Keynote Address

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What are the key attractions of infrastructure for institutional investors and what role are they expecting infrastructure to play in their portfolios?

Infrastructure investment offers some unique characteristics such as diversification, better liability hedging and less volatility on valuations compared to other asset classes. The prescribed benefits are a result of the asset class being large in general and monopoly-like, with low correlation with the business cycle, a reliable earnings stream and substantial free cash flow. It also often offers a good inflation hedge, as inflation is usually built into the revenue streams.

Depending on the type of investor, infrastructure may play a very different role in one's portfolio. For example, a large public pension will be required to make investments in order to fund liabilities that are multigenerational, hence, when compared to the infrastructure asset class, there is a great alignment for the pension plan investing in infrastructure. For other institutional investors, investing in the infrastructure asset class may help create diversification within one's portfolio, where infrastructure should be predictable, a source of long-term cash flow and stable in nature.

Are you seeing changes in the way investors structure their portfolios?

As the investor base matures, they have begun to look for more accurate distinctions on different infrastructure strategies. Today is very different to five or six years ago, when investors were just investing for their first or second time. By now, some investors have already been invested with several managers and seen some GPs go through a full investment cycle, including the financial crisis. We are seeing two changes in the investor universe: (1) investors now like to participate in co-investments; and (2) they are expanding into new geographic markets, as part of their effort to diversify their portfolio. Co-investments are a more active channel for investors to deploy large amounts of capital. In expanding into new geographic markets, there is the combination of generating potential alpha in relatively untapped regions as well as increasing exposure to new opportunities and developing specific knowledge within those markets. Overall, as markets become more mature globally, investors are set to start building their portfolios via a mix of fund investment, co-investment and direct investment, and expanding geographically into some new markets, including Asia and Latin America.

2014 saw a lot of capital concentrated among a few of the largest players; will this remain the case in 2015?

The infrastructure sector is expected to see a continued increase in demand, and will remain desirable for a large number of investors who are attracted by the risk-adjusted returns from infrastructure investment. To date, the more established and larger funds were able to raise capital with relative ease. These large funds, typically globally-focused funds, are required to deploy a huge amount of capital, and the typical assets that they focus on would usually be the so-called 'trophy assets', which are often subject to a bidding war that can lead to an overly generous entry price. Additionally, the large players have faced a significant increase in the level of competition in recent years, with the large, experienced pension funds around the globe and some large SWFs setting up their own direct investment teams focused on infrastructure investing. These institutions not only have the advantage of being able to hire people with strong investment experience, they also come with a very low cost of capital, and hence are able to chase a deal more aggressively. Therefore, as the asset class continues to develop and mature, and investors' knowledge continues to evolve, demand for smaller funds or those with more specific strategy, either by geography or sector, will increase.

What are the biggest risks associated with investing in infrastructure and are these changing?

On any given asset, the risks associated include political, regulatory, environmental and business risks. Infrastructure assets are highly exposed to government regulation. Some of the sub-sectors within the infrastructure definition are politically and regulatory sensitive, such as utilities. This is especially true where governments pressure the utilities to share reductions in spending. We do see more challenges to come for energy transmission, distribution and retail businesses. The fact of the matter is that when some of these businesses are monopoly-like, they need to be regulated properly and in a balanced way for the system to work.

Other sub-sectors within infrastructure face different kinds of risk. For example, with a toll road, an investor may be willing to take the risk on the traffic volume, but should be worried about the risks involved with certain promises or undertakings in terms of connectivity with the toll road or the ability that some other developer may build a competing road 30 metres away. Investors must remember that these are not just assets, but shareholdings in a company, where each carries its own company-specific risks. Additionally, as many investors are going global with their program, they should be aware of any currency risk exposure. Despite these aforementioned risks, the infrastructure asset class should be viewed as low risk, as long as the investors actively address and mitigate these risks in their portfolio.

Is pricing of infrastructure assets a concern?

We have seen asset prices increase steadily since the financial crisis. This has also been supported by the encouraging level of availability of finance for infrastructure. There is plenty of money out there and that then increases the pressure to do deals and impacts pricing, especially in developed markets. Hence, investors should approach deals with caution in light of the aggressive bidding on some of the 'trophy assets'. For example, in Australia, ports will be in strong demand, in the US, power and midstream energy continues to attract a lot of capital, and in Europe, airports and telecommunications are expected to be the hot sectors for investors. We would expect these assets be transacted at a 'fair' price.

Do you see any regions or sectors that are attracting a lot of investor interest?

