Funds & Investors Report 2018

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London roundtable: How to stand out from the crowd by Viola Caon

The roundtable participants were:

- **Hamish Mackenzie** - Deutsche Asset Management
- **Andrea Echberg** - Pantheon
- **Bronte Somes** - UBS Asset Management
- **James Wardlaw** - Campbell Lutyens
- **Rob Gregor** - Basalt Infrastructure Partners
- **Adam Lygoe** - Macquarie Infrastructure and Real Assets
- **Nicolas Lucas** - Allianz Global Investors
- **Jean-Francis Dusch** - Edmond de Rothschild
- **David Cooper** - IFM Investors
- **Patrick Charbonneau** - PSP Investments
- **Emma Haight-Cheng** - AMP Capital

After a strong fundraising year, some of the most prominent London-based fund managers and institutional investors gathered in *IJInvestor*'s London offices to discuss what 2018 holds.

Thanks to a balance between equity and debt managers present, the conversation spanned various topics and featured a mix of views. There was consensus however that track record, diversification and operational expertise are vital for both existing and new managers to deliver value in an increasingly crowded market.

Attendees debated the evolution of ESG from a mere box-ticking exercise to something that investors are increasingly mindful of and want to see implemented in managers' propositions across sectors and regions.

Andrea Echberg - Pantheon

"The US is the main emerging market," argued one of the attendees when talking about potential new regions. Many were quick to point out however that this had been true for the past 10 years or so.

Other trends highlighted in the discussion were the emergence of Asian managers finally coming to market in large numbers, and private wealth managers making a first appearance in the European landscape.

Track record and operational expertise

Some $70 billion was raised in 2017 by unlisted infrastructure funds reaching final close globally. However, this large total was achieved by a lower number of fund managers than previously active in the market.

"What we have seen over the last couple of years has been a narrowing of the universe as there has been a shake-out of those funds that have performed well historically versus those that have had a more mixed track record," said Andrea Echberg, partner at Pantheon Ventures.

"The trend that we are starting to see coming out of last year and into this year is a widening of that universe, and it has been quite a tricky thing because it is very difficult for first-time funds to gain traction, even though the fundraising market is very active at the moment and there is a lot of money out there, it is very difficult without a track record behind you to get that momentum to the fundraise," she added.

And while Echberg spoke from an equity perspective, the same point seems to be valid on the debt side too. "I would agree wholeheartedly with a lot of that. The really big thing when we are out fundraising – and I am not surprised by this – is to be able to show a deployment track record. That is what wins you the mandates more than anything else," said David Cooper, head of debt investments, EMEA at IFM Investors. While track record might take longer to achieve, another way for managers to remain valuable in the eyes of investors is to try and differentiate their proposition, either by size or by offering some level of operational expertise, the attendees agreed.

"Managers have to show how they are able to add value to the assets they plan to invest in, through operational expertise. I think that is coming out louder and clearer. Maybe the corollary of that is specialisation, because it is more difficult to legitimately claim that you can add value across a broad range of different sectors and geographies if you do not have that operational expertise," said James Wardlaw, partner at Campbell Lutyens, one of the most active placement agencies in the funds industry.

David Cooper - IFM Investors

Some of that attempt to differentiate themselves has sometimes translated into a core-plus, or even value-add proposition sometimes, in the past couple of years. "In this return environment, core assets need very strong operational expertise. Not all investors have that expertise and it is not necessarily all the managers who have the right fee profile to make this work on a core asset. That is why there has been a tendency to go toward core-plus, because then the operational skills could be applied and generate an additional return," pointed out Patrick Charbonneau, managing director of infrastructure investments at PSP Investments.

So a strong track record can make you stand apart but investors need to be confident a manager can reproduce past successes.

"When we look at managers we look at track record, we look at operational expertise, and in this market it is quite easy to blur the story with very high returns. The real questions are: who has the real track record and who benefited just from the increasing popularity of the asset class? Who has an operational expertise, or who just rode the wave of the re-rating of the asset? That's the difficulty, I think, from an LP perspective: to see through this, break down the track record, break down operational expertise and commit money to the managers that we think will be able to replicate that business model," Charbonneau added.

Adam Lygoe, managing director at Macquarie Infrastructure and Real Assets (MIRA), added: "I totally agree. It's not just about the track record, it's about the replicability of that track record going forward. That's the tough part."

And it is not only vintage that matters, he argued: "Without a doubt, having operational expertise is going to be key going forward in terms of driving value, but relationships and access to specific situations can also help generate attractive entry pricing. Once acquired, it is about having an operational point of difference to enhance those businesses and create long-term value."

ESG – No longer a box-ticking exercise

Environmental, social and governance (ESG) requirements are nothing new for fund managers and investors but have become increasingly important in the current political environment.

"An emergent theme we are seeing is the ESG aspect and the requirement from partners to see that it is part of the DNA of the fund that they are investing in. I am not sure that that is necessarily translating into higher returns, but it definitely ranks higher in our investors' priority list than it used to," said Bronte Somes, head of infrastructure equity Europe at UBS Asset Management (UBS AM).

