ROUNDTABLE

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'People are expected to work together'

Shortly after covid-19 forced Australia into a period of lockdown, three industry figures told Daniel Kemp how they are responding to the crisis – and why they still sense some reasons to be positive

Our 2019 Australia roundtable painted a positive picture of the opportunities available in infrastructure, particularly in the mid-market space. At the time, our participants said the outlook was "very positive" and that "aside from a GFC-style shock", there was unlikely to be anything that would materially alter the outlook for the asset class.

Well, in the weeks immediately preceding our 2020 roundtable, that GFC-style event arrived in a manner no one could have anticipated. This year's discussion, held at the end of March, was our first to be conducted entirely via video-conference. Unsurprisingly, the novel coronavirus dominated the discussion.

The pandemic precipitated a sharp downturn in the world's public markets, and in broader economic and business sentiment more generally. Infrastructure assets, especially in the transport sector, but in other areas too, have not been immune.

"With the GFC, there was a 12-month lead-up to when Lehman collapsed where people knew the economy was starting to decline, with a further drop afterwards until the bottom in March 2009," says Cameron Blanks, a managing director at Pacific Equity Partners. "So, it was a long time coming and people were able to respond. This crisis has come on very suddenly – most people were blindsided and not long ago it was inconceivable to most that this was going to happen. We are all going through a period of readjustment, to try and understand what the future looks like after this crisis."

As Mark Hector, infrastructure and real assets portfolio manager at the A$100 billion ($64 billion; €60 billion) First State Super, puts it: "This is unprecedented for all of us, so we're all taking it week by week, month by month.

"Essentially our entire company is well set-up from an IT and communication perspective to be working from home full-time for an extended period. The federal government indicated they're expecting restrictions to last at least until the end of April, and I think we're all conservatively assuming it'll realistically be longer than that in some form or another."

Whatever the scale of the economic impact over the coming months, it is fair to ask what exactly normal will look like once we emerge on the other side, says Robin Dutta, head of infrastructure and PPP, project and export finance, at ANZ. "If we can look several months ahead, how will businesses view the need to alter those supply chains which have obviously been quite materially disrupted? Will that mean that the design and procurement of infrastructure has to adapt to cater to this? Those are legitimate questions to ask." The pandemic has clearly had a significant impact on all parts of the economy, with infrastructure investments and the firms that manage them being no exception.

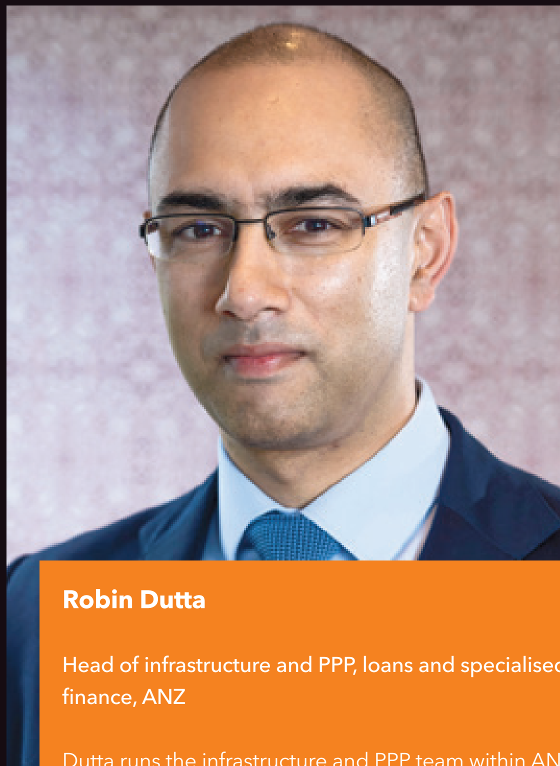
In Australia, several superannuation funds and GPs have made quick decisions on valuations.

In the week before our discussion, two of the country's largest funds acted:

Cameron Blanks

Managing director, Pacific Equity Partners

Blanks joined Pacific Equity Partners in 2002 and has recently been one of its leads on the Secure Assets Fund, its first infrastructure vehicle, which targets assets with a combination of secure and predictable revenue streams as well as compelling growth and operational enhancement opportunities. Prior to joining PEP, Blanks worked for Bain & Company in Australia and North America and spent seven years in the mining and construction industry in Australia, Asia and North America.



