ROUNDTABLE

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Is infrastructure bouncing back Down Under?

Across the world, the covid crisis has given way to economic uncertainty. Five Australian finance professionals gathered in Sydney to discuss the challenges and opportunities facing their market. Simon Watkins and Daniel Kemp report

As the covid-19 pandemic begins to fade into memory, infrastructure investors in Australia are facing new challenges from rising inflation, higher interest rates and the threat of recession. But the changed landscape also presents opportunities, driven by the climate change agenda and the growing importance of data facilities. Our roundtable guests began by discussing how their firms and portfolio companies are adjusting to this 'new normal'.

"Having a defined vaccine rollout offered a clearer exit path than existed in 2020, when everyone was still facing a range of uncertainties," says Robin Dutta, head of infrastructure in ANZ's project finance division.

"That flowed through to the nature of the transactions. There was a lot more deployment of capital across the breadth of the infrastructure sub-sectors during last year. So it was busier, but that doesn't mean it was free of disruption, and there are some issues stemming from covid that still impact a lot of our businesses and our exposures today, particularly delivery of new projects. There are some hangovers from covid that are still going to impact that delivery of new infrastructure capacity."

'Finding the groove'

Mark Hector, senior portfolio manager at Aware Super, agrees that the world has 'normalised' in the last six months. "Everyone did a pretty amazing job of getting deals done and managing existing assets during covid," he says. "It's easier now people are starting to travel a bit more, but I still feel like we're finding the groove.

"There's a new permanent normal. At our company we have a blend of work from home and office, with individual sector teams responsible for finding the optimal rhythm. We're incredibly productive from home thanks to amazing technology, but there are clearly cultural benefits from an appropriate level of face-to-face interaction and socialisation. So it's finding a reasonable balance that's also important to attract and retain talent."

Finding good staff is proving hard work, Hector says, citing key areas of technology as facing skills shortages. "Cybersecurity has become a key theme for obvious reasons over the last couple of years. So those skills are important, especially for some of the sensitive or critical infrastructure assets we own. We have noticed there's a shortage of those skills in the market and so the salaries are going up a lot as you have to pay appropriately to attract and retain those quality people."

When it comes to head office staff, some roundtable participants mentioned the challenge of building and maintaining culture in a hybrid-working environment. Vicki Rigg,

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Robin Dutta

Head of infrastructure & PPP, corporate finance, ANZ Banking Group

Dutta runs ANZ's Infrastructure Financing practice, supporting financial investors and industry participant clients. ANZ's Infrastructure Financing team supports investment with a focus on facilitating transition to net zero by 2050. Dutta joined ANZ in 2009.

Paul Foster

Managing director, Pacific Equity Partners

Foster joined Pacific Equity Partners in 2017. He has 24 years of principal investment experience spanning airports, toll roads, rail, energy utilities, water, health and education. Prior to joining PEP, he was head of infrastructure, Australia & New Zealand, at AMP Capital where he was responsible for leading the firm's investment activities in those markets.

Daniel Timms

Head of asset management, Australia and New Zealand, Igneo Infrastructure Partners

Timms oversees the management of Igneo's regional utility and transport infrastructure assets. He has over 19 years of energy utility sector experience. His current role includes originating, evaluating and securing investment opportunities in the energy sector.

Vicki Rigg

Managing director, Palisade Investment Partners

Rigg, who has more than 20 years' experience in the infrastructure sector, including in PPPs, transportation, renewables and midstream energy, co-founded Palisade in 2008. She focuses on the acquisition and management of infrastructure assets and oversees Palisade's funds and mandates.

Mark Hector

Senior portfolio manager – infrastructure and real assets, Aware Super

Hector oversees Aware Super's circa A$12 billion ($8.4 billion; €8 billion) infrastructure and real assets portfolio. He has been with the fund since May 2014 when he joined First State Super, which rebranded to Aware Super in 2020.

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>
> **ROBIN DUTTA**
> **ANZ**

managing director at Palisade Investment Partners, says this is a particular challenge when it comes to junior staff, who have not been immersed in a company culture.

"We all live off a kind of memory of culture within our organisations. You can't build a culture when you're not in the office. So it's very hard to educate and teach the juniors when they're at home three to four days a week," she says.

The realities of lockdowns and travel restrictions also posed challenges for infrastructure deals. More than any other asset class, infrastructure is about tangible assets that investors want and need to see in situ, to fully understand their potential and risks.

But due diligence at a distance is possible, says Daniel Timms, head of asset management for Australia and New Zealand at Igneo Infrastructure Partners. "Despite wave upon wave of lockdowns, working from home and border closures, the Igneo team were able to execute several meaningful transactions last year. Through utilising technology to undertaking virtual site visits, appointing regional advisers, being scrupulous and having lots of Zoom calls, we were able to successfully navigate due diligence processes."

