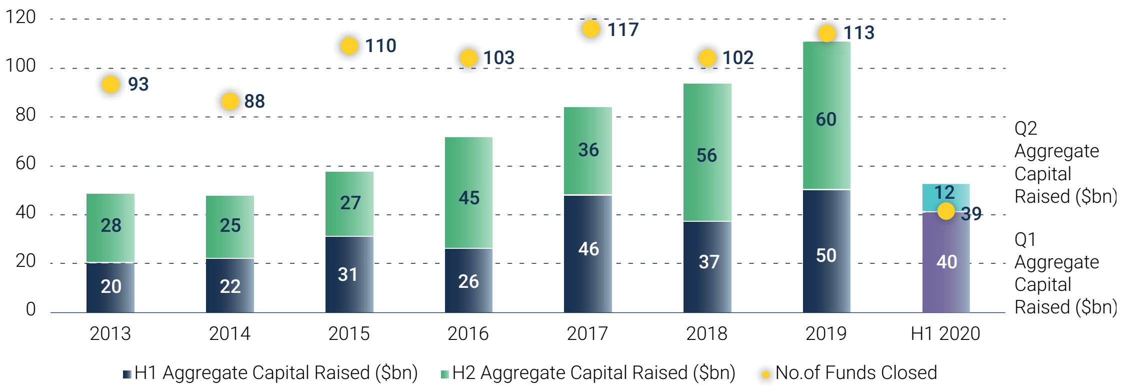
INFRASTRUCTURE | All change

Pantheon Partners, Andrea Echberg and Kathryn Leaf discuss how investors are navigating the headwinds and tailwinds triggered by the Covid-19 pandemic.

Infrastructure has been a fast-growing asset class undergoing rapid evolution. Large volumes of capital that have been raised in recent years – total fundraising leapt from **$48bn** in 2013 to **$110bn** in 2019 (see chart) – had caused investors to broaden the scope of their investing and to re-think returns expectations[1].



Infrastructure funds and total capital raised in US Dollars 2013-H1 2020.

Source: Preqin, data as of 3 July 2020.

Then came the Covid-19 pandemic. In common with other asset classes the impact on various sub-sectors has diverged widely, with some traditional sectors suffering in the face of severe headwinds, while some more emerging areas are benefiting from strong tailwinds. We asked Pantheon Partners Andrea Echberg and Kathryn Leaf to share their thoughts on whether investors will shift focus in response, and the implications for future portfolio construction.

How has the pandemic affected the asset class in a broad sense?

Andrea Echberg (AE): Infrastructure has proven to be relatively resistant to the pandemic and has generally benefitted from the essential nature of many of the assets. From the analysis that we have conducted across our portfolios we estimate that approximately two-thirds of the asset class has experienced little or no impact so far[2]. There have been some notable exceptions, especially those sub-sectors that rely on passenger footfall given the unprecedented lockdown imposed in many countries.

Kathryn Leaf (KL): We've also seen some impact to supply chains and certainly that has impacted greenfield infrastructure projects. But overall, the funding and contractual structures of most existing assets appear to have performed as expected at this point. The important thing to note is that many infrastructure assets are considered essential, benefit the wider community and so should demonstrate resilience in the long term.

How was the industry positioned prior to the crisis?

KL: The past few years have been characterized by a very frothy valuation environment. We were seeing deals being pushed further up the risk spectrum and investors stretching the definition of infrastructure, both in terms of the type of assets being acquired and the returns profile.

AE: One important factor is that the asset class learned a lot of lessons from the last financial crisis about high leverage. Even though prices had been rising and returns were being squeezed, we do still see more resilient financial structures within assets. Since the pandemic emerged, we have also generally seen banks accommodating those companies that have been severely impacted and that need waivers on covenants.

Which sub-sectors have been worst affected by the ongoing disruption?

AE: Assets that are facing the stiffest headwinds are in and around the transportation sector, in particular those tied to wider economic activity and that rely on daily footfall for their revenue, for example airports, ferries and toll roads.

KL: Taking airports as an example, most capital city hubs have reported declines of approximately 90% in passenger volumes, with expectations from industry analysts that it may take up to four years before we see a recovery to pre-pandemic levels. Other transportation assets are faring somewhat better. Ports for instance have similarly seen reduced trade volumes, but they have been somewhat shielded by underlying contractual structures and the essential nature of a lot of the goods being shipped.

AE: Away from transportation, one of the most impacted sectors is energy - and at Pantheon we focus on midstream. Many of these assets have relied on growth assumptions from drilling activity in the oil basins and they have been hit both by a pandemic-related drop in demand and the oil price tussle between Russia and Saudi Arabia.

And what about any sub-sectors emerging as winners?

