EQUINIX INC
Form 10-Q
November 01, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 30, 2006

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from ______ to ______

Commission File Number 000-31293

EQUINIX, INC.

(Exact name of registrant as specified in its charter)

Delaware	**77-0487526**
(State of incorporation)	**(I.R.S. Employer Identification No.)**

301 Velocity Way, Fifth Floor, Foster City, California 94404

(Address of principal executive offices, including ZIP code)

(650) 513-7000

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) Yes x No ¨ and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer x Accelerated filer ¨ Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the registrant s Common Stock as of September 30, 2006 was 29,176,241.

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PART I - FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

EQUINIX, INC.

Condensed Consolidated Balance Sheets

(in thousands)

	September 30, 2006	December 31, 2005
	(unaudited)	
Assets		
Current assets:		
Cash and cash equivalents	$ 84,639	$ 119,267
Short-term investments	61,322	52,105
Accounts receivable, net	24,129	17,237
Prepaids and other current assets	5,990	3,103
Total current assets	176,080	191,712
Long-term investments	20,385	17,483
Property and equipment, net	499,917	438,790
Goodwill	22,710	21,654
Debt issuance costs, net	2,685	3,075
Other assets	8,843	8,283
Total assets	$ 730,620	$ 680,997
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 23,007	$ 22,557
Accrued property and equipment	18,597	15,783
Borrowings from credit line	40,000	30,000
Current portion of accrued restructuring charges	13,848	12,400
Current portion of capital lease and other financing obligations	1,855	1,552
Current portion of mortgage payable	1,337	1,159
Other current liabilities	8,517	7,972
Total current liabilities	107,161	91,423
Accrued restructuring charges, less current portion	30,698	37,431
Capital lease and other financing obligations, less current portion	93,220	94,653
Mortgage payable, less current portion	57,828	58,841
Convertible subordinated debentures	86,250	86,250
Deferred rent and other liabilities	27,879	23,726
Total liabilities	403,036	392,324
Stockholders equity:		
Common stock	29	27
Additional paid-in capital	887,319	839,497
Deferred stock-based compensation		(4,930)
Accumulated other comprehensive income	2,791	1,126
Accumulated deficit	(562,555)	(547,047)

Total stockholders equity	327,584	288,673
Total liabilities and stockholders equity	$ 730,620	$ 680,997

See accompanying notes to condensed consolidated financial statements

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EQUINIX, INC.

Condensed Consolidated Statements of Operations

(in thousands, except per share data)

	Three months ended September 30, 2006	Three months ended September 30, 2005	Nine months ended September 30, 2006	Nine months ended September 30, 2005
	(unaudited)			
Revenues	$ 73,726	$ 58,096	$ 207,143	$ 159,259
Costs and operating expenses:				
Cost of revenues	49,137	40,955	138,045	116,639
Sales and marketing	7,502	4,829	23,180	14,793
General and administrative	18,631	12,078	53,486	33,594
Restructuring charges	1,527		1,527	
Total costs and operating expenses	76,797	57,862	216,238	165,026
(Loss) income from operations	(3,071)	234	(9,095)	(5,767)
Interest income	1,724	1,075	5,065	2,644
Interest expense	(3,551)	(1,928)	(10,984)	(6,332)
Loss before income taxes and cumulative effect of a change in accounting principle	(4,898)	(619)	(15,014)	(9,455)
Income taxes	(270)	(164)	(870)	(553)
Net loss before cumulative effect of a change in accounting principle	(5,168)	(783)	(15,884)	(10,008)
Cumulative effect of a change in accounting principle for stock-based compensation (net of income taxes of $0)			376	
Net loss	$ (5,168)	$ (783)	$ (15,508)	$ (10,008)
Net loss per share:				
Basic and diluted net loss per share before cumulative effect of a change in accounting principle	$ (0.18)	$ (0.03)	$ (0.56)	$ (0.43)
Cumulative effect of a change in accounting principle			0.01	
Basic and diluted net loss per share	$ (0.18)	$ (0.03)	$ (0.55)	$ (0.43)
Weighted-average shares	28,743	24,076	28,356	23,335

See accompanying notes to condensed consolidated financial statements

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EQUINIX, INC.

Condensed Consolidated Statements of Cash Flows

(in thousands)

	Nine months ended September 30,	
	2006	2005
	(unaudited)	
Cash flows from operating activities:		
Net loss	$ (15,508)	$ (10,008)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation	52,200	46,504
Stock-based compensation	23,540	6,291
Accretion of asset retirement obligation and accrued restructuring charges	2,795	1,043
Amortization of intangible assets and non-cash prepaid rent	833	240
Non-cash interest expense	643	1,451
Allowance for (recovery of) doubtful accounts	16	(457)
Loss on disposal of assets	6	4
Cumulative effect of a change in accounting principle	(376)	
Restructuring charges	1,527	
Changes in operating assets and liabilities:		
Accounts receivable	(6,908)	(3,823)
Prepaids and other assets	(2,305)	647
Accounts payable and accrued expenses	470	3,602
Accrued restructuring charges	(9,213)	(1,448)
Other liabilities	1,833	4,990
Net cash provided by operating activities	49,553	49,036
Cash flows from investing activities:		
Purchases of investments	(68,619)	(100,693)
Sale of investments		13,360
Maturities of investments	56,789	103,344
Purchase of Chicago IBX property	(9,766)	
Purchases of other property and equipment	(102,904)	(57,219)
Accrued property and equipment	2,814	2,245
Proceeds from sale of property and equipment	8	
Net cash used in investing activities	(121,678)	(38,963)
Cash flows from financing activities:		
Proceeds from exercise of warrants, stock options and employee stock purchase plans	28,756	11,217
Proceeds from borrowings under credit line	40,000	
Repayment of borrowings from credit line	(30,000)	
Repayment of capital lease and other financing obligations	(1,130)	(4,213)
Repayment of mortgage payable	(835)	
Debt issuance costs	(253)	(342)
Excess tax benefits from stock-based compensation	814	
Net cash provided by financing activities	37,352	6,662

Effect of foreign currency exchange rates on cash and cash equivalents	145	(100)
Net increase (decrease) in cash and cash equivalents	(34,628)	16,635
Cash and cash equivalents at beginning of period	119,267	25,938
Cash and cash equivalents at end of period	$ 84,639	$ 42,573
Supplemental cash flow information:		
Cash paid for taxes	$ 545	$
Cash paid for interest	$ 11,352	$ 5,277

See accompanying notes to condensed consolidated financial statements

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation and Significant Accounting Policies

The accompanying unaudited condensed consolidated financial statements have been prepared by Equinix, Inc. (Equinix or the Company) and reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary to fairly state the financial position and the results of operations for the interim periods presented. The balance sheet at December 31, 2005 has been derived from audited financial statements at that date. The financial statements have been prepared in accordance with the regulations of the Securities and Exchange Commission (SEC), but omit certain information and footnote disclosure necessary to present the statements in accordance with generally accepted accounting principles. For further information, refer to the Consolidated Financial Statements and Notes thereto included in Equinix s Form 10-K as filed with the SEC on March 16, 2006. Results for the interim periods are not necessarily indicative of results for the entire fiscal year.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

The Company believes it has sufficient cash, coupled with anticipated cash generated from operating activities and anticipated cash from financings expected to close in the fourth quarter of 2006 as described below, to meet its currently identified business objectives for at least the next twelve months. As of September 30, 2006, the Company had $166,346,000 of cash, cash equivalents and short-term and long-term investments. Since the quarter ended September 30, 2003, the Company has generated positive operating cash flow in each quarter and expects this trend to continue throughout the remainder of 2006 and beyond. In addition, as of September 30, 2006, the Company had $28,300,000 of additional liquidity available to it under the Company s Silicon Valley Bank Credit Line Amendment, which was amended in August 2006 (see Note 9), in the event the Company needs additional cash to fund expansion activities, fund working capital requirements or pursue attractive strategic opportunities that may become available in the future. In September 2006, the Company received loan commitments, subject to customary closing conditions, for a total of $150,000,000 to finance its Washington, D.C. Metro Area IBX Expansion Project (see Note 2) and Chicago Metro Area IBX Expansion Project (see Note 2) in long-term financing arrangements at anticipated rates of approximately 8%, which the Company expects to close during the fourth quarter of 2006. While the Company expects that its cash flow from operations will continue to increase, the Company expects its cash flow used in investing activities, primarily as a result of its expected purchases of property and equipment to complete these expansion projects, will also increase (see Note 12, Other Purchase Commitments) and the Company expects them to be greater than its cash flows generated from operating activities. As a result, while the Company believes it has sufficient cash, coupled with anticipated cash generated from operating activities and anticipated cash from financings expected to close in the fourth quarter of 2006, to meet its currently identified business objectives for at least the next twelve months, the Company will investigate additional financing opportunities in connection with the Company s current and future expansion plans, in order to continue to meet its cash requirements to fund its other capital expenditures, debt service and corporate operating requirements and maintain its cash and working capital position.

