KEYNOTE INTERVIEW

Practicing discernment amid enthusiasm

When there is heightened market exuberance around a sector, discernment is critical, say Morgan Stanley Infrastructure Partners' Yacine Saidji and John Ghirardelli

The hype around data centres is undeniable. The advent of artificial intelligence has seen deal volumes soar and valuations spike. However, it is often unclear whether data centre platforms will ultimately attract the AI compute on which those investment theses were founded. In the meantime, there are opportunities in other areas of the data centre ecosystem that are being comparatively ignored. As always, the focus must be on selectivity and discernment, say Yacine Saidji, managing director and co-head of Europe at Morgan Stanley Infrastructure Partners, and John Ghirardelli, executive director and head of digital for the Americas.

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Q How is the digital infrastructure opportunity set evolving?

Yacine Saidji: The huge demand for digital infrastructure is clear. We need more and better broadband connectivity, particularly to end users. We also need more compute and more storage, particularly given the proliferation of AI. That means more data centres. Then, of course, we need more ways to connect all of this – data centres to data centres and data centres to local network distribution points through high-capacity point-to-point fibre. Bottom line, the entire sector needs more capacity and therefore requires more capital expenditure.

Our role as infrastructure investors is to stay disciplined, find the right situations, and more specifically the right contractual constructs, so that we can achieve the appropriate risk-adjusted returns.

John Ghirardelli: Digital infrastructure supports the creation, consumption, storage and transportation of data. It refers to the physical assets and sometimes adjacent services that facilitate and enable those activities. The volume of data that is being created, consumed, stored and transported has increased by around 100 times over the past 15 years. In 2010, there was approximately 2 zettabytes of data flowing through the system. In 2025, that is forecast to exceed 200 zettabytes. As Yacine says, demand is incredibly strong.

The supply of capital has also increased over that period, and the sources of that capital have changed. The most recent phase has been led by large institutional investors and private infrastructure funds. As a result of the increasing demand and supply characteristics, we have seen an acceleration of digital infrastructure transactions across the globe, with the most recent surge occurring across the data centre ecosystem. We try to bring a differentiated point of view as we scrutinise market structure, business models, contract structure, counterparty risk and market-specific dynamics.

> *"Projections indicate that wholesale capacity will be one of the fastest growing segments... as enterprises are expected to continue to increase their demand for data"*
>
> **JOHN GHIRARDELLI**

Q What constitutes the right assets in the context of data centres, and what is likely to prove a mistake?

JG: Last year was the high-water mark for data centres in terms of global M&A activity, with north of $70 billion of deals closed. We have leveraged our thematic approach to the broader data centre asset segment, with real intentionality in terms of where we want

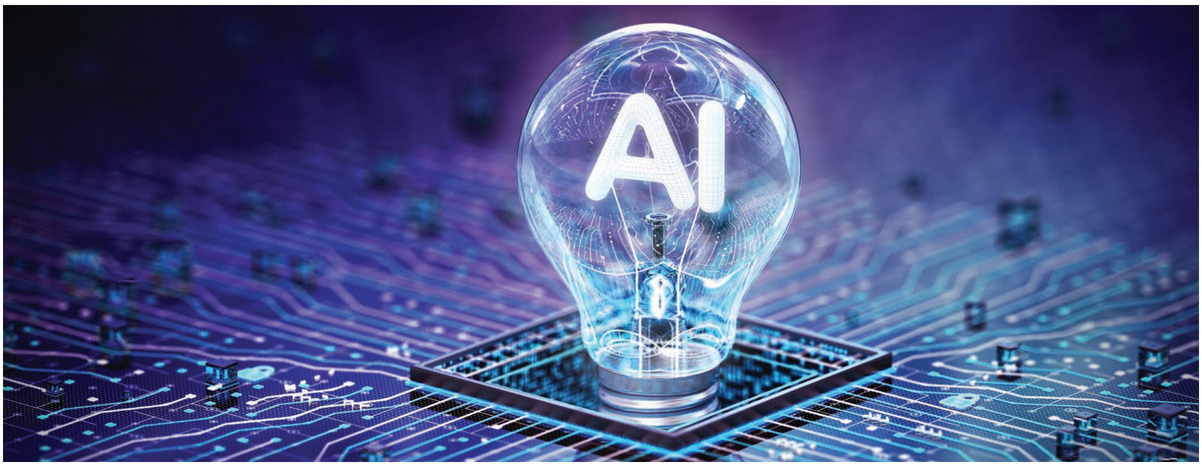
Q What impact will the continued proliferation of AI have on the data centre opportunity set?

