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Sector(s):

- Data Center & Network Services
- Management Services & Tools

Sub-Sector(s):

- Shared Hosting
- Virtual Private Servers (VPS)
- Discount Dedicated Hosting
- Hosting Automation

Key Public Companies:

- EarthLink [NASDAQ: ELNK]
- Interland [NASDAQ: INLD]
- Verio/NTT [NYSE: NTT]
- VeriSign [NASDAQ: VRSN]
- Yahoo! [NASDAQ: YHOO]

Key Private Companies:

- 1&1 Internet
- Ensim
- EV1 Servers
- Hostway
- Sphera

Key Topics:

- Market Share Analysis
- Market Size Forecast
- Key Vendor Events
- Key Trends

Executive Summary

In this year-end 2003 review of the Mass Market Hosting (MMH) sector, T1R reviews the latest developments in the shared, VPS, and discount dedicated hosting software and services sector. We continue to cover the key trends, events, and market share moves that we have observed in the past ninety days. We also continue to enhance our market share perspectives by integrating key third party data from Netcraft and Name Intelligence.

Purchase the full 45-page report at <https://shop.tier1research.com>

Trend Watch

- **The Need For Differentiation** - Increases in disk space and data transfer rates are just not going to create long lasting customer relationships. Hosters attempt to differentiate via new tools and applications, as well as marketing programs.
- **Industry Consolidation Continues** - Another round of acquisition activity in the past ninety days suggest that there will be more rather than less activity in the coming year, as the mass market hosting sector in the U.S. continues to mature.
- **Hosting Automation Remains Hot** - The "return of the ASP model" continues to weave its way back into the minds of SMBs, and hosting automation platforms play a key role in enabling hosting providers to offer their end customers the third party applications necessary for a successful online presence.
- **Renewed Focus On Infrastructure** - At the end of the day, this business is still about mission critical infrastructure. In the past quarter, we saw a great deal of attention being paid to the data center footprints of mass market hosting providers, with the general trend being one of expansion to accommodate current and anticipated future growth.
- **Executive Management Appointees** Many mass market hosting providers made executive management appointees in the quarter, with the focus of the hires predominantly on growth through sales and marketing.

Event Watch

- **SBC [SBC] and Yahoo! [YHOO]** announced an expansion of their existing relationship for access that encompasses Yahoo! Small Business' suite of infrastructure services.
- **C I Host** has an unsatisfactory status with the Better Business Bureau of Fort Worth, Texas.
- **1&1 Internet**, the European giant that entered the U.S. market late last year, announced the end of its free hosting promotion, which resulted in over 140k sign-ups and represents upwards of \$50mn in lost revenue over three years.

Market Share/Size Watch

- **Market share moves:** 1) EV1Servers.net is first to break 20k discount dedicated servers under management; 2) Interland ends 4QF03 with \$26.7mn in revenue, 9,213 dedicated servers and 194k shared accounts; 3) Hostway sales were up 2x and clients up 3x in 2003
- **Name Intelligence:** total domain names registered tops 36mn; utilization rates at 41%.
- **Netcraft:** we take snapshots of the Netcraft Hosters Report for both Active Sites and IP Addresses for January 2004, compare this to the October 2003 results, and review the similarities and differences between our firms methodologies.

TREND WATCH

In search for the top trends within the mass market of hosting since our last MMH report in November of 2003, we focused on recurring news and events that touched on multiple companies within the sector, or events that we believe will have a profound impact on the sector moving forward. We arrived at a short list of five significant trends, a couple of which expand on the trends identified in our previous quarterly reports, combined with some new trends we are witnessing in the market.

We go into expanded and detailed specifics for each 4Q03 trend below, leveraging our on-going daily newsletter coverage of the sector. At a glance, the trends are as follows:

