Igneo Infrastructure Partners

Middle-market infrastructure investment opportunities and trends

Digital, transportation, energy transition, and waste and water

Jorge Fernandez, Institutional Real Estate, Inc.'s managing director, infrastructure, recently spoke with **Michael Ryder** and **John Ma,** North American co-heads with Igneo Infrastructure Partners. Following is an excerpt of that conversation.

Given current macro trends and where we now find ourselves in the interest-rate cycle, what are the investment trends in the sector verticals Igneo focuses on?

Michael Ryder: Generally, our sectors are performing very well. Starting with the digital space, the transaction market has come off a bit from the exuberance of 2021 and 2022, which was largely driven by demand increases that occurred during COVID-19 and resulted in heightened transaction activity and high valuations across the digital sector. A degree of realism has returned to the market, with significant demand growth still projected for the next 10 years, as faster connectivity, the need for denser networks and increased data storage are required to satisfy the growth driven by AI and other data trends.

Waste and water, which is another sector we focus on, tends to be a more stable market through the cycle with stable underlying demand trends. The largest opportunity today is related to the circular nature of these investments – increased recycling, conversion to lower-emission technology for disposal and energy from waste opportunities. We have global investments in all three of those areas, and we continue to see opportunities.

John Ma: In renewables and energy transition, strong underlying tailwinds continue, driven by the pace and level of policy support for energy transition, as well as fundamental underlying demand for reliable power. The higher interest-rate environment is making projects more expensive, and supply-chain constraints are impacting new renewable project development. The Inflation Reduction Act is helping to offset some of that, but it's also contributing to the increased demand and inflation we're seeing for equipment and contractors. Underlying all this, there is good demand from offtakers and financing parties for well-structured projects.

It's a very strong market within transportation. There's quite a bit of dynamism in the sector right now, despite less publicity. Since the pandemic, we've continued to see movement in the industry, given people are still trying to recover from the supply-chain constraints during the peak of COVID-19 and into the early and latter parts of 2022. No company wants to be in the position they found themselves in when everything was bottlenecked. Shippers want more reliable and more resilient supply chains. We continue to see demand for and investment into transportation and logistics. Passenger demand has also rebounded strongly for passenger-related transportation. Across the board, players are looking at investing into reliable transportation and supply chains. The other broad macro theme we see in transportation is strong effort to try to decarbonize the transportation sector, whether through renewable-fuel projects, electric-vehicle charging or similar initiatives.

What region do you feel has the most opportunity for growing the transportation business?

Ma: In freight, there is still a lot of manufacturing activity and growth clustered around the central and southern parts of the United States, and a lot of port activity on the coasts. Rather than identify a specific region in the United States, I would categorize it into freight-related transportation and surface transportation. Metro regions need a lot of investment, given population growth into some of the U.S. metros, where there is a lot of demand for improved passenger-related transportation infrastructure.

Can you comment on the relative attractiveness of middle-market versus large-cap infrastructure investing?

Ryder: As a middle-market specialist, Igneo has a deep understanding of the small and mid-sized company environment. We drive value creation in the businesses we acquire. We take a platform approach to many of our current investments, where we bring capital and investment experience in similar investments on a global basis, and we partner with portfolio company management teams to clearly define our medium-term growth objectives and then, together, pursue organic and inorganic opportunities to achieve those goals. In mid-sized companies, where often the management is quite lean, we augment the management's capabilities and capacity and work collaboratively with them to build the business.

With larger-cap companies, it's a bit harder to move the needle to drive value creation within a business where management is often less in need of the hands-on collaboration, active management and oversight approach we bring. Furthermore, financial leverage is often more important in a larger-cap transaction. They're often using significant leverage to help generate the returns, and higher interest rates can be a bigger headwind. The mid-cap space is a truly exciting place to be investing, where we can grow significant value. We've been investing in the middle market for 30 years and know how to take a business from a small or mid-sized family-owned or privately owned company to the next level by bringing in more sophisticated approaches to management, thinking through in a more systematic way the strategies around growth, as well as employee engagement, health and safety, and other components that become more important as a business grows.

Where are you identifying new opportunities in the North American market in 2024?

Ma: We're seeing a lot of interesting new investment opportunities across all four of the industry verticals we focus on as we head into 2024, those four industry verticals being: renewables and energy transition; transportation and logistics; digital infrastructure; and waste and water. The volume of opportunities is enabling us to be very selective about where we're spending our time. We've screened hundreds of investment opportunities during this past year. We're trying to focus our time and resources on situations where we believe we've got an angle of some sort, such as specific industry insights or experience from our global platform, where we've invested in a sector and have built a strategy or a thesis that is differentiated.

