ROUNDTABLE

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# Creating value in a volatile environment

*Digitalisation and decarbonisation trump a brutal macroeconomic climate when it comes to infrastructure managers' value creation plans, our panel tells Amy Carroll and Anne-Louise Stranne Petersen*

Value creation begins with asset selection, and, in a ferociously competitive market, originating quality assets at attractive prices is no mean feat. "The number one rule is discipline in asset selection," says Christoph Bruguier, senior investment director and partner at Vauban Infrastructure Partners. "[That means] ensuring you are targeting genuinely essential infrastructure at attractive pricing that is inflation protected, with strong downside protection. That is where value creation really starts."

But the challenges don't end on completion, particularly in a volatile market such as this. Value creation professionals are having to navigate a torrid macroeconomic environment, re-evaluating plans for capex and making tough decisions on opex, as well.

The situation varies considerably by sector, of course. "Most of our investments have limited GDP exposure, and therefore there really shouldn't be any material impact on capex decisions," says Roger Pim, senior investment director, infrastructure, at abrdn. "After all, being able to take a long-term approach to value creation, is a fundamental tenet for infrastructure investment, particularly in the core/core-plus space."

"We take a long-term view," adds Bruguier, "so we will not stop investing capex when it comes to things like digitalisation and decarbonisation, which are mega-trends that are impacting pretty much every type of infrastructure asset. LPs are supportive of that because they recognise that it is part of the long-term value creation and preservation of assets, irrespective of the cycle."

Indeed, the support of underlying limited partners is a critical consideration when it comes to value accretive investment. "The denominator effect has had a short-term impact on some investors' appetite for new commitments, due to the fact that infrastructure valuations have held up well while the listed markets and real estate, for example, have struggled, leaving some investors at the upper end of their allocation," says Pim. "That may limit their capacity to commit over the short term, so in some sense infrastructure is a victim of its own success."

## The energy crisis

Meanwhile, infrastructure managers appear sanguine about the impact of the energy crisis on value creation plans. Grégoire de Chammard, asset management director at InfraVia Capital Partners, for example, says his firm

**Roger Pim**
**Senior investment director, infrastructure, abrdn**

Roger Pim has more than 20 years' experience in private markets and was one of the founders of abrdn's infrastructure business in 2013. He is a member of the investment committee and, in addition to investment and asset management, is responsible for ESG, strategy and business development. Prior to joining Standard Life in 2002, Pim worked for Goldman Sachs.

**Anne Foster**
**Senior director and global head of ESG, Quinbrook Infrastructure Partners**

Anne Foster has 18 years' experience across investment, financial advisory, project financing and asset management in the infrastructure, global energy, property, mining and industrial sectors. For a decade, Foster has specialised in renewables and energy transition. Before joining Quinbrook, she worked at Deutsche Bank and Credit Suisse.

**Christoph Bruguier**
**Senior investment director and partner, Vauban Infrastructure Partners**

Christoph Bruguier has extensive experience across brownfield and greenfield investment in the transportation, energy, digital and social infrastructure sectors. Before joining Vauban in 2019, Bruguier worked at InfraVia Capital Partners. Prior to that, he spent 22 years at HSBC.

**Grégoire de Chammard**
**Asset management director, InfraVia Capital Partners**

Grégoire de Chammard oversees the performance of several portfolio companies in different sectors and jurisdictions, supporting strategic planning M&A, operational performance, contract management and financing. He joined InfraVia in 2017 after a decade working for large energy and utility corporations in France and the US.

looked carefully at the P&L and cashflow implications when energy prices first began to skyrocket, exploring how much of that cost could contractually – or through regulation – be recouped.

"Having carried out that exercise," he says, "we realised that, in the case of energy assets, we were actually going to benefit from the situation, while in other sectors we took appropriate action to push costs through, meaning the net impact on the portfolio was minimal."

Pim, meanwhile, points to the advantages the energy crisis has had in terms of accelerating decarbonisation initiatives within assets. "The situation has helped highlight the importance of reducing exposure to fossil fuel price fluctuations."

Indeed, it is clear that decarbonisation initiatives are one of the most critical value creation levers that an infrastructure manager can employ and never more so than in the current environment. "As a long-term investor, decarbonisation is at the heart of the strategy at every portfolio company," says Pim. "We want to ensure these assets are relevant for the long term."