- **The Need For Differentiation** The market for shared and discount dedicated hosting services has become increasingly commoditized over the past couple of years. Successful hosting providers cannot compete simply on price, nor are increases in disk space and data transfer rates going to create long lasting customer relationships. We witnessed a number of hosters attempt to differentiate via new customer facing application, self service tools, and marketing programs.
- **Industry Consolidation Continues** -- Picking up where we left off last quarter, there was another round of acquisition activity in the past ninety days. All signs suggest that there will be more rather than less activity in the coming year, and the mass market hosting sector in the U.S. continues to mature.
- **Hosting Automation Remains Hot** - As the industry matures, and the “return of the ASP model” continues to weave its way back into the minds of SMBs, hosting automation platforms can offer hosting providers an alternative means to manage their infrastructure while being able to offer their end customers the third party applications necessary for a successful online presence, encompassing customer-, employee, and partner-facing initiatives.
- **Renewed Focus On Infrastructure** - At the end of the day, this business is still about mission critical infrastructure. In the past quarter, we saw a great deal of attention being paid to the data center footprints of mass market hosting providers, with the general trend being one of expansion to accommodate growth.
- **Executive Management Appointees** Many mass market hosting providers made executive management appointees in the quarter, signifying a changing of the guard for many firms. The focus of the hires was predominantly on sales and marketing.

To the right is an executive overview of each of the current trends found in this report.

Exhibit 1: Top Five Trends and Trendsetters

Rank	Trend	Trend Setter(s)
1	The Need For Differentiation	Affinity Internet, Alabanza Interland, Intermedia.NET, Macromedia, Panda Software, NetSuite
2	Industry Consolidation Continues	Data393, DellHost, FindWhat, Hostway, , HugeHosting, Miva, NationalNet, NetworX, VenturesOnline, VeriCenter, WebDCI
3	Hosting Automation Remains Hot	Ensim, Microsoft, Sphera, SWsoft, WebHost Automation
4	Renewed Focus On Infrastructure	Equinix, EVIServers, iPowerWeb, C I Host, Hostopia, Server Central, ServePath, Terremark, Verio
5	Executive Management Appointees	Alabanza, HostingPlex, Hostway, Interland, NetSuite, Sphera, Verio

Source: Tier 1 Research

TREND #1: The Need For Differentiation (Excerpt)

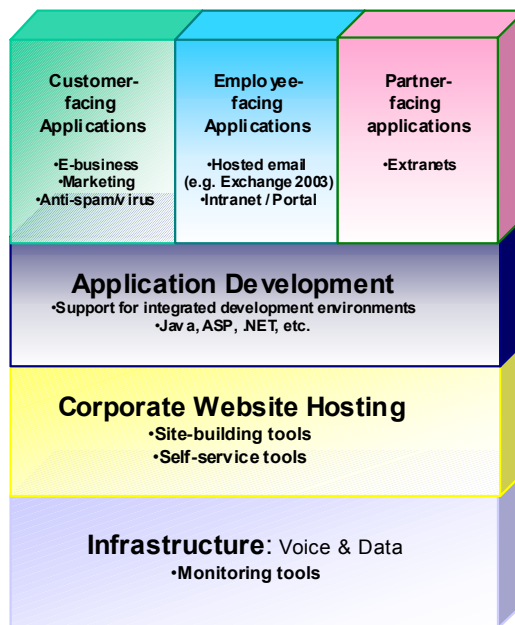
T1: BOTTOM-LINE

TIER 1 - BOTTOM-LINE: The mass market of Web hosting – both shared and low-end dedicated services – has become increasingly commoditized over the past couple of years. Successful hosting providers cannot compete simply on price, nor are increases in disk space and data transfer rates going to create a long lasting customer relationship. Hosters took a hard look at the entire application infrastructure stack in 4Q03 and are actively trying to touch each layer with new tools and applications, as well as sales and marketing programs.

T2: SUMMARY

Many of the market leading hosting providers hit the market this quarter with new and improved offerings designed to differentiate themselves from lower cost providers. These hosting providers realize the problems facing their business if the difference between retaining or keeping a customer is \$1 per month, so new applications broadening the reach into the application infrastructure stack, as well as new marketing programs designed to get the hosting provider more in touch with its customer’s business, were unveiled. For example, Affinity Internet announced a partnership with Macromedia as well as other web design services for its ValueWeb brand. Also, Interland partnered with Panda Software for anti-virus solutions, launched new vertically-oriented hosting packages, and updated its affiliate program offering cash for referrals.

Exhibit 2: Application Infrastructure Stack



Source: Tier 1 Research

Hosting providers are looking to differentiate their offerings throughout the application infrastructure stack with new tools and marketing programs.

TREND #1: 1 & 1 Internet (U.S.) Concludes Promo

1&1 Internet (U.S.) concludes free hosting promo that could have been \$50mn in industry revenue

(From 1/27/04 commentary, revised 2/13/04))

1&1 Internet, the privately held mass market hosting provider, announced the end of its free hosting promotion and the availability of its entire line of infrastructure products and services to US customers. The promotion resulted in over 140k sign-ups, which at \$15/mo, would represent this industry loss of \$50mn in revenue over the three years covered in the promotion.