Revenue Recognition and Allowance for Doubtful Accounts

Equinix derives more than 90% of its revenues from recurring revenue streams, consisting primarily of (1) colocation services, such as from the licensing of cabinet space and power; (2) interconnection services, such as cross connects and Equinix Exchange ports; (3) managed infrastructure services, such as Equinix Direct, bandwidth, mail service and managed platform solutions and (4) other services consisting of rent from non-IBX space. The remainder of the Company s revenues are from non-recurring revenue streams, such as from the recognized portion of deferred installation revenues, professional services, contract settlements and equipment sales. Revenues from recurring revenue streams are billed monthly and recognized ratably over the term of the contract, generally one to three years for IBX space customers. Non-recurring installation fees, although generally paid in a lump sum upon installation, are deferred and recognized ratably over the longer of the term of the related contract or expected customer relationship.

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Professional service fees are recognized in the period in which the services were provided and represent the culmination of the earnings process as long as they meet the criteria for separate recognition under EITF Abstract No. 00-21, Revenue Arrangements with Multiple Deliverables. Revenue from bandwidth and equipment is recognized on a gross basis in accordance with EITF Abstract No. 99-19, Recording Revenue as a Principal versus Net as an Agent , primarily because the Company acts as the principal in the transaction, takes title to products and services and bears inventory and credit risk. To the extent the Company does not meet the criteria for gross basis accounting for bandwidth and equipment revenue, the Company records the revenue on a net basis. Revenue from contract settlements, which is for when a customer wishes to terminate their contract early, is generally recognized on a cash basis when no remaining performance obligations exist to the extent that the revenue has not previously been recognized.

The Company occasionally guarantees certain service levels, such as uptime, as outlined in individual customer contracts. To the extent that these service levels are not achieved, the Company reduces revenue for any credits given to the customer as a result. The Company generally has the ability to determine such service level credits prior to the associated revenue being recognized, and historically, these credits have generally not been significant. There were no significant service level credits recorded during the three and nine months ended September 30, 2006. During the three and nine months ended September 30, 2005, the Company recorded a total of $247,000 and $607,000, respectively, in service level credits to various customers associated with two separate power outages that affected the Company s Chicago and Washington, D.C. metro area IBX centers.

Revenue is recognized only when the service has been provided and when there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the receivable is reasonably assured. It is customary business practice to obtain a signed master sales agreement and sales order prior to recognizing revenue in an arrangement. The Company assesses collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer. The Company generally does not request collateral from its customers although in certain cases the Company obtains a security interest in a customer s equipment placed in its IBX centers or obtains a deposit. If the Company determines that collection of a fee is not reasonably assured, the Company defers the fee and recognizes revenue at the time collection becomes reasonably assured, which is generally upon receipt of cash. In addition, Equinix also maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments for which the Company had expected to collect the revenues. If the financial condition of Equinix s customers were to deteriorate or if they become insolvent, resulting in an impairment of their ability to make payments, greater allowances for doubtful accounts may be required. Management specifically analyzes accounts receivable and current economic news and trends, historical bad debts, customer concentrations, customer credit-worthiness and changes in customer payment terms when evaluating revenue recognition and the adequacy of the Company s reserves. A specific bad debt reserve of up to the full amount of a particular invoice value is provided for certain problematic customer balances. A general reserve is established for all other accounts based on the age of the invoices and an analysis of historical credits issued. Delinquent account balances are written-off after management has determined that the likelihood of collection is not probable.

Net Loss per Share

The Company computes net loss per share in accordance with SFAS No. 128, Earnings per Share; SEC Staff Accounting Bulletin (SAB) No. 98; EITF Issue 03-6, Participating Securities and the Two-Class Method Under FASB 128; EITF Issue 04-8 The Effect of Contingently Convertible Instruments on Diluted Earnings per Share and SFAS No. 123(R), Share-Based Payment. Under the provisions of SFAS No. 128, SAB No. 98, EITF Issues 03-6 and 04-8 and SFAS No. 123R, basic and diluted net loss per share are computed using the weighted-average number of common shares outstanding. Options, warrants and contingently convertible instruments were not included in the computation of diluted net loss per share. Under EITF Issue 03-6, the Company s preferred stock qualified as a participating security, but was not included in the Company s basic and diluted net loss per share calculations for prior periods as the holder of preferred stock did not have a contractual obligation to share in the Company s losses. In addition, under EITF 04-8, the Company s Convertible Subordinated Debentures qualify as contingently convertible instruments; however, they were not included in the Company s diluted net loss per share calculations because to do so would be anti-dilutive for all periods presented.

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table sets forth the computation of basic and diluted net loss per share for the periods presented (in thousands, except per share amounts) (unaudited):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Numerator:				
Net loss	$ (5,168)	$ (783)	$ (15,508)	$ (10,008)
Denominator:				
Weighted-average shares	28,991	24,076	28,606	23,335
Weighted-average unvested restricted shares issued subject to forfeiture	(248)		(250)	
Total weighted average shares	28,743	24,076	28,356	23,335
Net loss per share:				
Basic and diluted	$ (0.18)	$ (0.03)	$ (0.55)	$ (0.43)

The following table sets forth potential shares of common stock that are not included in the diluted net loss per share calculation above because to do so would be anti-dilutive for the periods indicated (unaudited):

	September 30,	
	2006	2005
Series A preferred stock		1,868,667
Series A preferred stock warrant		965,674
Shares reserved for conversion of convertible secured notes		224,229
Shares reserved for conversion of convertible subordinated debentures	2,183,548	2,183,548
Unvested restricted shares issued subject to forfeiture	247,750	
Common stock warrants	9,490	152,359
Common stock related to stock-based compensation plans	3,935,819	4,482,973

Income Taxes

Income taxes are accounted for under the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts that are expected more likely than not to be realized in the future. The assessment of whether or not a valuation allowance is required often requires significant judgment including the forecast of future taxable income and the evaluation of tax planning strategies in each of the jurisdictions in which the Company operates. The Company also accounts for any income tax contingencies in accordance with SFAS No. 5, Accounting for Contingencies.

The Company is currently in a net deferred tax asset position, which has been fully reserved. The Company will continue to provide a valuation allowance for the net deferred tax asset until it becomes more likely than not that the net deferred tax asset will be realizable. For the three and nine months ended September 30, 2006, the Company recorded a tax provision of $270,000 and $870,000, respectively. For the three and nine

months ended September 30, 2005, the Company recorded a tax provision of $164,000

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and $553,000, respectively. The tax provision recorded in each of these periods is attributable primarily to federal alternative minimum tax. The Company expects the alternative minimum tax situation to continue throughout the current taxable year based on its financial outlook for the year. The Company has recorded this income tax provision within accounts payable and accrued expenses on the accompanying balance sheets as of September 30, 2006 and December 31, 2005, along with other taxes, such as personal and real property taxes (see Note 6). During the nine months ended September 30, 2006, the Company reduced $825,000 of this income tax payable within accounts payable and accrued expenses, and increased additional paid-in capital as a result of excess tax benefits associated with the stock options exercised by employees during the periods.

Construction in Progress

Construction in progress includes direct and indirect expenditures for the construction and expansion of IBX centers and is stated at original cost. The Company has contracted out substantially all of the construction and expansion efforts of its IBX centers to independent contractors under construction contracts. Construction in progress includes certain costs incurred under a construction contract including project management services, engineering and schematic design services, design development, construction services and other construction-related fees and services. In addition, the Company has capitalized certain interest costs during the construction phase. Once an IBX center or expansion project becomes operational, these capitalized costs are allocated to certain property and equipment categories and are depreciated at the appropriate rates consistent with the estimated useful life of the underlying assets.

