INFRASTRUCTURE INVESTMENT REPORT

Private equity is well positioned to support critical projects, build value, and strengthen communities

2021

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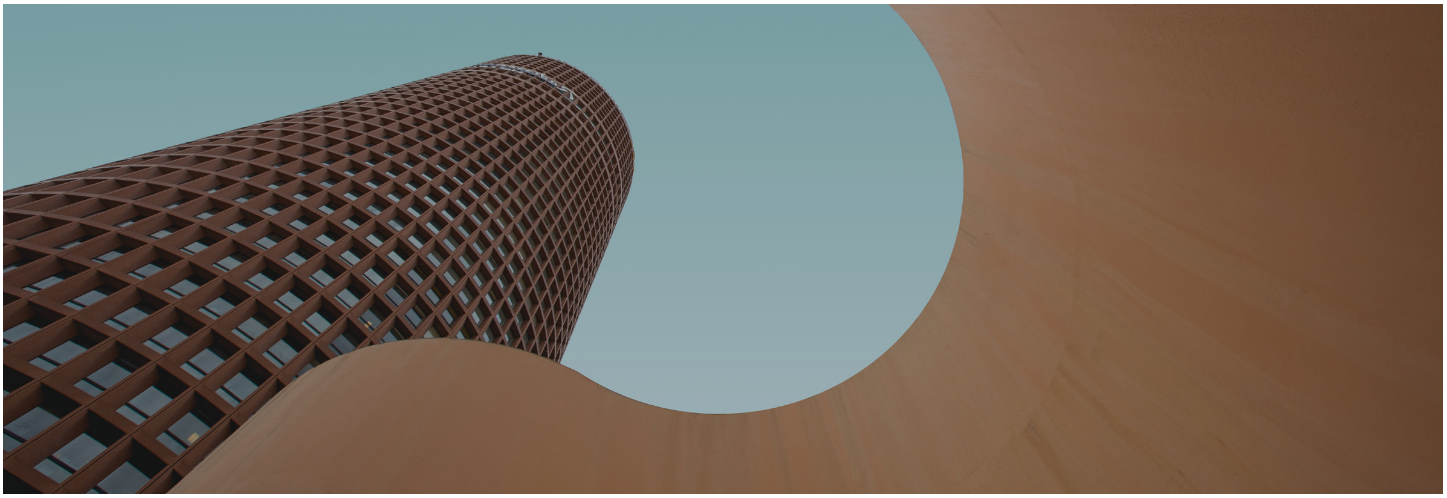
CohnReznick
ADVISORY • ASSURANCE • TAX



EXECUTIVE SUMMARY

Private equity (PE) and infrastructure have natural overlaps: reliable cash flows, long-term horizons, and durability in down markets. At the same time, infrastructure projects have their own unique risks: Political, regulatory, and market risks are all common. Investing in the sector – utilities, clean energy, roads, bridges, wireless communication, among many others – requires expertise, regulatory know-how, and a keen eye for promising projects.

PE interest in infrastructure was already gaining steam before the COVID-19 pandemic. Optimism around new infrastructure spending has galvanized the PE market, and fundraising has been historically high over the past four years. The pandemic's effect on society has had a profound impact, particularly on infrastructure, generating a new impetus to upgrade our struggling infrastructure system. Work-from-home mandates and remote learning led to a surge in wireless technology and telecommunications usage. They also led to fewer cars on the road, shifts in cargo shipments by rail and ship, and fewer trips to the airport.

This report takes a deep dive into PE trends in the infrastructure space, which is facing a more dynamic environment than it has in many years. More people will be working and learning from home for the foreseeable future, putting strains on telecom-related infrastructure and less wear and tear on our highways. We now have an opportunity to make substantial upgrades – roads and bridges can be repaired, buildings can be upgraded with smart technology, and rail and marine terminals can be strengthened.

