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INFRASTRUCTURE INVESTOR

Weathering the storm

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Dealflow has never been better, managers are raising record amounts of capital and different strategies abound. But can the European market survive the growing onslaught of nationalism and protectionism? Bruno Alves and six industry professionals try to find out

Plus ça change, plus c'est la même chose. So goes the old French saying, which roughly translates to: "the more things change, the more they stay the same" (that is, until we stop being able to use old French proverbs in English writing).

Last year, when we gathered for our annual European fund managers' roundtable, our participants walked away with a bittersweet conclusion - Europe as an investment destination and European fund managers had never had it better; yet the dark clouds of political volatility loomed large and heavy on the horizon.

Much has happened in the 12 months since our last gathering. Brexit, then a threat, has become a reality and a frenzied US election campaign produced without a doubt the most stunning political upset of 2016, with American voters electing Donald Trump as their president, eschewing establishment candidate Hillary Clinton.

So, much like last year, high-level political volatility is definitely here to stay. But again, much like last year, European fund managers - and investors targeting Europe as a destination - have never had it better.

This is not the wishful optimism of a roundtable held the day after Trump was declared the victor, where you could be forgiven for thinking that our participants - including Antin's Angelika Schochlin, Arcus's Simon Gray, Ardian's Benoît Gaillochet, Infravia's Bruno Candès, Infracapital's Andy Matthews and DC Placement Advisors' Nina Dohr-Pawlowitz - were inclined to keep on the sunny side of the road. It is rather an accurate reflection of the last 12 months.

A quick look at the managers around the table reveals that those that have recently come off the road - like Ardian and Infravia - have raised their largest-ever funds; new strategies, like Infracapital's greenfield fund, are meeting with success, showing that diversification works; and for all the talk about increased competition, the assembled party has been remarkably creative and successful in identifying new investment opportunities, be they data centres or psychiatric clinics.

However, we are still meeting on the morning after Trump's surprise election, so it is unsurprising that our first point of conversation turns to this greatest of political upsets.

"Political surprises and volatility are definitely here to stay and I don't think we've seen the last of it," Gray, who is hosting our roundtable at Arcus's London headquarters, says.

"I think there is a trend across the Brexit vote and the recent US vote: it is people feeling disenfranchised and despondent with the status quo and looking for a change.

"There does appear to be a thread of shifting towards a more protectionist, nationalistic approach and that has to, at some point, have ramifications for world trade and investment flows. I think you'd be a very brave person to say this won't have an impact on the European infrastructure market."

Schochlin adds: "We are seeing the rise of populism and nationalism in many parts of the Western world and we are right in the middle of this [trend]."

HEART OF NATIONALISM

Taking Gray's cue, Matthews also believes infrastructure will end up being affected by all this political upheaval: "I think at the infrastructure level this is bound to have an impact on certainty and dealflow. We will all remain focused on our views of what defines infrastructure and how certain the cashflows and the regulation that go with it are."

But, at the same time, everyone around the table agrees that infrastructure spending is very much at the heart of these nationalist, populist movements. Also, as Candès points out, "there is a real possibility that the US vote will create some volatility in the markets and a flight to quality and that infrastructure as an asset class ends up benefiting from that".

For the time being, though, as usually happens in the aftermath of a shock, the immediate question is whether business will carry on as usual. "What we saw after Brexit was investors putting investment decisions on hold with regards to UK assets," recalls Dohr-Pawlowitz.
"However, they came back since, so I expect, when it comes to the US election, that they will also go on hold for a couple of months starting from now and they will then make up their minds."

"If you look at Europe as an infrastructure market, we have always considered it as an aggregate of different countries with different approaches to PPPs, concessions and so on. It's true that with the recent evolution in politics, this perception that we don't have a single market like in the US has increased," Gaillochet offers.

But the big question is whether the euro will still be around in the future. If the euro disappears, that will be a bigger shock. None of our participants are ready to believe in that though - a quick show of hands reveals that all of them think the euro will still be around in five years' time.

And long may it continue, for were it to implode - an event that would likely be swiftly followed by the disintegration of the EU as a whole - it would probably take with it what continues to easily be the world's most dynamic infrastructure market.

Put simply, Europe has it all. Whether you are core or core-plus, large-cap or mid-market, an energy or social infrastructure aficionado, you will find a steady stream of assets for investors of all shapes and sizes. In this sense, no other market comes close to it.

WHERE'S THE WIFI?

"For us, digital infrastructure - data centres, fibre optic, towers - is where we are the most bullish right now. Essentially, everything that relates to digital communication. That's where we see the biggest opportunity, because the underlying demand is so strong the sector is somehow immune to policy changes," finds Candès.

"Second, if you believe in COP21, then renewable energy is also interesting. But I think that, as of this morning, this has become a question mark," he adds, alluding to Trump's lack of belief in climate change.

Matthews agrees: "We've recently invested in a rural broadband business and we see this as a new kind of utility. There's a lot of opportunity and a lot of demand from European countries to connect everyone to the fibre network."

"We are also seeing a lot on the telecoms and broadband side," says Schochlin, "and equally in the energy space, particularly in midstream, where we see quite a rich dealflow. Social infrastructure is also very active."

She dwells on the latter: "I was actually surprised that so few people are looking into social infrastructure investments. They are clearly part of a nation's assets and if you dig a bit deeper you will find very high barriers to entry, regulation… you'll essentially find all the characteristics present in a more 'classic' piece of infrastructure."

"The world is changing," Schochlin concludes. "As an equity investor, you need to go beyond a reactive approach and have a vision of things before they happen, so you know how to position your companies."

