

KEYNOTE INTERVIEW

Transport's big drivers



*From decarbonisation to digitalisation, transportation is a sector on the move, says Arcus Infrastructure Partners' **Michael Allen***

Q How is the growing sense of urgency around climate change impacting the transport sector and what investment opportunities is that creating?

Transportation is the second largest contributor to greenhouse gas emissions and so there is, of course, a huge focus on decarbonising the sector. That is giving rise to a vast array of investment opportunities.

Those opportunities cover not only decarbonisation itself, including electrification and alternative fuel infrastructure, but also the improved connectivity and efficiency needed to reduce congestion, which has positive implications for cutting emissions as well.

Meanwhile, the supply-chain disruption that we have seen as a result of covid has led to an increase in near-shoring, reducing transportation distances, which will also be a net positive

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from an environmental perspective. Consumers are becoming more socially responsible, which is another driver behind the greening of road, rail and maritime transport, all of which will require significant investment.

To put the investment opportunity in some context, in 2021 we looked at 89 transportation investment opportunities that met our requirements at first screening. We narrowed that funnel down pretty quickly, but I think that shows the breadth of opportunity that exists.

Q What are the opportunities pertaining to public transport?

If you want consumers to make green

choices then you have to have good public transport and, whilst this is primarily the remit of local cities and municipalities, we have seen private investment opportunities involving buses, and ferries for example, really open up in the past few years.

There are a number of different business models when it comes to buses, but what is common to all of them is the need to decarbonise the fleet. If you want to attract more people to use public transport, you also need to improve its efficiency and make the journey feel seamless and integrated. This is where investments to support digitalisation in transport is a huge opportunity.

Q And what about the individual adoption of electric vehicles? What opportunities do you see there?

There is a debate to be had about whether we should be encouraging the

individual adoption of EVs. Obviously, if someone is going to purchase a vehicle, it is better that it is electric and there are significant subsidies available across Europe. But that isn't going to alleviate congestion or some of the issues around the mining of minerals to manufacture electric cars. There are also significant challenges that remain around EV charging and related infrastructure because, whilst there are lots of sources of public funding available, they are not being harnessed in a co-ordinated way.

Business models still have to evolve and we have struggled to identify attractive standalone businesses that will be effective in addressing large scale EV charging infrastructure needs on attractive economics. Currently we are supporting our existing transportation assets with EV charging installations and solutions. For example, Brisa, the largest motorway services provider in Portugal, has rolled out EV charging across its sites and at its head office.

Q Another trend that has long helped shape transportation investment needs is urbanisation. How is that playing out in a post-covid world?

We did see urbanisation halt in some large cities during covid and in London the trend arguably went into reverse. But despite that interruption, I think the long-term trend will remain unchanged. Whilst employers have recognised the need for flexibility, many are increasingly encouraging staff to return to the office. In Europe, 73 per cent of the population are already living in cities and city infrastructure is struggling to cope. There is a lot that needs to be done.

For example, cities are looking at different ways of managing traffic flows, including ways of monitoring when vehicles enter and leave control zones and where they park, so that a charge to enter or a fine can be applied. There could be interesting opportunities for

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infrastructure investors to co-operate with municipalities to deliver those solutions, although the fact that there are so many different models emerging certainly makes it challenging.

Q Where else do you see interesting transport investment opportunities?

Specialist fleets that support offshore wind, for example, represent an interesting space, which is obviously benefiting from strong tailwinds in energy transition. We also like the movement of freight generally, having invested in an intermodal ISO tank container business, Peacock Leasing, last year. With that investment, we leveraged our deep experience in the rail leasing sector, gained through investments in Angel Trains and Alpha Trains and our knowledge of the maritime sector.

The ESG credentials of Peacock Leasing were also really important for Arcus. Chemical and agricultural products, whether liquid or gas, used to be transported in drums which corroded and leaked. They were often also poorly disposed of. Peacock Leasing's ISO tanks are more durable, lighter and better insulated, which means less CO2 emissions and are safer to operate. Meanwhile, a very large percentage of the tank containers can be recycled.

