

KEYNOTE INTERVIEW

Scaling up



Applying capability, capacity and capital to mid-market companies can create the dominant players of tomorrow, says managing partner at Arcus Infrastructure Partners, Ian Harding

Q What makes infrastructure an attractive asset class today?

Infrastructure has always been an attractive asset class. It has simply gained more prominence and more capital flows in recent years due to low yields in the fixed-income markets. Ultimately, infrastructure's defensive characteristics – namely, that it provides essential services, generates robust cashflows and yield and, by nature, generally has a strong position in its market – make it an attractive place to invest your capital. This has always been the case and it will continue to be so in the future.

Q And what makes the European mid-market a particularly interesting

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space within the broader infrastructure landscape?

We like the European mid-market space because we are successful in identifying underdeveloped companies with strong, entrepreneurial management teams and can then apply professional capital which we use to scale those assets into something more institutionalised. In short, Arcus provides capability, capacity and capital to grow these companies into dominant players in their markets. We are seeing a wealth of companies that fit this profile and there is no shortage of opportunities for us to deploy capital at good entry prices.

Q What are some of the most compelling opportunities that you are seeing right now in the mid-market energy space?

There are a large number of energy opportunities, primarily driven by the decarbonisation agenda and transition to net zero. The shift from centralised to decentralised energy systems also brings with it a variety of small to mid-market opportunities, including smart metering, or sub metering, where we currently have two investments – SMA and Horizon – in our portfolio. There are also microgrids or private wire systems – providing electricity for local use; and finally, what we call renewable-plus opportunities. Arcus recently acquired a business called Momentum, based in Denmark, which we would categorise as renewable-plus.

In addition, there are some interesting leasing models that are being put in place in the energy space, otherwise known as private estate or industrial infrastructure. There are district heating opportunities, hydrogen and renewable fuel opportunities – essentially a whole raft of nascent businesses that are on the frontier of what we would call infrastructure today, but that will likely become core or core-plus infrastructure of the future.

Q And what about opportunities in the communications sector?

We have been involved in communications infrastructure for over a decade. Our first investment was in Shere, a UK and Netherlands towerco. We are also invested in TDF and we have two fibre-to-the-home businesses, Swiss4net and E-Fiber. This remains a sector of real interest because of the volume of demand for connectivity and data storage. Of course, that demand has only increased as a result of lockdown restrictions during the covid-19 pandemic. Communications was always an industry that was going to grow, but the pandemic has accelerated that growth. As they say, connectivity has become the fourth utility.

Q The other sector that you focus on, transport, has fared less well through covid. What does the future hold?

The pandemic has hit transport much harder than many other sectors. Airports and toll roads, in particular, suffered material patronage and traffic declines due to the various lockdowns and travel restrictions that people across Europe have been experiencing. Fundamentally, we believe transport assets that operate in a local monopoly, providing essential services, will recover. The challenge will be plotting that recovery and growth path, given the political influences and unexpected lockdowns that populations are continuing to experience.

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“ESG is a critical component of infrastructure investing”

From an Arcus perspective, we have become more creative in the sector, focusing on newer forms of transport and logistics. A good example would be our cold storage logistics business, Constellation, and Peacock, which is an ISO tank container leasing business. Peacock has benefitted from the pandemic because a lot of the liquids that it is transporting are disinfectants and hand sanitisers, which experienced a significant increase in demand over the past two years.

More recently, we also bought a business called HB, which is a logistics business supporting the food services industry in the Netherlands. This creativity is important. You can't just look to traditional forms of transport – ports, toll roads and airports. You have to look at changes in mobility and supply-chain patterns. There are still opportunities out there that will allow you to generate a good return, but you have to spend a bit more time thinking about where you want to invest.

Q What changes are you seeing with regard to the role of ESG?

ESG has been around in different guises for many years – it was previously called corporate social responsibility – and clearly it is a central theme in every infrastructure market, indeed in every market, today. This has been driven largely due to regulation. There is the EU taxonomy, the Task Force on Climate-related Financial Disclosures and the Sustainable Finance Disclosure Regulation, for example, all of which are designed to enhance managers' reporting of the ESG performance of their portfolio companies and support the climate change agenda.

At Arcus, these ESG principles have been largely embedded in our processes and decision making for over a decade, so this is nothing new for us. But we strive to improve this year on year. We submit annually to GRESB infrastructure ESG assessment, which is a great forum for benchmarking the



Q What does the future hold for European mid-market infrastructure?

In the near term, there will continue to be a wealth of opportunities in the mid-market space for businesses that are ripe for development and growth to become more established, market-dominant players. This will continue to be the case over the next decade. We don't see this changing any time soon. At the same time, there are capital-chasing opportunities, so managers will have to be creative. For example, investors will continue to find new areas of frontier infrastructure that demonstrate strong infrastructure characteristics but that are not yet considered core. Those that do display creativity will continue to find good entry points from a valuation perspective and ultimately good businesses in which to invest.

relative ESG performance of infrastructure assets and we are proud that our performance has improved broadly year on year. In 2021, we achieved four sector leader awards. ESG is a critical component of infrastructure investing. It is imperative that it is taken seriously. It isn't only a question of shareholder value. This is about stakeholder value and making sure you are investing sustainably, not just for economic value.

Q To what extent are technology and data analytics shaping the mid-market infrastructure landscape from an investment and asset management perspective?

Technology and data are becoming increasingly important. Perhaps not from an investment standpoint, as infrastructure investors don't like taking

on technology risk. But you do find infrastructure investors incorporating new technology and data analytics into the management of their assets.

A good example would be our container leasing business, Peacock, which is currently in the process of installing tracking devices on its fleet so that the tanks containers can be digitally geolocated. This helps from an asset register and security perspective and can also allow, in some cases, for the temperature of the liquid products being carried to be remotely monitored, important for safety and integrity of the product. A clear example where adding technology can improve the value of a business.

Another example would be in the management of our rolling stock company, Alpha Trains, which undertakes enhanced remote monitoring of the performance of individual asset

components. Alpha Trains uses remote monitoring of key predictive failure indicators to initiate a maintenance or operational intervention, which results in better asset performance, availability and lower maintenance costs. This process saves money in maintenance and less lost revenue while assets are out of service due to these interventions being done on a planned preventative basis rather than a reactive one. It all comes down to being smarter with the data that you have.

Q What are the biggest challenges facing mid-market infrastructure investors?

The biggest challenges are the ones that are hard to forecast – the black swan events or the grey rhinos, that you can predict but which have a very low probability of actually happening. The current pandemic is a good example. Everyone knew that pandemics existed, but the likelihood of a global one actually happening, and lasting, was considered incredibly small. These events are extremely difficult to manage.

Arcus has been around for more than a decade and we have managed assets through the financial crisis, the European sovereign crisis and now through the pandemic. We have been cycle tested and this experience allows us to recognise that these things do happen, and while no one can predict them, everyone needs to be ready to react. We adapted our investment strategy for precisely this reason and we are now the controlling investor in every investment that we make. This is so that we can react quickly and dynamically to any of these unforeseen occurrences. All of the Arcus team do a huge amount of due diligence on the way into a deal, of course, which gives us some confidence in how an asset is going to perform in a whole array of different scenarios, but there will always be things you simply can't predict. In these situations, we have to be flexible, fleet of foot and work with management teams to adapt to the new reality. ■