Interest incurred is capitalized in accordance with SFAS No. 34, Capitalization of Interest Costs. Total interest cost incurred and total interest capitalized during the three months ended September 30, 2006, was $3,905,000 and $354,000, respectively. During the nine months ended September 30, 2006, total interest cost incurred and total interest capitalized was $12,026,000 and $1,042,000, respectively. There was no interest capitalized during the three and nine months ended September 30, 2005.

Asset Retirement Obligations

SFAS No. 143, Accounting for Asset Retirement Obligations and FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, an Interpretation of FASB Statement No. 143 establish accounting standards for recognition and measurement of a liability for an asset retirement obligation and the associated asset retirement cost. The fair value of a liability for an asset retirement obligation is to be recognized in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated retirement costs are capitalized and included as part of the carrying value of the long-lived asset and amortized over the useful life of the asset. Subsequent to the initial measurement, the Company is accreting the liability in relation to the asset retirement obligations over time and the accretion expense is being recorded as a cost of revenue. The Company s asset retirement obligations are primarily related to its IBX Centers, of which the majority are leased under long-term arrangements, and, in certain cases, are required to be returned to the landlords in original condition. All of the Company s IBX center leases have been subject to significant development by the Company in order to convert them from, in most cases, vacant buildings or warehouses into IBX centers. The majority of the Company IBX centers initial lease terms expire at various dates ranging from 2010 to 2020 and most of them have renewal options available to the Company.

During the three and nine months ended September 30, 2006, the Company recorded accretion expense related to its asset retirement obligations of $138,000 and $394,000, respectively. During the three and nine months ended September 30, 2005, the Company recorded accretion expense related to its asset retirement obligations of $135,000 and $382,000, respectively. The Company records its asset retirement obligations liability within other liabilities on the accompanying balance sheets (see Note 8).

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock-Based Compensation

On January 1, 2006, the Company adopted the provisions of, and accounts for stock-based compensation in accordance with, SFAS No. 123(R), Share-Based Payment, and related pronouncements (SFAS 123(R)). The Company elected the modified-prospective method, under which prior periods are not revised for comparative purposes. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date for all stock-based awards made to employees and directors based on the fair value of the award using an option-pricing model and is recognized as expense over the requisite service period, which is generally the vesting period. The Company has three types of equity awards or plans, which have been impacted by SFAS 123(R): (i) stock options, (ii) restricted stock with both a service and market price condition and (iii) an employee stock purchase plan (ESPP). SFAS 123(R) supersedes the Company s previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB 25) for periods beginning in fiscal year 2006. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 (SAB 107) providing supplemental implementation guidance for SFAS 123(R). The Company has applied the provisions of SAB 107 in its adoption of SFAS 123(R).

Prior to the adoption of SFAS 123(R), the Company accounted for stock-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no stock-based compensation expense for employee stock options had generally been recognized in the Company s consolidated statements of operations because the exercise price of its stock options granted to employees and directors since the date of the Company s initial public offering generally equaled the fair market value of the underlying stock at the date of grant. The Company did, however, recognize stock-based compensation in connection with its restricted stock grants, granted for the first time in the first quarter of 2005, as these were deemed to be a compensatory plan under the provisions of APB 25 and, as a result, were accounted for as variable awards in the Company s consolidated statements of operation.

The Company currently uses the Black-Scholes option-pricing model to determine the fair value of stock options and shares purchased under the employee stock purchase plan as they only have a service condition. The Company currently uses a Monte Carlo simulation option-pricing model to determine the fair value of its restricted stock grants since they have both a service and market price condition. The determination of the fair value of stock-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the Company s expected stock price volatility over the term of the awards; actual and projected employee stock option exercise behaviors, which is referred to as expected term; risk-free interest rate and expected dividends.

As a result of the Company s adoption of SFAS 123(R), the Company recorded stock-based compensation expense of $6,885,000 or $0.24 per share and $23,540,000 or $0.83 per share for the three and nine months ended September 30, 2006, respectively; however, had the Company continued to record its stock-based compensation expense under the provisions of APB 25, the recorded stock-based compensation expense would have been approximately $2,049,000 or $0.07 per share and approximately $7,332,000 or $0.26 per share for the three and nine months ended September 30, 2006, respectively. For the three and nine months ended September 30, 2005, the Company recorded stock-based compensation expense in accordance with APB 25 of $1,358,000 and $6,291,000, respectively.

Stock-based compensation expense recognized during a period is based on the value of the portion of stock-based awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in the three and nine months ended September 30, 2006 included compensation expense for stock-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the fair value on the grant date estimated in accordance with the pro forma provisions of SFAS 123, and compensation expense for the stock-based awards granted subsequent to December 31, 2005, based on the fair value on the grant date estimated in accordance with the provisions of SFAS 123(R). In conjunction with the adoption of SFAS 123(R), the Company changed its method of attributing the value of stock-based compensation expense from the accelerated multiple-option method to the ratable single-option method for

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

stock options and its ESPP; however, restricted stock grants will continue to be amortized over the accelerated multiple-option method due to their market price condition. Compensation expense for all stock-based awards granted on or prior to December 31, 2005, will continue to be recognized using the accelerated multiple-option approach, while compensation expense for all stock-based awards granted subsequent to December 31, 2005, will be recognized using the straight-line single-option method (except for restricted stock as discussed above). Stock-based compensation expense recognized in the Company s results for the three and nine months ended September 30, 2006 is based on awards ultimately expected to vest; it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures. Prior to fiscal year 2006, the Company accounted for forfeitures as they occurred for the purposes of pro forma information under SFAS 123 and for any stock-based compensation that the Company recorded to its statements of operations under APB 25.

The Company estimates the expected term of options granted by taking the average of the vesting term and the contractual term of the option, as illustrated in SAB 107. The Company estimates the volatility of its common stock by using its historical volatility that the Company believes best represents its future volatility in accordance with SAB 107. The Company bases the risk-free interest rate that it uses in its option-pricing models on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on its equity awards. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore used an expected dividend yield of zero in its option-pricing models. Generally, stock options granted prior to October 1, 2005 have a contractual term of ten years from the date of grant, and stock options granted on or after October 1, 2005 have a contractual term of seven years from the date of grant.

On November 10, 2005, the FASB issued FASB Staff Position No. FAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards, that allows for a simplified method to establish the beginning balance of the APIC pool related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of SFAS 123(R). The Company is still in the process of calculating the APIC pool and has not yet determined if it will elect to adopt the simplified method.

If factors change and the Company employs different assumptions for estimating stock-based compensation expense in future periods or if it decides to use a different valuation model in the future, the future periods may differ significantly from what the Company has recorded in the current period and could materially affect its operating results, net income or loss and net income or loss per share.

For further information on stock-based compensation, see Note 10 below.

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Goodwill and Other Intangible Assets

Goodwill and other intangible assets, net, consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Goodwill	$ 22,710	$ 21,654
Other intangibles:		
Intangible asset customer contracts	4,234	4,051
Intangible asset leases	1,017	
Intangible asset tradename	328	313
Intangible asset workforce	160	160
Intangible asset lease expenses	111	
	5,850	4,524
Accumulated amortization	(5,185)	(4,349)
	665	175
	$ 23,375	$ 21,829

The Company s goodwill is an asset denominated in Singapore dollars. As a result, it is subject to foreign currency fluctuations. The Company s foreign currency translation gains and losses are a component of other comprehensive income and loss (see Note 13).

During the three months ended March 31, 2006, the Company finalized its accounting for the Ashburn Campus Property Acquisition from the fourth quarter of 2005 and, as a result, reduced property and equipment by $1,128,000, offset by an increase in several intangible assets in connection with various leases acquired from multiple tenants on the Ashburn Campus totaling $1,128,000. The Company amortizes these other identifiable intangible assets on a straight-line basis over their estimated useful lives. Other intangible assets, net, are included in other assets on the accompanying balance sheets as of September 30, 2006 and December 31, 2005.