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PE has a unique opportunity to be part of that upgrade. In 2020 alone, PE firms invested in wastewater management systems, thousands of wireless towers, toll roads, and smart building technology providers. A record amount of dry powder is on the sidelines, and investors are anxious to put it to use.

Finally, infrastructure investment also presents a unique opportunity to benefit a double bottom line: In addition to the substantial financial gain that can come from these long-term investments, there is also the potential to drive toward a broader public gain through community investment. By supporting efforts that improve access to education or healthcare, create jobs, protect against severe weather, and more, investors can help create stronger, more resilient communities.

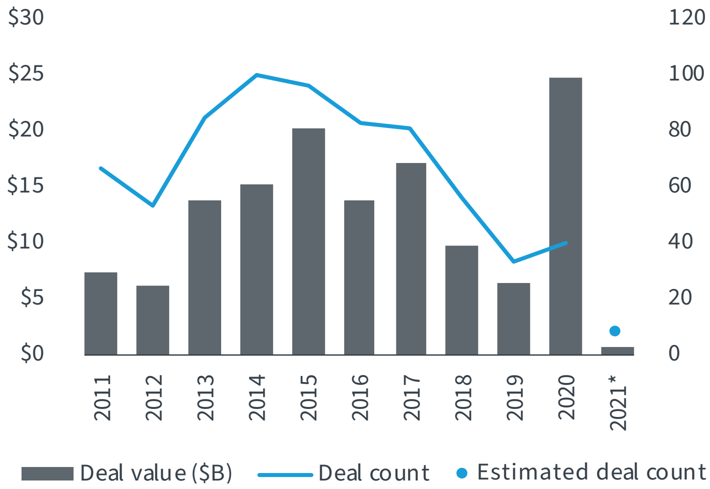
AN OVERVIEW OF DEALMAKING

PE infrastructure investing hit a new record last year. Almost $25 billion was funneled into U.S. projects and companies in a pandemic year that dented PE interest in dozens of other industries. It should be noted that two infrastructure buyouts were responsible for most of that gain. The take-privates of Zayo Group ($14.3 billion) and Pattern Energy Group ($6.7 billion) accounted for more than 80% of 2020 deal value, but there was a spate of smaller but still-significant deals that padded the numbers. As an asset class, infrastructure has minimal correlation to most sectors and markets – which was borne out last year, as lockdowns and travel restrictions led to less road and airport usage, while remote working and learning and social distancing mandates led to a massive lift in telecommunications, mobile technology, and wireless infrastructure.

Infrastructure is a niche strategy within private equity itself. “Quick flips” are rare, and by necessity, holding times are typically longer compared to other strategies. On the other hand, infrastructure investments tend to perform well even in down markets. Utilities, wireless communication, and a host of other services are considered essential to retail and business customers alike. That often translates to minimal customer turnover, prohibitive switching costs, and more reliable cash flows over the long term.

Given their price tags, infrastructure projects are top-heavy with bigger investors. Firms such as Blackstone, Brookfield, Goldman Sachs, and First Reserve are frequent actors in the space. Increasingly, though, infrastructure projects are a perfect fit for PE’s limited partners (LPs) – pension funds, insurance companies, sovereign wealth funds, and college endowments. With large capital bases and long-term investment horizons, LPs can comfortably invest in toll roads, marine terminals, and other projects. Three Canadian pension plans now own the Skyway Concession Company, which operates an 8-mile toll road in Chicago. CalPERS, the largest public pension plan in the U.S., is a co-investor in an Indiana toll road that stretches 157 miles. Other examples include a marine terminal operator in New Jersey (The Canada Pension Plan Investment Board), a developer of water infrastructure projects (Government of Singapore Investment Corporation), and a wireless communications infrastructure provider (California State Teachers’ Retirement System).