Pacific Equity Partners managing partner Paul Foster agrees: "It felt to us as though by the middle of last year things were getting back to some sense of normality, notwithstanding having to do due diligence by Zoom and having people walking through facilities and assets with a GoPro strapped to their chest due to ongoing mobility restrictions."

Of course, the pandemic also prompted a spate of corporate thinking and strategic adjustment. This fuelled a rising volume of potential transactions, but with this increasing quantity, the quality of opportunities became more mixed, according to our roundtable participants. For investment professionals, this has required a greater focus on early assessment.

"We've been very busy," says Foster. "We sold two businesses last year from our Secure Assets Fund I and we acquired a new platform asset for the fund as well. The pace of activity certainly hasn't slowed, but I think we are seeing more variable quality of opportunities coming in at the top of the dealflow pipeline. As a result, we're having to be really focused at triaging what we spend time on and devote team resources towards."

Rigg echoes this sentiment: "There's

still a significant amount of capital in the market chasing infrastructure-like returns and also more opportunities hitting our inboxes than I think I have ever seen in my career, so you do have to be good at triaging opportunities, because many of the proposals we get sent really aren't infrastructure and don't have those infrastructure characteristics that have held up so well through covid."

In a sense, this is a positive sign for infrastructure. If sellers are extra eager to promote assets as 'infrastructure' then it speaks volumes about the perceived value of this asset class in the Australian market.

An uncertain economy

The recognition of value in infrastructure is partly a result of the lessons learnt during the covid crisis. But it also reflects the emerging economic uncertainty. Australia's Reserve Bank raised interest rates by 50 basis points in early June, and soon after our roundtable met, its governor, Philip Lowe, said he expected inflation to reach 7 percent by the end of the year.

But this is not an economic outlook that our panel of experts finds too concerning – at least not yet.

"Infrastructure as an asset class generally is showing itself again to be pretty attractive. Aside from the obvious examples like airports and people transport assets that have been affected most by covid, on the whole infrastructure has performed pretty well, as you'd expect for essential services with long-term stable cashflows," says Hector. He adds that much infrastructure revenue is in some way inflation-linked, thus mitigating the risk of higher prices.

Participants were also sanguine about the prospect of increased debt servicing costs. All averred that their leverage was low and typically hedged.

"Approximately 80 percent of the debt across our portfolio companies is currently hedged," says Timms. "We have traditionally taken a fairly conservative outlook on long-term rates, and despite the current economic environment, our long-term outlook hasn't changed. Many of our portfolio companies have inflation protection, which has offset the impact of increasing rates. However, this is very much a watching brief given the rapidly changing environment."

Dutta adds: "The reality is that the vast majority of our exposures are investment-grade businesses, and that generally means borrowers have been disciplined about mitigating interest rate risk and refinancing risk."

Indeed, from some perspectives, rising interest rates may even be a boon. Rigg points out that infrastructure businesses and investors often have significant reserve accounts to cover maintenance. For those reserves, higher interest rates can be cashflow positive. The only challenge, she adds, is that banks become a little more

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DANIEL TIMMS
Igneo Infrastructure Partners

nervous as future interest rates are uncertain. "Increased uncertainty in the debt market makes acquisitions harder. For example, in an uncertain market, banks won't hold their debt pricing for as long."

While participants are confident about the immediate situation and the fundamental strength of infrastructure in the face of economic stress, they also gave reasons for caution. Foster points out that "infrastructure is not a homogeneous asset class".

He continues: "There are subsectors within the asset class that have proven to be genuinely essential and resilient when it comes to this sort of economic environment. And there are other subsectors and assets that are more exposed to what's going on in the general economy. So you have to understand idiosyncratic and factor-based risks in your portfolio. Assuming that a business or asset will behave in a certain way because it has the infrastructure asset class tag on it is foolhardier today than it's ever been."

Looking more widely, Hector also cautions against complacency. "The world is a strange place at the moment with respect to where interest rates and inflation are going. We've got the energy crisis, we've got stuff going on in Ukraine, which could worsen. Markets go in cycles and sometimes it can impact consumer confidence. So we can't kid ourselves here – you can go through periods where infrastructure assets could suffer some blowbacks."

Two mega-trends

With due caution noted, the discussion moved on to emerging opportunities. Two themes stood out: first, the climate agenda and the need for carbon reduction; second, the digital revolution, which if anything has been accelerated by the covid crisis.

