostopia also offers support services like marketing and project management services. Furthermore, through its cooperative marketing program, and other marketing tools and applications, Hostopia help its customers in the launch and growth of their businesses. Hostopia offers marketing consultation services to help clients develop hosting strategies and sales plans.

## INDUSTRY OVERVIEW

Consumer internet adoption ultimately drives business website development as businesses see greater value to developing websites as a platform to reach online consumers. According to Internet World Statistics, internet penetration has tripled over the past six years with internet penetration at 16.7% as of November 2006, against the world population of 6.5 billion. Looking for trivia, a Google search for ‘web host’ will return nearly 190 million results.

A web hosting service is a type of internet hosting service that allows individuals and organizations to put their websites on the internet. Web hosts are companies that provide space on a data centre that is either owned/rented (referred to as colocation) and internet connectivity to their clients.

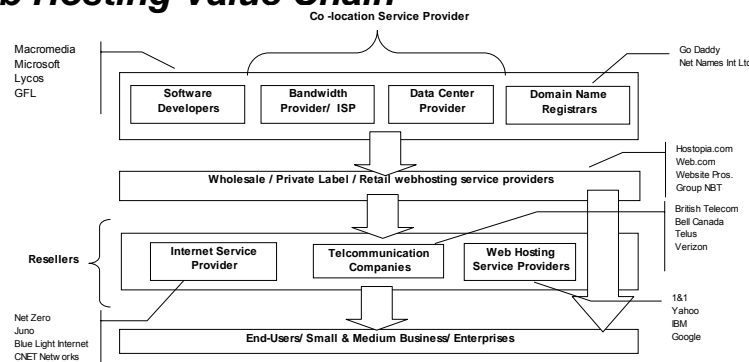
There are basically three types of web hosting services a web host can offer – **shared web hosting, dedicated server hosting, and virtual private server hosting**. A shared web hosting plan is suitable for small users willing to share a server although each customer has its own unique domain name. This type of web hosting service is less expensive and limited to low traffic websites.

Moving up the value/cost curve, dedicated server hosting and virtual private server hosting are web hosting services suited for a website that is viewed almost a million times in a day.

Websites can be uploaded by means of File transfer Protocol (FTP) or a Web interface. Many providers offer this service for free to their subscribers. Plain web hosting is more appealing to individuals. However, SMEs or large corporations typically want more than a simple hosting of their websites and require a more comprehensive packages including database support, application development platforms (PHP, Java, and ASP.NET), e-mail, E-commerce, quick responsive customer service, etc.

With the internet affecting businesses more and more, the large base of small and medium sized businesses (SMEs) without a web presence, presents a big opportunity for web hosting companies. In the U.S. alone, 94% of SMEs have internet access at work, however, 47% of them do not have a website<sup>1</sup>.

### Web Hosting Value Chain



**Integrated Web Hosting service providers:** Integrated web hosting service providers have their own data center storage and bandwidth facilities and develop web based software and application platforms through in-house research and development. There are not many such companies which are completely integrated across the value chain as most turn to third-party applications for at

<sup>1</sup> Source: Interland Spring 2005 Business Barometer survey of 1,032 executives from SMEs

least a sub-set of their applications. Looking at the facilities provisioning, we believe it is increasingly uneconomic for a relatively small company to maintain its own data centre facilities and bandwidth networks. Data centre management requires scale to reach efficiencies while negotiating bandwidth contracts and peering relationships requires scale and reach. In Canada, the incumbent telecom providers TELUS, MTSAllstream, Bell Canada, Aliant, and Rogers are relatively integrated yet each has chosen to use Hostopia. The data centre and co-location businesses have seen the rise of Canadian providers Q9 Networks and Peer 1 Networks while the U.S. has Equinix, Switch & Data, Intermap and the more IT focused Savvis. Pipex, one of the largest players in UK, is another player which has its own data center facilities and does most of the software related R&D in-house.

**Outsourced & White Label Web Hosting service providers:** Companies that outsource data center and bandwidth facilities and part of their software development fall under the outsourced category. A majority of web hosting companies prefer leasing data center facilities and buying bandwidth from a bandwidth provider given the need for scale as discussed. A while label web hosting service provider sells its web hosting services at the wholesale level to companies such as ISPs, resellers, web hosting companies and telecom service companies. These companies in turn sell the web hosting services to the end users under their own respective brands.

**White Label Web Hosting Service Providers:** As explained, white label providers and wholesale web hosting service providers retail to web hosting service providers such as ISPs, Telecom companies, web hosting companies. Examples of such players are **Hostopia.com, Web.com, WebsitePros, and Web Fusion from Pipex. Wholesale providers in some cases sell applications on a wholesale basis to clients that are in turn competitors for their direct sales.**

The following table shows the main categories of web hosting providers. Larger web host providers may develop their application suites using a mix of outsourced and in house developed applications. Hostopia’s focus on wholesale provision limits channel conflicts for web host providers. This limit of conflict was cited as a competitive advantage by various Hostopia clients we interviewed.

Category	Description	Companies
<b>Network-based service providers</b>	Companies in this category highlight the combination of their internet datacenter facilities and hosting services (e.g., security and storage) and traditional wide-area network (WAN) infrastructure as the platform for broad managed services or application-oriented networking value propositions.	AT&T, Qwest, SAVVIS, Bell, Telus, Rogers, BT Verizon
<b>IT outsourcing firms</b>	Companies take a bottom-up view, subsuming the web hosting function into their overall enterprise IT outsourcing/systems management value propositions.	IBM, EDS, SAVVIS
<b>Managed services providers (MSPs)</b>	This group includes providers that focus increasingly on applications as well as infrastructure management and non-facilities-based providers that specialize in outsourced IT infrastructure management, including enterprise and public internet-facing implementations.	NaviSite, SevenSpace (acquired by Sun Microsystems)
<b>Datacenter/Managed colocation service providers</b>	These are regionally based companies with two or three datacenter facilities. Providers in this space typically offer colocation services with a range of managed offerings that include monitoring, security, and disaster recovery/business continuity.	RaginWire (Sacramento, California), Q9, Inflow (nation-wide), Peer1
<b>Mass-Market and small and medium-sized business (SMB) focused providers</b>	Companies in this category provide shared and/or basic dedicated hosting services, primarily to small businesses. The business model revolves around volume-based, mass-customizable offerings that can be sold direct (typically online or through telesales) or through indirect reseller channels.	Pure plays such as Web.com, Hostway, Hostopia and Affinity, ISPs like Earthlink & online destinations like Yahoo!

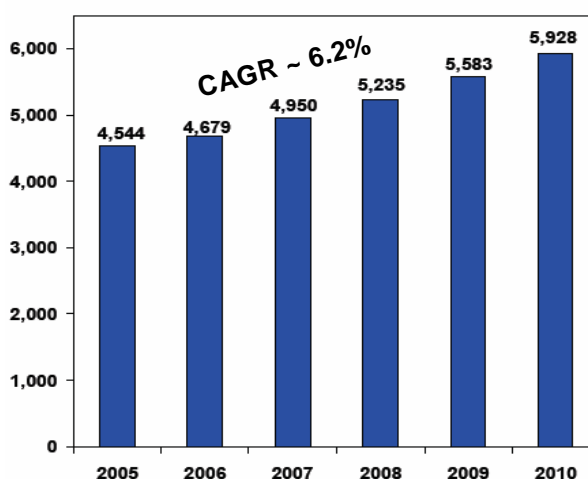
Source: IDC

## U.S. Web Hosting Market

The \$6.9 billion U.S. web hosting services market is forecast to grow at a 16% CAGR from 2005 to 2010, reaching \$14.5 billion in 2010 (Source: IDC). Websites today are now integrated into a business's sales and marketing programs, retail positioning, order processing, customer care, and more. The growth in the online population and online retail ecosystem is driving SMEs to upgrade existing online capabilities or to move online. Consequently, we support the bullish industry views for SME adoption and application development. The internet value proposition to SMEs recognizes the effective, targeted and economic marketing power of the web measured against conventional sources such as newspapers, local television that offer less targeted advertising with higher CPMs(cost per thousand viewers).