We also liked this business because the ISO tanks have multi-modal capabilities and because of the application of digital technology for tracking, which means customers know exactly where their product is at any point in time. The technology can also be used to corroborate product integrity, which is very important, especially in the food industry.

Finally, the ISO container market is highly fragmented. We have already more than doubled the size of the business since we first invested in February last year. We are now the sixth largest player and significant opportunity for further consolidation remains.

Another recent transaction for us was HB Returnable Transport

Solutions, based in the Netherlands. That is a so-called returnable transport items business focused on the transportation of food produce in the Dutch food industry. Again, there is a strong sustainability angle. Instead of the single-use packaging used to transport fresh produce, it uses reusable items. It is a highly regulated market, which means barriers to entry are high. The level of operational expertise necessary to manage the high number of items involved – HB has around 11 million items – in an integrated network is also a significant barrier to entry. That intersection between logistics and the food industry, is an area that we find very exciting.

Q On the face of it, transport was the sector that was most badly affected by the pandemic. How has that impacted demand for assets and perceptions of risk profiles?

You are right. Transport would initially appear to be the sector that suffered the most, as a result of lockdowns and travel bans, but not all assets were affected in the same way. There was a bifurcation between transport catering for passengers and that catering for freight, in particular. The sector that was hit hardest was airports, of course, but demand-risk roads also suffered as a result of strong measures taken to prevent people getting in their cars.

Interestingly enough, however, once restrictions were lifted, there was a certain reticence to use public transport as people feared they were more likely to catch covid. That actually provided a boost for road transport, although obviously not an ideal outcome from an emissions perspective.

Overall, I would say that transport assets that operate local monopolies, providing essential services will recover. Indeed, many are recovering faster than we would have expected.

I would add that we also see strong relative value in the transport sector

when compared to say digital infrastructure, for example, which was clearly an area that exploded in popularity as a result of the pandemic.

Q And what about the challenges we face now, in terms of rising inflation and rising interest rates?

Our house view is that the current high levels of inflation could be quite stubborn and will be here for at least a year. There is also a risk, although I don't think it is a big risk, that if interest rates keep going up that could threaten recession. We have therefore spent a lot of time thinking about how these macroeconomic factors will impact each of our assets and, in particular, how resilient our investments will be in a higher inflation environment in terms of revenues, costs and also capex.

To give you two extreme examples in the same sector. The Brisa concession has inflation indexing stipulated within the agreement so there is a clear pass-through in terms of tolls. High inflation is actually good for the asset. We have another road asset in Poland – a very structured PPP – where the bulk of the revenues are availability-based, so inflation will have a very negligible impact. Those are two investments, ostensibly in the same area, that will respond very differently.