For the three and nine months ended September 30, 2006, the Company recorded amortization expense of $160,000 and $638,000, respectively. For the three and nine months ended September 30, 2005, the Company recorded amortization expense of $15,000 and $45,000, respectively. The Company expects to record the following amortization expense during 2006 and beyond (in thousands) (unaudited):

Year ending:	
2006 (three months remaining)	$ 143
2007	237
2008	180
2009	67
2010	38
Total	$ 665

2. IBX Acquisitions and Expansions

Washington, D.C. Metro Area IBX Expansion Project

In February 2006, the Company announced its intention to build out a new IBX center within the Ashburn Campus in order to further expand its existing Washington, D.C. metro area IBX center (the Washington, D.C. Metro Area IBX Expansion Project). In May 2006, the Company began new construction to build out one of the undeveloped buildings located on the Ashburn Campus for a cost of approximately $60,000,000, of which approximately $56,000,000 is expected to be incurred in 2006. The

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

center will feature an updated design that will enable the Company to support the increased power and cooling demands of customers. The Company intends to open the new center for customers during the three months ending March 31, 2007. The Washington, D.C. Metro Area IBX Expansion Project will fulfill the Company s obligation to invest at least $40,000,000 in capital improvements to the Ashburn Campus by December 31, 2007 pursuant to the terms of the Mortgage Payable on its Ashburn Campus. In September 2006, the Company received loan commitments, subject to customary closing conditions, for $40,000,000 to finance this Washington, D.C. Metro Area IBX Expansion Project in a long-term financing arrangement at anticipated rates of approximately 8%, which the Company expects to close during the fourth quarter of 2006. In September 2006, the Company elected to borrow $40,000,000 from the Silicon Valley Bank Credit Line Amendment to partially finance this project (see Note 9).

Chicago Metro Area IBX Expansion Project

In June 2006, the Company purchased a 228,000 square foot stand-alone office/warehouse complex for $9,766,000, including closing costs in a cash transaction in June 2006. The Company intends to build an IBX center, which will be the company s second IBX center location in the Chicago Metro Area, in multiple phases (the Chicago Metro Area IBX Expansion Project). This new IBX center will be interconnected to the Company s existing downtown Chicago IBX centers through redundant dark fiber links managed by the Company. The Company plans to invest approximately $165,000,000 to build out the first phase, of which approximately $40,000,000 is expected to be incurred in 2006. This includes an investment of approximately $40,000,000 to construct a specially built 250,000 square foot shell, acquire access to power and provision fiber for interconnection to the Company s downtown Chicago IBX center location. The site development plan allows a second expansion phase at an incremental investment of $30,000,000. The Company intends to open the new center for customers during the three months ended September 30, 2007. In September 2006, the Company received loan commitments, subject to customary closing conditions, for $110,000,000 to finance at least 60% of the construction costs or a maximum of $110,000,000 in a long-term financing arrangement at anticipated rates of approximately 8%, which the Company expects to close during the fourth quarter of 2006. In September 2006, the Company elected to borrow $40,000,000 from the Silicon Valley Bank Credit Line Amendment to partially finance this project (see Note 9).

New York Metro Area IBX Expansion Project

In September 2006, the Company entered into a long-term lease for a 340,000 square foot building in the New York metro area. The Company intends to build an IBX center, which will be the Company s fourth IBX center in the New York metro area, and this new center will be interconnected to the Company s existing IBX centers in the New York metro area through redundant dark fiber links managed by the Company (the New York Metro Area IBX Expansion Project). Payments under this lease total $59,410,000, which will be paid in monthly installments through September 2021. The lease, which commenced in October 2006, contains a three-year option to purchase the building for $39,000,000. The Company intends to build out the new center in multiple phases and expects to open the first phase for customers during the three months ended September 30, 2007. As previously announced, the Company intends to invest approximately $80,000,000 to $90,000,000 to build out the first phase of the new center, of which approximately $4,000,000 is expected to be incurred in 2006. The Company expects to finance at least 60% of the capital expenditures required to complete the New York Metro Area IBX Expansion Project in the form of short and long-term financing arrangements, which it expects to obtain in 2007.

3. Related Party Transactions

A significant amount of the Company s Asia-Pacific revenues are generated in Singapore and a significant portion of the business in Singapore is transacted with entities affiliated with STT Communications, which is the Company s single largest stockholder. For the three and nine months ended September 30, 2006, revenues recognized with related parties, primarily entities affiliated with STT Communications, were $1,279,000 and $4,117,000, respectively, and as of September 30, 2006, accounts receivable with these related parties was $1,062,000. For the three and nine months ended September 30,

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

2006, costs and services procured with related parties, primarily entities affiliated with STT Communications, were $864,000 and $2,883,000, respectively, and as of September 30, 2006, accounts payable with these related parties was $283,000. For the three and nine months ended September 30, 2005, revenues recognized with related parties, primarily entities affiliated with STT Communications, were $1,344,000 and $4,625,000, respectively, and as of September 30, 2005, accounts receivable with these related parties was $875,000. For the three and nine months ended September 30, 2005, costs and services procured with related parties, primarily entities affiliated with STT Communications, were $744,000 and $2,240,000, respectively, and as of September 30, 2005, accounts payable with these related parties was $354,000.

4. Accounts Receivable

Accounts receivables, net, consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Accounts receivable	$ 48,631	$ 36,430
Unearned revenue	(24,222)	(19,048)
Allowance for doubtful accounts	(280)	(145)
	$ 24,129	$ 17,237

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Unearned revenue consists of pre-billing for services that have not yet been provided, but which have been billed to customers in advance in accordance with the terms of their contract.

5. Property and Equipment

Property and equipment consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Leasehold improvements	$ 416,729	$ 395,698
IBX plant and machinery	178,540	146,896
IBX equipment	81,775	63,786
Computer equipment and software	40,283	26,253
Buildings	50,526	51,280
Land	24,967	15,415
Furniture and fixtures	2,544	2,218
Construction in progress	47,435	17,271
	842,799	718,817
Less accumulated depreciation	(342,882)	(280,027)
	$ 499,917	$ 438,790

Leasehold improvements, IBX plant and machinery, computer equipment and software and buildings recorded under capital leases aggregated $35,309,000 at both September 30, 2006 and December 31, 2005. Amortization on the assets recorded under capital leases is included in depreciation expense and accumulated depreciation on such assets totaled $4,119,000 and $2,354,000 as of September 30, 2006 and December 31, 2005, respectively.

As of September 30, 2006 and December 31, 2005, the Company had accrued property and equipment of $18,597,000 and $15,783,000, respectively. The Company s planned capital expenditures during the remainder of 2006 and 2007 in connection with recently acquired IBX properties and expansion efforts are substantial. For further information, refer to Other Purchase Commitments in Note 12.

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Accounts payable	$ 2,420	$ 3,337
Accrued compensation and benefits	8,855	8,632
Accrued taxes	3,100	3,571
Accrued utility and security	3,958	3,420
Accrued professional fees	2,039	1,303
Accrued interest	682	873
Accrued other	1,953	1,421
	$ 23,007	$ 22,557

7. Other Current Liabilities

Other current liabilities consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Deferred installation revenue, current	$ 6,843	$ 6,324
Customer deposits	825	868
Deferred rent, current	408	399
Other current liabilities	441	381
	$ 8,517	$ 7,972

8. Deferred Rent and Other Liabilities

Deferred rent and other liabilities consisted of the following (in thousands):

	September 30, 2006 (unaudited)	December 31, 2005
Deferred rent, non-current	$ 20,710	$ 18,392
Asset retirement obligations	4,043	3,649
Deferred installation revenue, non-current	2,835	1,334
Other liabilities	291	351

	$ 27,879	$ 23,726

The Company currently leases the majority of its IBX centers and certain equipment under non-cancelable operating lease agreements expiring through 2025. The centers lease agreements typically provide for base rental rates that increase at defined intervals during the term of the lease. In addition, the Company has negotiated rent expense abatement periods to better match the phased build-out of its centers. The Company accounts for such abatements and increasing base rentals using the straight-line method over the life of the lease. The difference between the straight-line expense and the cash payment is recorded as deferred rent.

