

KEYNOTE INTERVIEW

A bright future in North America



Federal communications programmes, a supportive renewables policy and upgrades to ageing infrastructure are driving investment opportunities in the US, says Jessica Kennedy, managing director at Northleaf Capital Partners

Q How much appetite for infrastructure are you seeing from North American institutions today?

It is important to differentiate between Canada and the US. A lot of Canadian institutions have been active investors in infrastructure for a number of years. The US has lagged slightly, but that is now changing. From pension funds to insurance companies, US institutional investors are increasingly active in this space.

What LPs are looking for varies depending on the maturity of their programme. Some are just starting out and looking to make their first investments,

SPONSOR
NORTHLEAF CAPITAL PARTNERS

while others are looking to round out exposures with particular subsectors or types of manager. Indeed, as the industry continues to grow, we are seeing increased specialisation amongst GPs.

The range of strategies on offer is proliferating. As a mid-market manager, we have observed an increased recognition that mid-market exposure offers something different and even complementary to large or mega-cap exposures. We are also seeing more sector specialists emerge.

Q From core through to opportunistic, where on the risk spectrum are LPs showing the most interest?

Many LPs define the various infrastructure risk profiles differently. In Europe, where infrastructure has a longer history and there is a greater degree of manager choice, LPs may have a more defined set of risk spectrum targets.

At Northleaf, while we are absolutely focused on finding opportunities that deliver the appropriate risk/return characteristics, we are not hung up on the terminology. We are focused on finding patient, off-market opportunities and being an active investor that



Q What impact are President Biden's bills likely to have on infrastructure investment opportunities in the region?

Broadly speaking, we expect the bills to be positive for infrastructure on both the public and private sides. They are bringing funds and attention to what is one of the world's largest investable markets. Although it typically takes time for government policy to translate into investable opportunities, we do expect to see immediate benefit in the communications infrastructure sector, in particular.

There are a number of federal funding programmes already in place and, with these bills, these will certainly increase in scope. Another positive effect is the continued support of renewable power and new subsectors such as hydrogen, which we see as a real benefit for the US market.

drives growth. That is how we are able to add value.

We are invested in a wind farm in the US, for example, that took us three years to acquire. We got to know the developer, we crafted proposals and we worked on revenue strategies. In other words, we were acting like an owner before we actually were the owner and that is how we began our value creation process. If we had come across that same wind farm in a very tightly priced auction, it wouldn't have been an attractive opportunity for us.

Q How do you find those off-market opportunities?

It is about spending time working with undercapitalised developers and industrial companies in order to build relationships and to become the capital partner of choice. Our focus on the mid-market means that we are in the

“There is a lot of relative value to be found in the mid-market if you forge the right relationships and engage early”

privileged position to identify a large number of opportunities. There are many more small assets, such as wind farms and regional roads, than there are large utilities or airports.

At the same time, we only look to complete three or four transactions a year, which means we can start with a very wide funnel and then whittle that pipeline down to just a few deals. We can afford to be highly selective based on risk/return profile.

Of course, this is a competitive industry and there are certain subsectors that we avoid. But there is a lot of relative value to be found in the mid-market if you forge the right relationships and engage early to avoid auctions.

Q Which sectors are particularly attractive at the minute?

Our investment pipeline is deeper and

more diverse than it has ever been, which is really exciting. One of the high-level themes that I would point to is the increasing demand for data and connectivity, driven in part, of course, by the pandemic. We're also seeing the transition away from fossil fuels as part of the broader energy transition theme driving opportunities. Finally, a lot of jurisdictions are working creatively to replace ageing infrastructure.

Diving deeper down into those trends, we really like some of the rural communications opportunities that we are seeing. In some cases, these companies effectively have a monopoly in a particular region which, of course, is attractive for us as infrastructure investors. Elsewhere, we continue to see value in roll-up strategies across the communications industry and specifically in data centres.

Meanwhile, we have always been very active in renewable power and will continue to be. We specifically look for renewables opportunities that offer a risk/return profile that fits our fund strategies.

Renewable power assets with long-term contracts are quite expensive and we expect returns to remain low. That said, we still see opportunities where there may be non-traditional revenue agreements, for example, or where there may be some installation work required or where we can commit to invest before revenue contracts are in place. By taking selective risk we are able to hit the risk/return profiles that we are targeting.

Another really interesting investment area involves contracted revenue opportunities in newer subsectors. We are used to seeing these revenue lines in renewable power and in the PPP sector, but we are now seeing the contracted infrastructure model being applied to other subsectors including energy transition investments and less conventional infrastructure such as physical security companies. We are seeing long-term contracts put in place

with diversified counterparties, and that offers a really attractive risk/return profile for our investors.

Q How are investors responding to a growing emphasis on sustainability and the energy transition more broadly?

These themes are front and centre when it comes to fundraising. Just a few years ago, while ESG and climate change may have been widely discussed in certain regions, notably Europe and Canada, that focus was far less prevalent in the US. That is now changing.

ESG considerations and concerns are part of every fundraising meeting, no matter the jurisdiction. And LPs are not only interested in the manager's ESG policies and practices; they are also looking through to the portfolio companies.

This heightened focus has come about very quickly. Indeed, a growing number of investors are implementing very specific policies and investment goals, in particular around fossil fuel avoidance. Some are even selling off positions that have fossil fuel exposures.

Infrastructure, after all, is an asset class that is uniquely linked to climate. These assets need to be able to adapt so that they continue to enable society to function for decades to come. As a result, we are starting to see investment activity from certain managers being specifically aligned with one or more of the UN SDGs. This is a newer development but one that we expect to continue to be a focus for both GPs and LPs.

Q Does that present a particular challenge for the US, given its historical reliance on fossil fuels?

The biggest challenge we see right now is how to implement the energy transition. North America has traditionally been a conventional energy market. The transition will certainly

be complex and different regions are going down different paths.

We are already seeing energy hiccups in some parts of the world. North America is not there yet, but we fully expect obstacles along the way as the world continues to transition from conventional energy. For example, Spain's extremely high current electricity prices demonstrate some of the unintended consequences of a broader energy transition.

Investors are implementing all these policies to avoid fossil fuels, but the reality is that there will still be a need for certain conventional energy assets in the near to medium term. As a mid-market investor, that is the number one challenge that market participants are facing.

Q What do you believe the future holds for the North American infrastructure market?

We are extremely positive about what the future holds. We believe we will see more investors moving into the asset class and more fund managers as a result.

At the same time, we expect to see more demand for specialisation in different parts of the market. That is great news for us as a mid-market manager. We will also see more strategies focused on particular sectors or particular parts of the risk spectrum.

Infrastructure is still behind private equity and real estate when it comes to that stratification, but it is fantastic to see the evolution in product offerings and investor preferences. As I mentioned earlier, our pipeline has never been stronger or more diverse and we see those opportunities coming from both traditional and up-and-coming sectors.

We are seeing more investment opportunities and there are more investors looking to deploy capital in infrastructure. That growth on all sides is hugely exciting. ■