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Transport's driving forces

Transport infrastructure investment hots up as passenger volumes return and as decarbonisation and deglobalisation mega-themes revolutionise the sector, five industry professionals tell Amy Carroll

A global pandemic upended traditional perceptions of risk. Sectors once considered inherently resilient revealed themselves to have hidden vulnerabilities. Transport infrastructure epitomises this recharacterisation. Roads, rail and, of course, airports, were temporarily devastated by rolling lockdowns. The sector's recovery has, however, been nothing short of remarkable, with traffic across all verticals now back to historical norms.

Furthermore, the global imperative to decarbonise a sector that represents 24 percent of total emissions means the need for investment is immense. Against this backdrop, transport infrastructure deal activity is ramping up significantly, with a wealth of diverse and compelling opportunities for players focused on the industry.

"We are seeing a lot of toll road opportunities – both greenfield and brownfield," says Francisco Del Pozo, head of infrastructure funds at Bestinver, citing recent transactions across the US, Europe and Latin America.

"We are seeing fantastic levels of activity," adds Rafick Ramadan, director and head of infrastructure, EMEA at Crédit Agricole CIB, which operates as M&A adviser, debt adviser and debt financier in the transport sector. "Our closed transportation deals encompass airports, roads, rail, ports, ferries, EV charging and e-buses. Europe represents the bulk of those transactions by number, but we have also been absorbing some jumbo deals from Australia and the US."

Herman Deetman, managing director at Infracapital, meanwhile says his firm has been spending significant time focused on buses. "It is a sector that has historically been unloved, but we are seeing interesting consolidation opportunities. Another highlight is specialist logistics, including cold storage, as well as sector-specific services for industries such as pharma."

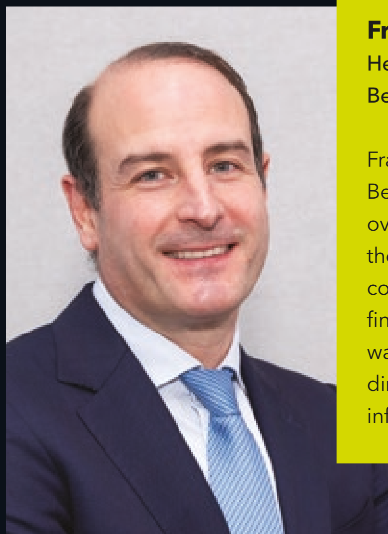
"We are seeing a lot of activity around toll roads," adds Oleg

Wes Dick
Head of Onex Transportation Partners

Wes Dick leads Onex Transportation Partners, a new platform focused on mid-market investment in transportation-related assets used for land, air, marine and industrial applications across North America and Europe. Dick was previously senior vice-president at BBAM, an Onex portfolio company. He began his career at Credit Suisse.

Rafick Ramadan
Director and head of infrastructure, EMEA, Crédit Agricole CIB

Rafick Ramadan is deputy head of infrastructure sector at Crédit Agricole CIB, where has worked for almost 17 years. He began his career at PwC.



Francisco Del Pozo
Head of infrastructure funds, Bestinver

Francisco Del Pozo joined Bestinver in 2020. He has over 20 years' experience in the development, design, construction, operation and financing of infrastructure. He was previously a managing director in Macquarie Capital's infrastructure team.

Herman Deetman
Managing director, Infracapital

Herman Deetman joined Infracapital in 2019 and has over 30 years' experience as financial adviser to companies, governments and investors in infrastructure sectors. Deetman began his career at Kleinwort Benson, moving on to UBS, Deutsche Bank and HSBC.

Oleg Shamovsky
Managing partner, Arjun Infrastructure

Oleg Shamovsky joined Arjun as managing partner in 2024 to lead the firm alongside Surinder Toor. Shamovsky previously held senior roles at Partners Group, GIP and KKR, where he was head of core infrastructure in Europe.

Shamovsky, managing partner at Arjun Infrastructure. "There was a period of uncertainty regarding traffic recovery post-covid but now that traffic has returned, so have transactions.

"We also really like motorway services areas. We own Welcome Break, for example, which has proved to be extremely resilient and is outperforming benchmarks. Our exposure to SMAs has also given us the opportunity to explore adjacencies including EV charging."

Shamovsky says that other areas of interest include cargo transport, which also proved resilient during the pandemic. "A push by European governments to move cargo from road to rail in order to support decarbonisation and reduce congestion is driving that sector, as well.

"I would say that there are attractive pockets within aircraft leasing. That is not a sector that is typically viewed as infrastructure, due to relatively short contracts. Nonetheless, I can't foresee a world without air travel, and we are coming across compelling propositions."

> *"There are some convincing arguments for hydrogen playing a role in shipping, but the problem is that it is very expensive"*
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> **IAN HARDING**
> **Arjun Infrastructure**

Onex Transportation Partners has a somewhat different strategy, says the firm's head, Wes Dick: "We aren't active in the traditional transport infrastructure hunting grounds – toll roads, shortline rail, airports and ports. We focus instead on businesses that provide essential services using transportation equipment.