9. Debt Facilities and Other Financing Obligations

Silicon Valley Bank Credit Line

In January 2006, the Company fully repaid the $30,000,000 Borrowing from the Silicon Valley Bank Credit Line. In August 2006, the Company amended the Silicon Valley Bank Credit Line to increase the line

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

to $75,000,000, replacing the previously outstanding $50,000,000 line of credit arrangement with the same bank, and added General Electric Capital Corporation (GE) as a lender (the Silicon Valley Bank Credit Line Amendment). The Silicon Valley Bank Credit Line Amendment allows for issuance of letters of credit (in addition to revolving borrowings). The Silicon Valley Bank Credit Line Amendment also has an option for the Company to increase the amount of the line to $100,000,000 at a later date, subject to approval of the lender or lenders electing to participate in such increase. Borrowings under the Silicon Valley Bank Credit Line Amendment will continue to bear interest at variable interest rates, plus the applicable margins, which were in effect prior to the amendment, based on either prime rates or LIBOR rates. The Silicon Valley Bank Credit Line Amendment matures on September 15, 2008 and is secured by substantially all of the Company s domestic personal property assets and certain of the Company s real property leases and contains several financial covenants, which require compliance with maximum leverage and working capital ratios and a minimum EBITDA target, all of which the Company was in compliance with as of September 30, 2006.

In September 2006, the Company elected to borrow $40,000,000 (the $40,000,000 Borrowing) from the Silicon Valley Bank Credit Line Amendment, of which $20,000,000 of the $40,000,000 Borrowing was borrowed at the prime rate and bears interest at 8.75% per annum and the remaining $20,000,000 was borrowed at a spread over the one-month LIBOR rate and bears interest at 7.824% per annum. The $40,000,000 Borrowing was used to fund capital expenditures and construction costs related to the Washington D.C. Metro Area IBX Expansion Project and Chicago Metro Area IBX Expansion Project. As of September 30, 2006, the $40,000,000 Borrowing from Silicon Valley Bank Credit Line Amendment had an effective blended interest rate of 8.29% per annum.

As of September 30, 2006, in addition to the $40,000,000 Borrowing, the Company had also utilized $6,700,000 under the letters of credit sublimit with the issuance of five letters of credit under the Silicon Valley Bank Credit Line Amendment reducing the amount of borrowings available to the Company from $75,000,000 to $28,300,000. These letters of credit automatically renew in successive one-year periods until the final lease expiration dates. If the landlords for any of these five IBX leases decide to draw down on these letters of credit, the Company will be required to fund these letters of credit either through cash collateral or borrowings under the Silicon Valley Bank Credit Line Amendment.

At the time the Company entered into the Silicon Valley Bank Credit Line Amendment, a total of $321,000 of issuance costs remained unamortized related to the Silicon Valley Bank Credit Line. In addition, the Company incurred $253,000 of additional issuance costs to secure the Silicon Valley Bank Credit Line Amendment. In accordance with EITF Issue 98-14, Debtor s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements , the Company has capitalized the total of such issuance costs, which are being amortized to interest expense using the effective interest method over the life of the Silicon Valley Bank Credit Line Amendment. These debt issuance costs, net of amortization, were $529,000 as of September 30, 2006.

In October 2006, the Company utilized an additional $7,800,000 under the letters of credit sublimit associated with the Silicon Valley Bank Credit Line Amendment in connection with the new lease for the New York Metro Area IBX Expansion Project and fully repaid the $40,000,000 Borrowing (see Note 17).

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Maturities

Combined aggregate maturities for the Company s various debt facilities and other financing obligations as of September 30, 2006 are as follows (in thousands) (unaudited):

	Capital lease and other financing obligations	Mortgage payable	Borrowings under credit line and convertible subordinated debentures	Total
2006 (three months remaining)	$ 2,348	$ 1,505	$ 40,000	$ 43,853
2007	9,568	6,022		15,590
2008	9,842	6,022		15,864
2009	10,122	6,022	86,250	102,394
2010	10,409	6,022		16,431
2011 and thereafter	128,354	90,838		219,192
	170,643	116,431	126,250	413,324
Less amount representing interest	(82,123)	(57,266)		(139,389)
Plus amount representing residual property value	6,555			6,555
	95,075	59,165	126,250	280,490
Less current portion of principal	(1,855)	(1,337)	(40,000)	(43,192)
	$ 93,220	$ 57,828	$ 86,250	$ 237,298

10. Stockholders Equity and Stock-Based Compensation

The Company s employee stock plans are a long-term retention program that is intended to attract, retain and provide incentives for talented employees, officers and directors, and to align stockholder and employee interests. The Company considers its stock plans to be critical for its operation and productivity and essentially all of the Company s employees participate. The Company s stock plans are described below.

Stock Option Plans

In May 2000, the Company s stockholders approved the adoption of the 2000 Equity Incentive Plan as the successor plan to the 1998 Stock Plan. In August 2000 the Company no longer issued additional grants under the 1998 Stock Plan, and unexercised options under the predecessor 1998 Stock Plan that cancel due to an optionee s termination may be reissued under the successor 2000 Equity Incentive Plan. Under the 2000 Equity Incentive Plan, nonstatutory stock options, restricted shares, restricted stock units, and stock appreciation rights may be granted to employees, outside directors and consultants at not less than 85% of the fair market value on the date of grant, and incentive stock options may be granted to employees at not less than 100% of the fair market value on the date of grant. Options granted prior to October 1, 2005 generally expire 10 years from the grant date, and options granted to employees and consultants on or after October 1, 2005 will generally expire seven years from the grant date, subject to continuous service of the optionee. Stock options and restricted shares granted under the 2000 Equity Incentive Plan generally vest over four years. As of September 30, 2006, the Company has reserved a total of 8,219,601 shares for issuance under the 2000

Equity Incentive Plan of which 1,685,475 were still available for grant, and the plan reserve is increased on January 1 each year by the lesser of 6% of the common stock then outstanding or 6,000,000 shares. The 2000 Equity Incentive Plan is administered by the Compensation Committee of the Board of Directors, and the Board may terminate or amend the plan, with approval of the stockholders as may be required by applicable regulations, at any time.

In May 2000, the Company s stockholders approved the adoption of the 2000 Director Option Plan, which was amended and restated effective January 1, 2003. Under the 2000 Director Option Plan, each non-employee board member who was not previously an employee of the Company will receive an automatic initial nonstatutory stock option to purchase 7,000 shares (in addition to an option for 8,000 shares if chairperson of the Compensation or Nominating Committees, or 13,000 if chairperson of the Audit Committee, granted from the 2000 Equity Incentive Plan), which vests in four annual installments. In

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

addition, each non-employee board member will receive an annual nonstatutory stock option to purchase 2,500 shares (in addition to an option to purchase 2,500 shares granted from the 2000 Equity Incentive Plan) on the date of the Company s regular Annual Meeting of Stockholders, provided the board member will continue to serve as a director thereafter. Such annual option shall vest in full on the earlier of a) the first anniversary of the grant, or b) the date of the regular Annual Meeting of Stockholders held in the year following the grant date. A new director who receives an initial option will not receive an annual option in the same calendar year. Options granted under the 2000 Director Option Plan will have an option price not less than 100% of the fair market value on the date of grant and will have a 10-year contractual term, subject to continuous service of the board member. As of September 30, 2006, the Company has reserved 393,440 shares subject to options for issuance under the 2000 Director Option Plan of which 335,938 were still available for grant, and an additional 50,000 shares is added to the reserve on January 1 each year. The 2000 Director Option Plan is administered by the Compensation Committee of the Board of Directors, and the Board may terminate or amend the plan, with approval of the stockholders as may be required by applicable regulations, at any time.

In September 2001, the Company adopted the 2001 Supplemental Stock Plan, under which non-statutory stock options and restricted shares may be granted to consultants and employees who are not executive officers or board members, at not less than 85% of the fair market value on the date of grant. Options granted prior to October 1, 2005 generally expire 10 years from the grant date, and options granted on or after October 1, 2005 will generally expire seven years from the grant date, subject to continuous service of the optionee. Current stock options granted under the 2001 Supplemental Stock Plan generally vest over four years. As of September 30, 2006, the Company has reserved a total of 1,493,961 shares for issuance under the 2001 Supplemental Stock Plan, of which 160,479 were still available for grant. The 2001 Supplemental Stock Plan is administered by the Compensation Committee of the Board of Directors, and the plan will continue in effect indefinitely unless the Board decides to terminate it earlier.

