Global Insight Series:
Building Canadian Digital Infrastructure

Report Contents

DIF Capital Partners Brings Together its Global Digital Experts and Portfolio Company CEOs for a Global Digital Insights Forum in Winnipeg

Winnipeg, June 2023

On June 7th, Winnipeg played host to DIF Capital Partners' "Global Digital Insights Forum", where we brought together our global team of in-house digital experts, industry advisors, and portfolio company leadership to share market insights, best practices, and to discuss the long-term outlook for the digital sector.

This event was part of our broader, two-day "Digital Days" meetings that were focused on fostering a close-knit ecosystem across our global fiber companies as part of DIF's value creation agenda.

As a leading global mid-market infrastructure manager, DIF is proud to have built a proven track record of investing in and scaling digital infrastructure platforms globally. This includes our investment activities in Canada, where we are building out the rural fiber network in Manitoba and Saskatchewan with support from our federal (Canada Infrastructure Bank), provincial, municipal and First Nations partners through our investments in Valley Fiber and RFNOW.

Speakers and Moderators

Vincent Liu, Partner & Co-Head of North America
DIF Capital Partners

Simon Rozas, Head of European Digital Infrastructure
DIF Capital Partners

Dan Fetter, Head of North American Value Creation
DIF Capital Partners

John Maduri, DIF Digital Advisor
DIF Capital Partners

Hank Wall, CEO
Valley Fiber, Canada

Chris Kennedy, CEO
RFNOW, Canada

Tommi Linna, CEO
Valoo, Finland

Josh Zuerner, CEO
Joink, United States

Christopher Rautenberg, Managing Director
Ruhrfibre, Germany

The Global Fiber Opportunity Landscape

1. The internet has become the fourth utility, and fiber is the fastest way to access it

- Over the last two decades, the internet has become an integral part of our daily routines, connecting us to information, opportunities, and each other. It has become a lifeline for education, healthcare and commerce.
- Covid-19 only accelerated this trend – the internet became essential for children to access quality education, for entrepreneurs and small business to compete in the digital marketplace, communities to access healthcare and telemedicine, improving outcomes and saving lives.
- Driven by rapid adoption, digitization across sectors, and ever-growing use cases, global data consumption is accelerating, which in turn, underpins the significant need for continued investment into digital infrastructure.
- Accordingly, digital infrastructure assets in strategic markets that provide critical, backbone services and products have the key characteristics of traditional infrastructure assets:
  - Sticky, predictable, and recurring revenues
  - Implicit and explicit inflation pass-throughs
  - Barriers to entry, in certain markets

2. However, not all fiber infrastructure is created equal

- The significant capital allocated to the sector has resulted in an overbuild of fiber networks in these areas following a land grab in urban/suburban markets.
- Simon Rozas, DIF's Head of European Digital Infrastructure, emphasized that not all fiber assets have equivalent infrastructure characteristics, stressing the need to be selective with target markets, and then to be highly strategic with the commercial strategy employed.
- Vincent Liu, Partner and Co-Head of North America, discussed the need for a deep bench of global expertise combined with a nuanced understanding of local dynamics with boots-on-the-ground to implement a business plan and create long-term value.
- DIF's strategy within the fiber landscape has been to look for white spaces in the industry by targeting underserved markets reliant on legacy technologies in order to achieve superior risk-adjusted returns, social good, and to provide the foundation for building a competitive moat around the businesses we've chosen to back.

> **"The Great Canadian Rural Prairie Story during Covid-19 was that you needed internet and it wasn't there"**
>
> **– Chris Kennedy,** CEO of RFNOW

3. Finding niches in the market is critical to achieving superior risk-adjusted returns

- Throughout the event, it became clear that the genesis of nearly every DIF fiber portfolio company was the realization from the founders that the leading incumbent telecom companies were racing to large urban/suburban centres and not prioritizing rural communities. As Hank Wall, CEO of Valley Fiber explained, *"When you realize connectivity isn't just a problem you are having, but everyone around you is having as well, eventually you run out of reasons to not build something yourself."*
- These rural communities in turn were left to rely on deficient legacy technologies, leaving both commercial and residential consumers with slow, and often unreliable internet access. For example, when DIF invested in Valoo, its Finnish fiber platform, only 15% of single dwelling units (mostly located in suburban and rural areas of the country) had access to next-generation data infrastructure in order to access high-speed internet.
- What emerged from the network build-out across DIF's portfolio companies was that the economic model for rural fiber boasts significant advantages relative to urban/suburban models. We believe that high-quality rural fiber businesses display higher sustained levels of market penetration, lower churn rates, higher revenue per subscriber ("ARPU"), and lower monthly operational expenditures per subscriber. This is often supplemented by one-time government subsidies from local and federal agencies, who are prioritizing rural communities to ensure that all residents have access to high-speed internet. These subsidies and grants given to the first-movers in the market provide a meaningful reduction in capex requirements and accordingly, mitigates the risk of a competitor seeking to build a competing and geographically redundant fiber connection.

