

'This is a historic decade for fibre'

Jack Colbourne and **Christopher Ehrke**, who jointly lead the TMT sector team at European mid-market manager Arcus, walk us through the evolution of the European telecoms market, the emergence of new asset classes and why fibre is the most future-proof technology

Q What attracted you to telecoms infrastructure 15 years ago?

JC: We mostly come from a general infrastructure background, but there are several people within Arcus who have spent more of their careers investing around telecoms, including telecoms service operations, such as mobile operators or fixed network operators. So, in a way, we've kind of gone upstream.

Originally, we got into telecoms infrastructure because we felt that, before the global financial crisis, we were in a very overheated infrastructure market and we were looking for assets that were underappreciated for one reason or another. At the time, telecoms wasn't really on the radar for most infrastructure investors. We thought that you could identify or somehow 'ring fence' sub-systems or asset pools of the wider telecoms picture that had characteristics that were more like infrastructure and less like telco service operations, which we know from experience are more volatile and often subject to really high levels of competition.

Typically, the elements we were looking for were a bit buried within bigger phone or mobile phone companies, but had these defensive or near-monopoly characteristics we were after, often in the context of access networks, whether fixed or wireless.

Q How has the sector changed over this time period?

CE: Over the past 15 years we've been investing, there's been a significant upgrade in telecoms infrastructure. We've gone from relatively basic low-bandwidth fixed networks and much more sparsely populated 2G mobile networks to ever more densified fixed and mobile networks

that are a lot more reliable, and consistently deliver improved performance in line with customer expectations.

That evolution, coupled with the continued explosion of data and connected objects, has led to the confirmation of new asset classes over time, including data centres, fibre networks and, in the near future, smart city networks, which didn't really exist back then or were nascent. But the principles for identifying good telecoms infrastructure assets remain the same – it's all about avoiding technology risk and making sure you've identified and are investing in the underlying infrastructure, which is mostly involved in delivering access.

“Ultimately, we believe that fibre is a relatively future-proof technology”

Ehrke

Moreover, today's customers are similar. We're still dealing, in a vertical way, with the mobile network operators who are now offering other services, not just mobile telephony but also internet-bundled products delivered over both fixed and mobile links. The operators have been under significant pressure over this period to provide more for less from a retail perspective. That, coupled with this proliferation of

networks and requirements, means that the operators are under significant pressure on the investment side, and this unlocks investment opportunities for long-term fund investors such as ourselves.

Q Fibre roll-outs seem to be generating considerable dealflow across Europe. How attractive is that opportunity?

JC: Fibre has been around since the late 1970s in long-haul networks, and there was a boom of deployment in the 1990s that didn't end well. But the nature of what was being laid down then was different, and fibre wasn't being built out to every house.

For most of Europe, this is only the third local network to be built since electric communications began well over a century ago. In most streets in much of urban Europe, there will be a copper line, a coaxial cable TV line, and now a fibre line. So, this is a historic decade in terms of the development of new fibre networks deployed on a very wide scale, and requiring very large amounts of investment.

CE: Ultimately, we believe that fibre is a relatively future-proof technology. If you look at fibre-to-the-home, there's a significant opportunity in Europe and there's a significant difference in network penetration between the various countries, with some notable laggards such as Germany and the UK. In particular, there are certain European countries where governments have struggled to date with how to incentivise fixed-network upgrades, given strong and reticent incumbent telco operators, and that has meant that fibre roll-outs have probably not progressed as quickly as required.

As a contrasting example, France has



Christopher Ehrke

been running a well-organised regional concession auction programme for rural areas over the past couple of years that will drive a relatively fast build-out of fibre-to-the-home across the country. The French incumbent, Orange, is also actively participating in this programme and is now publicly saying it will ultimately be moving away from copper.

JC: To give you an idea of scale of what is happening in France, our investee company TDF, where we manage a 45 percent equity stake, is by no means the biggest player in fibre, but all the same is implementing deployments for about 720,000 homes passed under this state programme – that’s larger than any implementation that is actually under way in the UK today or, we believe, in Germany.

Q You mentioned there are significant differences between the various European countries. Can you expand on that?

JC: Actually, in some respects, European countries have a lot of similarities, in that they operate pretty much the same technologies, but often at surprisingly different stages of evolution. Virtually every European country now will have either a completely or largely privatised state-owned incumbent, but the kinds of opportunities out there vary, depending on the history



Jack Colbourne

of these companies and sectors. For example, countries such as Portugal and Estonia have very high penetration of fibre-to-the-home, while other big countries such as Germany and to some extent the UK, have next to none.

Similarly, the current main delivery method of broadband varies markedly, and a lot of that has to do with the historic penetration of cable TV across these economies. Cable TV networks have been extensively reconfigured to be able to deliver broadband in some countries, and generally provide today a superior product to copper, even though they weren’t originally designed to deliver two-way communication.

Q You mentioned data centres, which are relatively newer assets. Would you invest in them?

JC: We would. In fact, we’ve done them in the past, but we don’t have any right now, except through TDF, which is predominantly a broadcast and towers company but has a small number of regional data centres they operate.

We think data centres are a slightly hard asset class to get right. They’re quite specialised, surprisingly, when you think that they’re pretty much all big boxes with lots of racks of equipment, generators, cooling equipment and so forth. But

as investments, some have gone very well and some very badly, very often driven by being subtly wrong technically, or not well located in ways that may have not been immediately obvious when someone pushed the ‘go button’ on the investment. So, in principle, it’s an area we’re quite interested in, but also one where we will tread carefully and rely quite heavily on local experts for some of the assessment.

Q Some institutional investors, such as OPTrust, for example, are taking a lead in investing in telecom assets. Why do you think that’s the case?

JC: I think they may well be interested because they perceive value in telecoms that they’re not seeing in other sectors. In today’s market, if you want to buy a water company or a gas distribution network, you really do have to pay up because they are well-understood assets and they are perceived as low risk – in essence, there’s mainly regulatory risk and not much else.

CE: I would also add that intelligent institutional investors today understand that there are big underlying market shifts influencing developments in the infrastructure world.

In particular, we are all very aware of digital disruption. In that sense, I think many investors are coming to the conclusion that telecom networks are a key enabler for many other anticipated developments in the infrastructure space, including catering for the changes that will be brought about by decarbonisation and expected changes in demographics. They understand that holding a portfolio of telecoms investments is, to some extent, a bet on a rising tide, which may not come in as fast or as evenly as we all might like, but nevertheless is a good prospect for solid returns from long-life assets. In the end, that’s what we’re all trying to do here. ■

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