U.S. infrastructure PE deal activity



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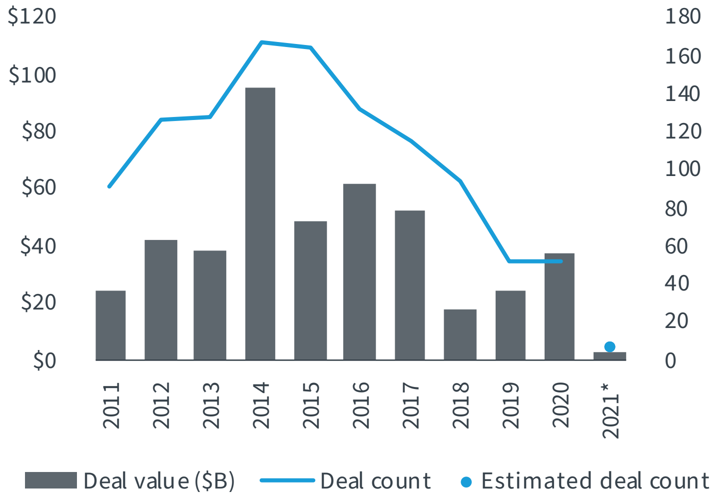
U.S. infrastructure M&A deal activity



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AN OVERVIEW OF DEALMAKING

Exit lanes

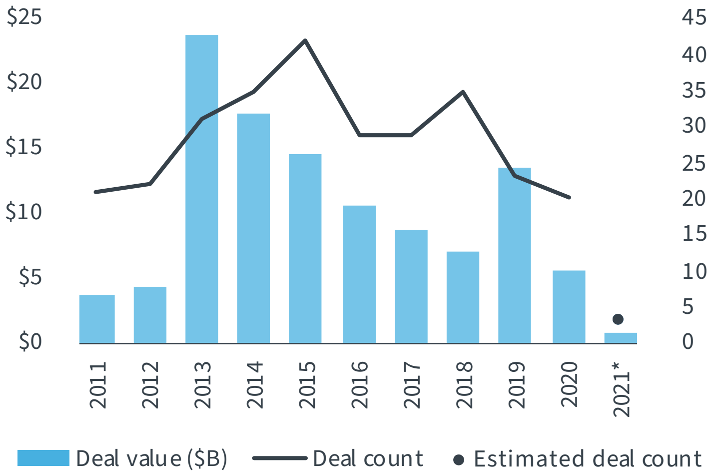
Infrastructure exits have waned in frequency, falling to a ten-year low in 2020. It's worth noting that infrastructure investments behave differently than typical PE deals; infrastructure-related companies can be exited with ease, but projects are different. An investment in a toll road, for example, can stretch for more than a decade, as costs are recovered incrementally over several years. The same can be said for rail infrastructure, airports, and marine terminals. In those cases, PE's goal is to recover capital over time, benefiting from reliable cash flows instead of looking for opportunistic exits. For renewable energy companies, the timelines are also longer than normal. One strategy of PE renewable energy firms is to finance a project's development costs at the outset, where the risks are greater, but the payoffs are bigger. Capital returns can take several years – assuming the project successfully comes online – making renewable energy another long-term investment strategy.

Will 2021 usher in a P3 wave?

Public-private partnerships (P3s) are a natural fit for PE, but aren't as common as they could be. P3 transactions are spearheaded by federal, state, or municipal governments but financed by private investors, typically at the beginning of a project. Stability is prized by investors, and P3 arrangements can be sabotaged by political risk. Deals must be reliable and of high quality for PE firms to agree to them. While P3s may appear safe on paper, many investors have been burned by failed projects that get shut down by new administrations.

One question investors are asking today is whether 2021 will change those trends. COVID-19's impact has been substantial for many state and city budgets, and private capital can be an attractive option for governments facing shortfalls. The recovery from the pandemic presents an opportunity for P3 transactions. For investors, however, there are other questions, especially around transportation. Projects such as toll roads and bridges hinge on transportation trends, and what those will look like depends on how many workers become commuters again, continuing shifts in where people live, and other factors. Professional investors are often more accurate than bureaucrats in studying those trends, and they often have more recent experience and better expertise than city managers do. 2021 may prove to be a dynamic year for public-private partnerships.