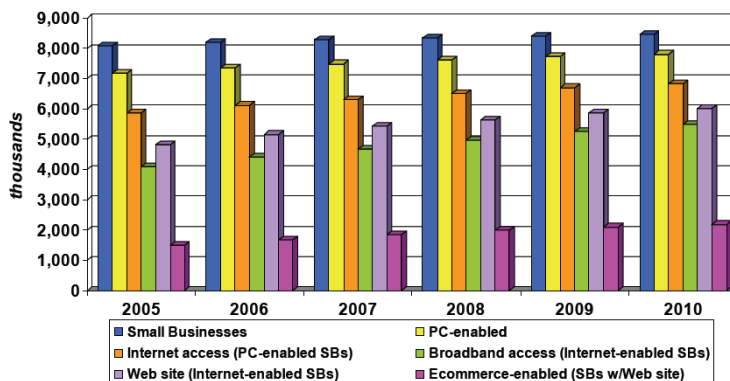
The SME hosting market is highly fragmented with a large number of competitors, most of which have a market share of less than 1%. According to a study by Yankee Group, in 2005, the U.S. SME and mid-market-focused web hosting market was worth \$4.4 billion and growing at a rate of 6%. 79% of U.S. small businesses currently host their websites with third-party service providers. Nearly 20% of these currently use "free" hosting services from ISPs or other service providers. We foresee significant demand from SMEs moving to upgrade their website capabilities with "free" hosters to more sophisticated and comprehensive application suites from non-commodity hosters. The table on the right shows the increase in small businesses' spending on web-hosting services.

**Small Business Spending (US\$M)**



Source: IDC, 2006

Beyond adoption of non-web enabled users, we see significant opportunities for application providers to meet the need to upgrade websites for growth in broadband access the greater capabilities enabled through increased bandwidth.

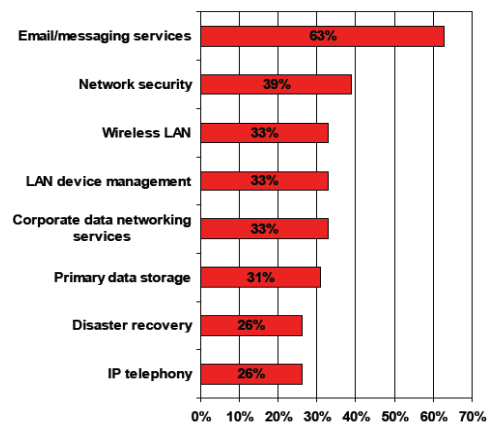


Source: IDC, 2006

Larger players such as Microsoft, Google and Yahoo have also entered the web-hosting market. Microsoft has always been a key developer of technology used in web hosting. It began several years ago by building technology and other products meant specifically for web hosting, and by partnering with hosting providers. In February 2006, Google took its first step into the hosting market, offering a free website hosting service called Google Page Creator, built around a browser-based site builder. Users of Google’s Gmail service could create sets of pages and link them together, using up to 100MB of storage space on Google’s servers.

Microsoft had introduced a very similar service with the beta release of its Office Live product. Part of a larger suite of hosted business tools, Office Live also includes a browser-based site building tool, and hosts the sites produced on its servers. Both services were immediately popular. Microsoft created 4,000 new domains in the first five days of its service, claiming that more than 100,000 people had signed up for the service in that time. The company continued issuing accounts as resources became available. Google saw an overwhelming flood of interest in the new service. The demand caused the company to stop handing out new accounts just a few hours after launch.

These large players will keep coming out with new offerings, making the market more fragmented than it already is and complicating the issue of free and discounted web-hosting. Another study by IDC shows the different products that customers would be willing to purchase from their existing web-hosting providers. This opens up extra opportunities for the web-hosts to offer additional products over their existing platform. E-mail/ messaging services are the most immediate services that come to mind when we consider a web-hosting function. Other services that score high are network security and wireless LAN service.



Source: IDC 2006

The key points that can be inferred from the above discussion are:

- SMEs are increasing their spending on web-services and this trend is likely to continue in the future as well.
- Other web features like email and messaging services provide opportunities for market expansion. There is also a huge scope for services like broadband, Ecommerce etc.
- Bigger players like Google, Yahoo etc. have made the market more competitive by offering free/discounted web-hosting.

### **UK Web Hosting Market**

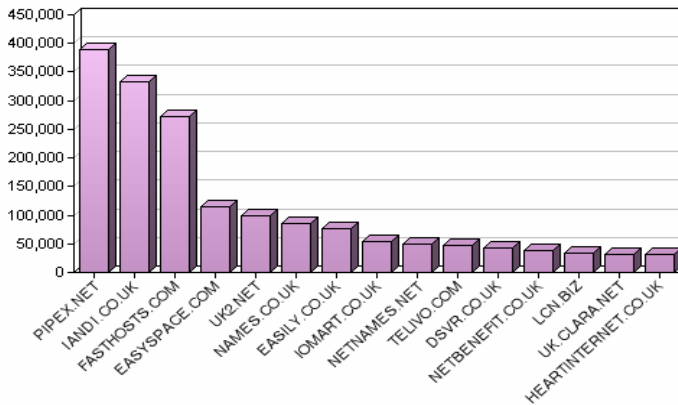
The UK web hosting market is dominated by resellers, and has not yet reached North American maturity levels. There are a lot of companies which are in need of a website. The UK Web hosting market is the third largest in the world with over 2.9 million customers<sup>2</sup>. In 2005, the average domain name registers per month was 110,000. In 2006, the number has gone up to 130,000.

<sup>2</sup> Source: Group NBT Press Release (December 13, 2006)

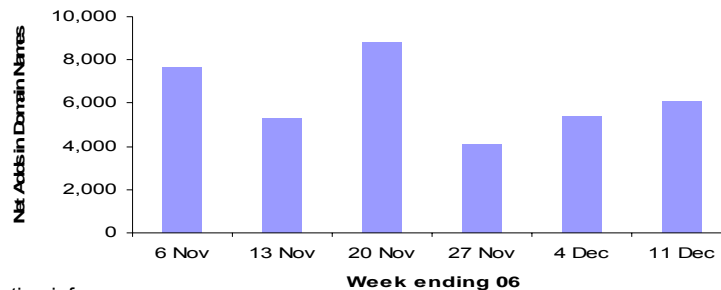
According to a recent news release by Group NBT on December 13, 2006, their combined market share from their three operating brands was 5.6%. Group NBT's total revenues from UK for the FY06 was £12.305M. This implies the total UK web hosting market size of £219.7M.

