

## KEYNOTE INTERVIEW

## Connecting to a digital future



*Next generation connectivity networks are vital to the transformation to a fully digitalised economy, says Infracapital's **James Harraway***

Today's challenging economic environment is putting pressure on telcos, which could lead to some interesting future investment opportunities, according to James Harraway, transaction managing director at Infracapital. Investment propositions in the data centre space are being driven by ongoing migration to the cloud, and hyperscale demand may be waning, but regional co-location is emerging as a hot space.

The continued consolidation of Europe's fibre networks is creating both investment and divestment opportunities. Harraway outlines what it takes to be successful in today's market.

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**Q To what extent has digital infrastructure proved its resilience through this period of macroeconomic turmoil?**

Overall, I would say that we have seen digital infrastructure assets display real resilience. We focus on investments in rural fibre networks where businesses benefit from high barriers to entry by virtue of high build costs. As a result, these assets are also often supported by government subsidy. Furthermore, the assets provide essential services to

customers for which there is steadily growing demand and often no practical alternative. This has promoted resilient revenues.

Of course, inflation has had an impact on both operational and network deployment costs. Businesses have typically been able to mitigate this by passing through higher costs to customers as well as focusing on efficiency in order to bring costs down. Scale also helps to build resilience and we are fortunate that we were early investors in the sector. A number of our assets are therefore well established in their respective markets. For example, we made our first UK rural fibre

investment in 2015 with Gigaclear, which is now the leading rural altnet with an efficient operating model and a resilient customer base.

### **Q Which subsectors within digital infrastructure are most attractive in the current market, and what is driving those digital infra opportunities?**

The overall opportunity set is being driven by the broader digitisation megatrend, with ever-growing demand for better connectivity from consumers and businesses alike. Specific investment opportunities come from two main sources. First, large telecoms companies are coming under pressure to deleverage and are therefore looking to realise value through either disposals of non-core assets or partnerships to support funding. Second, platform assets either owned by entrepreneurs or early-stage investors are seeking institutional capital to support their continued growth ambitions.

In terms of specific subsectors, we split the digital infrastructure universe into three areas – fixed, mobile and data centres. Within those subsectors, Infracapital focuses on the European mid-market, which we define as deals with an enterprise value of up to €1 billion. Interesting investment themes continue to emerge in each of these verticals as the asset class evolves.

In data centres, for example, there is a significant opportunity in the mid-market in the form of regional co-location. The reason for this is that businesses are continuing to move data storage and computing power-off premises but are only willing to rely on the public cloud for part of the solution, with regional co-location picking up a lot of demand.

In the mobile vertical, meanwhile, mobile network operators are seeking to densify their networks in urban areas to support 5G and new rounds of technology, as well as increase geographical coverage within rural areas.

### **Q How do you look to create value through your digital infrastructure investments?**

Value creation in digital infrastructure requires a laser focus on efficiency, both in deployment of networks and operations. One thing we have learnt is that the challenges faced are similar between markets and we facilitate regular seminars where we get all our management teams together to share experiences on a particular issue.

We have debated topics including technology, cybersecurity, marketing and routes to revenue. This helps us identify and share best practice as well as identify which key performance indicators matter most for operational outperformance. We work closely to track these KPIs, ensuring management teams have the support they need to deliver on those.

Finally, we see value creation in realising our investments as the sector consolidates. We believe in creating businesses that are leaders in particular regions, which can facilitate consolidation as it progresses.



The challenge is that this requires significant investment which they may not be able to fund, and we are therefore seeing interesting opportunities to invest in neutral host providers. These are businesses that own mobile infrastructure that is then shared by multiple mobile network operators.

Our UK business, Neos Networks, is benefiting from this trend and is already supporting the infrastructure of one of the main UK mobile networks. It is also currently in exclusivity to partner with rail operator Network Rail to build a new fibre network. As well as supporting the safe running of the railway, this new fibre network will facilitate high-quality connection for passengers on trains and in stations.

### **Q How do you expect those opportunities to evolve over the next year or so?**

While the overall telecoms sector has been performing well this year, it is clear that some of the large telecoms players will come under increasing pressure to dispose of infrastructure assets as they feel the impact of higher interest rates on their financing structures. We also expect some large-scale M&A, which will trigger smaller asset disposals. These are likely to be interesting for our mid-market focused strategy.

In addition, we are closely following regulatory dynamics. While there has been significant support from governments for fibre deployment, which a

number of our assets have benefited from, regulators are still playing catch-up. They are yet to evolve from a world where their primary concern was regulating a single monopolistic provider, to one where there are multiple operators with strengthening market positions in particular regions.

**Q There has been a lot of discussion regarding the consolidation of the European fibre market. What are you seeing in this regard?**

Consolidation has always been part of our investment thesis in European fibre. While there are benefits to being nimble in the network deployment phase, as networks are built out there are increasing benefits to be had from scale. We have invested in businesses that we believe will be important pieces on the chessboard as consolidation plays out, and we have already been engaged in consolidation with our assets. For example, Nexera in Poland has already consolidated seven smaller businesses. Infracapital in Germany, meanwhile, was itself created through the consolidation of two leading regional alternative network providers.

At Infracapital, we have also recently executed a NetCo-ServCo split that will help in realising cost savings and improving performance, and also positioning the asset to acquire further businesses.

Looking ahead, we expect the pace of consolidation to accelerate, driven by a number of factors. These factors include incumbent operators increasingly looking to defend market positions; less availability of financing and at a higher cost; and other inflationary pressures – all of which can be mitigated by increasing scale.

**Q How do you approach ESG in the digital infrastructure space?**

At Infracapital, we see ESG as a value-enhancing lever in its own right and therefore responsible investing is

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critical to our strategy. Most people think about the ‘E’ of ESG but the ‘S’ is equally important. That is one of the reasons why there is so much government support for rural fibre networks.

Rural fibre networks bring considerable benefits to communities, whether it is access to essential services such as online banking, or the ability to run businesses from those areas. Equally, on the environmental side, fibre networks are more carbon-efficient than copper networks, reducing pressure on transport systems by increasing the ability to work from home.

**Q Digital infrastructure became a hot sector through the pandemic.**

**How would you describe competitive dynamics today?**

There was a lot of dealflow during the pandemic. This was driven by the step change in investment required in telecoms networks and an increasing recognition from investors of the criticality of next generation telecoms infrastructure. This has resulted in some indigestion in the financing markets, which we are now starting to see work through, but this has meant we’ve seen reduced competition in some cases – creating interesting opportunities to invest.

**Q What do you think it takes to be successful in the sector?**

First of all, I would point to experience. We have been investing in digital infrastructure since 2011, and in that time, we have learnt a lot about what works and what does not. Following on from that, I would say a ruthless focus on the commerciality and economics of what you are doing. It takes time and diligence to build elements of the telecoms infrastructure ecosystem into assets that will generate long-term predictable cashflows. Most importantly, a focused strategy and discipline is key in how you define what digital infrastructure is as the sector continues to evolve.

**Q How do you expect the sector to evolve in the longer term?**

We are still only at the beginning of what can be achieved in a fully digital economy. You only have to look at some of the recent advances in areas such as artificial intelligence, autonomous vehicles and the internet of things. All of that is being enabled by next generation connectivity networks. There are going to be significant changes in the way we live and work in the years to come. But what we do know is that the world will become increasingly digital, and the infrastructure being constructed today is fundamental to that transformation. ■