"These businesses provide long-term contractual cashflows and strong unit economics, as well as attractive opportunities to add value. We currently have a $5 trillion installed base of transportation equipment across Europe and the US."

Investment appetite for the transportation sector, which was so recently out of favour, appears to be booming. Even airports are once again changing hands. "I would say airports are the sector of the moment. We have 13 transactions that are either live or have recently closed, including a high-profile sell side M&A mandate," says Ramadan.

Del Pozo agrees, although he adds he would be less inclined to invest in greenfield projects, or the expansion of existing airports. "We would favour brownfield operating airports with strong monopolistic characteristics and where there is solid data on how that asset performed through covid," he says.

Decarbonising transport

Each transport infrastructure vertical has different supply and demand dynamics, business models and return expectations, of course. There is, however, one unifying force and that is decarbonisation.

"There is not a business we are interacting with that is not actively working to reduce its carbon footprint," says Dick. "The airlines, for example, are under massive pressure. The technologies that exist today are limited when it comes to decarbonising the aeroplane itself, so those airlines are looking to other parts of the value chain to make improvements.

"That includes the equipment used to load passengers, catering and baggage. These vehicles don't travel long distances and the routes are predictable, and the charging infrastructure is in place. This is therefore a perfect market in which to introduce EVs."

Deetman, meanwhile, points to the role that Infracapital is playing in the decarbonisation of the bus sector. "Zenobe, for example, offers bus operators a fully integrated solution around the batteries on buses and the charging infrastructure in depots. The decarbonisation of transport is at the heart of that business's mission.

"Infracapital also owns Inland Terminal Group in the Netherlands, which is focused on container transportation along waterways. Its barges have traditionally been fuelled by diesel, but customers are now focused on decarbonising their logistics chains.

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> **WES DICK**
> **Onex Transportation Partners**

One large customer has already funded a hydrogen barge while we are working with another on a hybrid barge."

One of the biggest investment opportunities presented by the decarbonisation agenda, of course, is EV charging. "We are bullish on EV charging," says Ramadan. "We recently closed a transaction for Electra in Belgium and earlier in the year we financed IPlanet for IP Group and Macquarie in Italy."

Shamovsky, meanwhile, reiterates that EV charging is central to Arjun's SMA thesis. "We have developed conviction around EV charging along motorways, because we feel that the majority of people will charge their cars at home overnight, which will meet their needs in terms of travelling to work, the gym or the shops. People who travel long haul, however, will have no choice but to recharge along the motorway, which means we see this as a growing and less price-sensitive customer base."

Del Pozo doesn't agree that city-based EV charging models won't work. "If the location is right, I think people will use city-based charging. People are used to fuelling their cars in particular fuelling stations and not everyone is able to charge at home," he says, adding that he thinks the ideal EV charging model encompasses diversified revenue streams including renewable energy generation.

Onex, however, has not yet invested in EV charging because while the long-run economic opportunity is clear, there is so much capital chasing the space that it can be difficult to find an entry point with attractive risk-adjusted returns, says Dick. "What we are doing is accessing the same economic opportunity through adjacencies in the value chain, such as exploring partnerships with OEMs by providing capital to grow captive leasing companies for EV trucks.

"Customers are demanding 'truck-as-a-service', which bundles the vehicle, EV charging infrastructure, long-term maintenance plans and insurance, all in one monthly payment. We are picking up EV charging exposure that way instead."

Sustainable fuels

Not all transportation sectors can be electrified of course, and a great deal of work is currently taking place to develop sustainable fuels suitable for the aviation and maritime industries. Crédit Agricole currently has two advisory mandates with producers of sustainable aviation fuels (SAF).

"That is a sector we are looking at closely," says Ramadan. "The key issue, however, is one of pricing. The difference in price when compared to traditional hydrocarbon fuels is still substantial. In addition, with no price benchmark, nor pricing history, banks and investors are not willing to take price risk on SAF. In the near term, government intervention will be required to help bridge that gap because SAF really is the only way forward for decarbonising aircraft."

Certainly, if you look at emissions per kilometre travelled, aviation is currently by far the most polluting form of transport. "It is not surprising when you consider how much energy is required to get a heavy plane full of passengers, cargo and fuel up into the air," says Shamovsky. "Governments and investors are pushing for more sustainable infrastructure and clearly aviation does not fit that bill."

There are a number of possible solutions, according to Shamovsky. "The first is the ability to substitute kerosene for sustainable fuels," he says. "The problem, however, is one of adoption, because of the costs involved.

There are other solutions being developed as well, however.

"For example, Partners Group recently invested in a company called Climeworks which builds equipment that sucks in air like a vacuum cleaner, before removing all of the carbon. While much of green investment is directed towards reducing or removing carbon emissions, there are also technologies being developed to reverse emissions. Again, it is currently extremely expensive and not economical at a large scale. But as that technology improves and costs reduce, I think it could be an interesting alternative for the aviation industry."

