Roundtable

SPONSORED BY
- ANZ
- DIF
- PACIFIC EQUITY PARTNERS
- PARTNERS GROUP

Australia

PHOTOGRAPHY: MATTHEW VASILESCU

Moving to the mid-market

With Australia's asset-recycling programme over, dealflow is now a solidly mid-market affair. But our roundtable participants tell **Daniel Kemp** they do not see a slowdown soon

This time last year, the talk at our Australia roundtable centred on the end of big-ticket, government-led privatisations and the implications this would have for dealflow.

One year later, and this dynamic has continued to evolve, with last year's WestConnex and Victoria land registry auctions definitively ending the asset-recycling chapter in Australia's recent infrastructure story.

But, perhaps surprisingly, the participants we gathered this year remain positive about the pipeline of opportunities. Mid-market transactions are an increasingly viable option, and renewable energy is still presenting opportunities for those smart and brave enough to know where to look.

"We still see a strong pipeline of projects, particularly in the PPP space and renewables," says Martin Hanke, senior director of Dutch Infrastructure Fund. "Particularly in PPPs, there are more coming to market simultaneously than we've seen for quite a while. And we don't see a slowdown at all in terms of renewables. Some projects are probably taking a little longer to come to market, but there's still quite a deep pipeline of opportunities."

This level of opportunity in the mid-market is underpinning the strategy being pursued by one of the newer entrants to the asset class in Australia: Pacific Equity Partners, which held a first close on its Secure Assets Fund last year and is well on its way to reaching its target of A$700 million ($501 million; €444 million) in 2019. The fund targets infrastructure businesses with a combination of secure revenue streams and compelling opportunities for growth and for operational enhancement. Its investments thus far have focused on smart metering.

The firm's managing director, Cameron Blanks, says its strategy is "quite different" from those of more traditional infrastructure players. "We've been focused on corporate carve-outs or public buyouts for 21 years as a private equity business," he says. "So that's really the space that we're looking at in infrastructure or infrastructure-like investments." He makes the point that the Secure Assets Fund was launched precisely to target smaller ticket sizes than some of the sector's big hitters are willing to look at.

"The type of deals that we're looking at generally don't have anything to do with public spending," he says. "So, we don't spend a lot of time thinking about what's going on with government projects and the like."

Another firm that had a busy 2018 was Partners Group, which continued its push into Australian renewables by further developing its Grassroots Renewable Energy platform and making other investments. "For us, it's business as usual," says the company's senior vice-

"We are the diversification into the Australian and New Zealand markets for a lot of investors, so we live and die by what we do here" **Blanks**

AROUND THE TABLE

Robin Dutta, head of infrastructure and PPP, loans and specialised finance, ANZ
Dutta runs the infrastructure and PPP team within ANZ's project finance division. His role includes a focus on transport and social infrastructure PPPs, and on the transition to a low-carbon economy. He joined ANZ in 2009 and was a director at Citibank prior to that.

Martin Hanke, senior director, Dutch Infrastructure Fund
Hanke joined DIF in Australia in December 2015. The fund was part of the Pulse consortium that won the A$5.4 billion Cross River Rail PPP this year. He previously worked at PwC for more than nine years.

Mark Hector, infrastructure portfolio manager, First State Super
First State Super is one of the largest superfunds in Australia with A$95 billion of AUM. Around A$4.5 billion of this is invested in infrastructure and real assets. Hector was appointed to his current role in May 2014, having previously been a project director at Leighton Contractors.

Cameron Blanks, managing director, Pacific Equity Partners
Blanks joined PEP in 2002 and has recently been one of its leads on the Secure Assets Fund, its first infrastructure vehicle. He previously worked for Bain & Company in Australia and North America.

Tim Michalas, senior vice-president, Partners Group
In addition to his role as senior vice-president, Michalas also serves as a director of Partners Group's High Capacity Metro Trains PPP in Melbourne and its Sapphire Wind Farm in New South Wales. He was previously a senior associate at Access Capital Advisors.

> Opportunities will centre much more around capacity expansion, whether it's in the energy, transport or social infrastructure sectors"
> **Dutta**

president, Tim Michalas. "We're progressing with our value-add strategy, and we think that the infrastructure sector more broadly is going to change as that wave of privatisations dries up."

The message is clear: opportunities still exist, but the headline-grabbing mega-transactions are going to be much fewer and farther between.

Robin Dutta – head of infrastructure and PPP, project and export finance, at ANZ – says investors will be "sorely disappointed" if they expect to see the volume of privatisation deals in Australia over the past three years replicated. "Opportunities will centre much more around capacity expansion, whether it's in the energy, transport or social infrastructure sectors," he says. "A lot of investors with existing assets have capacity-expansion opportunities therein that they'll put capital to work in.