Managers are still some way away from launching ESG-only infrastructure strategies and some of them, including UBS AM, have preferred including this policy on more traditional and liquid asset classes like equities.

"We have been having conversations lately with many investors who are certainly thinking about it. It is quite difficult though, unless you go with a pure renewables strategy. For instance, many local government pension schemes in the UK and many pension fund managers in the Netherlands want to rule out any form of carbon and we always ask whether that stretches to investing in certain roads for instance. The question is always how far they are willing to take that path," said Pantheon's Echberg.

ESG in a broader sense can also be an add-on to a strong track record to help win investors over, others point out. "We are finding that the ESG compliance strategy, or a strategy which only considers ESG-compliant assets, and the ability to show that we were able to deploy capital widely in that area with good results has been extremely important for us as well," said Emma Haight-Cheng, partner at AMP Capital who has been investing in mezzanine debt globally for the past six years.

Jean-Francis Dusch, CIO of infrastructure debt at Edmond de Rothschild, agrees that the ability to show flexibility within ESG is beneficial: "I agree that it is important to show that you can deploy broadly across the ESG remit as it can be quite difficult in terms of reporting. We are committed to sustainable development and we always look for a way to meet the demand of investors that goes beyond reporting. Sometimes the shortcut to ESG investing is renewables. We instead think that energy transition can be a very good way to show your commitment to this policy without restricting our investment horizon as much."

But the definition of ESG can change in different geographies. Again from the debt side, but traditionally more at the senior secure end of the spectrum, IFM's Cooper said: "To stereotype hugely, European investors are often far more focused on ESG compared with US investors and probably would not want us to go off and finance CCGT infrastructure in the US. US investors on the other hand would probably see financing CCGT as a green deal. They might even want us to explore opportunities to invest in carbon-related projects in places like Europe where they would see they might get a premium because a lot of the European investors wouldn't be so keen on investing in those particular markets."

Adam Lygoe - Macquarie Infrastructure and Real Assets

LPs – Asia and the rise of European private wealth managers

But where has all the capital being flowing in from? And more importantly, where is it expected to continue to flow in from?

Asia definitely receives the lion's share of the attendees' interest, as existing investors – like the Koreans – increase their allocation to the asset class abroad and new, much anticipated investors – like the Japanese – are finally deploying capital into infrastructure.
On a slightly smaller scale in the Asian continent, Taiwan has started to get mentioned more frequently among those investors who are expected to become big players going forward.

Generally, the room seemed to agree that it is only the tip of the iceberg. "There is still a lot of capital to be raised from the pension side. In the US and Asian pension industry for instance, they have

Bronte Somes - UBS Asset Management

only just scratched the surface," said Rob Gregor, partner at Basalt Infrastructure Partners.

However, in the US case, support is mainly coming from public pension funds: "On the infra equity side at least, it's the public pension funds that have really got behind the asset class rather than the endowments and foundations. However, there is certainly a widening base of capital flowing out of the US at the moment," said Campbell Lutyens' Wardlaw.

"There are a lot new LPs coming," agreed Pantheon's Echberg, "I think it is a pretty global market. Asia is definitely a growing market, we started to see that in Korea over the past couple of years and it is certainly waking up in Japan now. And Taiwan too. Less so in China to date, but maybe that will change."

In Europe, she pointed out, private wealth managers are starting to look at infrastructure as part of their asset allocation. "Across the whole of Europe and the UK there is healthy activity among both pension funds and life insurance companies in particular. But we have also seen a lot of interest in the private wealth space which is now looking at infrastructure as a product".

While China may not be on everybody's list just yet, MIRA has some Chinese capital among its 700-strong investor base.

"We definitely see a lot of capital coming out of Asia at the moment. Talking to our investors globally, we either hear of new allocations or existing allocations being increased. We rarely see allocations being reduced. We see a lot of capital coming out of Japan, Korea and Taiwan, but also see significant capital flows coming out of China, notwithstanding the FX restrictions that can pose limits," Lygoe said.

MIRA's MD also mentioned Italy as a growing market for the firm: "Italy is really starting to open up for infrastructure as an asset class. It started off with LPs investing with F2i at home and then broadened to include Europe mandates. They are now looking globally and increasingly see infrastructure as a part of their portfolio composition."

Lygoe also said that, while the bulk of the capital is coming from pension funds, insurance companies and sovereign wealth funds, at MIRA they are starting to have conversations with the sophisticated retail market and family offices. "These players have typically been focused on shorter hold/higher returning asset classes with liquidity, but they are now starting to be willing to lock their money away for a period of time and have that defensive income-generative strategy in their portfolio," he said.

Looking elsewhere, Australian superannuation funds, who have traditionally invested domestically, now need to deploy capital abroad. But they have predominately been doing so by going direct on deals rather than allocating capital to foreign fund managers.

However, the effort of going abroad has not often been matched by expected returns. If any capital is to come into overseas funds from those players, it is likely to benefit high-yield, core-plus strategies, some attendees pointed out.

Hamish Mackenzie - Deutsche Asset Management

IFM's Cooper, whose organisation was set up with the support of 29 Australian superannuation schemes, says it is beyond doubt that they are actively looking to invest abroad.

