

KEYNOTE INTERVIEW

The power of connectivity



Communications infrastructure demand has skyrocketed in the face of covid-19, fuelling long-term tailwinds, says Melody Investment Advisors founder and managing partner Omar Jaffrey

What are the key drivers behind the growth of communications infrastructure?

On the demand side, all of us are using communications infrastructure more and more each day. As an example, we each now carry multiple connected devices. Enterprises need to connect vast amounts of their data to clients and employees who are all ever more mobile. Cisco forecasts in its annual report that the number of devices connected to the internet will be 3x that of the earth's population by 2023 and that 5G speeds will increase 13x by 2023 to 575 Mbps. This incredible demand requires enormous digital infrastructure capacity.

Meanwhile, the supply of communications infrastructure remains limited in terms of macro towers, fibre, data centres, small cells and spectrum.

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Investors around the world recognise this widening gap between supply and demand. They also recognise that investments in this area are highly sustainable and resilient.

Another important trend to point out is outsourcing. For the past three or four decades, communications assets have tended to be owned on balance sheets by corporate users such as the wireless carriers and phone, cable and technology companies. Even financial services firms tended to want to own their data centres and control their fibre assets/connectivity. But now, they are more likely to share. All these factors are coming together to create

a very strong environment for investment that is likely to last for at least the next 10 years.

What sub-segments are you focused on? Why do you believe they are attractive?

We focus on four verticals at Melody: telecom easements, which are direct ownership of land and rooftop easements for cell site leases; tailored solutions for macro towers; carrier partnerships; and data centers and fibre. By way of background, digital infrastructure starts with wireless spectrum where, in the US, you have just had a very robust auction for Citizens Broadband Radio Service, which is what ultimately enables mobile communication. This service then connects to physical infrastructure – the towers and small

cells – which then connect into fibre and data centres. Finally, the overlay of all that is satellites, which connect the otherwise unconnected nooks and crannies of the world. These assets are both local and global.

That is the broad landscape. And each of the areas – spectrum, towers, small cells, fibre, data centres, satellites – all have slightly different regulatory and technical dynamics, as well as different supply and demand fundamentals. Melody focuses on areas that we believe provide durable, long-term returns with strong counterparties. We focus on longer duration assets, with less operating and capital expenditure intensity, strong downside protection and stabilised cash yields. With that in mind, our bias is towards wireless infrastructure in the stable, dollarised North American market with a specific focus on our four key vertical areas.

You may have noted the recent debate created by Elliot Management in its challenge to Crown Castle regarding the latter's move into fibre. In Elliot's presentation, the macro tower business was referenced as the "best business ever" by Wall Street analysts. We agree – we think the communications infrastructure ecosystem is rather unique and offers strong, durable returns with growth well into the next decade as we go from 4G to 5G and then 6G.

What are the advantages and disadvantages of being so specialised?

In order to be so focused, you obviously have to be bullish on the space in which you are operating. In our opinion, digital infrastructure offers a \$1 trillion-plus global investment opportunity. We specialise in this area because we believe it is where you want to be. Just look at the impact that covid-19 has had on toll roads, shipping, airports, airlines, travel and leisure, retail and real estate. All these were supposed to be safe and "uncorrelated". However, as we have now experienced, if you want true resilience and

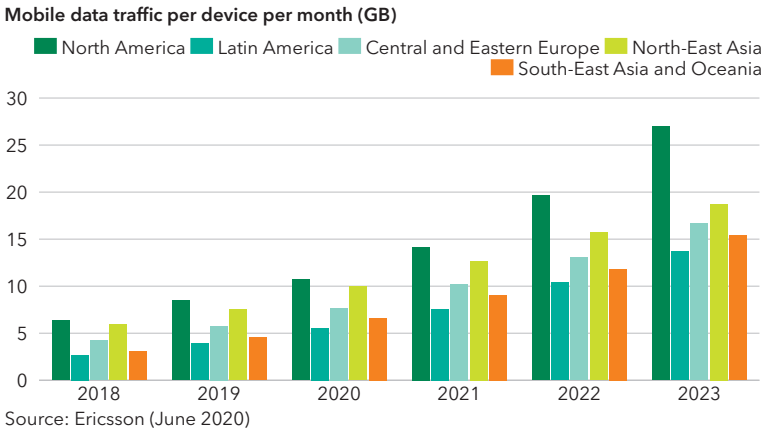
The communications sector has benefited during covid-19. How long do you expect this tailwind to last?

For digital infrastructure, there has been an absolute skyrocketing of need. Zoom and other comparable stocks are up 200 to 300 percent this year. We are seeing a significant pick up in investments across the entire digital infrastructure landscape.

But, at the same time, we are in a human interfacing/high touch business. Communicating with LPs and making investments has had its own set of challenges over the past six months. We had never done virtual eight-hour diligence sessions via Zoom before. However, it has worked – sometimes awkwardly – but it has worked.