Some of the major players in the UK web hosting market are Group NBT, Pipex, RackSpace, Hostway, 1 & 1, Fasthost among others. RackSpace, Hostway and Group NBT fall in the managed hosting space though Group NBT has presence in shared hosting as well. 1 & 1, Fasthost and Pipex are predominantly present in the shared hosting market. The chart below shows the leading web-hosting companies by domain names. (The total domain names registered are approx. 3M)

**Leading web-hosting companies in United Kingdom by domain names**



**Net Domain Name additions in UK**



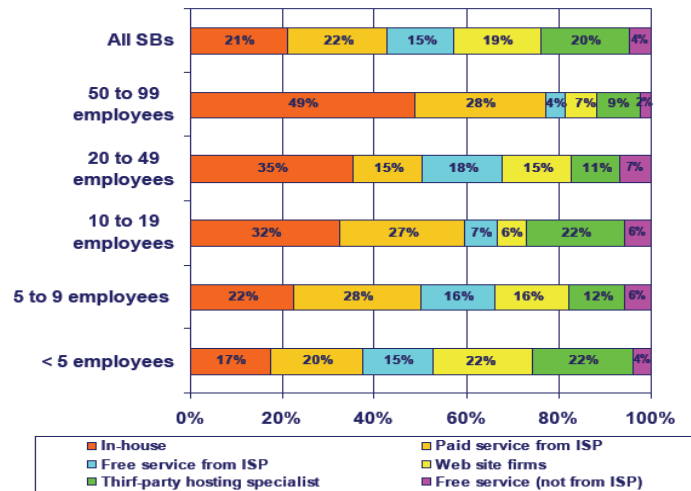
Source: www.webhosting.info

**Trends and Issues**

The competitive intensity of the web hosting industry focuses on price, application capabilities and breadth, reliability and 24x7 customer service. The multitude of providers has in many cases pushed their products towards commodity status. The low capital barriers to entry, lead many individual developers to enter the market. However, the outlook for small developers is increasingly tough as the applications get more sophisticated in a broadband enabled internet and as applications need to be fully integrated into a comprehensive set of applications. We expect accelerating consolidation of the web hosting industry. We believe the competitive intensity at the end-user level will drive incumbent telecom providers to outsource application development. Integrated telecom providers are increasingly challenged to keep abreast of new application developments that in turn need to be integrated into existing service suites.

**Dominance of in-house web-hosting**

A study by IDC supported that in-house web hosting is directly proportional to company size. Small businesses are naturally inclined to consider their current ISPs for web hosting given existing relationships and the opportunity to bundle services. However, many SMEs are turning to website designers design/upgrade services and provide hosting.



Source: IDC, 2006

Technical awareness amongst new users ranges across extremes. Many SMEs turn local advertising agencies, promotional companies or web developers to build web sites. Telecom service providers who miss the web development stage are likely to similarly miss follow-on revenues from other web-applications. However, the arguably greater risk to the incumbent provider is the potential commoditization of access provision as the value-add component becomes a separate consideration. The incumbent telecom service provider is thereby motivated to create their own web site building tools so that they can capture the prospective user at the first point in the value-chain.

### Competition and Consolidation

Price wars have become the norm for the industry, with competitors offering services at dramatically reduced prices, or even for free, as a means of acquiring market share. Price competition has slimmed down profits throughout the industry and commoditized many web hosting services. Consequently, competitors need to continually upgrade applications and broaden their product suites to strengthen relations.

There has been a natural evolutionary cycle of consolidation in the marketplace as the weaker players have either been forced to exit the industry or have been acquired by larger players. Most early players such as UUNET, Exodus, BBN Planet, Verio, Digex, and Loudcloud, are either extinct or have been acquired by larger players. National boundaries have been no barrier and large companies from across the world have targeted regional players often to facilitate new market entry, e.g., British telecommunications firm Cable & Wireless purchased U.S. web hosting company Digital Island in 2001.

### Integration issues

A growing number of web hosting companies have seen the proprietary code they used to piece together systems from a variety of vendors not stand up to increased loading. Clients who have suffered interoperability and scaling issues are migrating to larger providers who are seen to provide interoperable applications or more comprehensive suites of applications.

### Outlook

Relatively low prices should continue to dominate the market for very basic services. Consolidation should continue in the industry as technical requirements increase and demands for integrated application suites challenge small providers. Web hosting companies need to focus on bundling integrated services and providing enhanced customer support capabilities.

**APPENDIX I: Financial Statements – I/S**

<b>INCOME STATEMENT (US\$'000)</b>	<b>F2006</b>	<b>F2007</b>	<b>F2008E</b>	<b>F2009E</b>	<b>F2010E</b>	<b>F2011E</b>	<b>F2012E</b>
<b>Revenues:</b>							
Web hosting and applications services	17,295	21,625	26,544	33,626	40,286	47,725	57,816
Other services	662	845	963	1,220	1,461	1,731	2,097
<b>Total revenues</b>	<b>17,957</b>	<b>22,470</b>	<b>27,507</b>	<b>34,845</b>	<b>41,747</b>	<b>49,456</b>	<b>59,913</b>
<b>Cost of revenues:</b>							
Web hosting and applications services	1,756	2,564	3,063	4,003	4,743	5,564	6,700
Other services	246	357	459	520	711	835	1,005
<b>Total cost of revenues</b>	<b>2,003</b>	<b>2,921</b>	<b>3,522</b>	<b>4,523</b>	<b>5,455</b>	<b>6,399</b>	<b>7,705</b>
Gross profit	15,954	19,549	23,985	30,322	36,292	43,057	52,208
<i>Gross Margin</i>	88.8%	87.0%	87.2%	87.0%	86.9%	87.1%	87.1%
<b>Operating expenses:</b>							
Sales and marketing	3,899	4,776	5,753	6,674	8,009	9,290	11,055
Research and development	2,108	3,069	3,836	4,795	5,754	6,905	8,286
Project management	1,393	1,716	1,995	2,514	3,142	3,613	4,155
Technical support	2,259	3,006	3,673	4,224	4,858	5,538	6,313
General and administration	1,451	1,907	2,265	2,696	3,100	3,596	4,207
Amortization:	1,796	2,600	2,857	4,288	5,398	6,536	7,914
Amortization of intangible assets	332	752	740	969	1,177	1,425	1,724
Amortization of property & equipment	1,463	1,848	2,117	3,319	4,221	5,111	6,190
<b>Total operating expenses</b>	<b>12,905</b>	<b>17,074</b>	<b>20,380</b>	<b>25,190</b>	<b>30,261</b>	<b>35,478</b>	<b>41,931</b>
EBIT	3,049	2,475	3,605	5,132	6,031	7,579	10,278
Interest, net	23	516	1,355	1,430	1,610	1,877	2,252
Interest income	28	534	1,370	1,445	1,625	1,892	2,266
Interest (expense)	(5)	(18)	(15)	(15)	(15)	(15)	(15)
EBT	3,072	2,991	4,960	6,562	7,642	9,456	12,529
Income taxes (recovery)	1,069	1,128	1,885	2,493	2,904	3,593	4,761
<b>Net Income (Loss)</b>	<b>2,003</b>	<b>1,863</b>	<b>3,075</b>	<b>4,068</b>	<b>4,738</b>	<b>5,863</b>	<b>7,768</b>
Net income (loss) per share:							
Basic	0.47	0.31	0.27	0.35	0.41	0.51	0.68
Diluted	0.28	0.24	0.26	0.35	0.40	0.50	0.66
<b>EBITDA</b>	<b>4,845</b>	<b>5,076</b>	<b>6,462</b>	<b>9,419</b>	<b>11,430</b>	<b>14,115</b>	<b>18,191</b>

