

KEYNOTE INTERVIEW

Diversifying through the mid-market



*A mid-market investment strategy allows managers to access under-the-radar assets, but sell into a highly competitive environment, says **Jamie Storrow**, co-head of Northleaf Capital Partners' infrastructure programme*

Q How has the pandemic impacted your ability to transact and to manage existing assets within the mid-market space?

Transacting was definitely slower and more complicated at the beginning of the pandemic. The inability to travel and the challenges that some of our counterparties were facing in other parts of their organisations made it difficult to move forward with new business initiatives.

As the pandemic continued through 2020, we began approaching acquisitions in a hybrid manner – with local teams, operating partners and advisers carrying out onsite work, and our

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international teams working remotely from their home offices. This system has created a significant amount of transaction activity for Northleaf in 2021.

The situation has been very similar when it comes to managing existing investments. We have our local teams that have been able to manage assets onsite, but where international travel once existed, we now rely on technology for the most part. Even as travel resumes, we expect to use technology to a greater extent than was the case before the pandemic.

Health and safety has, of course, been our number one priority. We have ensured that no one other than the most essential employees are on site at any of our assets, and every one of those essential employees has received additional health and safety training on pandemic-related protocol.

Ultimately, we have made it through this turbulent period, and each of our assets has continued to operate in every location, which is something we are proud of. It has been time consuming and complex, certainly, but it has also challenged us to evolve our business continuity practices to accommodate a wider range of possible future scenarios.

Q How are the various build back better campaigns that are starting to emerge, including President Biden's stimulus package, likely to impact mid-market infrastructure?

For the mid-market in the near-term, it's possible the biggest impact from the US stimulus package will be related to the communications infrastructure space, where billions have been allocated to increase connectivity across the US, particularly in rural areas.

Over the medium term, we expect to see more civil infrastructure activity – those traditional, large-scale, physical infrastructure projects, although these opportunities tend to take longer to be actionable by the private sector.

So, we do see opportunities emerging from the new stimulus programme, but in our target size bracket, we do not expect it to materially shift our focus. At Northleaf, we tend to work outside of government-sponsored assets the vast majority of the time, so while the stimulus package is good news for the industry, it is not going to revolutionise the way we operate.

Q You mentioned the communications sector. Is that where you see the most interesting mid-market investment propositions?

Communications continues to be a very active space where we see years of remaining runway. There is an increasing demand for data, speed and reliability and, historically, there has been an incredible amount of under investment in the majority of countries we work in.

However, I would say that sustainable infrastructure is the most active sector for Northleaf right now. We invest across wind, solar, geothermal, battery storage and biofuels processing and storage. Sustainable infrastructure is our largest target market and we continue to see the most opportunities there. Everything related to energy transition is very active right now.



Q How would you describe LP appetite for mid-market infrastructure today?

We believe the mid-market has huge growth potential. There are numerous large- and mega-cap funds out there today, and the gap between the traditional mid-market – around the \$1 billion-\$2 billion fund size – and the mega players appears to be widening.

We now see a lot of investors either adding more mid-market managers or starting to invest in the mid-market for the first time, after years of being focused exclusively at the larger end of the market. Investors typically construct their portfolios with different diversification criteria in mind, such as sector or geography, and are now considering the mid-market to provide enhanced diversification and different underlying exposures. The assets and investment approaches are not identical in all parts of the market.

So, we absolutely see a growing investor base for this part of the market, as institutions seek greater diversification.

“We see a lot of investors either adding more mid-market managers or beginning to invest in the mid-market for the first time”

Finally, we are spending a lot of time looking at concessions and transportation. These opportunities tend to be more cyclical, but we expect an increase in activity in these areas over the next few quarters across most of the jurisdictions where we invest.

Q Communications and sustainable infrastructure could be termed covid winners. What impact has the pandemic had on competition? And how do you avoid overpaying?

There is definitely more competition – more firms are choosing to invest in sectors that have positive tailwinds

coming out of the pandemic – but it is important to note that there is also a great deal of new supply in those sectors.

Our strategy is to identify undercapitalised industrial companies and developers, and work with them to complete projects, or in some cases, acquire projects from them. Essentially, our sourcing strategy is to avoid competition on the way in and then sell into competition once we have grown and/or de-risked the investments. It is a competitive environment, certainly, but our job is to try and avoid competition where we can, and then take advantage of that competition once we have completed our business plans.

Q Is the ability to buy in a less competitive landscape and sell into a more competitive landscape the fundamental advantage of the mid-market?

First and foremost, the fundamental advantage is that there are far more investment opportunities in the mid-market across a broader range of sectors. Our economies commonly rely on many small infrastructure assets – such as local power plants, storage terminals and commuter roads.

But while there are a greater number of smaller assets out there, they are generally harder to identify. They are typically owned by smaller companies that don't necessarily have mature business development functions or access to sufficient development capital. As the assets increase in size, it is natural that they become more visible and additional sources of capital become available, including the public markets.

Q What role does ESG professionalisation play as you transition individual projects into larger companies, that then become of interest to a different type of investor?

Bringing new sustainable infrastructure into operation is a major part of

“Everything to do with energy transition is very active right now”

what we do. Completing construction or installation on time and on budget, for solar, geothermal, biofuels or carbon capture assets, is a significant component of our operations across all the markets where we invest.

At each asset, we also drive a wide range of ESG initiatives as part of our business plans. We ensure that there are goals for each of E, S and G, as we view each category to be of equal importance.

From an environmental perspective, apart from bringing new sustainable investments to market, where applicable we'll work on things like water recycling, bringing in more energy efficient equipment and transitioning to renewable fuels.

On the social side, we have developed a number of programmes, including scholarships and employment initiatives. Health and safety is always at the top of each board meeting agenda.

With respect to governance, we implement best practices across all countries and assets. It is very common for the CEOs of our various companies to share their experiences with one another, and to work with us to ensure we capture and optimise all relevant ESG data.

Q What are the most significant macro challenges on the horizon for your part of the market?

The biggest challenge we see is in the energy sector. There is a massive energy transition going on as we move away from fossil fuels and towards

sustainable electricity generation and electric vehicles, and as other industries begin to operate in a less fuel-intensive manner. This transition is going to take many years to complete. In the meantime, there is a huge, existing set of infrastructure assets that perform a critical function in processing, transporting and storing fossil fuels, and it is important that these assets continue to support society.

Who is going to own these assets in the long-term? How, and to whom will exits occur? These are probably some of the biggest considerations that we face right now, particularly in the North American context, where the energy sector has traditionally been the largest part of our industry.

Q Is inflation a concern or do you think infrastructure assets are generally sufficiently protected?

At Northleaf, our portfolios benefit from inflation. More than half of our revenue frameworks have built-in inflation protection, and so, overall, it is our friend. Obviously, we have to be conscious that inflation and interest rates are often correlated, but inflation, on its own, is an advantage for us.

Q What is the most significant change you've seen in the mid-market infrastructure sector since the beginning of covid?

My biggest observation during the covid period has been the acceleration of ESG approaches among both the investor community and infrastructure managers.

We have found that over the past year and a half, there has been a significant increase in the number of groups that cannot invest in or support any form of conventional energy. That is an astonishingly short period of time for such a transformation to have taken place, particularly in the context of how dependent our economies still are on fossil fuels. ■