- **Free Hosting Promotion Tops 100k:** Launched back in October 2003 and highlighted in our 3Q03 Mass Market Hosting report available at <https://shop.tier1research.com>, 1&1 had been offering any individual or business a free shared hosting account for three years. As stated, the promotion resulted in over 100k sign-ups, which at an ARPU of \$15/mo over three years translates to over \$50mn in hosting revenue given away. Naturally, T1R believes that had it not been for a free price tag, many of these accounts would not have been created. In fact, we have confirmed that only 35k are sites that are paying for their own domain. Nevertheless, 1&1 hopes to upsell all of these customers with additional value-added services.
- **European Portfolio Hits US:** As indicated in our original coverage of 1&1's launch in the U.S., the company has just launched its full suite of infrastructure services (available in Europe), ranging from domain name registration for \$5.88/year to shared hosting at \$4.99/mo to dedicated hosting at \$49/mo, a price point we saw its European counterpart Intergen release in the U.S. with its subsidiary SERVER4YOU. 1&1 also offers a virus scan service, an e-newsletter tool, and other commonly used tools and applications in the mass market arena. Of note, as previously noted, 1&1 is using SWsoft as the hosting automation software to power many of its offerings.
- **New Limited Time Promotion:** 1&1 also announced the launch of a limited time promotional offer, giving new U.S. customers \$550 worth of free software when they sign up for any shared hosting package. The free software includes NetObjects Fusion 7.5, PhotoImpact 8, Hello Engines! 4.1 Pro, Ranking Toolbox 3.0, and Wise-FTP 3.0.

Market Share Watch (Excerpt)

T1R tracks market share across: 1) domains hosted; 2) number of servers; and 3) revenue. We also explore third party market data from Netcraft and Name Intelligence.

There are a number of different ways to assess market share leadership, depending on what and how one looks at the market. To address this multi-faceted issue, as in previous quarters, in 4Q03 look at year-end 2002 metrics of providers across three primary attributes: 1) number of domains hosted; 2) number of servers (separating shared and LED); and 3) revenue. In addition, through an alliance with Netcraft (www.netcraft.com), we also included select data from Netcraft's January 2004 Hosting Report, to provide an additional perspective on the sector's growth.

In this quarter's report, we review several notable updates to our November 2003 market share numbers, review our market sizing estimates and domain name registration data recently published by Name Intelligence, and compare the results of Netcraft's January 2003 Hosting Report to October's report.

We begin first by reviewing the key market share moves that were made in the quarter.

Quarterly Activity

T1R exclusive with Hostway; sales up 2x, clients up 3x in 2003

(From 1/23/04 commentary)

Following up to privately held Hostway's recent acquisitions of Cephren and EPN, T1R had an opportunity to speak with the company to get an operational and strategic update. Focusing first on the operational side of the business, Hostway had a truly impressive 2003, doubling its revenue and tripling its customer base compared to 2002.

- **Record Revenues; Up 2x in 2003:** Hostway indicated that it effectively doubled its top line revenue in 2003 compared to 2002. Our previous estimates put Hostway's 2002 revenue at just over \$32mn, which means that 2003 was between \$60-65mn. At its current pace, we would estimate 2004 to approach \$100mn.
- **Acquisition Hungry:** Hostway took industry honors when it came to acquisitive moves in 2003 (especially since EPN closed last year), with an excess of \$60mn in deals completed.
- **Tripling Customer Base:** through its acquisitions and organic efforts, Hostway saw its customer base triple to roughly 300k hosted domains. T1R is always looking for granularity in a number like this, and we also learned: 1) approximately 80% are actively hosted domains; 2) the OS split is around 80% Linux, 20% Windows, and this is the case for new sign-ups as well; 3) 80% of the base is commercial, 20% is consumer; 4) roughly 10% of the commercial base has e-commerce; and 5) this includes roughly 6k dedicated customers and nearly 10k dedicated servers under management.

The company remains committed to its three-pronged strategy, which we outlined in our 1/14/04 commentary about the EPN acquisition. Additional details are as follows.

