



Evolving infrastructure

In recent years the amount of capital being raised for dedicated infrastructure funds has risen substantially and the sector has emerged as a major new area for investment. With raising and deploying capital in the traditional LBO market becoming increasingly difficult, it appears that private equity managers are also now targeting the space in ever greater numbers **By Ashley Wassall**

In November 2008, Swedish buyout house EQT announced the final closing of its first ever dedicated infrastructure fund on €1.2bn, significantly ahead of its €1bn target. The news was significant not just due to the amount raised – though in the current climate it was an impressive feat – but because it marked the third time in a year that a traditional private equity firm had branched out into the sector. In December 2007 UK-based CVC Capital Partners announced that it was launching an infrastructure investment business, which has quietly set about raising a \$2bn vehicle, while the following May global buyout giant KKR launched its own infrastructure arm, which is rumoured to be raising a fund of anywhere between \$5bn and \$15bn. Indeed the trio join a whole host of the industries top players, including Blackstone, Carlyle, Barclays Private Equity and 3i, who all operate separate infrastructure divisions.

What is more, infrastructure investments also came into vogue with large-cap buyout houses throughout 2008, as dealflow in traditional sectors dried up because of ongoing illiquidity in the debt markets. Five of the 14 €1bn+ transactions completed across Europe in 2008 could be considered to be infrastructure, or infrastructure-style, deals: the de-listings of oil & gas businesses Abbott Group and Expro International; the secondary buyout of fellow oil & gas company Converteam; the merger of Posten AB and Post Danmark A/S, the Swedish and Danish postal services; and the de-listing of waste disposal group Biffa. That these deals were completed, most with substantial leverage, displays the faith that both equity sponsors and banks have in such sectors going forward.

Sector stability

In fact, many argue that it is the continuing ability of infrastructure deals to get finance that provides one of the primary reasons that limited partners

are attracted to the space. “It is still possible to raise debt financing in infrastructure at the moment – it is more difficult but it is doable – and this has brought in investors and led to some very good fundraisings. Compare this to the traditional LBO space, where even firms with good track records are struggling to raise capital largely because of the fact that debt is unavailable and the fund cannot invest,” explains Alain Rauscher, chairman of the newly established Antin Infrastructure Partners. To illustrate his point, Rauscher cites the example of Antin’s investment in UK train rolling stock company Porterbrook; a £2bn acquisition that was financed by a banking syndicate including Lloyds TSB and closed in October 2008, just as Lloyds and others were agreeing their bailout with UK Government. Antin is itself currently raising its inaugural vehicle and has just held a first close with a €300m cornerstone investment from its sponsor and minority owner, BNP Paribas. The fund has a target of €1bn.

That banking doors have remained open in the infrastructure space when they appear so firmly closed to private equity and other asset classes reinforces the confidence many have in the sustainability of the sector, notwithstanding the current economic gloom. “It would be unrealistic to say that infrastructure businesses will emerge unscathed; toll roads for example are already showing decline in revenue. But they are somewhat insulated and if you look

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at the long term growth profile, even during previous downturns, it is amazingly consistent,” Rauscher argues. This long term stability is another attractive feature of the asset class for many LPs, particularly pension funds and other investors for whom the security of the asset is paramount. “Some LPs are happy to trade down on returns a little for safer assets. Pension funds and insurance companies especially have targeted the sector as it fits well with their liability profile,” confirms Lennart Blecher, head of EQT Partners’ infrastructure team.

This stability has been aided by significant investment from governments all over the world, many of which have recently announced their continued commitment to infrastructure spending as part of broader economic stimulus packages. To avoid large capital outlays this spending is often deployed through Public-Private Partnerships (PPP), which typically involve private entities footing the bill for new projects in return for long term contracts from the government to run them. “In the developed world people always demand more and better services and this triggers increased focus and spending. Infrastructure spend over the last 20 to 30 years Europe-wide has been on a steady growth rate of around 8% a year and this is almost certainly going to continue,” Rauscher comments.

Doing deals

However, the fact that earnings and cashflow in infrastructure assets are typically fairly stable does not mean that prices remain flat. Indeed, both Blecher and Rauscher assert that their respective funds will focus on established assets that

have the potential for operational growth and both are targeting overall returns across the portfolio of around 15% – a figure that remains broadly in line with the long term

private equity average. Furthermore, in recent years there are several examples of private equity firms moving into core infrastructure areas and generating growth and returns that match the heightened expectations of today’s buyout generation. French buyout house PAI’s investment in water utilities business Saur is a case-in-point, with the company being bought for around €1bn in February 2005 and sold for in excess of €1.7bn just two years later, generating big returns for the investor.

Rauscher, though, suggests that such returns were made possible in part by the substantial leverage that buyout firms were able to raise during the boom years, and also by the fact that these companies were backed when they were approaching an expansion phase in their development, which allowed the sort of rapid growth not common among such assets. He therefore claims that private equity firms will struggle to remain competitive in the sector: “There have been a couple of successes, but the buyers of these businesses are unlikely to generate similar returns as the growth phase of the companies has been completed. There may continue to be interest in certain sectors, but only for individual cases where an angle can be found.”

Rauscher is also keen to emphasise that, despite the apparent convergence between the two asset classes, there are significant differences between infrastructure and private equity in terms of the characteristics of the

investments. “It is very important to differentiate proper infrastructure from private equity. For example, you will see investments in airlines described as infrastructure, but they are really services businesses and are as affected by economic fluctuations as any other corporate. In order to raise financing and do deals you need to focus on real infrastructure,” he explains. In addition, Blecher highlights the need for specific sector expertise in order to consistently make profitable transactions in the space: “It is important to have people who know the sector and have expertise in order to generate value from investments; it is very difficult to be opportunistic and timing-led.”

Competition and crossover

Infrastructure, it seems, has emerged into a major asset class in its own right and is posing substantial competition to other asset classes for the attention of investors. “The fact that the asset class provides a stable long term growth profile with downside protection could see it gain investors from other

public and private equity markets, which have seen big fluctuations in performance recently,” says Blecher. In the short term this will certainly be a concern for larger private equity groups, many of which are currently seeing their LPs attempting to reduce allocations or get out of funds altogether

through secondary sales as a result of liquidity issues. In the long term the attractiveness of the sector to investors such as pension funds will also be a concern, given that in Europe these groups have historically been difficult to convince of the benefits of private equity in any case.

In many ways this explains the evolution of several of the traditional buyout giants into global asset management firms, with separate business divisions for private equity, infrastructure, real estate and the like. This allows the groups to cater for the needs of large institutional investors, which (particularly in the current climate) are seeking to amass a diverse portfolio; creating strong potential for LPs in one vehicle to also commit some of their allocation from another asset class. EQT’s infrastructure fund, for example, received 60% of its commitments from its incumbent private equity investor base. It also allows the GP itself to be more diversified without resorting to attempting transactions in a sector with which it is not familiar and does not traditionally operate. However, according to Rauscher this development is something that only a very few of the most established firms would attempt, largely due to the resources required to do so effectively. “You need to have people who have expertise in the sector and relationships with banks for project financing, which means hiring whole new teams. We’ve probably seen most of the cross-over that’s going to happen, but who can say for sure,” he concludes. ■

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