The 1998 Stock Plan, 2000 Equity Incentive Plan, 2000 Director Option Plan and 2001 Supplemental Stock Plan are collectively referred to as the Stock Option Plans.

Stock Option Plan Activity

Stock option activity under the Stock Option Plans is summarized as follows (unaudited):

	Number of shares outstanding	Weighted-average exercise price per share
Stock options outstanding at December 31, 2005	4,162,539	$ 33.67
Stock options granted	1,104,385	53.58
Stock options exercised	(1,253,011)	19.83
Stock options forfeited	(373,882)	39.82
Stock options expired	(18,428)	130.55
Stock options outstanding at September 30, 2006	3,621,603	43.41

The total intrinsic value of stock options exercised during the three and nine months ended September 30, 2006 was $7,013,000 and $41,204,000, respectively. The intrinsic value is calculated as the difference between the market value on the date of exercise and the exercise price of the shares. The total fair value of options vested during the three and nine months ended September 30, 2006 was $10,785,000 and $26,981,000, respectively.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information about outstanding equity awards as of September 30, 2006 (unaudited):

	Outstanding			Exercisable	
Range of exercise prices	**Number of shares**	**Weighted-average remaining contractual life**	**Weighted-average exercise price**	**Number of shares**	**Weighted-average exercise price**
$2.13 to $17.70	512,484	6.55	$ 10.43	505,208	$ 10.48
$18.61 to $29.80	450,910	6.96	27.37	263,657	27.46
$30.00 to $30.02	379,512	7.36	30.02	228,708	30.02
$30.38 to $40.74	390,727	7.03	36.88	106,781	36.12
$40.83 to $44.70	240,163	8.48	42.18	76,799	42.15
$44.89 to $44.89	417,783	8.31	44.89	146,779	44.89
$45.08 to $52.51	156,108	6.55	48.17	5,901	50.24
$52.85 to $52.85	591,238	6.41	52.85	96,721	52.85
$53.09 to $72.00	285,340	6.80	58.94	21,155	57.50
$85.33 to $384.00	197,338	3.82	148.17	197,338	148.17
	3,621,603	6.92	43.41	1,649,047	41.81

The total aggregate intrinsic value of stock options outstanding and stock options exercisable as of September 30, 2006 was $78,121,000 and $36,495,000, respectively. As of September 30, 2006, the weighted average remaining contractual life of options outstanding and exercisable was 6.92 years and 6.51 years, respectively. The market value as of September 30, 2006 was $60.10 as reported by the Nasdaq National Market System. Cash proceeds from the exercises of stock options were $24,843,000 and $6,309,000 for the nine months ended September 30, 2006 and 2005, respectively.

Fair Value Calculations Stock Options

The Company uses the Black-Scholes option-pricing model to determine the fair value of stock options. The assumptions used to value stock option were as follows (unaudited):

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Dividend yield	0%	0%	0%	0%
Expected volatility	68%	75%	70%	79%
Risk-free interest rate	4.79%	4.04%	4.72%	3.93%
Expected life (in years)	4.58	4.00	4.56	4.00

The weighted-average fair value of stock options per share on the date of grant was $32.44 and $31.66, respectively, for the three and nine months ended September 30, 2006. The weighted-average fair value of stock options per share on the date of grant for the three and nine months ended September 30, 2005 was $23.67 and $25.39, respectively.

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Restricted Share Activity

As noted above, the Company grants restricted shares out of the 2000 Equity Incentive Plan. Restricted Share activity under the 2000 Equity Incentive Plan is summarized as follows (unaudited):

	Number of shares outstanding	Weighted-average grant date fair value per share
Restricted shares outstanding, December 31, 2005	280,438	$ 43.76
Restricted shares granted	274,000	44.43
Restricted shares issued, unvested (1)	(274,000)	44.43
Restricted shares issued, vested	(69,313)	43.76
Restricted shares canceled	(51,125)	43.76
Restricted shares outstanding, September 30, 2006 (2)	160,000	43.76

(1) On January 10, 2006 and May 22, 2006, the Company granted 250,000 restricted shares and 24,000 restricted shares, respectively, to its executive officers and at the same time, unlike the previous year s restricted stock grants (see footnote 2 below), issued these shares into an escrow account under the names of each of the executive officers. These shares have voting rights and are considered issued and outstanding. They are released from the escrow account as they vest. However, they are subject to forfeiture if the individual officers do not meet the vesting requirements. See Net Loss Per Share in Note 1.

(2) As of September 30, 2006, there was a total of 160,000 restricted shares outstanding and unissued. These restricted shares were granted on February 8, 2005 to the Company s executive officers. These shares were not placed into an escrow account in the names of each of the executive officers. These shares do not have voting rights and are not considered issued and outstanding. These restricted shares will only be issued when they become vested.

Unvested restricted shares as of December 31, 2005 totaled 280,438. Unvested restricted shares as of September 30, 2006 totaled 407,750 comprised of 247,750 issued shares and 160,000 unissued shares.

Fair Value Calculations Restricted Shares

The Company uses a Monte Carlo simulation option-pricing model to determine the fair value of restricted shares as they have both a service and market price condition. The assumptions used to value restricted shares were as follows (unaudited):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Dividend yield			0%	0%
Expected volatility			71%	80%
Risk-free interest rate			4.43%	3.55%

Market risk premium	8.5%	8.5%
Beta	1.28	1.28

The weighted-average fair value per share of restricted shares on the date of grant was $44.43 for the nine months ended September 30, 2006.

Employee Stock Purchase Plans

In May 2000, the Company adopted the 2000 Employee Stock Purchase Plan (the 2000 Purchase Plan) under which 31,250 shares were reserved for issuance, and after January 1, 2005, no additional shares were added to the 2000 Purchase Plan. The last purchase under the 2000 Purchase Plan was in July 2005, at which time the 2000 Purchase Plan ceased and the unused reserved shares expired.

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In June 2004, the Company s stockholders approved the adoption of the 2004 Employee Stock Purchase Plan and International Employee Stock Purchase Plan (the 2004 Purchase Plans , collectively with the 2000 Purchase Plan, the Purchase Plans) as successor plans to the 2000 Purchase Plan. A total of 500,000 shares have been reserved for issuance under the 2004 Purchase Plans, and the number of shares available for issuance under the 2004 Purchase Plans automatically increases on January 1 each year beginning in 2005 by the lesser of 2% of the shares of common stock then outstanding or 500,000 shares. As of September 30, 2006, a total of 1,160,584 shares remain available for purchase under the Purchase Plans. The 2004 Purchase Plans permit eligible employees to purchase common stock on favorable terms via payroll deductions, up to 15% of the employee s cash compensation, subject to certain share and statutory dollar limits. Two overlapping offering periods commence during each calendar year, on each February 14 and August 14 or such other periods or dates as determined by the Compensation Committee from time to time, and the offering periods last up to 24 months with a purchase date every six months. The price of each share purchased is 85% of the lower of a) the fair market value per share of common stock on the last trading day before the commencement of the applicable offering period or b) the fair market value per share of common stock on the purchase date. The 2004 Purchase Plans are administered by the Compensation Committee of the Board of Directors, and such plans will terminate automatically in June 2014 unless a) the 2004 Purchase Plans are extended by the Board of Directors and b) the extension is approved within 12 months by the Company s stockholders.

For the three and nine months ended September 30, 2006, 67,638 and 135,325 shares, respectively, were issued under the Purchase Plans at a weighted average purchase price of $29.14 and $28.91 per share, respectively. For the three and nine months ended September 30, 2005, 77,401 and 218,158 shares, respectively, were issued under the Purchase Plans at a weighted average purchase price of $22.94 and $15.62 per share, respectively. Cash proceeds from the issuance of stock under Employee Stock Purchase Plans were $3,913,000 and $3,408,000 for the nine months ended September 30, 2006 and 2005, respectively.