- **Global Growth:** both organically and through acquisition, Hostway is focused on strengthening its global footprint. Following the acquisition of EPN, it now has international data centers in London, Sydney, Canada, and South Korea. Additional points of presence in Asia and continental Europe were said to be coming soon.

Mass Market Hosting

4Q03 Quarterly Market Size/Share Review

Market Review

Exhibit 5: State of the Domain and Name Intelligence 1Q04 results compared to 1Q03

For specific information on the most active name servers powering the Internet, we recommend readers visit <http://www.dailychanges.com>, a Name Intelligence web site.

gTLD	1Q03	1Q04	Q/Q Growth	Q/Q Net Change
.COM	<p>See all the details in the full report available at https://shop.tier1research.com</p>			
.NET				
.ORG				
CNO Total				
.BIZ				
.INFO				
SUB Total				
.US				
TOTAL				

Source: State of the Domain (www.sotd.info); Name Intelligence (www.dailychanges.com)

The CNO zone saw Y/Y growth of 17%, and while the new gTLDs saw just over 4% growth, the real growth story was found in .US, which posted nearly 40% Y/Y growth.

Exhibit 6: U.S. Entities Outsourcing with Shared and Dedicated Hosting

		1999	2000	2001	2002	2003	2004	2005
Entities Outsourcing Web Applications using Shared Hosting								
Consumer	Non-firms							
Small Business	1-99 employees							
Medium Business	100-499 employees							
Large Business	500+ employees							
	Total Entities							
Entities Outsourcing Web Applications using Discoun								
Consumer	Non-firms							
Small Business	1-99 employees							
Medium Business	100-499 employees							
Large Business	500+ employees							
	Total Entities							
Total Entities Outsourcing Web Applications using M								
Consumer	Non-firms							
Small Business	1-99 employees							
Medium Business	100-499 employees							
Large Business	500+ employees							
	Total Entities							
Mix of Entities (Consumer + Business) Outsourcing w								
	Shared							
	Growth %							
	% Shared							
	LED							
	Growth %							
	% LED							
	TOTAL							
	Growth %							

See all the details in the full report available at <https://shop.tier1research.com>

Source: Tier 1 Research

Market Share Update

We start by focusing on actively hosted accounts, which is the best apples-to-apples comparison that we can make given the varying subtleties of how vendors tend to talk about customer counts. The top 20 vendors based on mid-year 2003 numbers in Exhibit 10 are listed, along with a comparison to year-end 2002, and total industry growth found below in Exhibit 13. It is worth noting that as a result of the additional granularity on OEM accounts provided in Exhibit 10, some of the data points within Actively Hosted Accounts may have changed per company (i.e. Verio and C I Host) compared to our February 2003 report, as we remain diligent in our effort to represent the market in the most accurate manner.

Exhibit 10: T1R Top 20 Actively Hosted Accounts (4Q03 versus 4Q02)

Company	4Q03	% share	4Q02	% share	growth
1 Yahoo! Small Business					
2 Verio					
3 Hostway					
4 C I Host					
5 Interland					
6 Affinity					
7 XO					
8 Earthlink					
9 pair Networks					
10 Network Solutions					
11 SBC					
12 IPOWERTWEB					
13 Homestead					
14 Tripod					
15 About.com (FreeServers)					
16 Omnis					
17 Webstation.com					
18 Atlantic.net (including Featureprice)					
19 Colossus.net					
20 SoftCom (myhosting.com)					
Subtotal	2,838,485	18.7%	2,344,747	18.2%	21.1%
Other	12,324,629	81.3%	10,532,045	81.8%	17.0%
Total	15,163,114	100.0%	12,876,791	100.0%	17.8%

See all the details in the full report available at
<https://shop.tier1research.com>

Source: Tier 1 Research

Description and Analysis

- In terms of sheer volume, Yahoo! Small Business took over the leader board by the end of 2003, as it continued to convert its broad base of users into monthly recurring customers.
- Hostway did over \$50mn in acquisitions in 2003 and essentially bought its way into the top three.
- Interland does not count the 50,000 sub-domains under management that it acquired through Trellix in its count of active sites, so neither do we.