Candès is very much on board with that sentiment. "I think you're seeing infrastructure expand out of its more restrictive boundaries and more into private equity or even real estate. If you think of an airport, for example, half of the revenues are derived from real estate-like, non-aero revenues. And we don't think this is necessarily a bad thing because you can create value with the right kind of management team."

"Markets change," reflects Gray. "When we were the first fund investor to buy a rolling stock asset in 2008, everybody said, 'That's not infrastructure - what are you doing?' Now it's seen as extremely high quality, core infrastructure. It was the same with our first telecom towers investment, in 2004 - today, it's also seen as resilient and core. The market is evolving and the perimeter is being expanded into nascent areas of infrastructure. I believe that's a good thing, assuming that the risks are analysed and priced appropriately. I'm sure there will be mistakes. But again, you're backing a manager, their intelligence and experience to identify and secure the best opportunities."

Still, as Dohr-Pawlowitz, the only placement agent around the table, points out: "I'd say most investors from insurance companies who are considering infrastructure investments would still like to stay with core investments because they see core infrastructure as a clear differentiator to other alternative investments, like private equity. The infrastructure investment thesis is still fundamentally more moderate and risk-averse, with insurance investors expecting a return of between 6 and 10 percent."

Fortunately, as Gaillochet highlights, Europe is not short on core assets either. "We are more focused on core brownfield and still see opportunities there from classical deal providers, like public authorities, which drove the recent privatisation of French airports; also from strategics, which are permanently reviewing their portfolios and selling assets; and from oil and gas companies that are still selling their non-core assets."

In addition, there is one appetising new source of European core assets: "Funds that first started their business in 2005-7 and have reached a 10-year maturity are now starting to sell, so we see more and more assets coming to the market from funds. I think that's an evolution of the dealflow."

DRY POWDER? LOOK BETWEEN THE CRACKS

This abundance of core and non-core opportunities helps explain why European funds have been so successful in attracting capital - a trend that is unlikely to reverse anytime soon.

"The asset class is still growing," stresses Gaillochet. "Fifteen years ago people were looking at it but maybe without fully understanding it; we now feel that all the big investors and even the smaller ones are developing an infrastructure strategy. We've seen this on our last fundraising and I would say this is a long-term trend.

"We still find investors who are short on infrastructure and are looking to managers and advisors to educate them further on the sector in trying to decide their own investment strategies. You can see very large pools of capital that still have a very small infrastructure allocation," Matthews adds. "Infrastructure is a very interesting market attracting interest from across the world and within it, Europe remains a very attractive destination for infrastructure investors."

"I agree and believe the asset class will still rise," says Dohr-Pawlowitz. "We see more and more insurance companies investing in infrastructure after the pension funds invested heavily into the sector over the last couple of years. We also see a focus from insurers on European-wide funds, but most investors would like to avoid currency risk. Finally, there is also a trend of larger allocations to the debt side, particularly for senior debt investments. And most investors investing into infrastructure debt are coming from the insurance industry."

It is not just new investors, either. Existing investors are also increasing their allocations to infrastructure, with most of our participants pointing to larger re-ups during their recent fundraisings - a trend partly driven, no doubt, by the persistent low interest rate environment.
What is more, that wall of capital is fuelling segmentation, a development that often gets lost among the headlines detailing record amounts of dry powder and fierce competition in the large-cap space.

"I think infrastructure is beginning to follow the path of private equity, with more focused investment strategies emerging. But once you drill down into individual strategies, you'll find that competition is not so intense. For example, the number of people competing for fibre optics projects is relatively small. There are a number of investors that just don't play in many sectors for perfectly good reasons," argues Gray.

Candès is also buoyant. "I'm not scared of competition - I think there's room for everyone. The market is expanding and it's segmenting and our clients are actually pushing towards that segmentation and that's creating great opportunities. I think deaflow has never been as solid as it is today."

Matthews rounds out the optimistic mood: "It's true that we talk a lot about dry powder, but we all seem very busy. And I think that's because of a focus on delivering our mandates. If you segment that dry powder, you will still find sectors looking for capital."

NEW TRENDS

With our conversation starting to wind down - and with the amount of high-level political uncertainty making it hard to offer concrete predictions for 2017 - we turn instead to where our participants have been spending more time on in 2016.

"We've been spending much more time on ESG reporting, making sure that best practice is embedded in our investment processes. And I think the other area that we've been focused on is the issue of cybersecurity, trying to protect our investments from a potential cyber-attack, in what is an era of increasing connectivity and digitalisation" offers Gray.

"ESG is becoming more important for both managers and investors, with some investors developing their ESG requirements further with a real focus on the social impact of infrastructure and this is something we have successfully addressed within our greenfield strategy," adds Matthews.
In fact, pretty much everyone around the table agrees that ESG is now a central part of their operations, although Dohr-Pawlowitz points out that, while ESG is getting more and more important to a growing number of investors, particularly from Scandinavia and France, it is not yet essential to all European investors.

Digital, this time not so much as a source of assets but as a portfolio consideration, is also on the minds of our participants. "Antin has founded an IT directors club, so that all the IT directors across our companies can address topics like cybersecurity for example," explains Schochlin, with Gaillochet admitting that Ardian is taking a similar approach: "We also have some team members looking at all the digital issues related to our portfolio and we organise regular meetings with our different chief executives to share all the opportunities and risks offered by digital."

For Candès, it is about "taking a transversal approach to the adoption of digitalisation" across InfraVia's portfolio, something he insists is "not presently being pushed by our clients" but is rather the fund manager's own initiative.

That seems wise. After all, even though political disruption is making the bigger bang these days, digital disruption is just around the corner…