KEYNOTE INTERVIEW

Full steam ahead on the road to recovery

Australia has put the worst of covid behind it, and opportunities for investment in infrastructure-style assets abound, say Pacific Equity Partners managing directors Andrew Charlier and Evan Hattersley

Q How has covid impacted Australia, your assets and your ability to transact?

Andrew Charlier: Australia went into a hard shut down in March last year and was able to close borders to stop the inflow of covid cases. Meanwhile, community transmissions were also stopped in their tracks after four to six weeks of stay-at-home orders. That has meant we have been able to open up as an economy in a way that hasn't been possible in some other parts of the world.

Obviously, there are industries where that doesn't apply. Airlines and the hospitality sector are still facing real challenges. But supported by all the government stimulus being poured into the economy, trading conditions are now generally strong.

In terms of our own portfolio, our infrastructure-style assets, or what we call secure assets, were largely unaffected. They all have very predictable revenue streams often providing critical services with take-or-pay revenue models and so other than navigating working practices during lockdown, there was no material impact. On the private equity side, some individual portfolio companies were affected by the first wave. But almost all of those businesses have recovered quickly and are now operating above pre-covid levels. The rebound has been pronounced.

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Evan Hattersley: Our ability to transact was also demonstrably unaffected. Last year was clearly unprecedented, but we still managed to complete four deals – two in our Buyout Fund and two in the Secure Assets Fund. That fits entirely with our long-term average and ambition. The ability to adapt to a different working environment and to keep deal flow progressing has been remarkable.

Q Aside from its relative covid resilience, what are some of the other attractions of Australia as a market?

AC: Australia has a well-established and stable democracy; good underlying fundamentals in terms of population and GDP growth and a broad range of drivers to the economy ranging from natural resources through to consumer products, financial services and business services. In addition, Australia is well-placed to sell, not just to the domestic market, but to high-growth regions throughout South-East Asia. Of course, some of those countries have been hit hard by covid, but these are trends we expect to persist well into the future.

EH: The Australian government also led the world in defining infrastructure as an asset class, starting with concessions for toll roads, and continuing to lead the way right through to registry assets for land and motor vehicles. The government championed the idea of asset recycling as well, building infrastructure and then selling it off to the private sector so that that capital could be re-invested again and again. That all began 30 or 40 years ago and has never stopped. We have a strong history of productive investment right across the economy and that shows no signs of slowing.

Q Where are you seeing the most interesting opportunities right now?

EH: On the infrastructure side, we see strong opportunities in the energy, transport and telecoms sectors. The energy transition from thermal to renewables is a major theme. That is also a parallel shift towards decentralisation, including rooftop solar and batteries, and the digitisation of that energy so that there is a two-way flow. In the transport sector, there is an obvious move towards electrification. That has started in the passenger market but is extending into the heavier end of the transport fleet.

Meanwhile, a proliferation of digital tools is driving data consumption, which will only be accelerated by the advent of 5G. That is going to require significant infrastructure investment in everything from the physical towers to the fibre backbone and data centres.

Finally, we are also seeing a growing number of opportunities in the waste sector. Historically, everything has been sent to landfill in Australia and New Zealand, but now we are seeing an increased focus on recycling.

Beyond sector, we are also seeing more dealflow emanating from corporates. Australian or multi-national businesses are looking to spin-off assets so that they can re-use the capital, or else are looking to monetise their infrastructure by allowing others to use it, but then need a third party to come in and help make that happen. We are seeing lots of opportunities in that corporate carve-out and corporate joint venture space and expect that to pick up further this year.

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>
> **EVAN HATTERSLEY**

Q How competitive is the Australian market?

EH: It really depends on the size of the target. For assets valued at over A$2 billion, the market is global and highly competitive. Most of the large, international infrastructure and private equity houses have set up offices in Australia, but typically only look to do around one deal every couple of years out of their Asian or Global funds.