"As the definition of infrastructure investment continues to evolve, we expect to continue to see more core plus-style opportunities. The dollar volume of transactions might arguably slow down, and they might take longer or be more sporadic. But I think the overall level of dealflow will still be there."

EXPANDING DEFINITIONS

The question of where deals will come from brings us back to a topic that has been much-discussed: how does one define infrastructure? "It feels like the definition of infrastructure is now being challenged continually," says Hanke. "We still require our investments to be in a physical asset, so we wouldn't look at land registries. But for our latest DIF Core Infrastructure Fund I, we are looking at deals with more re-contracting risk and in newer asset classes like data centres and healthcare. That's next to the more traditional infrastructure that we do through our DIF Infrastructure V fund strategy.""

But is this expanding definition something to be concerned about or embraced?

Blanks says: "Having spent 16 years in the private equity world, and being a relative newcomer to the world of infrastructure, it's actually surprised me how often every infrastructure conference or discussion asks what the definition of infrastructure is. From our perspective, the definition is becoming less important. It's more relevant to talk about a manager and its strategy, and how it's differentiated from others. That's actually much more important than deciding whether it's infrastructure or not."

The privatisation of land registries has offered an interesting case study in that regard. In recent years, the governments of South Australia, New South Wales and Victoria have all auctioned off registries, with Western Australia set to follow suit shortly.

First State Super was an early mover in this space. It formed part of the consortium that acquired New South Wales's registry, and went in solo to buy Victoria's for A$2.09 billion last August in what was its largest-ever equity purchase for a single asset.

"We don't get too caught up in definitions," says First State Super's infrastructure portfolio manager Mark Hector. "We invest based on what are good long-term risk-reward investments for our members.

> We don't get too caught up in definitions of infrastructure. We invest based on what are good long-term risk-reward investments for our members"
>
> **Hector**

"If you look at the common characteristics of many historical infrastructure deals, they were monopolies or essential services with high barriers to entry and very low competition. Land registries are, from our perspective, like a regulated monopoly, but with some GDP linkages as well."

At the end of the day, Hector says, investors are in the business of taking risk and coming up with the right price and gearing structures to generate reward. He says it would be "ridiculous" to miss out on an opportunity with a good risk-reward profile just because it did not fit neatly into a particular category: "If it falls in between traditional buckets, you price it accordingly."

The value-add strategies pursued by PEP and Partners Group, albeit with different focuses, show that the boundaries between infrastructure and private equity are increasingly blurred. Both fund managers have private-equity professionals involved in deals.

This is also true in the banking world, Dutta says: "On certain transactions, we've had blended deal teams staffed with traditional infrastructure financiers and our leveraged and acquisition finance team, because we need different perspectives as the market evolves."

EXPENDING ENERGY

One area where the Australian market has continued to evolve is energy.

The last 12 months were another uncertain period for the country's regulatory environment. At last year's roundtable, investors expressed cautious optimism at the prospect of the federal government passing its flagship energy policy, the National Energy Guarantee, into law.

Instead, Malcolm Turnbull lost his job as prime minister over internal party arguments around the sector. The policy was unceremoniously dumped, and so far there has been nothing to replace it.

"While there's been a lot of policy uncertainty, you can argue that the volume of investment hasn't been held back," Dutta says. "But having that policy certainty will be more important in the next few years, whether it is in generation or on the transmission and distribution side."

Partners Group's Michalas argues that it "would have been nice" to have had more policy certainty around ongoing subsidies for renewables. However, he adds that the business case for projects in the sub-sector is increasingly being driven by the fact that renewables are the cheapest option.

"The sector continues to march on, largely driven by costs coming down pretty substantially," he says. "But I agree with Robin: it would be nice to have a lot more certainty on the grid in particular, to get a clearer view on marginal loss factors and what's going to happen with augmentation and upgrades. There still seems to be some tension within government on this topic. Some want the grid to be made fit for renewables, and there are other areas of the government that don't."

The uncertainty has put off some investors, including First State Super. Hector says there is "no more complex" subsector, and that the instability in Australia's regulatory

> "The renewables sector continues to march on, largely driven by costs coming down pretty substantially. But it would be nice to have a lot more certainty on the grid in particular"
> **Michalas**

environment has made it difficult for the superfund to find appropriate opportunities.