U.S. infrastructure PE exit activity



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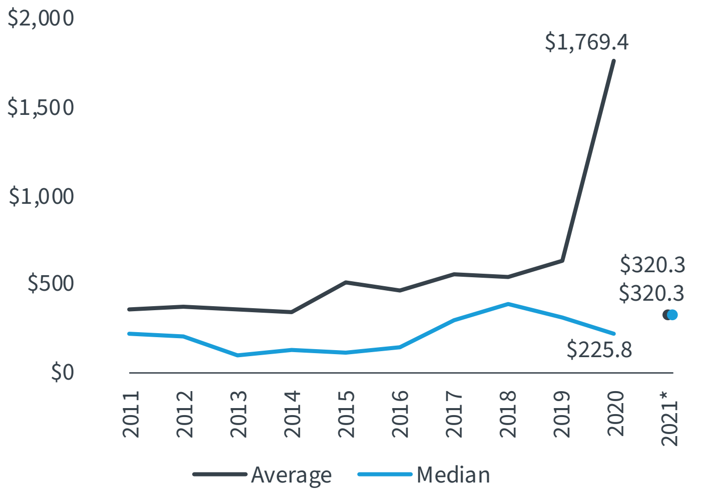
Median and average infrastructure PE deal size ($M)



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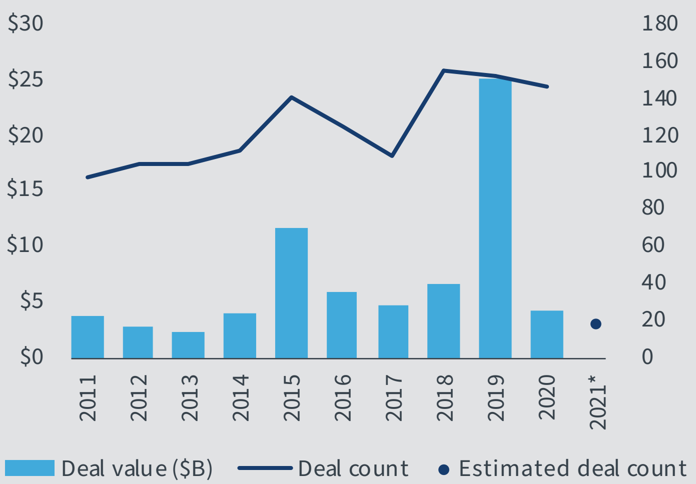
INFRASTRUCTURE BY SUBSECTOR

"We may see a tremendous amount of industry-specific M&A as private equity firms prepare to position themselves for infrastructure-related investment opportunities."
-Jeremy Swan, CohnReznick LLP

U.S. transportation PE deal activity



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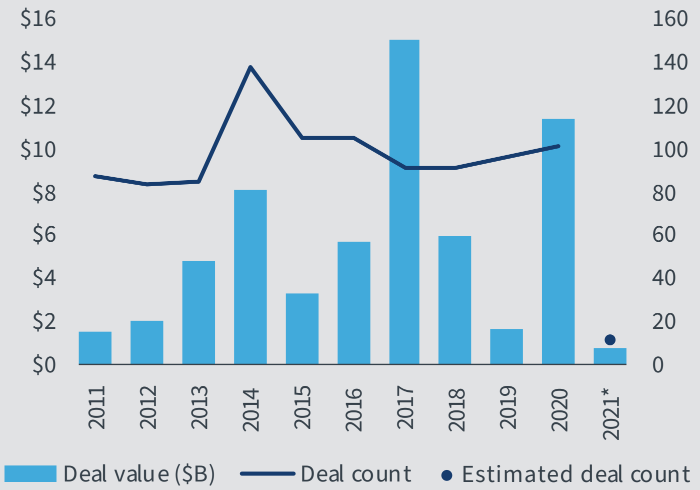
U.S. cleantech PE deal activity