Building a Leading Fiber Business in Rural Canada

John Maduri, one of DIF's Digital Advisors with nearly a 40-year track record in senior leadership roles at some of North America's preeminent telecommunications businesses, including Rogers, TELUS, Xplornet, and Frontier Communications, provided a spotlight on the Canadian fiber market and how to build a successful network locally.

1. Be First to The Market

First-movers in rural markets have the greatest opportunity to capture and sustain leading penetration and market share

While rural communities in the Canadian Prairies are highly attractive both demographically and economically, access to high-speed internet remains significantly below the 77% national average – with 12% penetration of gigabit-plus speeds in rural Manitoba and 1% penetration of gigabit-plus speeds in rural Saskatchewan. As a result, while the capex per subscriber in this region is higher, first-movers benefit from significant and pent-up demand for high quality fiber and can therefore achieve the lion's share of market penetration. Combined with one-time government subsidies targeting regions with insufficient data connectivity, the higher required capex creates a strategic moat in these markets. For example, in 2021, DIF secured the largest inaugural rural connectivity package in Canada, totaling C$164 million from the Canada Infrastructure Bank.

2. Take a Strategic and Disciplined Approach to Pricing

Rural markets can deliver higher revenue per customer ("ARPU") to providers with a disciplined pricing strategy

With higher-than-average GDP per capita, a scarcity of broadband infrastructure, and inferior but significantly more expensive incumbent technologies, the rural Canadian Prairies represent highly attractive revenue markets for fiber developers. Fiber companies that provide high-quality and reliable internet services can drive attractive ARPUs by thoughtfully segmenting their customer base and implementing differentiated pricing strategies linked to value.

> **"If you like urban fiber, you are going to love rural fiber"**
> – **John Maduri,** DIF's Canadian Fiber Advisor

3. Provide a Superior Customer Experience

Providers who focus on delivering a high-quality customer experience and superior fiber broadband are able to maintain industry-leading, low monthly churn rates

The customer churn rate represents one of the most significant factors defining fiber economics. Fiber is a truly future-proof broadband infrastructure asset, benefiting from a long, up to 50+ year asset life, and requiring little re-investment to upgrade and increase speeds and throughput over time. As a result, providers who can deliver a great customer experience are able to achieve significantly lower-than-industry churn rates, and therefore de-risk the capital expenditures on network build. Indeed, Valley Fiber and RFNOW have achieved 5x higher than average customer lifetime values when compared to the Canadian industry average. In turn, this allows high-quality providers to achieve strong downside protection on their investment.

As John Maduri explained, *"We spend a lot of money as an industry to acquire customers, and to roll trucks to build fiber connections. If you can hold onto your customers for longer, you can save a significant amount of opex, and sales and marketing expenditures."*

4. Leverage Network-Build Capex to Target Both Residences and Commercial Premises

An enterprise business creates a strong foundation of highly recurring, contracted cash flows to supplement the fast-growing fiber-to-the-home opportunity

John Maduri mentioned that many fiber companies aggressively target residential customers, all the while ignoring enterprise customers. As a result, many enterprise customers in rural markets are starving for fast, secure and reliable broadband infrastructure. Consequently, this segment represents a large opportunity set for fiber providers, and also provides a stable, recurring and contracted revenue base for investors. For example, DIF's U.S. Midwest fiber platform, Joink, built-out its fiber network in a highly strategic manner by targeting the enterprise segment first, which ensured that a highly recurring, long-term contracted cash flow base was in place before the fiber-to-the-home network construction began, supporting strong downside protection for the investment.

Key Takeaways

Fiber broadband represents an attractive opportunity set

- Compelling infrastructure characteristics relative to legacy broadband options
- Subscription-driven recurring revenue with inherent inflation protection
- Enormous and growing appetite for greater speed and bandwidth
- As the only true broadband infrastructure, fiber future-proofs the operator's need to keep up with this increasing demand for greater speeds and bandwidth

Rural broadband's characteristics make it a superior economic model

- First-mover advantage often yields higher market share and penetration, with strong government support creating a significant competitive moat
- Markets with attractive demographics and economics
- Lower competitive intensity results in lower monthly churn
- Utility-like, defensive and simple business model providing essential services to underserved communities

About DIF

DIF Capital Partners – market leading global mid-market infrastructure fund manager

DIF Capital Partners was founded in 2005 and is a leading independent global mid-market infrastructure fund manager with over €15bn AuM, invested successfully across closed-end funds and various co-investment vehicles

Global reach with local access
11 local offices with active sourcing, execution, and asset management capabilities

Large and experienced team
220+ professionals of which 125+ on the investment team with direct involvement in sourcing and managing investments

Superior realized returns
200+ investments and 115+ divestments, with a 16.8% realized return

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