

TRANSCRIPT: EPISODE 314

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[INTRODUCTION]

**Staci West (SW):** Welcome back to the Investing on the go podcast brought to you by FundCalibre. This episode focuses on the world of digital infrastructure including amplified demand and the pivotal role of digital infrastructure in emerging markets.

**James Yardley (JY):** Hi, I'm James Yardley, and today I'm joined by Tom Walker, fund manager of the Schroder Digital Infrastructure fund. Tom, thanks very much for joining us today.

**Tom Walker (TW):** Thanks for having me, James.

[INTERVIEW]

**JY:** Tom, last time we spoke we discussed how digital infrastructure has become mission critical to consumers, governments, and corporations. Can we start with a bit of an update about where we are for digital infrastructure? What are the growing demands and what's the outlook?

**TW:** Yeah, so I think the outlook is stronger than when we spoke about a year or so ago. And the real reason for that is the clear advent of AI and how that is going to become an essential part of our lives going forward. So, that has been a complete game changer for the digital infrastructure space over the last sort of 12 to 24 months. And what's interesting about AI and the increased demand that that's going to lead to, is that is on top of an already pretty bullish scenario where you've got exponential growth in data, you've got network bandwidth and latency issues, you've got security and privacy issues, and then sustainability, again, all kind of powering demand for this sector. So, AI really is making this digital infrastructure sector even stronger than it was 12 months or so ago.

**JY:** And can you unpick that a bit for us in your portfolio? So, AI, it's obviously transforming the data centre, I suppose, and I suppose a lot of these data centres are going to have to upgrade and there's going to be a lot of new data centres as well, presumably. How is this sort of benefiting your underlying holdings in the fund?

**TW:** Yeah, you are right. Data centres is absolutely the number one beneficiary today of artificial intelligence. What artificial intelligence is, is effectively these large language models giving us intelligence and they live in a data centre. So, as the Microsoft's, Amazon's, Meta's of this world look to build out their artificial intelligence infrastructure that they need, it is all in data centres at this point in time. And so that is absolutely the part of the portfolio seeing the greatest rental growth, the greatest demand for new data centres to come through, but also it's not going to end there.

What we think will happen is that artificial intelligence will eventually end up on your phone and there's going to be far more wireless communication to your phone, and that's going to have to involve the mobile phone towers. So, again, we're very positive when we think about the outlook for towers. And obviously, you know, the fibre that connects a data centre to a tower is also part of the portfolio. So, ultimately it's going to

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end up in more transmission, more information going through the fibre networks and then ultimately more being broadcast wirelessly from towers to people's mobile phones. So, at the moment it's data centres, but we think it's just a matter of time before we see that increased demand in other parts of the portfolio.

**JY:** Great. And one of the things of course we've had over the last couple of years is a huge increase in interest rates. It's been difficult for a lot of funds. I mean, how much has it impacted you and your companies and do you think you are set up to benefit from a lower rate environment?

**TW:** Yeah, interest rates have been a real sort of albatross around the neck of the sector really for two years or so now. We have seen - even before interest rates started to go up - because inflation was increasing, the cost of raw materials was also increasing. So that has just meant for a very long period of time now, it's a lot more expensive to build, just in putting together those raw materials that you need to build a mobile phone tower or data centre. So that's one element of the equation.

The other element, as you've mentioned, is interest rates and the cost it will now incur if you want to buy or build some new digital infrastructure, it's made it much less attractive to create that new supply. We've also seen a repricing of assets as interest rates have increased and valuations have therefore fallen over the last couple of years.

But what we believe now is that the listed market has priced in this new interest rate environment and we see very attractive valuations across data centres, towers, and then the fibre networks, you know, the market has priced ahead, they understand the new cost of finance and they're also, we think, attractively valued considering the increased amount of demand that's coming through for these assets. So yes, values have fallen over the last couple of years, but we think that they are absolutely in the right position now to generate strong total returns going forward.

**JY:** Can you give investors then a sense of the underlying holdings in the portfolio so we can get a bit of a feel for it? So, you've got exposure obviously to data centres, you've got exposure to towers, which are the phone masts presumably - what else is there in the portfolio? Is it primarily those two?

**TW:** Yeah, so data centres and towers form the bulk of the portfolio, kind of, you know, around 80% or so, 75%. We've also got fibre networks in there as well. You know, that is the kind of the inner workings of the lifeblood of the system if you like, transmitting data from tower to data centre, et cetera. So that's an essential part of the infrastructure.