**APPENDIX I (Cont'd): Financial Statements – B/S**

<b>BALANCE SHEET (US\$'000)</b>	<b>F2006</b>	<b>F2007</b>	<b>F2008E</b>	<b>F2009E</b>	<b>F2010E</b>	<b>F2011E</b>	<b>F2012E</b>
<b>ASSETS</b>							
<b>Current assets:</b>							
Cash and cash equivalents	3,038	27,368	26,341	29,225	33,272	39,485	47,673
Trade accounts receivable, net of allowance for doubtful accounts	1,568	1,320	1,982	2,323	2,783	3,297	3,994
Deferred tax assets	83	117	117	117	117	117	117
Prepaid expenses	269	377	432	523	622	724	850
<b>Total current assets</b>	<b>4,958</b>	<b>29,182</b>	<b>28,871</b>	<b>32,187</b>	<b>36,794</b>	<b>43,623</b>	<b>52,635</b>
Property and equipment, net	3,174	2,923	6,629	7,840	8,629	8,463	8,265
Other assets	61	61	95	106	112	109	105
Intangible assets, net	1,609	1,690	1,638	1,540	1,406	1,218	992
Deferred tax assets	481	1,101	1,101	1,101	1,101	1,101	1,101
<b>Total assets</b>	<b>10,282</b>	<b>34,957</b>	<b>38,334</b>	<b>42,774</b>	<b>48,042</b>	<b>54,514</b>	<b>63,097</b>
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>							
<b>Current liabilities:</b>							
Accounts payable	272	380	473	565	682	800	963
Accrued liabilities	512	705	706	805	936	1,078	1,272
Payroll and other taxes payable	26	35	35	35	35	35	35
Income taxes payable	155	269	269	269	269	269	269
Current portion of deferred lease inducements	80	80	80	80	80	80	80
Deferred revenue	923	983	1,189	1,394	1,670	1,978	2,397
Current portion of long-term liability	260	72	72	72	72	72	72
<b>Total current liabilities</b>	<b>2,228</b>	<b>2,524</b>	<b>2,823</b>	<b>3,220</b>	<b>3,743</b>	<b>4,312</b>	<b>5,087</b>
Deferred lease inducements	299	237	237	237	237	237	237
Long-term liability	244	293	242	242	242	242	242
<b>Total liabilities</b>	<b>2,770</b>	<b>3,054</b>	<b>3,303</b>	<b>3,700</b>	<b>4,223</b>	<b>4,791</b>	<b>5,567</b>
Series A redeemable, convertible preferred shares	5,170	0	0	0	0	0	0
Stockholders' equity:							
Capital stock	216	217	217	217	217	217	217
Additional paid-in capital	3,384	31,055	31,055	31,055	31,055	31,055	31,055
Deferred stock-based compensation	(26)	0	53	28	35	75	115
Accumulated other comprehensive loss	(44)	(44)	(44)	(44)	(44)	(44)	(44)
Deficit	(1,189)	675	3,750	7,819	12,557	18,419	26,187
<b>Total stockholders' equity</b>	<b>2,342</b>	<b>31,903</b>	<b>35,031</b>	<b>39,075</b>	<b>43,819</b>	<b>49,722</b>	<b>57,530</b>
<b>Total liabilities and stockholders' equity</b>	<b>10,282</b>	<b>34,957</b>	<b>38,334</b>	<b>42,774</b>	<b>48,042</b>	<b>54,514</b>	<b>63,097</b>

**APPENDIX 1 (Cont'd): Financial Statements – CF/S**

<b>CASH FLOW STATEMENT (US\$'000)</b>	<b>F2005</b>	<b>F2006</b>	<b>F2007</b>	<b>F2008E</b>	<b>F2009E</b>	<b>F2010E</b>	<b>F2011E</b>	<b>F2012E</b>
<b>Cash flows from operating activities:</b>								
Net income (loss)	3,216	2,003	1,864	3,075	4,068	4,738	5,863	7,768
Items which do not involve cash:								
Amortization	1,234	1,796	2,600	2,857	4,288	5,398	6,536	7,914
Stock-based compensation	24	20	200	0	0	0	0	0
Warrant issue expense included in general and administration	0	0	0	0	0	0	0	0
Non-cash interest	21	0	13	0	0	0	0	0
Deferred income taxes	(1,178)	614	(650)	-	-	-	-	-
Deferred lease inducements	(29)	63	(44)	0	0	0	0	0
Change in operating assets and liabilities:	-	-	-	-	-	-	-	-
Trade accounts receivable	(145)	(1,099)	248	(661)	(341)	(460)	(514)	(697)
Prepaid expenses	(94)	(18)	(108)	(55)	(90)	(99)	(102)	(127)
Increase in other assets	0	(37)	138	0	0	0	0	0
Accounts payable	(153)	(17)	108	93	93	116	118	163
Accrued liabilities	(82)	108	194	1	99	131	142	194
Payroll taxes and other taxes payable	5	(11)	9	0	0	0	0	0
Income taxes payable	0	155	114	0	0	0	0	0
Deferred revenue	88	78	60	206	205	276	308	418
<b>CF from operating activities</b>	<b>2,907</b>	<b>3,657</b>	<b>4,745</b>	<b>5,515</b>	<b>8,321</b>	<b>10,100</b>	<b>12,351</b>	<b>15,633</b>
<b>Cash flows from financing activities:</b>								
Conversion of preferred shares into common shares	-	-	194	-	0	0	0	0
Issue of common shares	-	-	21,966	-	0	0	0	0
Repayment of current portion of long-term liabilities	-	-	-	-	0	0	0	0
Repayment of long-term liabilities	(309)	(39)	(156)	(51)	0	0	0	0
Deferred initial public offering costs	-	-	-	-	0	0	0	0
Other Financing activities	-	-	-	-	0	0	44	44
<b>CF from (used in) financing activities</b>	<b>(309)</b>	<b>(39)</b>	<b>22,003</b>	<b>(51)</b>	<b>0</b>	<b>0</b>	<b>44</b>	<b>44</b>
<b>Cash flows from investing activities:</b>								
Acquisition of property and equipment	(1,825)	(2,081)	(1,600)	(5,823)	(4,530)	(5,010)	(4,946)	(5,991)
Acquisition of customer lists	(221)	(151)	0	0	0	0	0	0
Acquisition of intellectual property	(111)	(240)	(800)	(688)	(871)	(1,044)	(1,236)	(1,498)
<b>CF used in investing activities</b>	<b>(2,157)</b>	<b>(2,473)</b>	<b>(2,400)</b>	<b>(6,511)</b>	<b>(5,401)</b>	<b>(6,053)</b>	<b>(6,182)</b>	<b>(7,489)</b>
Effect of currency translation on cash balances	35	(4)	(36)	0	0	0	0	0
Increase in cash and cash equivalents	477	1,141	24,313	(1,046)	2,920	4,047	6,213	8,188
Cash and cash equivalents, beginning of year	1,420	1,897	3,038	27,351	26,305	29,225	33,272	39,485
<b>Cash and cash equivalents, end of year</b>	<b>1,897</b>	<b>3,038</b>	<b>27,351</b>	<b>26,305</b>	<b>29,225</b>	<b>33,272</b>	<b>39,485</b>	<b>47,673</b>

