Co-investment carve-outs in France extend infrastructure funding from physical assets to IRUs

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In France, fibre carve-outs (through which infrastructure funds support infrastructure operators to finance their fibre roll-outs) have been closely followed by several co-investment carve-outs, for which infrastructure funds support ISPs to finance their co-investment tranches in these fibre networks. These new carve-outs extend infrastructure funding from physical assets to indefeasible rights of use (IRUs) and create a precedent that could be considered in many other countries.

The French regulatory framework promotes co-investment in fibre networks. In medium- and low-density areas, (which represent more than 80% of premises in France), the regulator and the government have together organised the roll-out of a single network per area. The operator of this local network ('the infrastructure operator') is obliged to provide non-discriminatory access to all ISPs, including in a co-investment mode. This mode involves purchasing IRUs on one or several tranches of 5% of total lines. This means that an ISP no longer pays line rental in this tranche and only pays maintenance fees, which are typically 60% cheaper than line rental. For an ISP, a co-investment therefore corresponds to a virtual fibre asset, that it can capitalise. For a nationwide ISP with double-digit market share, the investment in co-investment tranches in all medium- and low-density areas is typically several billion euros.

In the last 3 years, most of the major infrastructure operators in France have carved out important parts of their physical fibre in entities that enable infrastructure funds to invest in these very low risk assets (for more details, see Analysys Mason's *Fibre carve-out: apparent similarities hide important differences that investors need to understand*. In parallel, Analysys Mason has supported ISPs and infrastructure fund managers on co-investment carve-outs, in which a special purpose vehicle (SPV) purchases IRU tranches and leases lines within these tranches to an anchor tenant ISP, and potentially to other smaller ISPs.

The co-investment carve-out model enables its anchor tenant ISP to lease lines at advantageous prices that reward its long-term commitments

The economic model of a co-investment carve-out is based on the space between IRU one-off costs (that are fixed once each tranche is purchased) and line rental revenue net of maintenance (that are proportional to the number of lines used and therefore, to a wide extent, variable). The following are key drivers of this economic model.

- The fill rate of the IRU tranches (that is, the proportion of the IRU tranches that is leased to an ISP) evolves over time, and as the anchor tenant and other ISPs acquire fibre customers. This fill rate can be optimised by applying an appropriate IRU purchasing policy: it is generally not efficient to purchase an IRU tranche when demand represents only a fraction of the tranche capacity.

- There is space between complete IRU one-off costs (taking into account the detailed pricing structure of each infrastructure operator) and line rental prices net of maintenance to the anchor tenant and to the other smaller ISPs.
- Potential anchor tenant commitments can limit the risk of lower-than-expected fill rates but are then generally compensated by lower per-line rental prices compared to smaller (non-anchor) ISPs.

Some other drivers could potentially affect the economic model of a co-investment carve-out, but contracts are generally designed to limit their effects by passing them to client operators.

- The maintenance costs on lines used, as well as final drop costs, are (more or less) directly transformed into equivalent revenue. It is nevertheless important to ensure that no significant divergence between revenue and costs materialises for the SPV under reasonable scenarios that differ from the base case
- As is the case for any long-term contract, indexation clauses can have an important impact over the years. It is therefore important to ensure that no significant divergence between revenue and costs can result from the uncertainty about long-term macro-economic drivers (in particular, inflation).

Co-investment carve-outs, like fibre carve-outs, present a particularly low-risk profile in France, where there is virtually no risk of overbuild in medium- and low-density areas, and where fibre is clearly identified as the target technology by all retail players. Such models can nevertheless also be considered in many other countries, where reasonable commitments from the anchor tenant may assist to mitigate the intrinsic risks of the model.

Please contact Omar Bouhali (Partner, Paris) to discuss how Analysys Mason can help operators and investors to analyse and optimise innovative investment models in fibre assets.