KEYNOTE INTERVIEW

Not all data centres are created equal

Contractual revenue arrangements, ESG criteria and location are all critical for lenders in the data centre space, says Edmond de Rothschild's Jean-Francis Dusch

Major fibre projects are maturing, with a greater emphasis now on network extensions and consolidation between equity owners. The towers space is less active, yet although there are great opportunities, the same cannot be said for data centres.

With the advent of artificial intelligence, the data centre market is pretty hot. Selectivity is therefore paramount, says Edmond de Rothschild's global head of infrastructure, Jean-Francis Dusch. For infrastructure debt managers, this means a laser focus on contractual arrangements as well as location, particularly in Europe, where prime sites can be scarce.

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Meanwhile, sophisticated debt managers with true digital expertise are also scanning the horizon in a bid to identify the next digital infrastructure value proposition. The jury is still out on satellite, with question marks around quality of service and cost. But this emerging technology could yet become a competitor/complimentary offering to fibre further down the line.

Q What is the scale of the deployment opportunity today within the digital infrastructure market?

Digital infrastructure has represented around 20 percent of our portfolio for over 10 years now. As our team's head of digital, I am an ex-TMT guy, which is probably why we were one of the first infrastructure debt manager to embrace digital as part of our investment strategy, back when we set up our business in 2014.

Last year, however, digital infrastructure represented somewhere between 25 percent and 30 percent of our deployment. It could certainly have been more in terms of the volume of dealflow that we

Q Are there any lessons that the industry can learn from the challenges faced in the fibre space?

I started working in the telecoms industry when the first mobile licenses were being granted outside of the incumbents. At that time, business plans were something of a crystal ball gazing exercise, but the reality was that everyone ended up underestimating the potential of the market. With fibre optic broadband, the opposite turned out to be true, albeit not by such huge margins it could discredit the sector and the lending activity.

This is where experience matters. We have been and always will be conservative in how we size debt. There is always a buffer there and asset selection is also critical. There are so many parameters that have to be considered, including the nature of the addressable market, and I think our prudence has paid off in that our debt structures have remained viable and financial covenants met, even when assets have not delivered on the initial business plan. Of course, we held discussions about what we would do in the event of a default, about the risk of acceleration and the enforcement of security packages, but in the end that did not happen and the fibre assets in our portfolio continue to perform well.

It is important to always remain humble and not to assume you are better than anyone else, but above all, it is important to be selective. Over the past four or five years, there have been somewhere between 10 and 15 digital infrastructure assets that we could have selected. We chose the best five or six according to a strict set of criteria rather than jumping at any opportunity that came our way, simply because digital was deemed to be hot.

saw, but diversification is, of course, paramount.

Q How is the opportunity set for fibre evolving?

We are still seeing opportunities, although I would agree that it seems that we are nearing the end of a cycle in some core European countries. The fibre optics opportunities that we see today tend to be less about major capex than they have been in the past, and more about the extension of existing networks and consolidation. We still see some new fibre projects being developed in the Nordics, for example, and there is always some level of activity going on in other markets, be that Germany, France or the Netherlands. But, certainly, there is not the same degree of major roll-out that we have seen in recent years.

"It will certainly be interesting to see if satellite emerges as a viable alternative"

I do not see satellite as a threat – certainly not in the short-term – but it does represent a question mark on a five-to-10-year horizon. It will all depend on the quality of service provided and how cost-effective it ends up being to maintain these satellites once the network has been deployed.

Q How much appetite is there for towers?

Again, we continue to see opportunities in towers in relation to upgrades and refinancings, as well as a bit of M&A. But it is not the primary driver of our digital infrastructure dealflow as much as we see and invest in good proprietary assets. For example, we have participated in multi-billion euro deals such as KKR's acquisition of Altice's towers in France, but we also see much smaller deals. We are agnostic on size.

Q By comparison, data centres have been dominating dealflow in recent months. How significant a lending opportunity do data centres represent today?

The interesting thing is that up until around two to three years ago, we were still having to explain data centre investments to LPs. There was this concern that data centres were more of a real estate play. Clearly there are underlying characteristics to data centres that make them eligible as infrastructure and it is possible to structure investments in such a way that they fulfil the necessary criteria for an infrastructure finance-type deal. Of course, as AI has become a reality over the past year or so, the demand for data and for data centres has only grown.

Q What do you look for in a data centre and what do you try to avoid?

First and foremost, you have to be happy with the contractual arrangements, the quality of the counterparties and the revenue mix. It could be that there is a single corporate that has entered into a long-term contract or there may be a mix of clients. In that case, we would want to ensure, for example, that the top 10 to 20 clients represent the majority of revenues and that there is a history of strong contract renewals. This all speaks to the credibility and visibility of cashflows.

Then, when it comes to capex plays, in particular, location is extremely important. In the context of Europe, many of the strongest sites have already been developed and prime locations can be in short supply.

I would also point to the importance of working with experienced sponsors – owners that you know will take a long-term view. Generally speaking, we find that equity sponsors have been active in this space for decades and have deep expertise. They know which contractors and operators to use, and they have the necessary technical skills to develop and manage these data centres, as well as other digital assets.

Q What ESG considerations do you need to take into account when investing in data centres?

That is certainly an important point. First of all, we need to ensure that they are powered by renewable energy. That is the most obvious way to guarantee that data centres are aligned with our ESG convictions. But we are also seeing data centres play a role in the energy transition more broadly.

"Up until around two to three years ago, we were still having to explain data centre investments to LPs"

There is a huge amount of data associated with energy efficiency and the roll out of smart meters, for example. And when it comes to EV charging, you almost need a mini iCloud to manage those networks.

There is a huge amount of data management involved in these big transitional initiatives, which is just one reason why we are seeing countries announce hundreds of millions, if not billions, in support for the development of data centres.

Q Is the data centre space becoming overheated?

Not really, because that valuation risk is borne by the equity holders. Of course, we will not go after assets that have been overvalued, not least because in those circumstances the debt quantum we would be willing to offer might be unacceptable to the sponsor. The debt structure is something that is within our control, and we run our own valuations on assets and size the debt accordingly.

Q What new digital infrastructure opportunities do you see on the horizon?

It will certainly be interesting to see if satellite emerges as a viable alternative. I do not see it as a threat to fibre optic at the moment, but it is possible that it will play a role in the provision of data further down the line.

Having a seasoned head of digital infrastructure who has a deep understanding of all these technologies, as well as good relationships with equipment suppliers and financial sponsors across the digital infrastructure ecosystem, helps us form a view on what the next value proposition in the digital space will be and over what time horizon. On that basis, we believe it will be five to 10 years before satellite reaches a level of maturity where it could feasibly become a scalable investment opportunity. ■