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## APPENDIX II: Key Management

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**Colin Campbell, CEO & COO** - Colin Campbell has been the Chief Executive Officer & Chief Operating Officer since April 2006. Since 1999, he has held various key positions with Hostopia. He has over 15 years of management experience with companies providing web services, online software delivery services, and communication and internet services. Prior to joining Hostopia, Mr. Campbell held the position of Senior Vice President, Internet Services at Look Communications Inc., a communications service provider in western Canada. At Look Communications, Colin led the Internet team, guiding internet product and services development. He was also responsible for mergers and acquisitions in the product area. Mr. Campbell is a co-founder of the Canadian Internet Registration Authority and served on its board from June 2001 to January 2003. Previously, Mr. Campbell held the position of Chief Operating Officer of TUCOWS Interactive Inc. (a web services and online software delivery services provider) and Chief Operating Officer of Internet Direct, an Internet service provider – both companies co-founded with his brother Bill. Mr. Campbell holds a Bachelor of Arts in Commerce from the University of Toronto. Mr. Campbell now owns 12.5% of the outstanding shares of Hostopia. Of note, Mr. Campbell also owns 25% of GFL (Hostopia's Ukrainian affiliate/related party).

**William V. Campbell, President** - William Campbell also has close to 15 years experience in the web services industry. He has been the President of Hostopia since April 2006. Prior to that he was the company's Chief Executive Officer (August 2001 to April 2006), and was Chief Technology Officer from August 2001 to June 2005. Prior to Hostopia, Mr. Campbell held the position of Chief Technology Officer in TUCOWS Interactive Inc., a web services and online software delivery services provider. Also, Mr. Campbell was the Chief Technology Officer in Internet Direct, an internet service provider. The company later merged with I.D. Internet Direct Inc., another Internet service provider. Mr. Campbell has a diploma from Control Data Institute; and currently owns 12.5% of the outstanding shares of Hostopia.

**Michael Mugan, CFO** - Michael Mugan has been the Chief Financial Officer since May 2000. In 1972, Mr. Mugan was with a predecessor firm of KPMG, LLP. He went on to become Vice President; Finance of the Resource Group of George Weston Ltd. a Canadian based food processing and Distribution Company in 1981. Mr. Mugan found a consulting firm in 1998 that took assignments within the high technology and agri-business industries. Mr. Mugan is a certified Chartered Accountant and holds a Bachelor of Commerce (Honors) degree from the University of Windsor. Currently, Mr. Mugan owns 0.11% of Hostopia's shares outstanding.

**Paul D. Engels, Executive Vice-President Chief Marketing Officer** - Paul D. Engels has been the Executive Vice President and Chief Marketing Officer since November 2005. Prior to this, Paul was Vice President, Marketing and Sales from January 2004 to November 2005 and Vice President, Marketing and Business Development from January 2002 to January 2004. Mr. Engels has a 20-year background in senior sales, marketing and product management roles in leading technology and Internet-related businesses. Prior to joining Hostopia, Mr. Engels was the Vice President Marketing, Enterprise Solutions at Sprint Canada (a telecommunications services provider); Vice President Marketing at Internet Direct /Look; and Director, Software Products at Pitney Bowes of Canada Ltd. (a business services company). Mr. Engels holds a Bachelor of Arts (Honors, Joint Specialist in Political Economy) from the University of Toronto. Currently, Mr. Engels owns 0.03% of Hostopia's shares outstanding.

**Dirk Bhagat, Chief Technology Officer** - Dirk Bhagat has been the Chief Technology Officer since June 2005. Prior to this Mr. Bhagat held various positions within the company which include Vice President, Research and Development from November 2003 to June 2005. Mr. Bhagat has extensive experience in systems and software development and engineering, including public-key encryption infrastructure, computational complexity theory and Internet security. Mr. Bhagat holds a Bachelor of Science in Software Engineering from the University of Toronto.

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## APPENDIX III: Board of Directors

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**John Nemanic, Former Chairman** - John Nemanic was the Chairman of the Board since December 1999, until he resigned February 9, 2007 to pursue other business opportunities. He has extensive experience in managing internet or web services companies. Prior to this, Mr. Nemanic served as the President and Chief Executive Officer of Internet Direct, an Internet service provider. The company later merged with I.D. Internet Direct Inc., an Internet service provider. Previously, he held the position of the President and Chief Executive Officer of TUCOWS Interactive Inc., a web services and online software delivery services provider. Mr. Nemanic holds a Masters of Business Administration, a Bachelor of Administrative Studies Degree and Bachelor of Arts Degree from York University. He also owns 25% of GFL (Hostopia's Ukrainian affiliate/related party). Currently, Mr. Nemanic owns 12.9% of Hostopia's shares outstanding

**Colin Campbell, Acting Chairman / Director** - Please see "Management Team" above.

**William V. Campbell, Director** - Please see "Management Team" above.

**Michael Cytrynbaum, Director** - Michael Cytrynbaum's experience ranges from the field of finance/strategy to the telecommunications industry. He is the President of First Fiscal Management Ltd. (a private consulting firm specializing in financial reorganizations, mergers and acquisitions, strategic planning and negotiation); and Central Minera Corp (a junior resource company). Mr. Cytrynbaum is chairman of Look Communications Inc. (a communications service provider) and Ignition Point Technologies Corp. (a broadband communication provider). He is a founding director of Microcell Telecommunications Inc. (a wireless telecom services provider bought by Rogers Communications). In addition to his role at Hostopia, Mr. Cytrynbaum also serves as a director on the boards of Callinan Mines Ltd. (a junior resource company) and Peer 1 Network Enterprises, Inc. Mr. Cytrynbaum holds a Bachelor of Arts and a Bachelor of Common Law from McGill University.

**Mathew George, Director** - Mathew George has more than 10 years experience in the private equity and investment banking industries. Currently, he is Vice President of TELUS Ventures, the strategic venture investment arm of TELUS Corporation. It manages a venture capital fund that invests in emerging U.S. and Canadian technology companies. Prior to joining TELUS Ventures in 2001, Mr. George worked for the Abu Dhabi Investment Authority. There he was responsible for the global co-investment and direct private equity investment activities of Abu Dhabi Investment Authority's Private Equity group. Mr. George has also worked in the Mergers & Acquisitions Group at Warburg Dillon Read and Barclays de Zoete Wedd, both in London and New York. Mr. George also serves as a director on the boards of Apparent Networks, Inc., Vision Critical Communications Inc. and the Arts Club Theatre Company. Mr. George is a member of the Chartered Financial Analysts Institute and the Vancouver Society of Financial Analysts. Mr. George is a Chartered Financial Analyst and holds a Masters of Business Management from the Ecole des Hautes Etudes Commerciales in Paris, with specialization in Analytical Finance from the University Of Chicago Graduate School Of Business. He also holds a Bachelor of Technology (Honors) degree in Electrical & Electronics Engineering from the Regional Engineering College in Calicut, India.