Doing multi-hundred-million-dollar acquisition transactions has also been challenging, as we are used to face-to-face assessment of management teams and business plans. Nonetheless, I feel we have done a good job of evaluating, diligencing, underwriting and even closing deals in the covid-19 environment, including two very complex large transactions. There was a pause back in April and May, but now we are just powering on through.

In terms of our assets, the construction slowdown in various markets did create some initial stress. There were players out there desperately wanting to upgrade their infrastructure, but covid-19 restrictions meant the local environment was challenging and human capital was not available. Now, however, we are effectively back in full swing. We have seen no degradation of revenues at an asset level. In fact, there has been a meaningful uptick. People have realised the weaknesses that exist in their digital infrastructure and they are working to ameliorate those weaknesses. That has been a positive trend for us.



uncorrelated investments, then invest in digital infrastructure, where there is a decade long tailwind at least.

Within digital infrastructure, you need to start making your picks. Over the past year, we have looked at more than 100 transactions. We have done three. You have to be thoughtful about what it is you want to do and where you want to place your personal capital and that of your LPs. In doing that, everyone has a different risk/return prism that they look through. There are transactions that we leave to others in order to focus very narrowly on those where we believe we can add real value. If there are situations where we don't think we can bring a lot to the table – where it is just about money – we will tend to back off. There is no doubt that

more generalist infrastructure funds are starting to recognise the value of digital infrastructure, which is why we see so many leaning into this area. But there are a huge number of regulatory, technological and strategic vectors to understand and risks to unpack, which is why we believe domain expertise is needed. Various layers of customer demand, local environments, technology and regulations need to be properly underwritten.

We think we are specialising in the right area and we think we are specialising at the right time. LPs value this specialisation as well. Being generic in this space results in the loss of a lot of the layers of both risk and reward.

Q How much differentiation is there in communications investment strategies?

If you invest in ports, ports all tend to be similar in structure. Highways don't vary all that much. But digital infrastructure is nuanced and so you do see differentiated investment approaches. For example, there are areas that are more tech centric. That tends to involve more of a growth equity type risk. Then there are areas that are very operationally intensive – requiring high levels of human capital. That is more of a private equity play. Then there are the areas that mimic infrastructure – long duration, strong counterparties, high free cashflow margins and strong downside protections. That is where we focus – looking to reposition those assets to drive strong returns.

Q Will other sub-sectors ultimately be viewed as viable investments?

Things like smart buildings, smart roadways and connected cars are going to change our whole approach to infrastructure. Automated vehicles will be using both road infrastructure and digital infrastructure. We will be moving away from a siloed approach to a point at which all infrastructure will have an overlay of connectivity. That

“The communications infrastructure ecosystem is rather unique and offers strong, durable returns”

is, in part, why we are seeing so much interest in wireless spectrum. Shopping malls, arenas, airports, roads, ports – all those traditional infrastructure assets – are going to require huge amounts of digital infrastructure to keep track of goods and human capital.

Q Why do you favour the US over other markets?

Canada is a very attractive market, but it is only around a 10th of the size of the US. Mexico also has its own opportunity set, but obviously there are FX issues that need to be dealt with in that region, plus different regulatory and political environments. That is why all our investments to date have been in the US.

We are open minded about where we invest within the US market because generally the regulatory environments and counterparties are very similar across the various states. It is because of that homogeneity of regulation and technology, as well as the

“If you want true resilience and uncorrelated investments, then invest in digital infrastructure”

single currency and rule of law, that we find the US more appealing than other geographies. Furthermore, the US is the global leader in telecommunications and 5G investment.”

Q Is there technology risk associated with investment in this sector?

It is not technology risk, per se, but there is an awful lot happening in the ecosystem. There is a technology refresh from 4G to 5G that will have profound implications and it is important to understand what those implications are for your sub-sector.

Then there are the newer technologies being tested by the likes of Google around satellites, for example. You have to understand whether these developments are positive, neutral or negative for the areas in which you are looking to invest. There have been advances in optical cables and developments in the speed and throughput of other technologies. These are all things that you need to digest. It is important to lean on experts to help you navigate the changes in this complex ecosystem. But, for the most part, the direction of travel and the velocity of travel is positive.

Q What do you think the future holds for US communications infrastructure?

We are very bullish and expect to see many attractive investment opportunities. We have surrounded ourselves with world-class experts. We know all the key counterparties in the space and there is no doubt that this is an investment story that is only just starting to gather momentum.

You only need to look at the rising capital budgets. Carriers are bringing forward their capex plans, meaning that, even throughout covid-19, investment opportunities have been vibrant. These are trends that are not going to go away and we believe that for at least the next decade, communications infrastructure is the place to be. ■