Some examples will give a flavor of the types of opportunities we're focusing on. We're looking at opportunities related to the ramp-up in AI-driven demand for computing power and digital networks. Given the dynamism in the transportation sector, we're evaluating a number of opportunities related to decarbonization and the electrification of transportation. We've also been leveraging our experience in waste and recycling to evaluate a few situations in the energy-from-waste sector. Within Igneo, we've made a number of successful investments in the energy-from-waste sector, and we're looking to leverage that institutional experience to pursue a couple of specific situations in North America. Some opportunities come from activity at our existing portfolio companies, such as Patriot Rail, a leading U.S. shortline freight-rail holding company, or U.S. Signal, a fiber and data center company. Our presence enables us to see other opportunities within those sectors.

Can you speak to how value-enhancement initiatives shift or adapt at different points in the economic cycle?

Ryder: Value-creation and growth opportunities are frequently driven more by the industry sector, strategy and opportunity than by what point we are in the cycle. That said, we're always considering the broader economic environment when we partner with our management teams to devise those medium-term value-creation strategies. At different times in the cycle, we may see increased inorganic activity driven by the environment, when it is more challenging to access capital or leads to higher financing costs. This may cause other owners to look to divest, creating an opportunity for investors like us. We can bring in additional equity to make attractive add-on acquisitions or project acquisitions. Inflation can also drive interesting dynamics and value initiatives in our businesses. Most of our portfolio is able to pass on inflation pressure to our customers through inflation pass-through clauses in their contracts, or through new contracts and pricing dynamics. But inflation also impacts costs at our companies and the cost of living for our employees. We need to be supportive of our employees with fair and equitable wages. Our companies work closely with suppliers to identify and manage cost efficiencies across their cost base, while building long-term sustainable relationships that will enable the whole value chain to grow through cycles. Importantly, we don't see this as a one-time transactional relationship. We look to grow long-term relationships with our customers, with our suppliers, that then enable us to manage our businesses better through the macroeconomic cycle. We're looking to have long-term sustainable companies that will be successful through the cycle and able to make a positive contribution to the communities and industries in which they operate.

How do logistics and onshoring trends affect the various sectors in which Igneo invests?

Ma: In transportation, there are direct effects from some of these trends. Post-COVID, there's an even greater premium within the transportation and logistics space on resilience, reliability and dependability for customers. The rail sector should be a beneficiary of that. For example, the shortline industry sees itself as a partner between the railroads and the factories, shippers and warehouses that produce, ship and store the goods. The shortline rail industry plays an important role in that resilient national supply-chain and logistics network. From an onshoring trend perspective, it's early, and we're monitoring it closely. Indirectly, logistics and onshoring trends have impacted other sectors we look at. In renewables, for instance, there is a lot of demand but also supply-chain and equipment bottlenecks and a gap in domestic manufacturing capacity, be it high-voltage electrical equipment, batteries, solar panels or turbines.

How do you expect the uncertainties presented by a U.S. election year will affect your business in 2024?

Ryder: The political situation in 2024 and uncertainty about the outcome of the federal election may reduce competition and contribute to an attractive investment environment, as less-experienced North American investors may step back for a short period of time. However, we invest in high-quality businesses that are not dependent on any single policy outcome. It will be a year where everyone needs to keep their eyes wide open. American competitiveness on an international scale is driven by our sustained investment in our domestic infrastructure. In recent decades, that investment hasn't been as much as would have been ideal to maintain the systems, processes and assets that support and facilitate the efficient operating of our economy. Consequently, the opportunity to invest material capital in improving those assets, in increasing the efficiency with which our economy runs, will be a benefit, regardless of your political affiliation.

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CORPORATE OVERVIEW

Igneo Infrastructure Partners is the direct infrastructure investment team of the First Sentier Investors Group. Igneo seeks to deliver superior risk-adjusted returns by acquiring and managing high-quality, mature, mid-market infrastructure companies operating in the renewables, digital infrastructure, waste-management, water utilities and transportation/logistics sectors across the United Kingdom, Europe, North America, Australia and New Zealand. Operating since 1994, with one of the longest-established teams in the market, Igneo creates sustainable long-term value through innovation and proactive asset management.

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