Worldwide infrastructure spending is expected to grow, according to various different publications. Megacities in both emerging and developed markets are going through demographic changes, which will create new requirements on

infrastructure assets, either through new developments or upgrades of existing assets. We believe emerging markets, backed by the growing urbanization and increasing prosperity of these markets, present attractive opportunities within the infrastructure space. Asia, China and India represent the largest opportunity set, where infrastructure spending is vital in sectors such as power, water and transportation. In Latin America, Brazil is the largest economy in the region, with the greatest need and potential for infrastructure improvements. This is a result of the Brazilian government promoting growth by stimulating domestic consumption in the past decade, leaving infrastructure as the bottleneck for future growth potential. With the ever improving transparency of the regulatory framework in these emerging markets, albeit with the return premium over developed markets being squeezed, we do see investors are now gaining interest in these regions.

How are regulatory changes such as the Alternative Investment Fund Managers Directive (AIFMD) affecting the infrastructure market?

We have found that increased regulation, such as the AIFMD, can make it harder to raise and manage alternative investment funds in Europe. The rules are exceedingly complex, and some managers have decided to avoid them altogether by not actively marketing in Europe. Also, the wide concept of an alternative investment fund under the Directive has the potential to capture arrangements which would not ordinarily be regarded as a 'fund', such as a co-investment arrangement or SPV to buy and manage infrastructure assets. If the vehicle does constitute an alternative investment fund, then the requirements of the AIFMD will be triggered, including registration with a financial regulator and the need for a depository, as well as the marketing restrictions for non-EU funds. Clearly this will add significant costs and timing issues to deal structuring which were not present before.

What are the key qualities you look for in fund managers you work with?

At MVision, we think like an investor. We follow the five 'Ps' principal: people, process, performance, philosophy and portfolio. And we spend a huge amount of time on each of the 'Ps' before we decide to work with a manager. People – we look for people that have solid experience with a proven track record in the desired strategy. We are looking for managers that genuinely believe and are dedicated to what they do. Philosophy – we look for a strategy that should be addressing a gap in the market, or is helping to resolve a problem in the market (i.e. increasing infrastructure investments to drive or maintain the growth rate in a particular country, or increasing alternate power sources to minimize or replace some traditional energy sources). Process – does the manager have a proper investment process in place, a clear decision making mechanism, and proper back-office support in order to ensure the transparency requirements from investors are met. Performance – the track record of the GPs, either from their previous funds, or in the case of spin-outs, from their prior firms. Portfolio – we look for managers that have demonstrated experience in playing an active role in driving changes and building value through active management of the asset.

Have you seen any changes in the role of placement agents in the last few years?

As investors are getting more sophisticated, the role of placement agents will be required to change accordingly, and anybody that fails to do that will be left behind. Put simply, the distribution model does not work anymore. Placement agents should serve as a solution provider to both the investors and the managers. Creative solutions should be structured to help bridge the gap between the stakeholders. The placement agents should spend resources to help strengthen the internal firm's knowledge of the asset class and any related issues.

What are the prospects for firms attempting to raise capital in 2015? How can they differentiate themselves?

We feel optimistic about good GPs being able to raise capital in the market. We see investors such as pensions and insurers continue to have increasing interest in infrastructure funds, as they look for assets that are safer than equities, but, at the same time, offer better returns than low-yielding bonds. We are also encouraged by the strong asset pipeline around the globe. There might be competition, but there is a diverse pipeline with a number of assets that may be available. In terms of differentiation, there are two areas that are often raised as part of the dialogue, which can be a source of differentiation: (1) the ESG aspect of investing – given the long horizons, ESG is arguably more pertinent than other asset classes; and (2) operating talents – due to the ever increasing sophistication of running the asset either through a regulatory or operating perspective.

Founded in 2001, MVision is widely recognized as one of the world's leading independent international advisory firms, focusing on raising capital for Private Equity, Real Estate, Real Assets, Credit and Direct transactions in both the developed and emerging markets.

MVision has a long-standing reputation for working with winners - the firm's clients are current and future market leaders across the globe. MVision firmly believes that fund-raising is far more than a one-time event; it continues to assist clients with the on-going task of funding and growing their businesses effectively, managing issues such as positioning, growth and performance.

Together the team represents 20 nationalities, speak 19 languages and operates out of offices in London, New York, San Francisco, Hong Kong and Sydney. The depth of the team's expertise across all areas of the market allows their clients privileged access to the strategic industry insights vital to achieving success.

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