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Asset managers on the front line

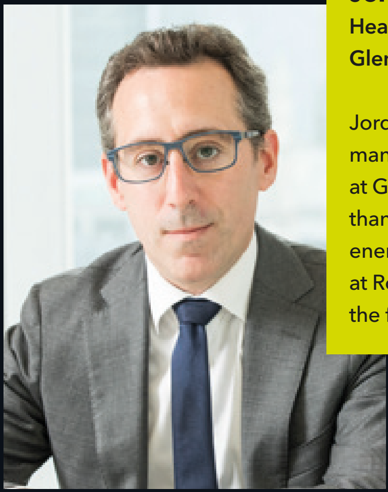
From tackling volatile energy prices to capitalising on M&A opportunities amid market dislocation, the skills of asset managers are more important than ever, five infrastructure professionals tell Amy Carroll and Kalliope Gourntis

Infrastructure's asset managers certainly have their work cut out for them in 2023, dealing with a punishing confluence of macroeconomic and geopolitical forces. But the fundamentals of the asset class and its dominant investment drivers remain strong, and asset managers also spy opportunity amid market dislocation.

"2023 has carried on from where 2022 left off, in terms of continued inflationary pressure, rising interest rates and a scarcity of labour, with the addition now of a potential recession in some geographies," says Guillaume Friedel, partner at Antin Infrastructure Partners. "However, infrastructure is better protected from some of these scenarios than other asset classes and can also benefit from trends that are stronger than the economy, including decarbonisation and the digital transition. As we saw during covid, crises can even accelerate such themes."

Simo Santavirta, head of asset management for infrastructure at Ardian, agrees: "We have been happy with how resilient the asset class has proven over the past three years, through covid and then war in Ukraine," he says. "Over 85 percent of our revenues are inflation linked and we actively hedged financing positions when rates were low. Finally, our approach to leverage has always been cautious, so we feel confident regardless of how 2023 plays out."

Graeme Dunbar, senior investment director at abrdn, meanwhile, says his firm is seeing some attractive M&A opportunities in the current environment. "Volatility also creates opportunity. Towards the end of 2022, we had the opportunity to bring forward some capex and execute quickly on



Jordi Francesch

Head of asset management, Glennmont Partners

Jordi Francesch is head of asset management and chief risk officer at Glennmont Partners. He has more than 18 years' experience in the energy sector and spent 10 years at Royal Dutch Shell before joining the firm.

Graeme Dunbar

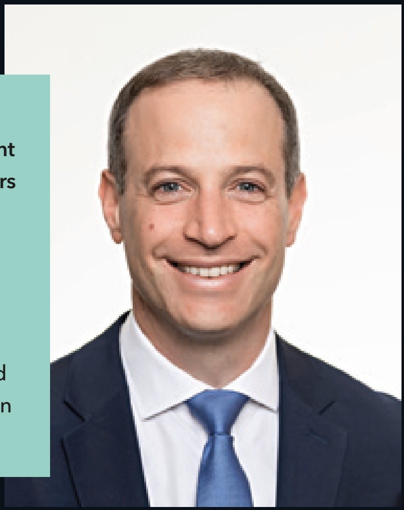
Senior investment director, abrdn

Graeme Dunbar has more than 20 years' experience in private markets and was one of the founders of abrdn's infrastructure business in 2013. Prior to joining Standard Life in 2008, he spent 10 years with KPMG, working in both the UK and Australia.

Neil Krawitz

Partner, head of asset management & ESG, Arcus Infrastructure Partners

Neil Krawitz was part of the team that founded Arcus in 2009. Prior to joining the firm, he was part of Babcock & Brown's European infrastructure team. Krawitz started his career with EY in the transaction services team.



Guillaume Friedel

Partner, Antin Infrastructure Partners

Guillaume Friedel joined Antin in 2008 and is based in New York. He previously worked at Credit Suisse in London, where he was initially part of the M&A team before joining Credit Suisse's private equity business DLJ Merchant Banking Partners.

Simo Santavirta

Head of asset management for infrastructure, Ardian

Simo Santavirta is head of Ardian Infrastructure Asset Management. He previously spent 13 years at the global power generation group InterGen. An engineer by background, Santavirta began his career at Finnish energy company Fortum Oyj.

an M&A opportunity for one of our portfolio companies at a valuation that just wouldn't have been possible six or nine months earlier, and we have other similar bolt-on opportunities currently under review. As well as managing risk, there is real potential to create value at this point in the cycle."

There have been challenges for the energy sector in the form of windfall taxes and pricing caps, of course. "These interventions should be limited to supporting people through a cost of living crisis and we would like to see them phased out in the current energy market normalisation," says Jordi Francesch, head of asset management at Glennmont Partners. "Other than that, I agree, we see 2023 as a year of opportunity in the energy sector. New geographies are opening up for clean energy including Asia-Pacific. We are also seeing new technologies such as energy storage going mainstream, while the high level and volatility of electricity prices have led to innovation in PPA structures."