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, with emphasis around the transition to a low-carbon economy. He joined ANZ in 2009 and was previously head of loan syndications. Prior to that, he was a director at Citibank.

Mark Hector

Infrastructure and real assets portfolio manager, First State Super

Hector is infrastructure and real assets portfolio manager of First State Super, one of the largest superfunds in Australia with almost A$100 billion of assets under management. Around A$6 billion of this is invested in infrastructure and real assets, which Hector has overseen since joining the fund in May 2014. Prior to this, he was a project director at Leighton Contractors where he was responsible for leading its equity investments in greenfield projects in Australia and New Zealand. He has also held project finance roles with Japanese bank MUFG, Babcock & Brown and ABN AMRO.

AustralianSuper reduced the value of its unlisted assets by 7.5 percent on average and UniSuper reduced the value of its infrastructure portfolio by 6 percent. After our discussion took place, Hostplus moved to cut the value of its unlisted portfolio by between 7.5 and 10 percent.

Out-of-cycle process

"We're definitely going through an out-of-cycle process of revaluing all of our unlisted assets, as all LPs and GPs should be doing," Hector says. "We've got legal requirements to make sure all our assets, particularly our unlisted assets, appropriately reflect market conditions. If there are material changes in market conditions, as clearly we're seeing at the moment, we're required as soon as is reasonable and practical to adjust those valuations."

All superfunds go through an extensive process with external valuers in the run-up to the end of Australia's financial year on 30 June. The current processes, however, are generally being carried out internally and involved a bit of what Hector describes as "guesswork".

"There's naturally a little bit of guesswork at this early stage of the crisis," he says. "We're talking to external valuers to get their views on how they'll be approaching it in June, as well as talking to our peers, fund managers and asset-level management teams.

"As best as we can, we prefer to try and stretch or adjust cashflows without necessarily changing asset-specific discount rates. But where there is a little bit more uncertainty on the cashflow side, we will be taking more prudent or conservative views on those asset-specific discount rates, or taking the low end of valuation ranges.

"Time is going to tell whether there will be some broader macro increases in general equity market risk premiums across infrastructure and broader unlisted asset classes."

Pacific Equity Partners has also been busy in the early stages of the crisis, albeit approaching the problem from a different perspective to that of a superfund.

> *"Many infrastructure assets have investment-grade credit ratings and you don't earn those unless you have some liquidity measures in place to withstand a short-term demand shock"*
>
> **ROBIN DUTTA**
> **ANZ**

"We've been making sure our portfolios are performing well, that our portfolio companies have taken all the actions they need to take and have thought about their contingency plans," Blanks says. "It's been a good opportunity to really dive in and make sure all of our businesses were responding in the right way."

The firm is currently "mopping up the tail end" of fundraising for its Secure Assets Fund, a vehicle with a target of A$700 million. The fund has made three investments: two in the smart metering space, the third in the 'last mile' infrastructure space, and a take-private bid for publicly listed Zenith Energy in the process of being finalised.

"All our assets in the Secure Assets Fund are in very good shape, with good liquidity and cashflows," Blanks says. "We've got no problems in that portfolio at all.

"A couple of things in our broader private equity fund need more attention than others, but that's a pretty understandable place to be [in] given the disruption in the market.

"We're fortunate that we've got over A$3 billion of committed and undeployed capital [across the whole business] – it's really now a matter of us turning to where we focus our attention on deployment."

For ANZ, the emphasis is again different as a debt provider, but the bank has been no less busy. A particular focus has been on working with clients and businesses that have been especially affected by severe, short-term drops in demand. However, Dutta points out that the infrastructure asset class should be inherently more resilient to these kinds of shocks than businesses or assets in other sectors.

"Many infrastructure assets have investment-grade credit ratings and you don't earn those in the first place unless you have some liquidity measures in place to withstand a short-term demand shock," he says. "While there's no question some assets, particularly in the transportation sector, will suffer in the short to medium term, it's fair to say their business models should have an underlying resilience.

"Several of them will also have financial flexibility – whether it's undrawn liquidity, the ability to suspend discretionary capex or dividends, and so forth – that will probably see them through this. The need to avail these measures doesn't invalidate the underlying investment thesis, which has been made with an investment horizon, in some cases, of multiple decades."

On the topic of distressed assets, all three participants agree there may be attractive opportunities at some point. None expect them to appear quickly, though.