"We've struggled with this," he says. "As a socially minded superfund that's very ESG-focused, we would love to do more in greenfield renewables in our own backyard. But as a fund that also needs to find the best risk-reward for our members globally, we've found better opportunities for renewables offshore, particularly in Asia." He mentions that First State Super invested with Equis Energy before the latter company's acquisition by Global Infrastructure Partners and other investors in 2017.

DIF has invested in one of the country's first energy-from-waste projects, in Western Australia, with construction beginning earlier this year. Hanke says DIF was "happy" to see the technology arriving in Australia, but he does not expect to see a flood of such schemes similar to what has taken place in Europe. "These projects are resource-intensive to develop," he says. "So although there are some other projects that are trying to get up, I don't think there'll be a rush."

AUSTRALIA VS THE WORLD

With energy providing little certainty, is this having an impact on how investors view the market in comparison with other countries or regions?

Michalas says Partners Group's investors still view Australia positively. "We've had success investing in Australia and it's on that basis that we've been successful in raising money here," he says. "Our Australian dealflow has to be compared and benchmarked to investment opportunities all over the world in line with our global relative-value approach. An example would be in Mexico and the US, where we see the midstream gas space as attractive, whereas in Australia it's too core and we don't see it as a particularly investable opportunity for us. If Australia stacks up in certain sectors, we'll invest. But if it doesn't, then we have no compulsion to put money to work there."

Hector says that First State Super, as an Australian superfund, is obviously keen to put money to work in its home market when it can. In fact, it is able to invest between 40 and 100 percent of its infrastructure portfolio in the country. However, Hector adds that Australia is a "highly developed and competitive marketplace".

"As the Australian superannuation system continues to grow, we've recently loosened our ability to invest a bit more offshore," he says. First State Super is now able to put up to 20 percent of its portfolio in non-OECD countries and up to 60 percent in OECD countries.

"We've got a reasonably healthy allocation to investing in emerging markets compared to some other funds," says Hector. "We're currently underweight, but we found that if you can do your homework you can take advantage of distressed situations. We wouldn't ever consider going in on a direct basis in emerging markets, so we partner with sophisticated investors that have been locals for a considerable period."

PEP is also different, with offshore investors providing the vast majority of its capital, which is deployed solely in Australia and New Zealand. "We have some Australian investors, but more than 80 percent of our investors

> We still see a strong pipeline of projects, particularly in the PPP space and renewables. There are more PPPs coming to market simultaneously than we've seen for quite a while"
> **Hanke**

are international," Blanks says. "We are the diversification into the Australian and New Zealand markets for a lot of investors, so we live and die by what we do there."

He points to PEP's experience in the market to demonstrate its ongoing attractiveness if investors know where to look.

LOOKING AHEAD

One other seismic event in the Australian market in 2018 was the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry. Although no infrastructure fund managers were implicated, could it still have an impact on the sector?

Blanks points to one second-order effect that could have implications: that money has begun to flow away from the retail superannuation funds that came under criticism during the Royal Commission and towards industry funds such as First State Super. The latter have traditionally been big supporters of unlisted assets, including infrastructure.

However, he adds that ESG "permeates all that we do", from examining environmental sustainability and the social governance within companies in which PEP invests, to looking internally at issues such as diversity.

"If you haven't made some significant changes within the next decade, I think you're going to be dead," he says. "It's going to be a mandatory part of investors' assessment of who they invest in."

It is clear that ESG is already playing a role in an increasingly competitive marketplace, not just in Australia but around the world. With record amounts of capital raised, will the mid-market offer enough to keep infrastructure investors busy in Australia over the next 12 months?

"We have a very positive outlook, certainly in the markets that we look at," Hanke says.

Hector says First State Super will be "very selective" and increasingly focused on downside risk after a busy period of deployment. "We're quietly optimistic that we can find investments in Australia and offshore," he says. However, he adds that, aside from an event on the scale of the global financial crisis, "it's hard to see prices suddenly getting materially lower any time soon because interest rates will continue to be low and there is a very health supply of capital."

Dutta describes the short-term outlook as positive. "Some transactions might take longer to close, but that just reflects the migration from brownfields to greenfields in the bulk of those big projects," he says. "Otherwise we still see pockets of secondary M&A and capacity expansion. So while volume might be lower than we've seen in the last couple of years, I expect day-to-day activity to keep ticking over."

Blanks says that, when it comes to the Secure Assets Fund, PEP invests in businesses that are not exposed to GDP and that there are deals in the pipeline. "We'll keep on going out and finding situational opportunities that we can invest behind and make good operating performance improvements," he says.

A continuing shift away from the big-ticket transactions in Australia is to be expected, then. But dealflow in the mid-market looks set to remain strong. ■