**Robert H. Kidd, Director** - Robert H. Kidd is a director of Genesis Microchip Inc. He has more than 25 years of varied experience. He has held key positions in the management of several companies, in the area of research, technology and entertainment. Mr. Kidd is President of Location Research Company of Canada Limited. Previously, Mr. Kidd served as Chief Financial Officer of Technology Convergence Inc. from 2000 to 2002; Lions Gate Entertainment Corp. from 1997 to 1998; and InContext Systems Inc. from 1995 to 1996. He has also served as Senior Vice President, Chief Financial Officer and director of George Weston Limited from 1981 to 1995 and as a partner of a predecessor firm of KPMG LLP. Mr. Kidd is active on several professional committees, including the Toronto Stock Exchange Investors & Issuers Advisory Committee, the Canadian Institute of Chartered Accountants Emerging Issues Committee and the Canadian Securities Administrators Committee on Conflicts of Interest in Underwriting. In the community, he serves as Vice Chairman of Appleby College Foundation, a lecturer in Finance, Faculty of Management Studies, and University of Toronto. Mr. Kidd is a Fellow of the Institute of Chartered Accountants of Ontario; and holds a Masters of Business Administration from York University and Bachelor of Commerce from the University of Toronto.

**David McMahon, Director** - Mr. McMahon has over 30 years of telecommunications experience, most recent as a Vice President, Global Carrier Sales at TELUS in Toronto. David McMahon has been the Vice President of Customer Care and Carrier Services for Partner Solutions of TELUS Communications since January 2003. He has been with TELUS Communications for more than 7 years and has held various key positions, including Vice President, Ontario Acceleration Program from 2000 to 2001 and Vice President Operations/Carrier Relations/Engineering and Customer Care, TELUS Integrated Communications from 1999 to 2000.

**Christopher Scatliff, Director** - Christopher Scatliff has over 13 years of management experience at senior positions of various companies; he has also served on the Canadian Government Ministerial Advisory Group for the 1998 OECD Conference. He is founder and Chief Executive Officer of KORE Wireless Group Inc., a Virginia based mobile virtual network operator specializing in machine-to-machine wireless communications. Previously, Mr. Scatliff has held the position of Executive Vice President of Itemus Inc., President and Chief Executive Officer of UUNET Canada (now MCI Canada). He was appointed as the Vice President and Managing Director of Computer Sciences Corporation, for Europe, Middle East, and Africa from 1993 to 1996. Mr. Scatliff was also a member of UUNET's International Management Board from 1998 to 2000 with executive responsibility for Latin America. He holds a Bachelor of Science degree in Physics from the University of Manitoba.

## APPENDIX IV: Peer Comparison

Peerset	Key Products & Services	Technology Partners	Marketing/Distribution Partners	Remarks
<b>Hostopia</b>	<ul style="list-style-type: none"> <li>* The company provides private-label services:</li> <li>* Web services - includes web hosting, email, e-commerce, security.</li> <li>* Outsourcing Solutions - WebHostOS, technical support, billing and domain registration.</li> <li>* Partner support - project management services, marketing services, and HostopiaConnects.</li> </ul>	<ul style="list-style-type: none"> <li>* The company has aligned with industry leading technology providers to offer robust and advanced technological solutions for its customers.</li> <li>* Technological alliance with Open SRS, Register.com, and ProStores</li> <li>* Memberships with industry recognized associations - United States Telecom Association, FISPA, ISPA, TIA.</li> </ul>	<ul style="list-style-type: none"> <li>* WebHelps partnered with Hostopia in September 2005 to offer traditional web hosting services and various reseller plans.</li> <li>* Include hosting service providers, primarily ISP's, telcos, cablecos, domain registrars and other web service providers.</li> </ul>	
<b>Web.com, Inc.</b>	<ul style="list-style-type: none"> <li>It includes:</li> <li>* Website design</li> <li>* Website hosting</li> <li>* eCommerce</li> <li>* Web marketing, and</li> <li>* E-mail.</li> </ul>	<ul style="list-style-type: none"> <li>* Partnering enables the company to offer innovative &amp; best-of-breed technological solutions to its customers.</li> <li>* Technology partners include Cisco, Compaq, Foundry Networks, Google, Hewlett-Packard, Lycos, Macromedia, Miva, Microsoft, Network Associates, Openware, PayPal, RealNetworks, Red Hat, Staples, Sun Microsystems, Verisign, Verizon, VERITAS, Yahoo!, and WebTrends.</li> <li>* The company partners across industries like: Yellow page directories, broadband services, telecommunications, cable television, retail, financial services, insurance services and others.</li> </ul>	<ul style="list-style-type: none"> <li>* Working with these partners make buying of company's products and services easier for small and medium-sized businesses.</li> <li>* Additionally, the company gets an access to the already established large customer base of these partners.</li> <li>* Strategic distribution partners include: R. H. Donnelley, Dex Media, Earthlink, British Telecom, Terra Lycos, Thomas Publishing, Ambassador Yellow Pages, Hawaiian Telecom, Encore Software, Office Depot, CompUSA, Amazon.com, and Monster Worldwide.</li> </ul>	<ul style="list-style-type: none"> <li>Distribution partners include:</li> <li>* <b>Enterprise Distribution Partners:</b> sell company's products under partner's brand name.</li> <li>* <b>Enterprise Resellers:</b> sell products jointly under partner's brand name and Web.com's brand name. Payments are either based on fee paid by Web.com per customer or as a percentage of revenues generated.</li> <li>* <b>Value-Added Partners:</b> sell products jointly under partner's brand name and Web.com's brand name. However, they tend to be smaller and more locally focused, and may sell their own products &amp; services.</li> </ul>
<b>Website Pros, Inc.</b>	<ul style="list-style-type: none"> <li>It includes:</li> <li>* eWorks! XL and SmartClicks, a comprehensive package that includes website design and publishing, internet marketing and advertising, search engine optimization &amp; submission, and lead generation.</li> <li>* Additionally, the firm offers premium services related to e-Commerce solutions &amp; advanced internet marketing.</li> </ul>	<ul style="list-style-type: none"> <li>* Partnering enables the company to provide industry leading technological solutions.</li> <li>* Includes 1&amp;1, Alltel, American Express, Constant Contact, Digex Inc., Discover Network, First Data Direct, Electronic Exchange System, eXselis, First National Merchant Solutions, Global Systems Telecom Inc., Homestead, IBM, InternetSeer, Insight, Kurant, MasterCard, Office Depot, Register.com, Ritz Camera, Sign-A-Rama, Sprint, Switchboard, VeriSign, VistaPrint, Yahoo!</li> </ul>	<ul style="list-style-type: none"> <li>* Strategic marketing relationships enable the company to leverage the brand and distribution of its marketing partners.</li> <li>* This provides the company with already established large customer base of small and medium-sized businesses.</li> <li>* Key strategic marketing partners include Discover Financial Service, LLC or Discover, Network Solutions and IBM.</li> </ul>	<ul style="list-style-type: none"> <li>* Third-party technology vendors include AOL, Constant, eBay, Google, Network Solutions, Switchboard, Yahoo!</li> <li>* Approximately, 92% of new customers acquired in the nine months ended September 30, 2006 came through strategic marketing relationships.</li> <li>* Customers acquired through strategic marketing relationship with Discover, Network Solutions and IBM were approximately 57%, 8%, and 2%, respectively, for the year ended December 31, 2005.</li> </ul>
<b>PIPEX</b>	<ul style="list-style-type: none"> <li>* Broadband services</li> <li>* Hosting services, and</li> <li>* Network services</li> </ul>	<ul style="list-style-type: none"> <li>* Company's joint venture with Intel (Pipex wireless) brings in strong brand and best-of-breed industry knowledge and technical expertise.</li> <li>* Juniper, Cisco and Cienna</li> </ul>	Not Available	<ul style="list-style-type: none"> <li>* Mix of organic and inorganic growth</li> <li>* Focused acquisition strategy - Bulldog's broadband, Toucan, Freedom to surf &amp; Homecall under broadband business, and Donhost in April 2005 under hosting business.</li> <li>* Hybrid cost of supply model - results in cost saving and low capex.</li> </ul>
<b>Group NBT Plc</b>	<ul style="list-style-type: none"> <li>* Website hosting and domain name registration services, and</li> <li>* Internet-related services</li> <li>* Three main operating brands: <ul style="list-style-type: none"> <li>* NETBENEFIT - high quality managed hosting services</li> <li>* NetNames - corporate domain name management</li> <li>* Easily - cost effective domain name, email and hosting services</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>* The company has partnered with a number of leading global technology companies to provide advanced technological solutions for its customers.</li> <li>* Dell, Sun Microsystems, Cisco Systems, Microsoft, ICANN, Actinic, Swoft, Sophos, Network Appliance, GeoTrust, Foundry Iron Fortified.</li> </ul>	Not Available	<ul style="list-style-type: none"> <li>* NetNames Platinum service, which manages portfolios of valuable domain names for larger companies, is used by 30% of FTSE 100 companies</li> </ul>