"The saving pools are still growing down there so, by definition, they need to invest abroad. However it is true that they have done so more by buying more liquid assets, either equity or bonds, because they are worried about having to bring money back," Cooper said. He also added that when going overseas, many superannuation schemes have done so expecting increased yields and have been disappointed by the generally compressed market environment and FX exposure.

"I have the feeling that if we are going to see pockets of money coming out of Australia for equity strategies, it is going to be in high-returning strategies because otherwise they will rather do it cheaper by themselves," said Basalt's Gregor.

While capital keeps flowing in and the investor base is broadening, what will happen when interest rates on fixed income start rising again? "A lot of the capital flowing into unlisted infrastructure has come out of fixed income allocations, at least when it comes to equity. The question is, at what point might it be tempted back to fixed income? What happens when investors start getting 3%-4% back from their fixed income assets again? At some point, I would expect some of that capital to go back to fixed income," said Campbell Lutyens' Wardlaw.

Emma Haight-Cheng - AMP Capital

IFM's Cooper, whose debt unit always keeps a close eye on the broader credit cycle, including traditional fixed income performance, argued that certain investors might not rush back to their bond allocation, even if returns were to become higher again.

"I am not sure how much capital would go back to fixed income in that scenario. I think that those investors who have been investing in infrastructure for a while now have done so as part of a long-term approach to what their portfolio should look like. Many of those investors went from having zero to a significant number invested in infrastructure and that must mean they have had a good experience," he said.

Platform approach and the greenfield proposition

Another way for managers to differentiate themselves and attract the growing base of investors seeking higher-returns is by going greenfield. However, as the pipeline has considerably dried up in Europe for that type of assets, there are different degrees to which managers target that space.

Those going for the traditional greenfield option of investing into projects at a very early stage of construction tend to be those managers who have built an expertise in that area over the years. Among them are French manager Meridiam and UK-based InfraRed Capital Partners.

In other cases, greenfield is achieved with the so-called platform approach. In this instance, the manager in question establishes a joint venture with an existing company or business and through that platform it either builds new assets or develops existing ones. This is the strategy employed by the likes of Infracapital and Actis.

"I think there are two different things here. The more traditional PPP side has had a lot of headwinds in terms of deal flow. Some markets are better than others: there is a bit more activity in some parts of Europe and it may eventually wake up in the US but that has been more challenging so far. We have seen some of the alternative propositions looking at greenfield in other infrastructure sectors, which I think is interesting. We see the platform approach predominantly within generalist strategies, mainly because it is something that works in today's market. You can tend to find better value and build out better value through an existing platform which will then grow. Sometimes, a specialised platform has better access to bolt-on deals or opportunities," said Pantheon's Echberg.

The platform approach was what allowed PSP Investments to enter and succeed in the greenfield space, said Charbonneau. "Establishing platforms is how we cracked the greenfield infrastructure space. Our renewables platforms globally all have greenfield as the core of their business. We have also invested in a portfolio company in Chile, which has doubled its greenfield development footprint in the region in eight years. Our platform Roadis is another good example. We find that investing in platforms is the best way to get exposure to greenfield and manage the risk properly. We have not got exposure to pure-greenfield funds yet, although we are interested in that space," he said.

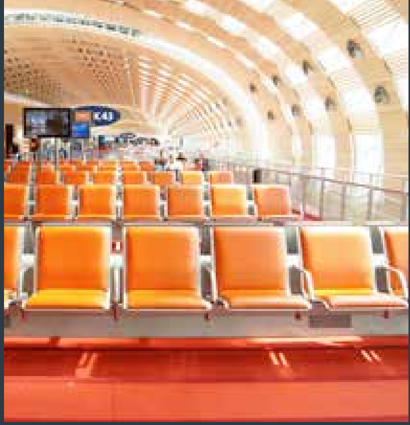
One problem with pure greenfield-only strategies is that it requires patient capital, argued Basalt's Gregor. "If a strategy only focuses on new-builds it typically includes an element of construction which takes a certain number of years to build out. LPs want to see their money invested relatively quickly so that, more importantly, they can start getting returns through sooner. That is probably why the market has not seen many greenfield-only funds so far, but rather operational focused funds that have a strong greenfield component. LPs can conduct due diligence on that component but in the meantime have the guarantee of getting exposure to brownfield assets which are going to be cash yielding from day one," he said.

The risk of going greenfield has not always been adequately remunerated, argued Deutsche Asset Management's managing director Hamish Mackenzie: "Not necessarily on construction risk, because if a manager is doing a good job that is going to be passed on to the contractor. But for instance on transport assets, the ramp-up risk can be quite significant for a fund manager."

Speaking from a debt perspective, Nicolas Lucas, director of infrastructure finance at Allianz Global Investors, said: "We do have several greenfield assets in our portfolio. In terms of pipeline, it is true that in Europe it is not as healthy as it used to be. If a manager wanted to raise capital for a greenfield-only strategy, it would have to go into renewables which is a very active segment and still has a lot of technologies to tackle, like offshore wind for instance. However, that would be a much specialised strategy which bears relatively high risk," he concluded.

LONDON ROUNDTABLE





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