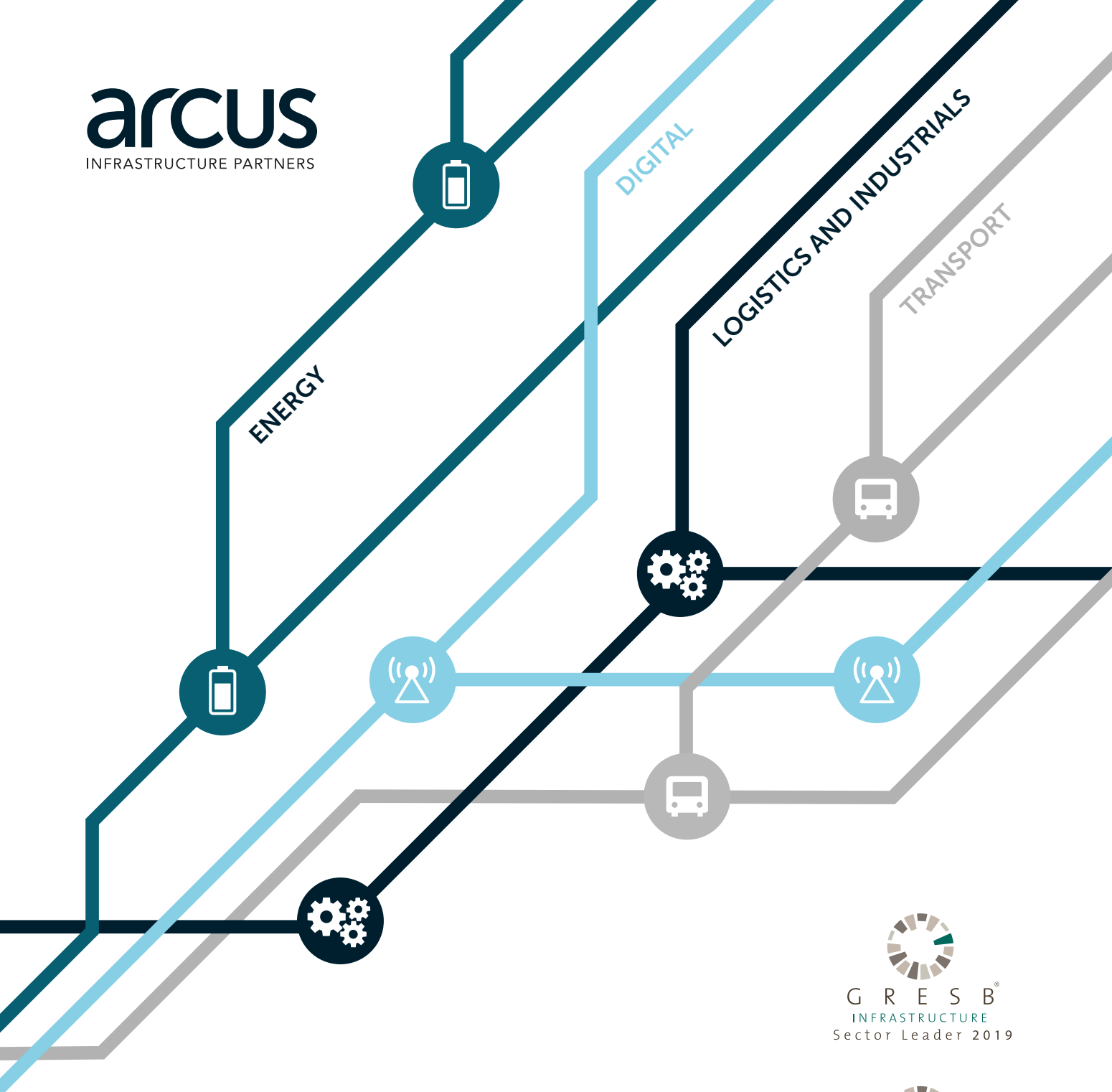
That is not to say that inflation is not a big issue. If you have an investment that is very growth orientated, for example, you need to look at how the cost of that growth is likely to change and what that means for the overall risk profile. Of course, you also need to be mindful of the implications of higher interest rates for financing. We have spent a lot of time reviewing our assumptions around the cost of debt and how long the hedging that we have in place will be able to insulate businesses from higher interest rates. We have deliberately taken advantage of extremely low interest rates over the past 18 months to lock in as much long-term fixed debt as possible.

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Q You described yourself as an optimist. What are your concluding thoughts on the future for this sector?

I am an optimist. And I do think we will continue to see lots of interesting transportation investment opportunities. But those opportunities will need to be reviewed very carefully in the context of all of the things we have spoken about – inflation, interest rates, sustainability, supply-chain disruption and consumer choice, to name just a few. I also think that investors would be prudent to avoid assets where competition is fierce and where there is a temptation to overpay. This is an exciting and evolving sector, but one that must be approached with experience and a measure of caution. ■

Michael Allen is a partner and part of the team that founded Arcus in 2009



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