KEYNOTE INTERVIEW

Communication is key

The outlook for digital infrastructure investment is brighter than ever for those firms with origination capabilities and strategic expertise, says managing partner and founder of Palistar, Omar Jaffrey

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Q What impact is the economic environment having on the overall attractiveness of the communications infrastructure sector?

The communications infrastructure sector remains a great space to invest in given the macro demand and supply trends, growth in usage of mobile data and need for faster connection speeds both at home and at work. We continue to see an excellent market environment. However, 'market valuations' have indeed pulled back for the sector when looking at publicly traded comps, in sympathy with the broader market. Still, there are pockets where valuations have been resilient, such as the tower and data centre spaces in the US. But, overall, the picture is one of declining valuations, which is attractive for firms like us, given the longer term strong tailwinds for revenue and profitability growth in the sector at large.

Access to capital is now an area of concern, with interest rates continuing to rise. But, while funding will be more challenging for business plans that are pushing boundaries, capital does remain available for more stable opportunities, albeit at higher requested returns.

A few years ago, one could borrow at 3 percent; today that same credit will cost you closer to 6 percent. This does impact the investment thesis on the margin, but given our greater than 10-year investment horizon, we still see plenty of compelling investment propositions in the market and we are leaning into this economic environment to buy great assets and businesses, and provide funding to the same.

Q What are the most interesting trends in the communications infrastructure sector today?

Top line revenues continue to grow in the sector generally, and the sector has proven that it remains uncorrelated to the market at the top line. It has, of course, benefited from the challenging covid environment of widespread home working and learning. Connectivity and – importantly – resilient connectivity, has been crucial. On top of that, the US federal and state governments are enabling investments in the sector

– see the $65 billion broadband plan. Although cost of debt and availability of capital are more challenging, being a creative investor in a sector with strong tailwinds is a winning strategy.

Q What are your views on the impact of satellites on traditional communications infrastructure?

Throughout my career, I have had a front row seat to various iterations of satellite-related opportunities. To me, satellite represents a phenomenal component of the digital landscape, but not a replacement for terrestrial infrastructure.

Satellite is fantastic for getting to areas where terrestrial infrastructure does not make economic sense – it is a gap filler. But it is challenging to replace existing terrestrial fibre and towers with satellite, which is considerably more expensive.

Latency is also substantially better with terrestrial infrastructure, as satellite technology is limited by physical separation as well as bandwidth. We have looked at a lot of satellite companies, but have not yet invested in any. We find terrestrial infrastructure to be the higher impact opportunity, currently.

Q What are you seeing of the interplay between fixed wireless and fibre, and how do you predict that will evolve going forward?

If you can economically get fibre to a location, then that is typically the best option. It allows for meaningful throughput, great stability, high speeds and low latency. It is not always easy to connect premises with fibre, however.

For example, in New York, it can take years to get zoning permission to simply cross the street. There are players using microwave connectivity from rooftop-to-rooftop, which allows them to turn on gigabit connectivity in 48 hours. That represents a deployment speed advantage over fibre.

The cost of fibre deployment, meanwhile, is linked to distance. It may not be economical to run fibre over long distances, which is where President Biden's $65 billion broadband plan comes in, providing subsidies to support fibre roll-out in more remote locations. The beauty of wireless is that distance does not affect costs. There is also new spectrum available for wireless today, alongside new technology, leading to speeds that are now on par with fibre.

The drawback to wireless, however, is that it is susceptible to interference from the weather and obstacles such as buildings and trees. Overall, I view wireless as an attractive complement to fibre, and we are actively looking at wireless investment opportunities.

Q How did the covid-19 pandemic emphasise the importance of ESG within communications infrastructure?

The covid-19 pandemic revealed the important social benefits that communications infrastructure can bring. Access to broadband, for example, became critical for education, work and human interaction, and the sector's positive impact has become increasingly well understood. It is important, nonetheless, that all portfolio companies have ESG ingrained in what they do.