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>
> **GRAEME DUNBAR**
> **abrdn**

Inflation linkage

Indeed, inflation linkage – one of infrastructure's principal advantages – is coming to the fore. But the ability to pass through cost increases is one of the most taxing issues facing asset managers today, nonetheless.

"If inflation proves not to be transitory, the conversations that infrastructure investors will need to have with stakeholders are going to become more challenging," says Neil Krawitz, partner at Arcus Infrastructure Partners. "If there are two or three rounds of passing on high single-digit or low double-digit compounding inflation rate increases, stakeholder relationships and management are going to become even more important."

Santavirta agrees. "It is important to ensure you understand local conditions and are in active dialogue with stakeholders rather than expecting an automatic pass through of costs," he says, adding that emphasising sustainability and ESG investment can help in this process.

In a number of abrdn's portfolio companies, the firm has municipalities as co-shareholders. "Those municipalities are, of course, very aware of affordability issues and the impact they have on local communities," says Dunbar. "That perspective can be extremely helpful when making decisions about the most appropriate course of action."

Krawitz adds: "We have had examples where conversations with regulators or governments have required open-minded creative thinking in order not to overly impact consumers, while retaining the shareholder economic position, even if achieved on a different time horizon."

Of course, it is the job of the asset manager to tackle unforeseen circumstances, and they have been given plenty of practice in recent years. "In asset management, you always have to plan for the worst, extending your financing and protecting your positions in line with negative scenarios," says Friedel. "It is easy to look back and say nothing bad ever happened before 2020, but in reality, that wasn't the case."

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> **SIMO SANTAVIRTA**
> **Ardian**

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>
> **JORDI FRANCESCH**
> **Glennmont**

Indeed, Francesch says that today's environment is less complicated for Glennmont than during the pandemic, when demand and price for electricity collapsed. "The challenges that we do see today primarily involve supply chain bottlenecks. The situation has eased two years post covid-19, but we are still not out of the woods. If you are going into project construction, you need to plan carefully and make sure you align your supply chains because lead times for main equipment are long. On top of that, there is a limited pool of human capital, including expertise in project construction and in the energy management of electricity."

Certainly, the attraction and retention of talent is a key issue. "Paying people appropriately and ensuring they are properly aligned, particularly in this environment, is key," says Dunbar.

But, overall, Friedel believes that while infrastructure's core characteristics have certainly been tested on multiple fronts in recent years, the asset class has not been found wanting. "Covid tested the essential nature of

Asset management and energy

There has been a dramatic change in the attitude of European corporates when it comes to PPAs, according to Jordi Francesch of Glennmont Partners. "Many are proactively starting to run tenders to secure and fix affordable power prices for long periods. This was always the case for US tech companies, but now we are seeing it amongst industrial manufacturing companies as well. That is a real game changer and there are big opportunities to be had.

"Something else that is interesting is electricity management – in the past, everyone tried to hedge or PPA 100 percent of their generation volumes," Francesch continues.

"Now, the trend is more like 60 or 70 percent, with the remainder proactively managed in the market. The Ukraine war has been one catalyst for the desire of power price hedging by large consumers, but that is also the result of a huge educational process, particularly among industrial companies and corporates."

However, Simo Santavirta of Ardian says it is important that you understand and manage volatility and that you structure the assets accordingly. "We are cautious with merchant positions, although they can be interesting. We have developed digital tools internally to analyse the risk and revenues in order to optimise both short- and long-term positions. That same tool can also be used for asset allocation purposes through consolidated risk metrics and the monitoring of aggregated risk and performance."

abrdn's Graeme Dunbar says: "The whole point of hedging is to reduce volatility and risk but as we have seen recently in Norway, for example, you can face situations where the system price differs significantly from individual price areas and if you don't understand hedging properly, you can find you achieve the exact opposite of what you had hoped.

"Add in government price caps with little, if any, guidance on how hedging will be impacted, and the position becomes extremely complex. We have pressed pause temporarily on our hedging activities on one existing investment, meaning we carry some additional merchant exposure for a period but, at present, we actually see that as less risky than implementing a hedging strategy when there are so many variables and unknowns."

Antin's Guillaume Friedel adds: "Hedging is not always as perfect as some investors think. We have observed that with renewables in the US. We therefore take the approach of avoiding and minimising merchant risk as much as possible and focusing more on PPAs.

"That may have meant we didn't capture all of the market opportunities that were available in 2022, but we focus more on the lower end of the spectrum in terms of merchant exposure, which better fits our approach."

infrastructure, with many businesses continuing operations in contrast with the rest of the economy, which largely shut down. Now infrastructure's inflation protection is being tested too," he says. "It may not always be easy, but infrastructure has demonstrated its ability to pass through costs. No two crises are the same, but to a large extent covid and now inflation have tested infrastructure models and infrastructure has proven itself to be resilient."