Mass Market Hosting

4Q03 Quarterly Market Size/Share Review

Company	2002 (Actual)				% Share	2003 (Actual)				% Share	Growth							
	Volume	C-MSP	Other	TOTAL		Volume	C-MSP	Other	TOTAL		Volume	C-MSP	Other	TOTAL				
1 & 1 Internet (US only)																		
About.com																		
(FreeServers)	11.3																	
Affinity	27.5																	
AIT																		
Alabanza																		
Aplus.net																		
Atlantic.net (including																		
Featureprice)																		
BizLand.com																		
Burlee																		
Burst.Net																		
C 1 Host																		
Catalog.com																		
Colossus.net																		
CrystalTech																		
DataPipe																		
Earthlink																		
EV1Server																		
ExpertHost																		
FatCow																		
Featureprice																		
Homestead																		
Hostcentric	2.3			13.2	0.4%													
Hostik	0.9	0.5		3.1	0.1%	2.4	1.0	0.1	9.5	0.1%	16%	16%	55%					
hostmysite.com																		
Hostopia																		
Hostway																		
INETU																		
Interland																		
Intermedia.net																		
Invotion																		
IPOWERWEB																		
Jumpline																		
Media3																		
Modwest																		
NetNation																		
NetLedge																		
Network Solutions																		
OLM.net																		
Omnis																		
pair Networks																		
Rackspace																		
Radiant																		
SBC																		
ServePath																		
SERVER4YOU																		
SoftCom (myhosting.com)																		
Superb Internet																		
Thruport																		
Tripod																		
VeriCenter (formerly Del																		
Verio																		
Web.com																		
Webstation.com																		
XO																		
Yahoo! Hosting/GeoCitic																		
SUBTOTAL																		
OTHER																		
TOTAL	2,588.4	361.1	446.1	3,395.6	100%	2,918.3	441.5	455.4	3,815.2	100%	13%	-	2%	12%				

See all the details in the full report available at <https://shop.tier1research.com>

Source: Tier 1 Research

About Tier1 Research

Tier1 Research is an independent research firm covering the IT and Telecom markets often referred to as the Internet infrastructure industry. Founded in September 2000, T1R's business model combines financial and strategic analysis of both public and private companies to bring a holistic perspective that merges the best of Wall Street with industry research. Tier1 Research works with institutional investors, venture capital firms, enterprise IT buyers, and industry vendors as an extension of their competitive analysis team. Services include the daily "Infrastructure Insider", hot topic and market sizing reports, financial models, online databases with deeper operational and statistical details, and consulting services.

Partners include: PrimeSourcing Advisors and AFCOM (for the enterprise IT buyers) and BNY/Jaywalk and Soleil Securities (for the institutional investor). The company is based in Minneapolis and has offices in New York and Silicon Valley. T1R can be reached at (763) 694-9992 or www.tier1research.com.

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Andrew M. Schroeffer founded Tier1 Research after a four-year career on Wall Street. Most recently, Mr. Schroeffer was Vice President and Senior Equity Analyst with the Goldman Sachs as the lead analyst in the Internet Infrastructure Services sector. Prior to joining Goldman Sachs in New York, Andrew was a Vice President and Senior Equity Analyst at U.S. Bancorp Piper Jaffray in Minnesota. At U.S. Bancorp, Mr. Schroeffer initiated and led the firms' coverage of the communication services sector starting with the release of a 280-page report on the expected dis-aggregation of the communications marketplace. Andrew graduated from St. John's University with honors and a BA in Accounting and Economics. Andrew has been quoted in numerous worldwide publications such as the Wall Street Journal, Red Herring, USA Today, HostingTech, Business2.0, and CFO Magazine. Mr. Schroeffer has also been interviewed on such television and cable programs as CNBC, CNNfn, the Nightly Business Report, and various ABC-affiliate programs.

Joshua Beil joined Tier 1 Research in August of 2001 from Exodus Communications, one of the leading web hosting providers, where he worked as the Senior Analyst in the Strategic Planning group. Prior to Exodus, Joshua worked at International Data Corporation (IDC) where he helped to create and maintain the Worldwide PC Tracker web product for the multi-national industry research firm. Mr. Beil holds a Certificate in E-Business from UCSC Extension, and he graduated with honors from the University of California at Santa Cruz with a major in Psychology. Joshua has been quoted in numerous publications including The Washington Post, CNET, Teledotcom, eWeek, WebHost Magazine, The Web Hosting Industry Review, Top Hosts, Host Buzz, and Linux World News. He currently resides in Honolulu where he has cofounded a wireless ISP, Skywave Broadband LLC. He can be reached at (808) 286-3774 or joshua@tier1research.com.

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