Fair Value Calculations Employee Stock Purchase Plans

The Company uses the Black-Scholes option-pricing model to determine the fair value of shares purchased under the Purchase Plans. The assumptions used to value shares purchased under the Purchase Plans were as follows (unaudited):

	Three months ended September 30,		Nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
Dividend yield	0%	0%	0%	0%
Expected volatility	68%	75%	69%	76%
Risk-free interest rate	5.03%	3.33%	4.95%	3.27%
Expected life (in years)	1.25	1.25	1.25	1.25

The weighted-average fair value per share of shares purchased on the date of purchase was $18.88 and $18.10, respectively, for the three and nine months ended September 30, 2006. For the three and nine months ended September 30, 2005, the weighted-average fair value per share of shares purchased on the date of purchase was $14.60 and $9.65, respectively.

Cumulative Effect Adjustments Under SFAS 123(R)

Upon adoption of SFAS 123(R) on January 1, 2006, the Company recorded the following two cumulative effect adjustments:

For awards with compensation cost recognized in the financial statements under APB 25 that were partially vested upon the adoption of SFAS 123(R), an adjustment to record estimated forfeitures was recorded as a cumulative effect adjustment upon a change in accounting principle totaling $0 and $376,000 in the Company s consolidated statement of operations for the three and nine months ended September 30, 2006, respectively.

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EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

For deferred stock-based compensation related to equity awards granted prior to the adoption of SFAS 123(R), such amounts were eliminated against additional paid-in capital upon adoption, which for the Company totaled $4,930,000 as of December 31, 2005.

Stock-Based Compensation Recognized in the Statement of Operations

The following table presents, by operating expense, the Company s stock-based compensation expense recognized in the Company s consolidated statement of operations under SFAS 123(R) for the three and nine months ended September 30, 2006 and under APB 25 for the three and nine months ended September 30, 2005 (in thousands) (unaudited):

	Three months ended September 30,		Nine months ended September 30,	
	2006	2005	2006	2005
Cost of revenues	$ 664	$	$ 2,385	$
Sales and marketing	1,623	248	5,647	1,149
General and administrative	4,598	1,110	15,508	5,142
	$ 6,885	$ 1,358	$ 23,540	$ 6,291

As of September 30, 2006, the total stock-based compensation cost related to unvested equity awards not yet recognized, net of estimated forfeitures, totaled $48,293,000, which is expected to be recognized over a weighted-average period of 2.6 years.

Pro Forma Stock-Based Compensation Under SFAS 123 for Periods Prior to Fiscal 2006

The following table presents what the net loss and net loss per share would have been had the Company adopted SFAS 123 for the three and nine months ended September 30, 2005 (in thousands, except per share data) (unaudited):

	Three months ended September 30, 2005	Nine months ended September 30, 2005
Net loss as reported	$ (783)	$ (10,008)
Stock-based compensation expense included in net loss	1,358	6,291
Stock-based compensation expense if SFAS No. 123 had been adopted	(7,404)	(27,806)
Pro forma net loss	$ (6,829)	$ (31,523)
Basic and diluted net loss per share:		
As reported	$ (0.03)	$ (0.43)
Pro forma	(0.28)	(1.35)

11. Stock Option Granting Practices

In June 2006, the Audit Committee of the Company s Board of Directors commenced an independent investigation of the Company s historical stock option granting practices and related accounting with the assistance of independent outside legal counsel. This review covers the timing and pricing of all stock option grants made under the Company s stock option plans since August 11, 2000, the day after the Company s Initial Public Offering (IPO).

EQUINIX, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As previously announced on June 12, 2006, the Company is currently cooperating with the SEC regarding the SEC s informal inquiry requesting documents related to the Company s stock option grants and practices. The Company also announced on June 29, 2006 that it received a grand jury subpoena from the U.S. Attorney for the Northern District of California and is cooperating fully with the U.S. Attorney s Office in connection with this subpoena. The subpoena requests documents relating to the Company s stock option grants and practices.

Based on the results of its review, the Audit Committee determined that the accounting measurement dates of certain stock option grants issued in the past differ from the actual grant dates. The Audit Committee concluded that the Company did not engage in intentional or fraudulent misconduct in the granting of stock options. However, the accounting measurement dates for certain historical stock option grants differed from their actual grant dates. As a result of revising the accounting measurement dates for these stock option grants, the Company has recorded an additional non-cash stock-based compensation charge totaling $444,000 in the Company s consolidated financial statements for the nine month period ended September 30, 2006. The amount of the charge was computed pursuant to the requirements of APB 25 for all historical periods through December 31, 2005 and pursuant to SFAS 123(R) for the three month period ended March 31, 2006. This $444,000 stock-based compensation charge represents the total charge for historical periods that the Company needed to record as a result of the Audit Committee s conclusion on this matter. This compensation charge has no effect on the Company s current cash position.

The Company concluded that the cumulative charge as a result of the difference between the measurement dates used for financial accounting and reporting purposes and the actual grant dates for certain stock option grants, totaling $444,000, was not material to any previously-reported historical period nor is it expected to be material to the current fiscal year. As such, this cumulative charge totaling $444,000 was recorded in the quarter ended June 30, 2006 and is included in the statement of operations for the nine months ended September 30, 2006, versus restating prior periods. This additional stock-based compensation was combined with the Company s stock-based compensation recorded in connection with FASB 123(R) for the nine months ended September 30, 2006 as outlined in Footnote 10. As of September 30, 2006, the total remaining incremental stock-based compensation charge related to these stock option grants with a revised accounting measurement date not yet recognized, net of estimated forfeitures, totaled approximately $14,000, which is expected to impact the Company s operating results through 2008.

The following table presents, by operating expense category, the Company s cumulative stock-based compensation charge totaling $444,000 recognized in the Company s consolidated statement of operations for the nine months ended September 30, 2006 (in thousands) (unaudited):

Cost of revenues	$ 63
Sales and marketing	99
General and administrative	282
	$ 444

There were no significant income tax effects relating to this adjustment for the Company. However, the Company is currently assessing if any negative tax consequences will impact the Company s employees as a result of this matter. When this determination is reached, the Company may decide to compensate the impacted employees in an amount sufficient to offset any negative tax consequences that they may incur. However, a final decision on this matter will not be made until the Internal Revenue Service provides additional guidance regarding Section 409A of the Internal Revenue Code, which is expected to occur later this year. Any such compensation that the Company elects to make to the employees for any negative tax effects would be recorded at the time that management, including the Board of Directors, makes that election or agrees to such a plan.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

12. Commitments and Contingencies

Legal Matters Relating to Stock Option Granting Practices

In June 2006, the Company received an informal inquiry from the Securities and Exchange Commission (SEC) and a grand jury subpoena from the U.S. Attorney from the Northern District of California (U.S. Attorney) requesting documents relating to its stock option grants and practices. Such inquiries are believed to be related to recent widespread investigations into the practices of public companies relating to the timing of option grants. The Company intends to fully cooperate in all government investigations.

On June 29, 2006 and September 18, 2006, shareholder derivative complaints were filed in the Superior Court of the State of California, County of San Mateo against certain of the Company s current and former officers and directors (the Defendants). The complaints allege that the Defendants breached their fiduciary duties by engaging in allegedly improper stock option grant practices since at least 2000, and by failing to adequately disclose such transactions. The complaints seek unspecified monetary damages, corporate governance changes and restitution. On October 13, 2006, a third shareholder derivative complaint related to allegedly improper stock option grant practices was filed in the United States District Court for the Northern District of California against certain of the Company s current and former officers and directors. The complaint seeks unspecified monetary and punitive damages, corporate governance changes, and the imposition of a constructive trust over certain stock options and related proceeds. At the appropriate time, the Company expects to file motions to dismiss these lawsuits due to the plaintiffs unexcused failure to make a demand on the Company before filing the actions. In addition to the current derivative claims, the Company may be subject to additional derivative or other lawsuits that may be presented on an individual or class basis alleging claims based on its stock option granting practices. Similar lawsuits and investigations have been commenced against numerous other companies based on similar allegations.