Meanwhile, for assets below A$500 million, we don't see anywhere near as much competition. The cheque sizes don't work for the big global firms given the origination and due diligence intensity required. And for assets valued somewhere in between, it really depends on the sector and deal situation. Only a small part of our dealflow involves broader auction processes. We much prefer to spend time developing relationships so that we can transact on a bilateral or limited party basis. We have successfully executed a number of corporate carve-outs in this manner where vendors' confidence in our ability to execute a deal and achieve a clean separation is often a key consideration.

Another significant part of our dealflow involves helping founder-led businesses reach the next level where comfort in having a local partner who brings a different set of skills including an ability to navigate capital markets is as important as the cash consideration provided.

Q How would you describe LP appetite for the Australian market?

AC: Clearly, there is extremely strong appetite for private markets across the board right now, but Australia's pension funds and superannuation vehicles are particularly supportive of alternative assets. We are increasingly seeing those institutions looking for long-term investments which lends itself to

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>
> **ANDREW CHARLIER**

the types of deals we complete in our secure assets fund.

EH: Australia has fared well during covid, which has attracted the attention of international LPs but, as Andrew alludes to, Australia also has the fourth largest pension system in the world, even though it is a relatively small country. Those pension funds are highly supportive of private markets firms.

Q How does Australia compare with other markets around the globe when it comes to its ESG sophistication?

AC: Europe is leading the charge, but Australia comes a close second. There is then some distance between Australia and what we see coming out of the US and Asian markets. Australia is particularly strong on safety, but we are now starting to see more of a push on the environment. Part of that, again, is our pension system, which offers personal choice. The younger generations, in particular, are choosing to invest in those that have the right ESG credentials. That then flows all the way through to investment. The trend is certainly towards more of a focus on ESG and not less.

EH: It used to be that around half of LPs probed us on ESG, but that is now increasing. LPs want to make sure ESG is something we are factoring into decision-making and they want to understand how we are driving positive ESG outcomes. We are actively working on building an internal ESG resource that can work with portfolio companies to set and achieve targets, as well as systematically tracking those outcomes. We recognise that it makes financial sense to be on the right side of these trends, but also that it is fundamentally the right thing to do. It is a key motivator for our investors, but also for everyone who works at PEP.

Q So, how would you describe your ESG approach?

AC: There are four steps to our approach. First, we exclude certain sectors. Second, we carry out a comprehensive risk, gap and opportunity assessment in the due diligence phase. The risk component may focus on environmental concerns, depending on the nature of the business, or it may include supply chain due diligence, for example.

Having ascertained the status quo, we then look to understand the gap that exists between that and exemplary ESG performance. We don't just invest in perfect businesses. Part of our role is helping to implement improvements to make businesses more valuable, so it is important to understand the nature of that gap. The opportunity element is then about understanding how a company could benefit from ESG trends.

The third step involves the asset management phase. Once we have acquired a business, we carry out comprehensive ESG compliance and monitoring practices, including rolling out policies and procedures where they don't already exist, for example around modern slavery or carbon tracking, which we put into every business that we own. We map the portfolio against the United Nations Sustainable Development Goals and report against relevant metrics.

Finally, the fourth step, is about value creation. How can we increase the value of the business from an ESG perspective? That comes down to aligning the incentives of the management team with ESG outcomes and ensuring the ESG credentials of the business are clearly understood by the market as we look to exit our investment.

Q What does the future hold for the Australian market?

EH: We are extremely positive about what the future holds. There is huge demand for the type of long-term, defensive assets that our Secure Asset Fund targets. Our strategy, however, is to invest in those assets at an early stage, helping them strengthen management teams, access capital and put the necessary systems and process in place, so that they can get to a critical mass, where they become hugely attractive to the wealth of capital that is looking for exposure to infrastructure.

The breadth and depth of our team means we are ideally placed to take advantage of those opportunities and to be good stewards of those businesses throughout our period of ownership.

Meanwhile, Australia itself appears to have put the worst of covid behind it and we are looking forward to a favourable 2021 and beyond, as the global economy opens up and trading with our regional partners resumes once more. ■