## APPENDIX IV (Cont'd): Peer Comparison

Peerset	Technology Features	Data Facilities	Key Clients	Remarks
<b>Hostopia</b>	<ul style="list-style-type: none"> <li>* Peering strategies - for sharing the digital distribution architectures of its peers.</li> <li>* Redundancy through clustered server environment</li> <li>* UNIX &amp; Windows hybrid platform</li> <li>* Industry leading SLAs, guaranteeing 99.9% up-time</li> <li>* RAID storage provided by network appliance</li> <li>* Multi-tiered firewalling</li> <li>* Multi-homed network through Border Gateway Protocol (BGP) technology</li> </ul>	<ul style="list-style-type: none"> <li>* State of art data centres with four North American points of presence</li> <li>* Intelligent Internet Data Center - 80,000 sq. ft. with capacity of more than 35,000 servers.</li> <li>* \$75 million has been invested in Internet Data Center for expanding it upto 150,000 sq. ft.</li> <li>* Has capacity capable of OC192 (10 Gigabits/sec)</li> <li>* Company lease space in data center facilities in Toronto, Ontario and one in Miami, Florida.</li> </ul>	<ul style="list-style-type: none"> <li>* Communication service providers, which includes telecommunication carriers, cable companies, Internet service providers, domain registrars and web hosting service providers.</li> <li>* Include Bell Canada, COLT Telecommunications, Covad Communications Company, Register.com, Inc., Rogers Cable Communications Inc., TELUS Communications Company and Verizon Directories Corp.</li> </ul>	<ul style="list-style-type: none"> <li>* Data centers are equipped with video surveillance, biometric and card-key access and 24*7 on-site security.</li> </ul>
<b>Web.com, Inc.</b>	<ul style="list-style-type: none"> <li>* Patented core technology</li> <li>* Microsoft Gold Certified Partnership</li> <li>* Scalable processes</li> <li>* World class customer &amp; online marketing support</li> </ul>	<ul style="list-style-type: none"> <li>* The company's data centers are co-located in Peer 1's data centers.</li> <li>* On August 31, 2005, the company sold its three data centers to Peer 1:               <ul style="list-style-type: none"> <li>* Atlanta, Georgia (36,210 sq.ft.)</li> <li>* Miami, Florida (64,174 sq. ft.)</li> <li>* Fremont, California (15,229 sq. ft.)</li> </ul> </li> </ul>	Not Available	<ul style="list-style-type: none"> <li>* Patented technology span across: Web hosting, Website design, Data center management, Web server management, and Graphic user interface.</li> <li>* Substantial patent position, spent approximately \$400 million in past 6 years for 19 registered patents (numerous pending).</li> <li>* Built over 4 million websites since inception.</li> </ul>
<b>Website Pros, Inc.</b>	<ul style="list-style-type: none"> <li>* Oracle-based proprietary workflow processes and CRM software.</li> <li>* Redundancy through the use of multiple application and web servers.</li> <li>* High-end security through card-key numeric entry, biometric access and infrared detectors.</li> </ul>	<ul style="list-style-type: none"> <li>* Spokane, Washington</li> <li>* Jacksonville, Florida.</li> <li>* A third-party co-location facility located in Jacksonville, Florida, which is staffed 24*7.</li> </ul>	<ul style="list-style-type: none"> <li>* Small and medium-sized businesses having fewer than 100 employees.</li> <li>* Customers fall into over 80 discrete industry classification categories.</li> <li>* Few of the largest categories consisted of restaurants, automobile repair and services, clothing accessories and footwear, salons and barbershops, gift, novelty and promotional items, plumbing and jewelry and time pieces and furniture.</li> </ul>	<ul style="list-style-type: none"> <li>* The two data centers are used primarily for firm's internal operations.</li> </ul>
<b>PIPEX</b>	<ul style="list-style-type: none"> <li>* Core network capacity of 10Gbit/s</li> <li>* 24*7 state-of-art Network Operations Centre</li> <li>* ISO 9001:2000 certification</li> <li>* Intel's first ever server centre of excellence</li> <li>* Local Loop Unbundling (LLU) &amp; WiMax focus</li> <li>* First ISP to achieve N3 accreditation</li> </ul>	<ul style="list-style-type: none"> <li>* Three data centres in UK (Manchester, Leeds, London Docklands)</li> <li>* Two in Germany (Cologne)</li> <li>* With data centres reaching capacity, the company has acquired additional space for data centres:               <ul style="list-style-type: none"> <li>* In Germany, 24,000 sq. ft. of space</li> <li>* In UK, 15,000 sq. ft. of space</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>* The company primarily focuses on SMEs.</li> <li>* CegeDim Rx - the UK's leading provider of pharmacy management systems</li> <li>* Fulham FC, Trinity Mirror,</li> </ul>	<ul style="list-style-type: none"> <li>* 'Boundary Networking' designed to protect remote users and satellite office networks from growing threats such as identity theft, malware and phishing.</li> <li>* LLU - to unbundle 100 BT's exchanges</li> <li>* N3 is an accreditation to provide broadband Internet access and services to community pharmacies as part of the NHS' New National Network, known as N3</li> </ul>
<b>Group NBT Plc</b>	<ul style="list-style-type: none"> <li>* ICANN Accredited Registrar</li> <li>* 100% network uptime with over 3Gbps bandwidth</li> <li>* Hosting solution is available on both Linux and Windows platform.</li> <li>* Servers powered by Dell, and Network powered by Cisco.</li> <li>* Microsoft Gold Certified Partnership</li> </ul>		<ul style="list-style-type: none"> <li>* The company focuses on SMEs in both the UK and continental Europe, and large global organizations.</li> <li>* British Airways, the Royal Bank of Scotland and Centrica.</li> </ul>	<ul style="list-style-type: none"> <li>* The company can register domain names in all available suffixes worldwide.</li> <li>* Availability of Dell's latest server range, the Dell PowerEdge 1950 and PowerEdge 2950 servers</li> </ul>

