KEYNOTE INTERVIEW

The rise of infrastructure private equity

Lennart Blecher, Alex Darden and Matthias Fackler of EQT on the emergence of a distinct value-add asset class

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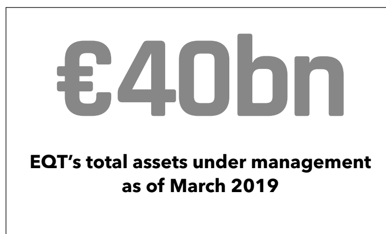
Q How has infrastructure private equity evolved, as a sub-segment of the asset class, over the past decade?

Lennart Blecher: You need to go back to the privatisation wave of the 1980s. Major infrastructure providers such as GE, Siemens and ABB, where I worked, started to build up their own private equity groups to take on concessions, raising equity and debt. That was the first wave of infrastructure investors – the strategics.

The second wave involved bank-sponsored funds in the 1990s and 2000s. The banks started raising money from institutional investors, but that was about deploying capital in core infrastructure.

Then, in the late 2000s, firms like EQT came to the market focused, not on deploying capital, but on adding value – transforming infrastructure companies by investing in growth, improving efficiency and de-risking. The resulting risk-adjusted returns have proved highly attractive and so institutional investors have increased their allocations year-on-year throughout the last decade.



EQT's total assets under management as of March 2019

Matthias Fackler: It is a very different approach to traditional infrastructure. We are developers of companies, first and foremost. A traditional infrastructure fund would never put fibre in the ground to meet rising demand for increased broadband speed and data volumes, for example. You can only build something from nothing with a private equity mindset.

Alex Darden: That private equity mindset is something that is talked about far more than it is actually practised.

It is all about being truly operationally focused. It is about building companies, as Matthias says, but there are myriad other components including something as simple as board assessments.

Making sure the right people are in place to help develop businesses is a skill that not

many infrastructure investors have. But these practices are fundamental to adding value.

Q What types of assets are infrastructure private equity players targeting today, and has that changed?

AD: We are specifically focused on five key sectors: energy, environmental, transport and logistics, telecoms, and social. The macro changes that are driving those sectors, on a global level, are incredibly exciting.

There are micro drivers in specific geographies as well – for example developments in supply chains that are reshaping logistics demands or changes in the way people are moving around the world.

The need for capital, not only to address that combination of macro and micro drivers, but also to refurbish ageing infrastructure, is vast.

MF: I would add two further trends. One is an expanding middle class with growing spending power, needing more transportation, consuming more energy and consuming more data. The other is a trend towards urbanisation.

Modern cities that want to attract new generations need to be able to provide state-of-the-art infrastructure. That does not only mean traditional infrastructure, around communications, transport and energy, but also social infrastructure such as sports facilities. They need to be smart cities, gearing up for the advent of self-driving cars and all sorts of other new technologies. All those trends make this a really interesting place to be.

> *"Modern cities that want to attract new generations need to be able to provide state-of-the-art infrastructure"*
>
> **MATTHIAS FACKLER**
> **EQT**

Q Embracing technological advancement is obviously fundamental to value creation in any sector. What is your approach?

LB: Digitalisation is hugely important. Market leaders, in terms of digital maturity, typically garner 11 percent higher revenue growth than average performers across all industries. Infrastructure has generally lagged by four to five percent.

We have invested significantly in hiring the best people from the likes of Google and Spotify to really focus on driving this digital maturity and by doing this, we think we can secure a 15 percent revenue growth advantage compared to a traditional infrastructure company.

MF: It is partly about downside protection. A lot of traditional infrastructure business models, such as parking, for example, have been severely disrupted by advances in technology and there is a real risk you will get left behind if you do not invest in digitalisation. But the other element to this is value creation.

That value creation comes from cost savings, but also from additional revenue potential. We have a lot of capital-intensive businesses in the portfolio such as energy plants, water plants and parking lots. Remote control centres which connect all these assets, enabling them to be managed jointly, can optimise your cost position.

Equally, you can massively affect volumes and even prices through an intelligent digital strategy. We have a team of 25 people working right across our portfolio. It is a big factor in risk management and value creation.