"Decarbonisation is clearly a key driver of capital allocation," says Foster. "We've chosen to play that in a few different ways, through things like smart metering and behind-the-meter assets in smaller last-mile utility businesses that are competing effectively with traditional large-scale energy companies to create more cost-efficient, high customer service outcomes for end-users."

Hector also believes that energy transition is "the number one theme".

"We have made some traditional investments in large-scale utility, wind and solar, but that's been a tough space to find value," says Hector. "As a long-term investor, we feel we need to move to storage solutions as a diversifier and opportunity to find some better risk/reward. So we have recently invested in an early-stage pumped hydro and storage development platform."

Rigg also cites the decarbonisation trend as crucial to the infrastructure sector. "We've got a huge amount to do to address climate change. Increased build-out of renewables needs to be a big part of that, but the technology to support the use of increasing amounts of renewable or intermittent generation is also going to continue to

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VICKI RIGG
Palisade Investment Partners

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> **PAUL FOSTER**
> **Pacific Equity Partners**

be a huge theme across the Australian market."

The conversation turns naturally from energy to the wider issue of environmental, social and corporate governance, which has become a powerful factor in investment decision-making. All participants emphasised how analysis of ESG issues is now a core consideration.

"For us it is completely embedded," says Dutta, "and I would go further and say it's almost a primary screening point before we get into the operating fundamentals of particular businesses. We have a distinct reputational risk committee that involves the highest levels of the bank."

Meanwhile, Timms says his organisation aims to cut through the alphabet soup of standards and metrics with a set of core principles. "Our approach is based on improving ESG performance to generate long-term sustainable value, rather than excluding certain companies or industries altogether. We focus on actions through our five minimum standards for ESG performance. These standards are applied to all of our portfolio companies and include safety performance, emissions reduction, diversity priorities, employee engagement and governance."

Infrastructure investment groups face an extra dimension to their ESG objectives. As well as assessing the issues at the top level, ESG issues permeate the activities of every individual investment. The challenge becomes how to drive ESG issues, not just at the outset of an investment, but in the day-to-day operations of every asset.

For Foster, it is a matter of incentives. "We take a meaningful proportion of the management incentive plan that is available to the CEOs and management teams at each of our investments and portfolio companies, and link it to explicit quantitative ESG targets. We make those targets quantitative, time-specific and relevant to each company, and the achievement of those targets determines whether that portion of the incentive plan vests. This mechanism has fundamentally and rapidly changed the focus and nature of ESG engagement inside and throughout our investee companies."

The covid lockdowns have also focused attention on the role of digital services and data. There has been a running debate in some infrastructure circles as to whether data centres should be regarded as infrastructure. For our participants the issue appears to be settled, though with a few caveats.

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MARK HECTOR
Aware Super

Timms. "Data is no longer just about entertainment, it's essential to the way we work, the way we communicate and the way we connect globally. That doesn't mean we consider all data assets as core infrastructure, and investments need to be considered carefully. We focus on assets with high barriers to entry and stable cashflows, like fibre-to-the-premise networks for example."

Rigg agrees: "There are a range of opportunities in digital. If you have a data centre that has long-term government contracts on it, then absolutely people would see that as a core investment. But if you've got a data centre in regional Australia that is uncontracted then that is less likely to be seen as core. So these days the market accepts that data falls within the infrastructure bucket, but that doesn't make everything to do with data a core investment."

While decarbonisation and data are the leading themes, the roundtable identifies other opportunities as well. Public sector bodies around the world are themselves facing challenges to their balance sheet, weighed down by the expense of the covid crisis, while simultaneously being acutely aware of the essential role of infrastructure in the economic recovery.

This adds a further opportunity for infrastructure investments, according to our participants.

"All Australian governments have really stretched balance sheets," says Hector, "so all of them, even the ones that have been a bit anti-privatisation, will be looking at freeing up their balance sheets with some long-term concessions or commercialisations."

Meanwhile, Dutta is looking to other public services where infrastructure investors can play a role. "The other area where we put a lot of focus is not just financing the acquisition of existing assets, but the delivery of social infrastructure in greenfield format," he says. "Again, it's a broad category and there's quite a bit that falls within that – education, healthcare, and the like – and we see quite a broad opportunity there."

The road ahead

The post-covid world of infrastructure investment in Australia is beginning to take shape. Hybrid working is embedded, as are techniques and technology for tackling due diligence challenges posed by lockdowns, which may yet of course return should covid rear its head once more.

The new economic uncertainty has not yet prompted serious concern, though there is a whiff of caution in the air. For our roundtable participants, the new environment requires renewed rigour in analysing prospects and securing their future, but at the same time it is a period of significant opportunity. ■