Risk and resilience

And resilience, of course, is the name of the game. "Resilience is something that we prioritise right from the first stages of origination," says Krawitz. "Last year, 10 percent of opportunities we looked at were screened out early on for ESG reasons like resilience. We also had a situation where on an investment opportunity with a concentrated asset location, resilience became an issue in due diligence because of expected increases in flood risk. In that case, we were concerned with the physical resilience and so the process wasn't continued."

In addition to physical risk, asset managers are also focused on transition risk, ensuring assets are primed to deal with potential changes to regulation around energy usage and carbon emissions, for example, Krawitz says. Recent initiatives that Arcus has undertaken from a resilience perspective include more frequent clearing of the borders alongside its road assets in Southern Europe to protect against forest fires, and early upgrades of equipment to reduce emissions, and water and energy usage, thereby future proofing assets against transition risks.

Krawitz adds that resilience doesn't only concern the assets that you own but rather the whole ecosystem that they operate in. "If you are reliant on an energy grid that is subject to physical risk, for example, you need to know how to deal with that as well as your own asset. You need to consider all scenarios that could impact a given location or industry."

Cyber-risk is a case in point. "Cybersecurity has become an increasingly important component of managing

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> **NEIL KRAWITZ**
> **Arcus Infrastructure Partners**

resilience, particularly in the wake of war in Ukraine," says Francesch. "It is also worth bearing in mind that energy assets have become the subject of national security concerns, as we have seen with the events related to Nord Stream 1 and 2 pipeline, for example. That brings with it different responsibilities and has been a real game changer."

Smart data

Data aggregation and analysis has become an increasingly important component of the asset management role, as well. In fact, Ardian has hired a team of data scientists. "For example, we recently launched Air Carbon, an in-house application for estimating and forecasting Scope 3 carbon emissions at airports in real time. We have also developed systems for risk management in the renewables market, as well as a tool for optimising production and maintenance of renewables assets," Santavirta says.

Arcus, meanwhile, utilises telematic devices on moving equipment to give information on location, speed and mileage, as well as engine hours and engine performance. "If you have been in the market for a long time and have data coming back from those assets, that gives you a real edge," says Krawitz.

Arcus is also working with its investee companies and suppliers on API data exchange for time-intensive administrative tasks such as receiving and sending inspection certifications to customers. "If you save five minutes per document by automating a previously manual recurring task in relation to a fleet of, say, 20,000 assets, that generates real efficiencies for the business," Krawitz explains.

Friedel, however, cautions that it is important not to put digital tools in place for the sake of it. "You have to be sure those tools are creating real value," he says. "First, you need to carefully identify and track the indicators that are most important to the business. You also need to ensure you have data-savvy people in your organisation and in your portfolio companies. You don't want to force data on management teams. You want it to be embraced, so it is vital to

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GUILLAUME FRIEDEL
Antin Infrastructure Partners

have people onboard that can champion its use."

The asset management army

With such a wide array of responsibilities, the role of the asset manager is certainly more important today than ever, not least because reduced exit activity in the current environment can mean longer holding periods, bigger portfolios and therefore more asset management required, Dunbar explains.

Of course, asset management isn't the exclusive remit of specialists. Investment teams also have an important part to play. "Fundamentally, we will always employ a model where the people who make investments also have responsibility for delivering those business plans," Dunbar says. "But increasingly you do need to be able to call on more specialist asset management expertise as well."

Friedel agrees. "Everyone on our team is responsible for asset management. It is at the core of everything that we do," he says. "We are all asset managers at the end of the day. We do have people who are focused on performance improvement, but everyone has a role to play."

Krawitz says that Arcus's analysis shows its asset management delivers on average more than 300 basis points of value add per investment. "If you don't have that strong asset management capability, you are at a competitive disadvantage achieving returns."

Santavirta adds: "Our strategy has always been to drive operational improvements through capex programmes, build ups and sustainability improvements.

"We create industrial value rather than financially engineering returns. To that end, we have built up a team of operating partners who work alongside us in recent years. This team comprises close to 30 seasoned former chief executives and chief operating officers who bring a different angle to both origination and asset management, enabling us to drive operational and industrial improvements."

Indeed, Dunbar expresses surprise that more attention is not always paid to the asset management function in due diligence. "Origination is a vital part of making any investment and tends to be the key area of focus for investors. However, the origination and execution phase of an infrastructure investment typically lasts somewhere between six months and a year.

"We can then hold assets for up to 10 years, sometimes even longer, and clearly what we do during that period to both protect and enhance value is absolutely critical to the eventual outcome" Dunbar says.

"Our assets tend to sit somewhere on the boundary between public service and private capital so managing those assets effectively and dealing with all the challenges that come our way during our stewardship is of paramount importance." ■