KEYNOTE INTERVIEW

Pioneering the energy transition

The decarbonisation of transportation and industry represents one of the most compelling investment themes of our times, say Infracapital's Martin Lennon and Ed Clarke

The energy transition continues to dominate infrastructure dealflow, with the decarbonisation of transport, manufacturing and industry representing a particularly attractive investment theme. Infrastructure investment manager Infracapital has experienced this across its portfolio since the mid-2000s.

The ability to originate disruptive businesses in bilateral transactions, to add value through hands-on operational improvement and to exit into a more competitive part of the infrastructure ecosystem means the mid-market is the place to be, say Martin Lennon, co-founder and CEO of Infracapital, and fellow co-founder, Ed Clarke.

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Q Which investment themes have proved most attractive over the past few years and what have been the key drivers?

Martin Lennon: Opportunities both directly and indirectly linked to the energy transition have formed a massive part of the dealflow that we've seen over the last 15 years. Obviously, that includes renewable energy generation, but it also encompasses the greening of transportation, industrials and manufacturing. The energy transition is currently a hot topic, but it's not new.

The second trend that has been very apparent in the mid-market space where we operate is the consolidation of fragmented sectors. We've seen lots of opportunities to bring assets together to create more efficient, scaled businesses, albeit still within a mid-market context.

I would add that the energy transition is an investment theme that has resonated strongly with our investor base. While there are clearly debates going on around the energy transition in parts of the US, generally speaking our international client base is looking to deploy capital in investments that not only garner attractive financial returns, but also result in positive environmental impact.

Q The energy transition opportunity set is deep and broad. Which subsectors are particularly compelling?

Ed Clarke: Energy transition in a transport context is a really interesting theme which is being driven by companies looking to lower emissions across their logistics chain. For example, we invest in a Benelux company called ITG, which owns and operates terminals inland of the major deep sea ports of Antwerp and Rotterdam. Working with ITG, customers ship freight on by barge, thereby taking transport off the roads. Already today, ITG's barges produce up to 75 pecent less CO2 per tonne km than trucking and we are investing to take that to 100 percent.

The business is also looking to transition those barges from diesel to either electricity or hydrogen. We've launched the world's first hydrogen fuel cell barge and just launched our first fully electric barge, with more to come. These initiatives are in partnership with major corporations such as Nike and Heineken.

A similar trend is playing out in the rail sector. There is a shift towards moving more freight by rail because it's more environmentally friendly when compared to trucks on the road. We have a rail freight business in the UK called GB Railfreight, which has commissioned the first hybrid freight trains for the UK network, something that's groundbreaking in the heavy rail sector. The plan is to gradually start replacing old diesel trains with greener alternatives.

The third area of investment that I would point to involves industrial decarbonisation, which accounts for around 25 percent of Europe's emissions. Heavy industry tends to use a lot of energy, particularly for heat, which accounts for roughly two-thirds of industrial energy demand. There are opportunities to invest in new industrial solutions that are more energy or heat efficient. In Fund II, we owned a business in Scandinavia, for example, called Adven, which had around 200 plants embedded in the processes of major industrial counterparties, producing energy on a greener basis. We see this trend continuing.

Q To what extent do you see opportunities to back emerging solutions and how do you assess the associated technological and political risk?

EC: We don't take new technology risk. We are interested in those elements of the energy transition where the technology is proven or well understood. The emphasis is more on commercialising that type of technology so that it delivers the stable cashflows that define infrastructure assets.

In terms of political risk, we're always mindful of how government policy will play out. This is particularly the case for emerging sectors that may need a degree of political support to mature to a point where they can succeed on their own merit.

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MARTIN LENNON

Q What makes the mid-market the place to be?

ML: We've been committed to the mid-market since the global financial crisis and we believe that the benefits that the mid-market offered then still hold true today. Firstly, I would point to the sheer volume of opportunities relative to the larger deal market. Furthermore, as active investors who like to roll up their sleeves, making improvements in businesses and addressing inefficiencies, the mid-market offers a much easier way to gain control and drive those changes.

I would add that we're in a unique period when it comes to the world's infrastructure. When we started out two decades ago, one of the attractions of infrastructure was that you were investing in things that were never going to change. The way that we generated and transmitted electricity and water, the way we travelled and moved our goods, was tried and tested. We were making assumptions on the longevity of those assets and our ability to make incremental improvements.

Over the past 10 years, however, the digital revolution and pressure to decarbonise has forced huge amounts of change. That has led to many of the legacy champions being challenged by younger businesses that have emerged out of that disruption. One of the most exciting parts of being a mid-market infrastructure investor is the ability to support that change and to help those disruptors develop and mature.

Finally, I would say that competitive dynamics are more favourable in the mid-market. It has always been possible to avoid auction processes but that has become easier than ever over the past two years given a reduction in the availability of capital. We see the ability to forge bilateral, partnership-style deals with entrepreneurs and owners that are not otherwise able to scale, or meet the opportunities that lie ahead of them, as a really compelling feature of the mid-market today.

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>
> **ED CLARKE**

Q How is LP appetite for the asset class? And will fundraising become less challenging?

ML: On balance, I am optimistic for the sector. Appetite is certainly there. If you look at the various sentiment surveys that are produced, the net promoter score for infrastructure is pretty positive. Infrastructure has not been immune to the macro issues that have impacted all areas of private markets over the past few years and some subsectors have fared better than others. But, generally speaking, the asset class has fared relatively well. There are factors to be wary of, of course, particularly pertaining to geopolitical changes and the uncertainty that comes with that.

EC: A lot of capital continues to flow into the mega-funds and it has certainly been challenging at the smaller end of the market over the past few years. I do believe that is now starting to change, however. Appetite for the mid-market is growing and hopefully that trend will continue to play out through 2025.

Q A lack of exits has been one of the biggest challenges that the asset class has faced – feeding into fundraising woes. How is the exit environment today?

EC: We have very successfully exited two funds entirely, most recently Fund II which has returned 22.6 percent IRR, and we're in the process of exiting the third. It's fair to say that the exit environment has been more challenging over the past few years as we've moved into a buyer's market. We believe the key ingredient is to ensure you have businesses that are relevant to today's needs. There will always be a buyer for the right assets.

In terms of the processes themselves, it's important to generate some kind of competitive tension. A lot of our exits have gone to large-cap funds which have raised substantial amounts of capital over the past few years.

It's also important to ensure you have a strong team alongside the asset you're selling. We pride ourselves on the work we do with portfolio companies to get them into great shape so that when it's time to exit, those assets are an attractive proposition for buyers.

Q What key trends will impact the asset class in the years ahead?

ML: The energy transition will continue to be the dominant feature of the market. I think that we will increasingly see niche, sector-specialist strategies alongside generalist funds. There's also a substantial opportunity to democratise the asset class, bringing it to the wealth and retail channels. That's a trend already starting to play out and may alleviate some of the fundraising shortages in the traditional institutional market.

In addition, I believe we'll continue to see more traditional asset management companies acquiring independent infrastructure players to complement their private markets offering. It will be interesting to see what impact this has on the wider market. Nothing ever stands still in this industry. It's important to always be focused on tomorrow as well as today. ■