We have found that because of the real estate characteristics of many of the assets we back, ESG is already prominent in corporate DNA. We are there to help them improve their practices even further and provide training to help establish ESG champions within our businesses. ESG is something that we lean into.

While communications infrastructure has inherent social value, its environmental credentials are often criticised. We work with portfolio companies to help them understand what it means to be net zero and encourage good corporate citizenship in terms of giving back to communities, for example.

Diversity and inclusion is also important to us. Palistar is a minority-led firm with a 40 percent minority senior management team, so our management company is highly international and diverse. ESG is a term that is used prolifically, but it is something that is genuinely ingrained within our organisation, and has been for a very long time.

Many of the companies involved today, however, are still scaling and are relatively small.

Q What opportunities do you see within the distributed antenna system (DAS) and small cell infrastructure sectors?

I think small cell opportunities depend on the topography of the region and what the macro-wireless infrastructure looks like. The US is a big country with a lot of land mass, which is different from nations such as Japan and Korea, which have very dense populations.

Where people have plenty of elbow room, a macro network will typically suffice. Small cells are used to fill in where the macro network becomes overwhelmed. For example, such infrastructure exists in New York on the corner of 42nd Street and Broadway. However, these are an adjunct to macro and not a replacement.

We have looked at a few opportunities, but have not yet invested. I think the small cell market will become increasingly attractive as macro networks become more congested due to a lack of incremental spectrum. A DAS, meanwhile, is used in venues such as stadiums and hospitals, where you get a significant amount of human traffic.

Q You primarily invest in the US. Why do you see this as an attractive market relative to other geographies around the world?

It is true that everything happening in digital infrastructure in the US is also happening elsewhere in the world, albeit at different stages of maturity. The US, however, enjoys the highest revenue per customer for wireless. The average revenue in the US is $60 a month. In Europe, it is half that sum and in Asia, the average revenue is approximately between $5 and $10. That purchasing power is also a good indicator for other subsectors. The US is substantially more profitable on a per user basis and that allows companies to be more vigorous in their capital deployment and to push through more innovative advancements.

The US is a market with 300 million people, plus 100 million vehicles, as well a strong legal system – all factors that combine to create an excellent backdrop. When we assess opportunities in other geographies, we must evaluate the same elements. Is there enough headroom for local carriers and service providers to deploy capital in a vigorous fashion? What is the competitive framework like? What is the local legal and regulatory environment like?

We are starting to think about investing internationally; but, taking all these factors into account, we will start to explore OECD countries first. Despite instances of growth, we aim to provide stable and enduring returns to investors, and so emerging markets are not for us.

> *"As spot prices have come under pressure and costs have increased, there is more demand than ever for a competent, durable partner"*

Q What about the relative appeal of different risk profiles in the communications infrastructure space?

You can choose to invest in hyper-growth communications opportunities. You can invest in turnarounds and push value through the business plan. Or you can invest in asset-rich communications businesses.

There are a lot of exciting developments taking place in younger, high-growth communications companies, but they involve considering several different types of risk, from market and competition risk to regulatory and technology risk. That is appropriate for some, but it is not our investment thesis.

Q How would you describe competitive dynamics in that core space, particularly as generalist funds increasingly pursue digital infrastructure investment?

I think the appetite we are seeing from generalist firms is a positive verdict on the communications infrastructure ecosystem. It must not be forgotten that it is an enormous ecosystem; there are five million towers around the world. Almost $140 billion is invested in data centre infrastructure each year. There is a $1 trillion investment opportunity in digital infrastructure, so I think there is more than enough room for everyone.

I would add, however, that there is less competition in the mid-market where we operate. We focus on more complicated, partnership-style opportunities and are viewed as a strategic player.

We are highly selective about our own proprietary deals, which we spend a lot of time and energy sourcing. We have evaluated 150 transactions over the past three years and have completed four. It is great there is so much capital targeting this industry because the needs are growing. As spot prices have come under pressure and costs have increased, there is more demand than ever for a competent, durable partner. ■