Hydrogen, meanwhile, is the other great hope for the transport industry, but again it appears that viable solutions remain a distant prospect.

"There are some convincing arguments for hydrogen playing a role in shipping, but the problem is that it is very expensive. Hydrogen is also difficult to transport and potentially hazardous and so I think it remains to be seen what role it will play in the evolution of the transport industry," says Shamovsky.

Despite these obvious challenges, the reasons to decarbonise are manifold. Customers are demanding it. Governments are demanding it. Crucially, debt providers are demanding it too, as assets with any form of fossil fuel exposure anecdotally become increasingly hard to finance.

Ramadan, however, says Crédit Agricole is not backing away from any transportation assets, so long as the appropriate ESG controls are in place.

"The financing community is certainly pulling away from financing upstream hydrocarbon assets, but we are not seeing that trend in transport," he explains.

"What we are seeing instead is investment in new subsectors such as EV charging, e-buses and e-ferries. Even in more traditional sectors we are seeing decarbonisation investment that requires financing, for example, electrification of cranes at ports. We are not backing away from transport at all, but the opportunities that we see are evolving."

Deetman adds that the way Infracapital thinks about transport is aligned with the way that the banking community is approaching the sector. "We will invest in a business that has a carbon footprint today, but only if we can see a route towards decarbonising during our holding period," he says.

Dick, meanwhile, says that as a general rule, attitudes towards decarbonisation continue to differ significantly between financing partners in the US and Europe. "There is less rigour around carbon footprint assessments

"Customers are now focused on decarbonising their logistics chains"

HERMAN DEETMAN
Infracapital

"If the location is right, I think people will use city-based charging... not everyone is able to charge at home"

FRANCISCO DEL POZO
Bestinver

and decarbonisation plans in the US. Whether that changes will largely be dependent on a political climate that is, at best, unpredictable right now."

"With no price benchmark, nor pricing history, banks and investors are not willing to take price risk on SAF"

RAFICK RAMADAN
Crédit Agricole CIB

Deglobalisation and other key trends

In addition to decarbonisation, deglobalisation is a trend with profound implications for transport. The rise of nearshoring and increasingly fractious geopolitical relationships, most notably with China, are changing the ground rules for infrastructure owners and operators.

"As production gets substituted, we are seeing shifts in traffic flows between imports and exports," says Deetman. "We prioritise finding businesses that will benefit regardless."

"One of our core areas of focus is facilitating movement of goods between the US and Mexico," adds Dick. Last year, Mexico surpassed China as the number one import partner for the US for the first time in decades.

Dick says: "As manufacturing moves, supply chains also need to move, and that is driving significant opportunities for investment. It is staggering to see all the infrastructure spending that is taking place in order to support the movement of goods over the Southern border."

Another trend worthy of comment, according to Shamovsky, involves last-mile logistics. "This trend is partly being driven by the rise of e-commerce and consumer expectations around how quickly we want our goods to be delivered. It is also being driven by shops seeking to maximise their shop floor by reducing the space dedicated to inventory storage. Road and rail links are required to go into these hubs and then primarily road links are required from the hubs into cities."

Meanwhile, yet another pronounced trend in the transport infrastructure sector in the wake of the pandemic has been a re-evaluation of revenue risk versus availability payments. "This is something we spend a great deal of time thinking about. It is at the core of our underwriting," says Dick.

"A lot of businesses serving supply chains absolutely boomed as covid drove demand and pricing ever higher. While that situation has now eased, over the last year or two we have been increasingly looking at opportunities that provide transport equipment under long-term contracts to end markets that are uncorrelated with consumer demand, for example the waste sector."

"The starting point is always looking for risk-adjusted returns that meet our double-digit returns mandate, which means there has to be an element of underlying risk," adds Deetman. "Nonetheless, we are typically more comfortable with revenue risk derived from B2B activity. For example, we own a container transportation business in Benelux and we also own a rail business in the UK where there is GDP exposure. Ultimately, we believe having exposure to a broad range of underlying sectors gives you resilience."

Ramadan agrees that diversified exposure to both revenue risk and availability payments is key. "Obviously, the financing structure has to be commensurate with the risk profile. If there is a merchant traffic story, we will diligence that thoroughly. I would say, however, that even merchant infrastructure assets performed well over the crisis, with most toll roads and even airports bouncing back quickly. We have seen firsthand that the asset class is robust through the cycles and so we will continue to finance revenue risk projects."

There are situations where traffic risk can sometimes be the less risky option, particularly in certain geographies. "We have invested in toll roads all over the world. We understand the sector so well that we feel we can go into almost any country and invest well, so long as the counterparty is trustworthy," Del Pozo says. "In fact, in some instances, we would prefer to take traffic risk over availability payments because we feel the model is more robust and less subject to adjustment." ■