YS: To answer this question, I think it is important to recognise the different categories of data centres that exist.

There are data centres for non-AI compute. These data centres continue to be useful, and demand is growing. Then there are data centres for telecommunications services, and then there are data centres primarily intended for AI compute, with different energy density requirements and design.

Of course, there is some blurring around the edges of those definitions, but broadly speaking those are the sub-verticals that make up the market.

Right now, we are seeing huge enthusiasm for data centres based largely on perceived AI potential. We are seeing deals in data centre platforms with an investment thesis based on the ability to serve the needs of AI in the future. And those needs are obviously important – estimates of the capex spend needed to power generative AI is in the hundreds of billions. The question, however, is what happens if you are not able to attract AI compute to your particular platform, or not to the volume to which you underwrote. My suspicion is that many of the prices paid have been based on those AI assumptions.



to deploy capital on an attractive risk-return profile.

The key elements we look for is durable demand, access to scarce resources (power, connectivity, etc), wrapped up in a business that has genuine differentiation in terms of product and execution, to enable stickiness with a range of high-quality customers.

From an infrastructure asset class perspective, we have a relentless focus on the visibility and durability of cashflows, typically underpinned by long-term contracts that have some element of pricing power via a unique go-to-market approach to commercialisation – either through contracted escalators or favourable market structure dynamics.

Q Which areas should infrastructure managers focus on instead?

YS: An important theme to highlight is decentralisation. We have seen this before with the decentralisation of macro towers, wireless networks and fibre, and now we are seeing the acceleration of the theme with data centres.

This decentralisation theme underpins our investment in French data centre firm UltraEdge, which has historically served the telecommunications industry and is now expanding beyond that. With more than 250 locations in France, matching the country's population distribution, UltraEdge's highly decentralised data centre portfolio enables low latency applications and high-speed connectivity.

When, in the future, there are systems deployed that require very low latency, such as assisted driving or autonomous vehicles, it will be necessary to have compute distributed throughout a region. If you are autonomously driving in Marseille with compute taking place in Paris, accidents will occur. Edge compute, a new layer of compute that takes place close to the end user, will be necessary. That is the position we are taking with UltraEdge. Having said that, the investment primarily relies on a 25-year inflation-linked take-or-pay contract with the country's second largest mobile phone company, and these edge volumes would be upside.

JG: Customer segmentation is another area of focus. Over the past five to 10 years, we have seen investors increasingly move up market, pursuing hyperscale customers such as Google, Microsoft, Amazon, Meta, Alibaba, Oracle and others. That has been a huge driver of growth on a global basis.

In the Americas, the regional multi-tenant wholesale co-location market segment is particularly interesting to us from a risk-adjusted return basis, which led to our recent investment in hybrid IT infrastructure provider Flexential. Wholesale customers comprise a long list of enterprises, technology and web-scale companies and select AI customers who need significant computing power for their core mission-critical operations.

In contrast, hyperscale customers are characterised by a few, very large and extremely powerful companies served by a growing number of data centre operators. Industry projections indicate that wholesale capacity will be one of the fastest-growing segments of the data centre market, as enterprises are expected to continue to increase their demand for data, a trend that could be further accelerated by the training and inferencing of customised enterprise AI models.

Compared with hyperscale facilities, multi-tenant wholesale facilities could be constructed closer to existing enterprise customers in Tier 1, Tier 2 and select Tier 3 data centre markets across the country, providing the crucial low-latency connections that are essential for running traditional, cloud and AI applications effectively.

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>
> **YACINE SAIDJI**

Q What are the key skills required to hunt effectively in this space?

JG: Both Yacine and I have been working in the telecoms and digital infrastructure space for more than 15 years. We have been through multiple cycles, and benefit from having both an investor and an operator mindset. We have negotiated lease contracts, and pricing with customers, and answered calls in the middle of the night when there were operational issues at certain sites. We try to leverage that experience on a daily basis as we partner with management teams.

YS: It all comes back to being ready to go into the details. Trends come and go. Discernment is key in this market. ■

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