**APPENDIX IV (Cont'd): Peer Comparison – Products and Pricing**

Webhosting - Key product features and pricing analysis					
Price Range & Features	Pricing (USD/month)				
	Hostopia <sup>1</sup>	Web.com	Website Pros Inc.	PIPEX	Group NBT
<b>Price Range - \$5 - \$10</b>	\$6.99 - \$11.99	\$7.95	N.A. <sup>2</sup>	N.A. <sup>2</sup>	N.A. <sup>2</sup>
Total storage	50MB	1GB			
Data transfer/Bandwidth limit per month	6GB	25GB			
# of email accounts	0	25			
Set-up fee	Free	Free			
<b>Price Range - \$11 - \$15</b>	\$9.99 - \$14.99	\$11.95	N.A. <sup>2</sup>	\$11.24	N.A. <sup>2</sup>
Total storage	2.6GB	2.5GB		1GB	
Data transfer/Bandwidth limit per month	32GB	100GB		25GB	
# of email accounts	23	150		350	
Set-up fee	Free	Free		Free	
<b>Price Range - \$15 - \$20</b>	\$14.99 - \$24.99	\$15.95	\$18.95	\$18.80	N.A. <sup>2</sup>
Total storage	3.75GB	2.5GB	75MB	3GB	
Data transfer/Bandwidth limit per month	48GB	100GB	3GB	25GB	
# of email accounts	30	150	5	750	
Set-up fee	Free	Free	\$35.00	Free	
<b>Price Range - \$25 - \$28</b>	\$19.99 - \$34.99	\$25.45	\$24.95	N.A. <sup>2</sup>	N.A. <sup>2</sup>
Total storage	4GB	5GB	150MB		
Data transfer/Bandwidth limit per month	48GB	500GB	5GB		
# of email accounts	30	350	10		
Set-up fee	Free	Free	\$35.00		
<b>Price Range - \$28 - \$35</b>	\$26.99 - \$39.99	\$29.70	\$31.95	\$32.02	\$32.11
Total storage	6GB	5GB	250MB	6GB	100MB
Data transfer/Bandwidth limit per month	80GB	500GB	10GB	60GB	2GB
# of email accounts	45	350	20	1,000	0
Set-up fee	Free	Free	\$35.00	Free	n.a. <sup>3</sup>
<b>Price Range - \$35 - \$50</b>	\$39.99 - \$69.99	N.A. <sup>2</sup>	N.A. <sup>2</sup>	\$37.68	\$39.67
Total storage	9GB			12GB	100MB
Data transfer/Bandwidth limit per month	160GB			100GB	2GB
# of email accounts	60			1,500	0
Set-up fee	Free			Free	n.a. <sup>3</sup>
<b>Price Range - \$50 - \$75</b>	\$69.99 - \$99.99	N.A. <sup>2</sup>	N.A. <sup>2</sup>	N.A. <sup>2</sup>	\$73.67
Total storage	19GB				200MB
Data transfer/Bandwidth limit per month	200GB				5GB
# of email accounts	90				0
Set-up fee	Free				n.a. <sup>3</sup>

<sup>1</sup> As on January, 2006, <sup>2</sup> N.A. - no offering in this price range, <sup>3</sup> n.a. - information not available

Source: Company Website

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TSXV:PIX	Peer 1 Network Enterprises Inc.	X							
TSX:Q	Q9 Networks Inc.	X							
TSXV:RCN	Radiant Communications Corp.	X	X						

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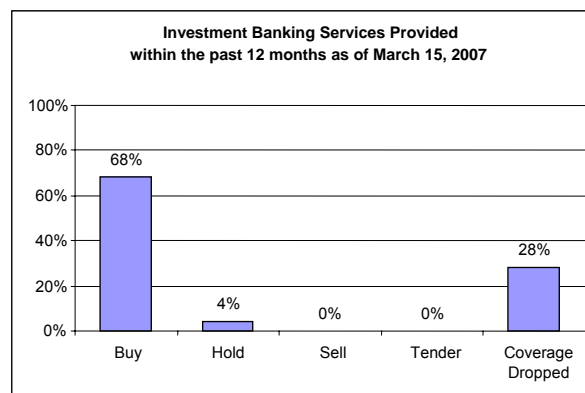
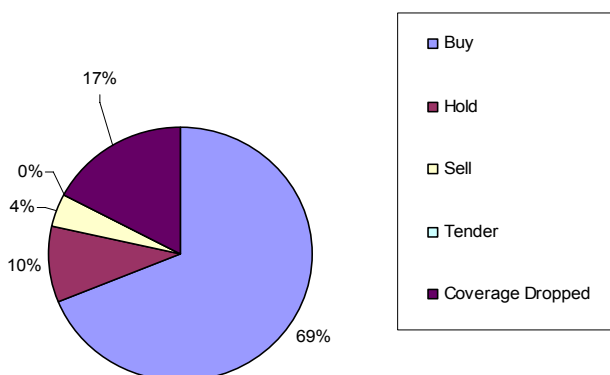
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Rating Distribution Dec 15, 2006 - March 15 2007



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## Risk Profile Parameters – Telecom Service Providers

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**Forecast Risk:** *High* – Haywood forecasts are below guidance. The Company has a history of missing targets. *Moderate* – Haywood forecasts are generally in line with guidance. The Company has a history of meeting or exceeding guidance. *Low* – Haywood forecasts exceed guidance. The Company has a history of meeting or exceeding guidance.

**Financial Risk:** *High* – The business plan is not fully funded but requires debt and/or equity financing. This categorization does not necessarily predict whether the additional funds will be raised. *Moderate* – The business plan is fully funded. The Company's debt is rated below investment grade. *Low* – The Company is fully funded with investment grade debt.

**Valuation Risk:** *High* – The current valuation is at the high end of historic levels and/or at a premium to peers. Where applicable, the DCF valuation is not more than 10% above the current equity valuation. *Moderate* – The current valuation is within historic ranges and generally consistent with peers. Where applicable, the DCF valuation exceeds the current capitalization by more than 10%. *Low* – The current valuation is at the low end of historic ranges and at a discount to peer valuations. Where applicable, the DCF valuation exceeds the current capitalization by more than 20%.

## Risk Profile Parameters – Technology/Special Situations

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**Forecast Risk:** *High* – Haywood forecasts are below guidance. The Company has a history of missing targets and/or Haywood expects guidance to be lowered. Sales are minimally visible. *Moderate* – Haywood forecasts are generally in line with guidance and sales are moderately visible. The Company has a history of meeting or exceeding guidance. *Low* – Haywood forecasts exceed guidance. The Company has a history of meeting or exceeding guidance and its sales are highly visible.

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**Valuation Risk:** *High* – The current valuation is at the high end of historic levels and/or at a premium to peers. Where applicable, the DCF valuation is not more than 10% above the current equity valuation. *Moderate* – The current valuation is within historic ranges and generally consistent with peers. Where applicable, the DCF valuation exceeds the current capitalization by more than 10%. *Low* – The current valuation is at the low end of historic ranges and at a discount to peer valuations. Where applicable, the DCF valuation exceeds the current capitalization by more than 20%.

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