We've also got telecom networks in there as well. Again, a lot of these telecom companies own lots of the fibre networks. But those are the three largest asset classes in this fund. Again, we want to be invested in the hardware, you know, the assets that are required for the digitisation of our economy. And that's predominantly data centres, towers and then the fibre networks.

**JY:** Yeah, so theoretically as we all become more connected, as we all use more data, your assets should benefit. [**TW:** Exactly] I believe there are around 2.7 billion people today who still don't have access to the internet. So why does it matter and can digital infrastructure connect these last people to the rest of the world?

**TW:** Yeah, so I mean, if you think about our daily lives with the phone, you know, in the morning you might be checking your news, you might be checking your bank accounts, communicating with colleagues, friends, family. You might be you know, going onto online courses, education, all sorts of things, entertainment, streaming, online gaming. So much of our lives are now using data and creating data. And I think the efficiency that that gives us all is kind of unarguable. So, when you think about emerging markets where internet penetration, for example, across Africa is 23%; across the Middle East and Africa, if you're to combine them together, it's about 39%. Compare that to the UK where it's 98%, you can just start to

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understand that if that internet penetration increases, the economic impact that will have on livelihoods is really going to be quite dramatic.

And so we think that there is both a social imperative from education as I was mentioning, connectivity from a social perspective, and then an economic imperative with regard to the efficiencies it's going to give to those economies as to why, you know, it has to happen that that internet penetration will increase across emerging markets. And so we believe that will happen. We think that the emerging markets offer a really interesting way to gain exposure to digitising economies that are really in their infancy. You can argue that, you know, European and US economies are pretty mature in terms of that internet penetration so you're going to need a lot more digital infrastructure built out and there will be a lot more connectivity and it will benefit both from the social element and the economic element.

**JY:** And does the fund have much exposure to emerging markets and how much of a limiting factor is it, things like smartphones and things? Are they readily affordable to everybody now or is that still a barrier to everyone getting connected?

**TW:** Yeah, so smartphones are pretty affordable in most of these emerging markets. You know, if you look at kind of your average monthly bill, you know, UK versus an emerging market or in some of the African countries, you know, you can see that they are much more affordable. They're much cheaper than the rates that we are paying over here. And so, a lot of people are connecting banks for example in emerging markets. So, the smartphone's already there, but they need more infrastructure as you've mentioned.

And in terms of the portfolio, the emerging markets will always be an important part of this portfolio. Today we've probably got around sort of 15 - 20%; that could well grow if we can find attractive companies at attractive prices. But it's just that growth, it's the immaturity in those markets that we really like with the very obvious need for more infrastructure with these young growing populations which need connectivity as much as all of the young population in developed countries need, we know where that penetration is likely to get to.

**JY:** Thanks Tom. And finally, can you give us a couple of examples of your favourite stocks in the portfolio which are benefiting from this trend?

**TW:** Yeah, so maybe if I can give you one developed market example and then one developing market example.

One of the developed market examples that we like is Next Data Centres [NextDC Ltd] who are an Australian group. They're one of the fastest growing data centre companies in that region. They have very strong demand from all the hyper-scalers, you know, like Microsoft or Google. And they recently actually raised equity earlier on this year to build out more of their development pipeline. Basically the management team was so confident that the demand was there, that the pipeline that we thought they might build out over a three to five year period, they were saying, no, we want to build it now; we want to raise equity to build that pipeline out because we're very certain it's going to be leased very quickly by the hyper-scalers. So, Next Data Centres would be one that I would highlight in the developed markets.

And then in a developing markets, Helios [Towers] is a really interesting company, so they give us exposure to mobile phone towers in Africa. So we were just talking about the kind of low levels of internet penetration across Africa and Helios is a real play on that increase in connectivity. So they give us pure tower exposure across Africa, about 82% in Africa, and then about 18% in Oman. We think that their earnings is going to grow very quickly. We think they're in a very dominant position to be the partner of choice for most of the mobile network operators in many of the countries across Africa.

So again, two great examples of one developed and one developing country in two different parts of our portfolio, Next in data centres and then Helios in mobile phone towers.

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**JY:** That's been fascinating. Tom, thank you very much for talking to us today.

**TW:** Thanks James.

**SW:** Schroder Digital Infrastructure fund seeks to take advantage of the ever-increasing demand for digital infrastructure and the sustainable transition to a digital economy. It holds around 40 stocks invested around the world in a mixture of emerging and developed markets. To learn more about the Schroder Digital Infrastructure fund please visit [fundcalibre.com](https://fundcalibre.com)