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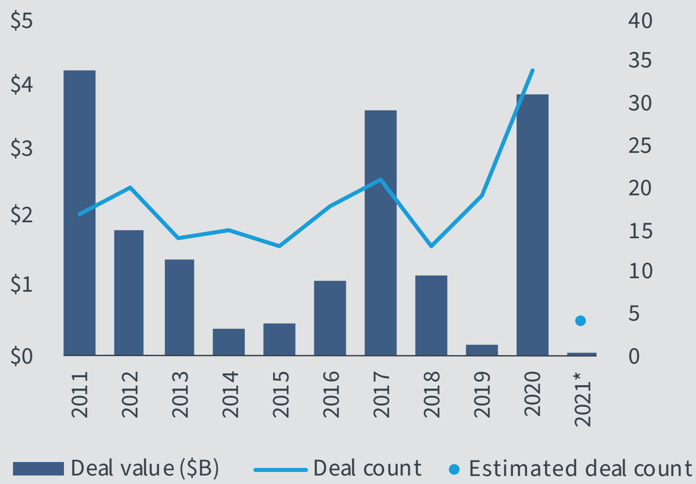
U.S. telecommunications M&A deal activity



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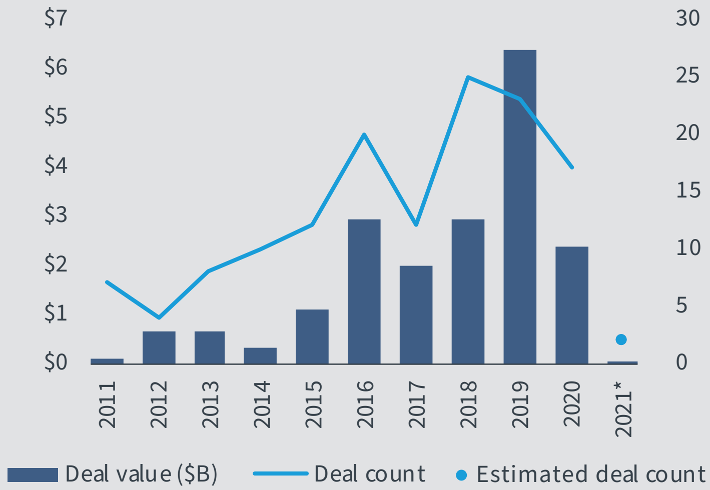
U.S. mobile technology M&A deal activity



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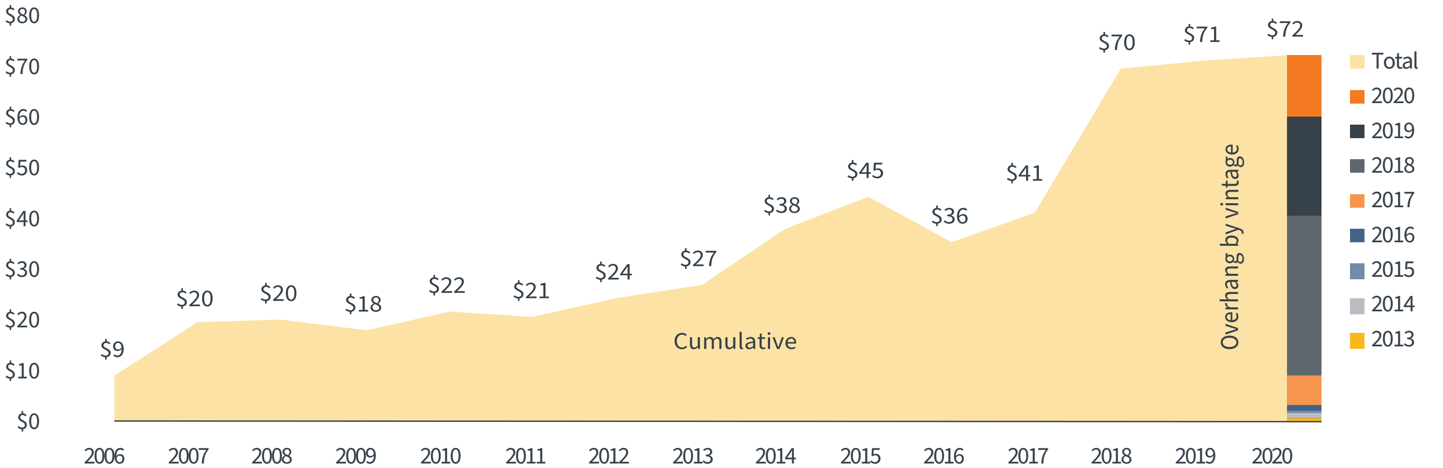
FUNDRAISING AND AUM