AD: Another example I would give is one of our portfolio companies on the West Coast, a container terminal that is undergoing a massive digitalisation effort right now. That is affecting how volumes move through the terminal, but also how we track and understand those volumes.

ESG, the right thing to do

LB: We sincerely believe in ESG and sustainability. If done correctly it will increase the value of our portfolio companies, so it is sound business sense.

We have a team within EQT developing tools used in asset selection and due diligence. We also have a framework for transforming companies so that they become more sustainable, stronger businesses, over the long term.

In addition, EQT has a scoring system that we introduced three years ago. We can already see how portfolio companies are improving in terms of sustainability year-on-year.

MF: ESG is obviously hugely important from an investor standpoint. We already have a number of LPs that won't commit to deals in certain asset classes. It is a major topic when we are fundraising, and I think we will only see more of that.

These issues are also becoming more important to the other stakeholders we deal with in transactions – regulators and governments – and I am quite convinced societal pressures will increase this further. Strong ESG programmes will be our licence to play going forward.

I am also convinced that good ESG is value-enhancing for investments because it will result in a higher multiple on exit. For example, I am responsible investment advisor for a large, decentralised energy business, with a few thousand plants and the clear target is to increase the share of renewables in that energy mix because we know this will result in a higher exit multiple.

How are they coming off the ships? How are they being loaded onto the ships to begin with? Are they going into the rail yards or the truck yards?

Technology is helping us understand the entire flow through the terminal and in turn is helping our customers understand where their products are.

It is a cost-saving play, but rather than being about eliminating labour it is more about increased capacity and improved efficiency of product as it moves through the terminal.

Q What other value-creation levers do infrastructure private equity players look to employ?

LB: We explicitly pursue a buy-and-build strategy across almost all of our portfolio assets. Larger organisations tend to have more professional management teams and size also matters when it comes to exit.

AD: It is important to add that we only pursue add-on acquisitions for a purpose, we do not just do it to create scale.

For example, there is a portfolio company, now called Segra, which is a fibre company on the eastern seaboard in the US. Because we approached due diligence from an operational perspective, we already had several acquisition targets identified when the original platform was acquired.

We were able to engage one of those targets, Spirit Communications, which fit the platform perfectly from a geographical perspective. It also had complementary products in addition to its fibre footprint.

We were able to take the product portfolio from the second company and integrate into the first, to create a very large business with a diversified product range that fits the customer base very well.

MF: Another transformation strategy that we have applied very successfully is de-risking and simplification. Just making the business model simpler and taking out that risk can sometimes make a business suitable for more passive ownership. That has played well in a number of cases.

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ALEX DARDEN
EQT

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LENNART BLECHER
EQT

Q How have expectations for returns evolved?

LB: The risk-free interest rate has dropped over the last decade but returns in value-add infrastructure have held up remarkably well. IRRs may have gone down a couple of percentage points in some places, but it is still possible to achieve returns in the mid to high teens, buying into assets with strong downside protections, as well as stable and predictable cashflows and earnings. I cannot think of another asset class right now where risk-adjusted returns are more attractive.

MF: Infrastructure returns, generally, have come down because assets are being priced more aggressively. But having the operational background to judge the risk profile and value potential means you can pay a full price and still generate the returns.

Q What does the future hold for the infrastructure private equity market?

LB: If you look at the value of deals completed in private equity and the value of deals completed in value-add infrastructure, last year, they are about the same at $400 billion. But there is only a fraction of the dry powder in the value-add infrastructure space. That means there are enough opportunities to go around for everyone, which makes it a very attractive place to be.

And remember that people are talking about $70 trillion of investment required to finance the global need for infrastructure through to 2035. No-one believes government will be able to provide that funding, so private investors have an enormous role to play. I think the asset class has a very bright future, but it can no longer be just about deploying capital, it must be about creating value through operational insight and skill. ■

Lennart Blecher joined EQT in April 2007 and is head of real assets, chairman of credit and deputy managing partner.

Alex Darden joined EQT in April 2008 and is head of US infrastructure.

Matthias Fackler joined EQT in September 2008 and is head of infrastructure for continental Europe.