Bruguier adds: "There is a lot we can do to decarbonise legacy assets to maintain their appeal and their essential role within communities. To give you one example, we have implemented a zero-carbon strategy at our parking assets to be implemented by 2025."

De Chammard agrees that investment in decarbonisation can help generate returns in the short term, particularly given the high energy prices we are seeing today. But adds that some decarbonisation efforts won't generate an immediate payback. "We don't just do it because the regulators, or our clients, or our investors require it. After all, it is our duty to enhance the value of our portfolio over time and we are convinced that a decarbonised asset is worth more than a non-decarbonised asset in the long term."

*"You need to think about how you can generate base returns before the asset is even levered. Leverage then becomes something incremental and not the core driver of performance"*

**ANNE FOSTER**
**Quinbrook Infrastructure Partners**

Anne Foster, senior director and global head of ESG at Quinbrook Infrastructure Partners, meanwhile, points to the ever-expanding range of decarbonisation options now at a manager's disposal. "The energy transition is more than producing green electrons and renewables. It is also about grid stability, energy efficiency and decarbonisation of data, buildings, the transport industry and other hard-to-abate sectors. Known as Power-to-X, this requires a wider spectrum of reliable, accessible solutions and provides significant opportunity," she explains. "Carbon capture is an interesting area, but we see it very much as a last mile approach and seek instead to drive direct decarbonisation opportunities and measures."

## Digitalisation

Alongside decarbonisation, technology implementation is one of infrastructure's most potent value creation tools. "Capturing additional value through better management of asset performance and output involves anything from tracking and tracing of energy supply and broader supply chains to AI-supported storage dispatch optimisation, or weather forecasting," says Foster. "We are constantly looking to drive value by implementing

these technologies and driving the latest innovations."

Bruguier points to the mobility sector, as an example. "We have installed micro data centres in the basement of our carparks to support data analysis," he explains. "Our fleet of rolling stock is also equipped with GPS, which provides a lot of information and supports decision-making around maintenance over time. In essence, digitalisation enables the same number of people to manage a larger asset base, therefore facilitating the efficient scaling of core infrastructure businesses. It's a very powerful aspect of value creation."

De Chammard adds that digitalisation is critical from both a defensive and offensive perspective. "If you don't digitalise your portfolio company, it will become obsolete. At the same time, you want to be ahead of the curve to capture the best opportunities and digitalisation is a big part of that."

However, de Chammard also says that in order to efficiently deploy a significant digitalisation programme, the company needs to be ready, and needs to choose the right solution and the right partner to create value. "Our growth tech fund is very helpful in making sure we have the processes and people to support management teams in this regard. We have also recently hired a digital and technology director who will help ensure these projects capture the maximum value," he says.

## People pleasing

Another important aspect of value creation involves making sure you have the right people in place to deliver on strxategy. That has become increasingly challenging in a notoriously tight labour market. "Over the past two years, unemployment in Europe has been very low," says de Chammard. "That has reinforced the importance of strong human resource policy."

"We have a broad range of experience in our team, but I think it is key to recognise what you don't know," adds Pim. "Our strategy is to hold majority stakes in most of our companies, and typically have a couple of our team join the board. But critically, in addition, we also always bring on board an experienced non-exec director. These are individuals who might have 30 or 40 years of industrial experience, together with important local networks. Not only is this good governance, but it also enables us to leverage off their extensive experience and knowledge."

Foster agrees that it can be difficult and expensive to fill senior positions, particularly in the fields of technology and ESG. She adds, however, that it is not just a question of finding the talent. "In a competitive market, it is also about having businesses that people want to join and stick with. It is about recognising what employees are looking for today, which may not be only a question of pay."

So what impact is a confluence of macroeconomic headwinds and powerful underlying mega-trends having on

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> **GRÉGOIRE DE CHAMMARD**
> **InfraVia Capital Partners**

valuations in the infrastructure space? In some sectors, at least, it seems the secular tailwinds are winning out. "If anything, we're seeing overall strong valuations in the energy space. That is partly a result of the amount of money targeting the sector and the asset class's position as core infrastructure," says Foster.