U.S. PE infrastructure dry powder by vintage



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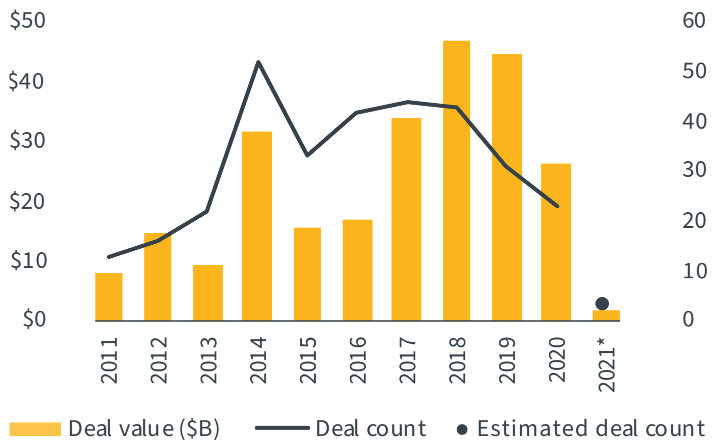
A glut of capital

Infrastructure funds have enjoyed four years of success on the fundraising trail. Between 2018 and 2019, PE infrastructure funds collected $91.6 billion of capital. LP interest in the asset class led to a surge in total dry powder, which leapt from $41.0 billion in 2017 to $70.0 billion a year later. As of last year, U.S. infrastructure funds had stockpiled a little over $72 billion in dry powder. Combined assets under management now sit at $157.4 billion, an all-time high.

The past four years have been a bonanza for the asset class because investors (and LPs) are optimistic about federal infrastructure spending. The Trump administration didn't succeed in passing a federal infrastructure plan, and the Biden administration is working toward a separate $2 trillion plan that hasn't materialized yet, either. Infrastructure is one of the few bipartisan issues in today's climate, and PE firms are anxious to assist. PE capital can help lighten the load for public sector budgets, and the number of projects on the docket would provide a big menu for investors to pore through.

LPs continue to back those funds, but almost always at the high end. Since 2012, infrastructure fundraising has been dominated by the $1 billion+ category, accounting for at least 70% of all capital raised during that time span. The infrastructure fund market also tends to be composed of larger funds. In 2016, for example, $1 billion+ funds accounted for 45% of all fundraises, an abnormally high number for any PE strategy. Not only are mega-funds more plentiful in infrastructure, but they keep getting bigger as well: On average, every vintage since 2012 has been larger than its predecessor. Part of that is LP confidence, but a bigger factor is GP competence. Infrastructure funds require expertise on multiple fronts, including regulatory and operational issues. Investors with several funds under their belts have an easier time soliciting LP capital and have an upper hand in the project investment process, as well.

U.S. PE fundraising in infrastructure funds



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Capitalizing on Today's Infrastructure Opportunity – A Q&A With Jeremy Swan

Jeremy Swan
Managing Principal, Financial Sponsors & Financial Services Industry, CohnReznick LLP

President Biden has pledged to spend trillions of dollars on infrastructure. What do you think are the potential private investment opportunities that this could create for private equity investors?