Responding to, investigating and/or defending against civil litigations and government inquiries regarding the Company s stock option grants and practices will present a substantial cost to the Company in both cash and the attention of certain management and may have a negative impact on its operations. In addition, in the event of any negative finding or assertion by the SEC, U.S. Attorney, court of law or any third party claim related to the Company s stock option granting practices, the Company may be liable for damages, fines or other civil or criminal remedies or remedial actions, or be required to restate its prior period financial statements or adjust its current period financial statements. Any such adverse action could have a material adverse effect on the Company s business and current market value.

The Company notes that while an unfavorable outcome to any or all of the above-mentioned inquiries, cases or complaints is reasonably possible, the amount of loss, if any, cannot be reasonably estimated at this time. As a result, the Company has not accrued for any settlements in connection with these legal matters as of September 30, 2006.

Other Legal Actions

On July 30, 2001 and August 8, 2001, putative shareholder class action lawsuits were filed against the Company, certain of its officers and directors (the Individual Defendants), and several investment banks that were underwriters of the Company s IPO. The cases were filed in the United States District Court for the Southern District of New York, purportedly on behalf of investors who purchased the Company s stock between August 10, 2000 and December 6, 2000. In addition, similar lawsuits were filed against approximately 300 other issuers and related parties. The purported class action alleges violations of Sections 11 and 15 of the Securities Act of 1933 and Sections 10(b), Rule 10b-5 and 20(a) of the Securities Exchange Act of 1934 against the Company and Individual Defendants. The plaintiffs have since dismissed the Individual Defendants without prejudice. The suits allege that the underwriter defendants agreed to allocate stock in the Company s IPO to certain investors in exchange for excessive and undisclosed commissions and agreements by those investors to make additional purchases in the aftermarket at pre-determined prices. The plaintiffs allege that the prospectus for the Company s IPO was false and misleading and in violation of the securities laws because it did not disclose these arrangements. The action seeks damages in an unspecified amount. On February 19, 2003, the Court dismissed the Section 10(b) claim against the Company, but denied the motion to dismiss the Section 11 claim.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2003, a Special Litigation Committee of the Equinix Board of Directors approved a settlement agreement and related agreements which set forth the terms of a settlement between the Company, the Individual Defendants, the plaintiff class and the vast majority of the other approximately 300 issuer defendants and the individual defendants currently or formerly associated with those companies. Among other provisions, the settlement provides for a release of the Company and the Individual Defendants and the Company s agreeing to assign away, not assert, or release certain potential claims the Company may have against its underwriters. The settlement agreement also provides a guaranteed recovery of $1 billion to plaintiffs for the cases relating to all of the approximately 300 issuers. To the extent that the underwriter defendants settle all of the cases for at least $1 billion, no payment will be required under the issuers settlement agreement. To the extent that the underwriter defendants settle for less than $1 billion, the issuers are required to make up the difference. On April 20, 2006, JPMorgan Chase and the plaintiffs reached a preliminary agreement for a settlement for $425 million. The Court has not yet approved the JPMorgan Chase settlement. However, if it is finally approved, then the maximum amount that the issuers insurers will be potentially liable for is $575 million. It is anticipated that any potential financial obligation of Equinix to plaintiffs pursuant to the settlement, of which such claims are currently expected to be less than $3.4 million, will be covered by existing insurance and the Company does not expect that the settlement will involve any payment by the Company. However, if the JPMorgan Chase settlement is finally approved, the Company s maximum financial obligation to the plaintiffs pursuant to the settlement agreement would be less than $2 million. The Company has no information as to whether there are any material limitations on the expected recovery by other issuer defendants of any potential financial obligation to plaintiffs from their own insurance carriers. On February 15, 2005, the court granted preliminary approval of the settlement agreement, subject to certain modifications consistent with its opinion. Those modifications have been made. On March 20, 2006, the Underwriter Defendants submitted objections to the settlement to the Court. The Court held a hearing regarding these and other objections to the settlement at a fairness hearing on April 24, 2006, but has not yet issued a ruling. There is no assurance that the court will grant final approval to the settlement. As approval by the Court cannot be assured, the Company is unable at this time to determine whether the outcome of the litigation would have a material impact on its results of operations, financial condition or cash flows.

On October 13, 2004, the Court certified a Section 11 class in four of the six cases that were the subject of class certification motions and determined that the class period for Section 11 claims is the period between the IPO and the date that unregistered shares entered the market. The Court noted that its decision on those cases is intended to provide strong guidance to all parties regarding class certification in the remaining cases. The Underwriter Defendants sought leave to appeal the class certification decision and the Second Circuit has accepted the appeal. Plaintiffs have not yet moved to certify a class in the Equinix case. Until the settlement is finalized and approved by the Court, or in the event such settlement is not approved, the Company and its officers and directors intend to continue to defend the actions vigorously. While an unfavorable outcome to this case is reasonably possible, and the Company can estimate its potential exposure to be less than approximately $3.4 million, it is not probable. In addition, as noted above, any payments are expected to be covered by existing insurance and, as a result, the Company does not expect that the settlement will involve any payment by the Company. As a result, the Company has not accrued for any settlements in connection with this litigation as of September 30, 2006.

Estimated and Contingent Liabilities

The Company estimates exposure on certain liabilities, such as income and property taxes, based on the best information available at the time of determination. With respect to real and personal property taxes, the Company records what it can reasonably estimate based on prior payment history, current landlord estimates or estimates based on current or changing fixed asset values in each specific municipality, as applicable. However, there are circumstances beyond the Company s control whereby the underlying value of the property or basis for which the tax is calculated on the property may change, such as a landlord selling the underlying property of one of the Company s IBX center leases or a municipality changing the assessment value in a jurisdiction and, as a result, the Company s property tax obligations may vary from period to period. Based upon the most current facts and circumstances, the Company makes the necessary property tax accruals for each of its reporting periods. However, revisions in the Company s estimates of the potential or actual liability could materially impact the financial position, results of operations or cash flows of the Company.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In July 2005, the Company received a Notice of Proposed Assessment of Income Tax from the state of Hawaii asserting a tax deficiency, plus interest, totaling $613,000 (the Tax Assessment). The deficiency is stemmed from certain refundable tax credits that the state of Hawaii subsequently disallowed in the examination of the Hawaii income tax returns for the tax years of 2000 and 2001 filed by Pihana Pacific, Inc., which the Company acquired on December 31, 2002. On January 12, 2006 the Company filed a request with the Board of Review in the state of Hawaii to appeal the Tax Assessment. The Company strongly believes the disallowance of the refundable tax credits by the state of Hawaii is inconsistent with the applicable tax laws and that it has meritorious defenses to the claim. The Company does not believe it is probable it will be required to pay the Tax Assessment upon the completion of the appeals process. There has been no significant development with respect to the appeal request. The Company is still waiting for a response from the State of Hawaii regarding the scheduling of a meeting with the Board of Review. As a result, the Company has not accrued for any loss contingencies in connection with this Tax Assessment as of September 30, 2006.

From time to time, the Company may have certain contingent liabilities that arise in the ordinary course of its business activities. The Company accrues contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated. In the opinion of management, there are no pending claims of which the outcome is expected to result in a material adverse effect in the financial position, results of operations or cash flows of the Company.

Operating Lease Amendments

In February 2006, the Company amended the lease to its corporate headquarter office in Foster City, California, to expand to the fourth floor of the building, which adds approximately 20,000 of additional square feet, and to extend the lease term an additional three years to March 2011.

Other Purchase Commitments

Primarily as a result of the Company s recent Washington, D.C. Metro Area IBX Expansion Project, Chicago Metro Area IBX Expansion Project and New York Metro Area IBX Expansion Project (see Note 2), as of September 30, 2006, the Company was contractually committed for $61,203,000 of unaccrued capital expenditures, primarily for IBX equipment not yet delivered and labor not yet provided, in connection with the work necessary to open these IBX centers and make them available to customers for installation. In addition, the Company has numerous other, non-capital purchase commitments in place as of September 30, 2006, such as commitments to purchase power in select locations, primarily in the U.S. and Singapore, through 2006 and 2007 and other open purchase orders which contractually bind the Company for goods or services to be delivered or provided during the remainder of 2006. Such other miscellaneous purchase commitments total $7,586,000 as of September 30, 2006.

13. Other Comprehensive Income and Loss

The components of other comprehensive income and loss are as follows (in thousands) (unaudited):

	Three months ended September 30, 2006	Nine months ended September 30,