

Staying Connected

While Arcus invests across a range of infrastructure sub-sectors, partners **Jack Colbourne** and **Christopher Ehrke** tell us why they see data and connectivity as the 'utilities' of tomorrow



Q Over the past years, we have seen telecom infrastructure become an increasingly mainstream asset class among infrastructure investors. What are the factors contributing to that trend?

CE: We see communication infrastructure as being increasingly crucial to how the world operates: from civil society, everyday life, and media consumption to communications, business processes, safety networks and critical infrastructure.

I think quality communication infrastructure is clearly seen today as an enabler – or in the absence of it, an inhibitor – to economic growth. The importance of that is increasing as is the speed at which there is a growing reliance on those networks.

Some of the key aspects of this trend include an increasing dependence on wireless networks, rapidly expanding data storage needs, necessary upgrades to fixed networks and the move towards fibre. As well as the evolution of surrounding machine-to-machine communications and the future needs associated with smart city solutions. So, you might say that data and connectivity are the 'utilities' of tomorrow, the way electricity and water are the utilities of today. All these needs, that require a large volume of investment, also mean there are more investment opportunities to go around.



Christopher Ehrke

To give you an example of the size of the opportunity – it's estimated that €55 billion of investment is required per year to achieve the EU's digital agenda targets.

Q Do you think telecom infrastructure has the inherent characteristics that make it suitable for long-term infrastructure investors?

JC: We think that there are aspects of telecom infrastructure that certainly do display similar characteristics to, for example, power, gas or water distribution grids, having natural monopoly characteristics. And then there are other parts within telecoms that categorically aren't like this, but are highly competitive and fast-changing.

So, our job is to accurately ring-fence and invest in those assets that qualify as infrastructure with the same characteristics as we would expect to find in, say, a road or power network. And that is the art of it for us.

Q What, then, would you consider to be outside that ring-fence?

CE: One example might be data centres that in some cases don't have particularly high barriers to entry. Maybe they're located where they can be easily replicated or maybe they're not well-placed for particular customers. Maybe they're subject to competition from some of the larger players or maybe they're constructed in such a way that they become outdated too quickly in terms of the technical specifications.

In short, you have to be careful to select assets that don't bear these kinds of technology or substitution risks, from a planning, location and technology perspective.

Q What about regulatory risk? Is that something that worries you?

CE: We don't see telecom infrastructure as an over-regulated sector; on this point, it's worth noting that we are also generally focused on 'open-access' infrastructure that can serve all telco operators, which is something regulators generally favour. So, the current situation is OK for now, but perhaps the risk of further

regulation is a space to watch as we move into a new phase of investment.

JC: Also, let me just add that there's a relatively settled regulatory position from the EU competition authorities, and this stance percolates down nationally. Most regulatory attention in practice focuses on national incumbents, such as Deutsche Telekom, British Telecom, OTE, and so forth, which are always judged to have significant market power, and are usually forced to open up elements of their physical network to competitors.

But, for the infrastructure specialists investing in tightly defined groups of real assets, these generally haven't been subject to much regulation. Equally, in terms of the defensive nature of some of these assets, regulation with a small 'r', such as local planning or local ordinances around building permits, has often been quite helpful in terms of mitigating or slowing the rate at which competing overlaying assets can be built, as well as generally encouraging end users to share assets that we own.

Q What is Arcus's track record and experience base in the telecom infrastructure space?

CE: We were an early investor in telecom infrastructure, and have deep, long-dated experience in the telco space which goes back to the beginning of some of our founding members' careers. I think within telecoms it is key to think about technological and demand risks and to try to avoid these as much as possible with your choice of assets.

JC: Some of us spent most of our early career investing in both fixed and mobile telecom operators, so downstream of what we're doing now. And I don't see how you could effectively want to be a supplier to those players, which is what we are when we provide some aspect of infrastructure that they need, without understanding their business extremely well. These downstream businesses are complicated and changing all the time and haven't necessarily exhibited great profitability, which is not ideal, but, in the end, they are different businesses from where we are now focused.

The big fixed and mobile telco opera-



Jack Colbourne

tors, and to some extent also the national broadcast incumbents, are constantly looking around for different ways to do things, and are subject to a significant amount of technological change. That, more than anything else, is why historically many infrastructure investors have found telecoms generically all a bit complicated. By contrast, we see value in well-defined pockets among the complexity, and this arises from having a good understanding of how these sub-sets fit into somebody else's operation, that is ultimately what we're talking about.

Q Aside from your telecom experience that pre-dates Arcus, you've also invested in the sector through your first fund and separate accounts. Can you elaborate on those investments?

JC: The first telecom investment in our first fund was Shere, an independent owner of communication towers in the Netherlands and the UK. Our initial involvement actually pre-dated Arcus's formation in 2009, so we were involved in the company for around 12 years. It was a buy-and-build investment thesis. The business grew about 10-fold between the first investment and 2016 when we sold it, through a mix of organic growth and M&A, both big and small. Shere was a classic example where we felt that the stable cashflow arising from towers – initially in the UK and then the Netherlands – was mispriced and had both better defensive characteristics and better upside potential than

the market was really giving credit for at the time. For Shere, we bought every site that we could for as long as we could, provided that it met a lot of other reasonably demanding technical and locational characteristics. We were actively looking for towers that were genuinely hard to replicate – that was very important to us – and to do this, it had to happen on a tower-by-tower basis.

CE: When we decided to acquire TDF, which is the largest broadcasting tower infrastructure operator in France, we saw fantastic potential. Above all, TDF has unique sites, and very strong and experienced management. It also helps that the company operates within the very strong French broadcast ecosystem, and TDF is well embedded at both a local and national level.

When the asset was put up for sale by its private equity owners, it was over-levered and, as a result of that, maybe not enough attention had been paid either to customers or to long-term strategy, as there were pressing short-term needs. We saw the long-term infrastructure nature of the asset which went beyond its particular trading position as of 2014 or 2015 – TDF has a very strong infrastructure position that is increasing as there is an increased reliance on data networks.

Since investing two years ago, we've really focused on an active asset management strategy and, I think, turned around the perception and engagement that we have with the customers. We've opened up the business significantly and really engaged in understanding and accompanying the needs and requirements of customers.

TDF is also a good example of the way that Arcus does things more broadly, which entails a very diligent, value-add, hands-on approach for asset management coupled with real sector knowledge. We prefer assets that need this approach, and that require that high level of attention and focus, and which, finally, can respond to the value-add that Arcus can bring to its investments. ■

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