From a private investment perspective, the size and breadth of the American Jobs Plan has certainly drawn attention. The private investment community can play a critical role in helping to achieve the plan's vision. It looks as though there will be significant opportunities not only to help with what is traditionally thought of as infrastructure – highways, bridges, ports, airports and transit systems, etc. – but also to strengthen the nation in a broader sense, through efforts to create jobs, improve public health, deliver clean drinking water, revitalize manufacturing, advance clean energy options, build affordable homes, and more.

Private equity investors are doubly well-positioned to contribute to the success of this "hard" and "soft" infrastructure. First, adding their financial capital to public capital will increase total resources to support the various plan components, thereby adding an accelerant for public infrastructure programs and investment. Given that private capital could be available much more quickly than public capital, PE could be an important accelerant for the program. Second, PE investors' intellectual capital from project and operations experience will be a great value-add to all the public entities involved.

This infrastructure push comes at a time when interest is rising across the investment community – and the larger business world – in not only doing well, but doing good. It's likely that many of the projects ahead will align with the aims of "impact investing" – projects that can drive meaningful change, from facilitating the transition to clean energy to increasing equitable access to housing, healthcare, education, and more. Those looking to meet limited partners' expectations from an environmental, social, and governance (ESG) perspective – or reassessing their own firms' policies and investments to make sure they are "walking the walk" on ESG – may find these projects a perfect opportunity to move toward those goals.

In addition to the interest and optimism around traditional infrastructure funds, there's also this parallel optimism around infrastructure credit funds. What do you think about the enthusiasm on the credit side?

Private credit funds rose in popularity during the 2008 financial crisis, when the big banks became restricted and their lending activities became more regulated. These funds can deliver outstanding returns. They are matching long-term liabilities, and diversifying beyond the traditional business cycle holdings. Infrastructure credit funds can generate a significant amount of institutional interest. They are highly attractive to investors because of their longer life when compared to traditional credit funds.

A recent Moody's study found relatively few infrastructure downgrades or defaults at the height of the pandemic. Please share your views on the sturdiness of infrastructure investing, both now and over the near term.
Once an infrastructure project is initiated, it is very rare that it would come to a complete and sustainable halt. If you look at the credit quality, the risk of default throughout the pandemic, it didn't change dramatically, we didn't see a huge step up in default rates. On the infrastructure projects, we didn't see huge write-downs from the infrastructure funds that are invested in them. When a project gets started, in all likelihood, it will get completed. The length and resilience of infrastructure projects is attractive to investors and their limited partners, and is also a hedge when it comes to downgrades or defaults.

If you're an investor in the infrastructure space, are you thinking about investing in infrastructure projects, or investing in operating companies that are well positioned to plug into the various infrastructure opportunities?

I think there are opportunities for both project investors and operating company investors. Whether investing in infrastructure or any other industry, a private equity investor will invest in those situations where they have experience and confidence in their firm's ability to achieve their investment goals. If your team is experienced managing infrastructure projects, you may gravitate toward those opportunities. The same would be true of operating company investors.

What should infrastructure funds do to get ready for an escalation of infrastructure spending?

I think first and foremost, you need to pick and choose where you want to focus: Which industry or industries? At the project level or the company level?

From a financing perspective, get yourself up to speed on public-private partnership (P3) investment structures. Expect and plan for the due diligence required to establish them, which may include cost-benefit analyses of full cost and revenue projections, risk-sharing scenarios, public opinion, and other factors. Educate investors on the risk that may be involved, and be prepared to negotiate to protect them as risk is defined and delineated between the parties. And be ready to really tout your differentiators – what expertise, experience, creativity, and innovation can you bring to a public project?

Read an extended version of this Q&A at [CohnReznick.com.](CohnReznick.com)

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