"They will take a while to come and I don't think we'll see mass distress in the broader infrastructure asset class," says Blanks. "It'll probably be three to six months before we really start to see those distressed assets come to market, particularly if their parents or funds need liquidity."

Refinancing risk

Hector highlights the potential for problems around refinancing of assets.

"We're definitely getting feedback that there are liquidity issues, or pricing issues with bank debt, and capital markets are either shut down temporarily or have seen very material increases in prices." he says. "If you've got near-term refinancing risk, that's clearly going to have an impact on assets."

He adds that one of the "obvious" sources for seemingly attractive deals during a recession can be the listed markets, due to the dramatic drop in share prices.

"But you've really got to be careful there," he says. "Reputationally, we don't want to be seen to be acting like vultures. And a high-quality company that's just seeing some short-term issues won't look too kindly on that sort of approach.

"On the other hand, if there's a listed company in serious trouble that is looking for a white knight, or a listed company that we feel is fundamentally undervalued coming out of the crisis, it's a different story, but that will take time to play out."

High-quality businesses and assets that are just suffering from short-term debt or liquidity issues should be able to navigate a way through, all our participants agree. However, the fall in equity markets may increase opportunities for corporate carve-outs. "Asset sales could help a company take the edge off other liquidity measures, like raising equity," Dutta says. "Over the last few years, investors might have perhaps been unsuccessful in their overtures, to both corporates or state counterparties.

"We may now be entering a period where investors are more likely to be rewarded for that creativity than perhaps in the past, so you might see some of those opportunities start to unlock and assets come to market in that vein."

PEP, of course, has been doing corporate carve-out deals for many years in the broader private equity space, and some of its initial work in the Secure Assets Fund has followed a similar pattern. Blanks agrees that these types of deals are likely to increase.

"These are classic times where it may not be the asset itself that's stressed, but the parent," he says. "You can think of some energy companies, for example, that might have issues in their broader portfolio, whether it's generation or other things unrelated to other assets downstream, and it could be a lot better for them to sell those assets to raise

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> **First State Super**

capital than go out and do an equity raising."

And on dealflow more broadly, none of our participants reported too much disruption – yet.

Dutta says deals that were in the pipeline from six weeks previously are still being carried out, thereby ensuring that everyone is staying busy. Blanks says he has been presented with numerous opportunities already by banks and advisors, although not many have been of a very high quality.

Things are likely to slow down a bit, with some processes pushed back a little to allow all parties time to consider their situations fully and develop a clearer picture. That will not necessarily mean they do not go ahead, though.

"It's just going to take a few months to settle down," says Blanks. "But I don't think it's going to have a long-term impact on dealflow. It might change the nature of the dealflow and delay some things a little bit, but the opportunities will come." He adds that electronic data rooms and virtual due diligence meetings have already become commonplace.

For First State Super, the focus so far has understandably been on its own portfolio and ensuring it has adequate liquidity.

"That's certainly not to say we're shut down to new business," Hector says. "But this type of crisis naturally rations capital and we're now being more selective about how we choose to deploy our capital."

The outlook for the future, then, at least as far as the asset class is concerned, offers some hope, with the prospect of increased asset sell-offs from both governments and private companies, and more chances to be imaginative.

Blanks says: "You need to be creative in environments like this and we think we're well-equipped to do that. The standard privatisation where a package is given and lots of people roll up – there is a role for those and they'll continue to happen, but it's certainly not where we're focused.

"We're looking at those complex situations where we can come in and make a difference, and I think there's going to be more and more of that, because of the market dislocation."

Hopeful outlook

As Hector adds, the situation is not all doom and gloom for investors.

"Coming out of any crisis, you expect and hope there will be some relatively better buying opportunities," he says. "While we're very focused on our existing portfolio at the moment, we'll continue to be patient and have dry powder ready for that."

The discussion over social licence to operate for infrastructure investors, as well as in the private equity space more broadly, has continued to rear its head in the last 12 months or so, with people as wide-ranging as Qantas chief executive Alan Joyce and former Democratic US presidential hopeful Elizabeth Warren having their say. The crisis could therefore prove an unrivalled opportunity for investors of all stripes, including in infrastructure, to show their worth.

"There's now almost an underlying expectation that the business community works together as a collective to address the crisis we're facing, both on health and economic grounds," Dutta says. "There are still details to hash out, but in most cases there's a common spirit in which people are expected to work together, even if they might be on opposing sides of a given contract." ■