

## KEYNOTE INTERVIEW

## Lighting the digital fuse



*US digital infrastructure stands head and shoulders above the competition, says Palistar Capital's Omar Jaffrey*

Digital infrastructure has evolved quickly over the past 20 years, with the emergence of smartphones, cloud computing and now flexible working, which has spurred investment into an industry that is constantly growing. This is particularly true of the US market. Famed for Silicon Valley on the West Coast and the continent's largest data centre market on the East Coast, digital infrastructure in the US is consistently adapting to meet consumer demand.

Omar Jaffrey, managing partner and founder of alternative assets manager Palistar Capital, discusses why investors are targeting the US market and which factors will most likely shape the asset class over the coming years.

**Q** How has North American digital infrastructure performed over the past year?

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From a demand perspective, the outlook continues to be rather positive. Data usage continues to grow at about 30 percent a year on the consumer side and, in many instances, there is a shortage of supply capacity or adequate speeds. The unique position of digital infrastructure is that demand for services is accelerating rapidly. At the operating level, most subsectors are performing well.

As a result of the strong fundamentals, there have been high value expectations in our sector. But the market is evolving, and over the past 12 to 18 months, as inflation rose and as interest rates were risen in response, we have seen a change in the availability of capital.

Debt capital, for instance, has become more expensive, or dried up in some cases, and as a result some businesses have had to rethink their growth plans. These types of market disconnects are now presenting opportunities for patient and nimble investors.

Conversely, well capitalised firms that have stable or growing free cash-flow profiles are doing well, supported by the demand environment. Tower businesses, for example, have continued to do well operationally, and we are not seeing valuation compression in private M&A in the tower market, where assets are both growing and benefiting from their inherent stability in an unpredictable macroeconomic environment.

**Q** What are the main factors driving growth?

One factor benefiting digital infra-

structure was that general infrastructure was severely impacted by the pandemic when everything came to a halt and we all moved online. At the same time, the shift highlighted a digital divide across the world.

In the US, even in New York City, there were children that could not be schooled from home because of inadequate internet. The reaction to this was president Biden's mobilisation of \$65 billion, included in the Bipartisan Infrastructure Deal, to bridge the digital divide and improve internet access.

Today, we are seeing a big push to build out connectivity either by fibre, cable or through wireless to people and communities outside the bubble of appropriate internet coverage. The recognition is that there needs to be more infrastructure for wireless, broadband and data centres; at the same time balance sheets are stretched and funding is limited. This is where firms like Palistar can step in to provide needed capital and unique funding structures.

### **Q How is the rapid evolution of AI influencing the asset class?**

Generative AI is going to be a game-changer. It might still be early days, but it is clearly going to require different kinds of data centre infrastructure.

Generative AI is going to need two types of data centre infrastructure. There is going to be a training/creation element for the models (large facilities in low-cost rent and power locations but with good telecommunications access) and then there needs to be deployment/distribution in real time (smaller facilities, likely closer to end users and less sensitive to power or location costs).

These will likely be in addition to current data centre demand, not instead of, and will require significant upgrades to the fibre and wireless infrastructure to connect them.

However, a proverbial Achilles heel could be the availability of power. There is going to be a great deal of

### **Q How is the sector looking to offset its increasing carbon footprint?**

We have been principally invested in the wireless business, so have very low energy consumption and no water consumption. Our carbon footprint is therefore very limited. Having said that, we constantly challenge ourselves on how to provide the best assets and services to our clients with the lowest carbon footprint, while at the same time helping them to minimise their own.

We have been experimenting with wind, solar and other sources of green energy, as well as battery storage at the base of our towers, to give customers an alternative energy option, as well as to make our towers more efficient. This is something we are actively working on and where the industry is heading – for green energy reasons and economic reasons in a high energy cost world – and we will be partnered closely with our customers and key vendors to enable these evolutions.

As an industry, we need to think about what more could be done, and we think that is happening as people consider colder climates for some deployments, to decrease cooling needs, or alternative uses for heat, such as district heating or even greenhouse.