Bruguier adds: "Assets that have strong inflation linkage and are not correlated to GDP, that are well hedged, with long-term interest rates locked in, are not going to see any significant decline in valuations in the short term, particularly given the amount of liquidity in the market today. Those assets that don't have those characteristics may suffer, however. Indeed, we have observed transactions being pulled, with vendors choosing to focus on value creation initiatives for now, before rescheduling the disposal for a later date."

Pim, meanwhile, says portfolio companies are continuing to secure bolt-on acquisitions at attractive valuations. "Some of the froth does appear to be going out of the market but we aren't seeing forced sellers or discounted prices," he explains. "Infrastructure is long-term by its very nature, so rather than forced sales, asset owners can delay any planned exits and instead focus on value creation initiatives and wait for conditions to improve. This is underpinned by the fact that managers are looking at the opportunity over a 10- to 20-year horizon and not just the next 12 months, and short-term market volatility has less impact on the overall returns."

## Locking in cashflows

While many infrastructure segments appear to be holding their own in the current environment, there is, of course, an element of GDP exposure in some sectors. Here, managers say, the trick is to lock down risk mitigation capabilities through contracts where at all possible.

"It's about shifting the risk profile and arranging contracted cashflows where you can," says Foster. "You need to lock in pricing as early as possible to try and avoid inflation or price volatility risk. When you are a majority owner, you have a lot more control over that process."

"When you purchase an asset," adds Bruguier, "it may not be 100 percent perfect. You may have to de-risk some part. That could mean entering into more contracted cashflows or finding alternatives to a subcontractor that may not be as credit-worthy as you would like. You may also have to dispose of part of the business. For example, we sold a small retail operation within an electricity asset we acquired in Finland. That is all part of the de-risking and active asset management required to maximise value."

Leverage is another important part of the picture, of course, not least because the cost of debt has increased sharply over the past 12 months. "The

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> **Vauban Infrastructure Partners**

priority has been locking in interest rates and ensuring we have refinanced ahead of time, to avoid pressure," says de Chammard. "Having said that, we have not seen any significant contraction of the credit market in the infrastructure space over the past 12 months. Of course, interest rates have gone up, but the liquidity is still there."

Foster concurs: "Anyone who has been around for a few cycles knows that you have to be aware that debt costs could rise if they haven't been locked in. But I agree the availability is still very much there. What's been important has been avoiding over-gearing. You can't expect to project-finance your way to 99 percent of your returns. You need to think about how you can generate base returns before the asset is even levered. Leverage then becomes something incremental and not the core driver of performance."

Pim agrees that moderation is key. "It's about retaining that degree of headroom so that when market conditions are buoyant, you don't take on as much debt as you are offered," he says. "We're always quite conservative on leverage. We also typically have long-term financing in place, which we look to hedge out. That might look expensive in good times, but it protects you in an environment such as this."

Bruguier, meanwhile, adds that, while interest rates have been increasing, in the short term they haven't been increasing in real terms because inflation has been so material. "If your assets are inflation-correlated, you may actually now be better off," he says.

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> **ROGER PIM**
> **abrdn**

## Dwindling opportunities?

But while infrastructure appears to be avoiding the worst ravages of an impending recession, with valuations remaining stable and debt still available on tap, is there not a danger that all the low-hanging value-creation fruit has been plucked in an asset class that is now increasingly mature?

"We are usually the first institutional owner of the assets we buy and that tends to support a range of value creation," says Pim. "Furthermore, decarbonisation, digitisation and other overarching trends are driving rapid change and the need for investment, leading to additional opportunities."

Bruguier, meanwhile, says there are even more opportunities to create value today than there have been in the past, particularly in the context of high energy costs. "That has created the impetus for switching from one fuel source to another, that is both greener, but critically also more cost effective, for example," he says. "In that sense, there is new low-hanging fruit that wasn't previously there."

Another example would be infrastructure's growing obligations when it comes to biodiversity. "There are incredible improvements you can make through changes in the way you use land, and we have seen direct correlations with capex reductions, [and] improvements in permitting and community relations," says Foster.

"Portfolio companies have experienced a host of different shocks over the past three years – from covid, through to high inflation and an energy crisis," says de Chammard. "That has meant they have been forced to adapt, creating new ways of operating. Certainly, I see no shortage of value accretive operational efficiency projects out there today. We remain extremely busy." ■