In our higher carbon intensity subsectors, like data centres, we will continue to analyse and take these into consideration as part of our investment decision, as we have so far. Without a doubt, there will be some legacy assets where it will not be easy to retrofit. Generative AI will also require a greater focus on liquid cooling, and that comes with its own set of environmental challenges.



pressure on the already strained power infrastructure.

The remaining pieces of the puzzle will also need to fall into place, including the design of the next generation of data centres (less space, more power per square foot), the placement of the appropriate fibre, and the mechanisms to deliver and distribute to the mobile environment.

Generative AI is going to be a bit like the Gold Rush. We will not be the ones digging for gold but supplying the picks and shovels, as it were, to the hyper-scalers. The inventors of this new

type of AI will need more infrastructure and data centre space, and our job will be to provide the connectivity.

### **Q Do you think this will change where future data centres are built?**

It is unusual that the US data centre market is still so centred around Northern Virginia. Other markets have developed, but it is still very Northern Virginia-centric, although this has recently started to change given power limitations in that market.

In the future, the industry is going

*“Now is the time to be a solutions-orientated capital partner for corporates and customers alike”*

market and, while capital is now more expensive, it is still available. As a contrast, capital is difficult to access in emerging markets and in Europe.

Access to power has changed since the Russian invasion of Ukraine. That has turned everything on its head: the US is probably in the most advantageous position.

**Q Where do you expect to see the best opportunities emerge for digital infrastructure investors over the next few years?**

Densification is a key theme. At the end of the day, you want to provide connectivity to customers, make sure that quality is high, and retain customers.

The wireless market has been dramatically altered since 2020 by the Sprint and T-Mobile merger. Prior to that, there were two large incumbents in AT&T and Verizon and two national but smaller players in addition to a few regional providers. Now there are four – with DISH being the fourth – well-capitalised and invigorated national players facing pressure to compete for customers and provide the best service.

From our conversation with end users, there is a need for better connectivity in metro environments. Human beings are always on the move and metro areas require more connectivity and denser networks. Metro areas are under pressure to provide millimetre wave spectrum, C-band spectrum and deploying that effectively means densification.

In the suburbs, wireless has become a good alternative where broadband fibre and cable might not make economic sense. Broadband connectivity is getting densified using wireless, and we are seeing that through the emergence of wireless internet service providers.

Another form of densification is the resiliency of the network. The US government recently built out FirstNet, a wireless network for first responders, with the help of AT&T. There

are additional use cases like this that could be done to provide connectivity and high-quality service. For example, we are seeing interest in densification by layering in a new spectrum that has higher frequency and runs over short distances.

And, as we discussed before, the decentralisation of some of these data centre and fibre networks is a massive opportunity.

**Q What are some of the main challenges for further growth?**

There is a mismatch today between enormous infrastructure need and availability of capital. Virtually every company is feeling pressure on the debt and equity side. We are trying to navigate that and find ways to invest capital to take advantage of the growth environment and an improved risk/reward environment for capital across many digital infrastructure subsectors.

Companies are looking for long-term, trusted partners, but that is the handbrake on the ecosystem. Interest rates have gone up and equity investors are generally being more prudent and judicious. We believe that now is the time to be a solutions-orientated capital partner for corporates and customers alike.

There is also some balance sheet breakdown, so one has to be very thoughtful. There have been misfires over the last few years with several exuberant investments. However, the healthy part is that the current environment allows us to pick and choose among our best ideas in an otherwise capital-constrained environment.

Digital infrastructure is a complicated industry with many technical and regulatory elements. We understand that and have benefited from being sector specialists. When interest rates were near zero, many firms were chasing the space, but in today's tougher financial environment, LPs want managers that have been through past cycles and have that experience. ■

to have to think about where to put AI learning centres and distribution centres, how to access power, and overall operating costs – both economical and environmental. Operators will have to think about access to cooling, as well as tax implications and whether local municipalities will play ball. Combined, we are going to see even more activity in the secondary/tertiary markets and a new, more distributed data centre network, not only by necessity, such as that lack of power in Northern Virginia, but also by use case and economics.

Fortunately, the US has a vast