AE: One of the main winners is digital infrastructure. We've seen in a matter of weeks an increase in the uptake of digital applications for work and education that we would have anticipated to take place over several years – and this, in turn, is driving the need for more investment into all aspects of the sector, from fiber roll-out to telecoms towers and data centres.

KL: Renewable energy is another sector that has been a relative winner. The operational assets have been resistant to the crisis due to their contracted revenues, which have largely insulated them from power market volatility, especially as they typically benefit from dispatch priority on national grids. Demand here is primarily driven by climate change targets, which are not expected to be impacted in the longer term. We have seen some delays in the build-out of greenfield projects, but again these impacts on supply chains have been relatively modest.

Where are you seeing deal activity in the current environment?

KL: There is certainly caution on proceeding with new investments, especially those structured and priced prior to the pandemic. We see continued deal activity, albeit more cautious, as it is much more difficult for GPs to originate assets in an environment where lockdown prevents them from meeting with company management teams.

AE: In general, the post-pandemic environment should see a return to fundamentals in terms of pricing and expected returns. For now, deals we've seen closed so far have been concentrated in sub-sectors such as digital infrastructure and renewables, which have been least impacted and are therefore easier to value – and pricing is still robust in these areas with little or no Covid-19 discount. We may even see competition drive prices higher for some of these assets, but we've not seen that coming through yet.

How are these factors likely to impact the asset mix in your portfolio?

AE: Looking at digital infrastructure, renewables, utilities and other less affected sub-sectors, there are obviously attractions. The investment rationale has generally been enhanced by the pandemic and there are long-term growth drivers. But we do need to exercise caution on pricing – and in the current environment we will carefully scrutinize counterparties underpinning assets as they could be affected by the economic conditions.

KL: In terms of the sub-sectors that have been negatively impacted, we don't expect to consciously reduce our exposure, but to the extent that our underwriting thresholds will be tightened we may see a corresponding reduction over time. We do, though, see attractive opportunities emerging for assets that are fundamentally sound, but that are being priced at substantial discounts due to wider negative sentiment.

AE: We focus on secondaries and co-investments, which by their nature are more opportunistic, and consequently we don't manage to rigid sector targets.

> “Our focus remains on finding businesses with strong fundamentals, to continue to be disciplined on pricing, and to build a high-quality, well diversified portfolio.

Our focus remains on finding businesses with strong fundamentals, to continue to be disciplined on pricing, and to build a high-quality, well diversified portfolio.

How do you see longer-term opportunities for infrastructure?

AE: Longer term we think the picture looks attractive for infrastructure investors. There are hard macro drivers, including government fiscal stimulus driving investment into infrastructure. High on their agendas – and feeding into the trends we've already discussed – is upgrading digital infrastructure to meet rapidly increasing demand and continuing to grow renewable energy capacity.

KL: We see a lot of the pandemic impacts as being relatively short-term and we remain optimistic about the longer-term picture in a lot of our sub-sectors. The biggest challenges for in the medium term will be in relation to more traditional parts of the asset class, such as transportation. But even here we expect most of our key assets to perform well over time and that their essential nature will continue to drive demand. We may see some behavioural change – for example, we've all become more accustomed to working from home and meeting people via video conference – and as a result growth will be slower for some time.

[1] Pantheon opinion. [2] Pantheon opinion based on our view and discussion with our GPs. There is no guarantee these trends will continue.

Biographies

Andrea Echberg, Partner

Andrea is a Partner and Head of Pantheon's Global Infrastructure and Real Assets Team. She is responsible for infrastructure and real assets investments covering primary, secondary and co-investments. She is a member of the Global Infrastructure and Real Assets Committee and is also a member of the International Investment Committee. Andrea has an engineering industry background followed by 21 years' experience in the infrastructure finance and investment sectors. Prior to joining Pantheon, Andrea led infrastructure direct and co-investment teams for Société Générale, Macquarie Capital and ABN AMRO delivering successful investments in both brownfield operating and greenfield PPP assets. She has a BEng in mechanical engineering from Imperial College of Science, Technology and Medicine. Andrea is based in London.

Kathryn Leaf, Partner

Kathryn is a Partner in Pantheon's Global Infrastructure and Real Assets team and Chair of the Global Infrastructure & Real Assets Committee. Kathryn also sits on Pantheon's International Investment Committee. She joined Pantheon's infrastructure effort in 2008 and her experience spans multiple investment strategies including fund investing, co-investing, direct investing and secondaries. Prior to joining Pantheon, Kathryn was with GIC Special Investments, where she was responsible for both fund investments and co-investments with a specialization in energy. Before that, Kathryn was responsible for direct investments at Centre Partners, a New York-based private equity firm. Kathryn began her career in Morgan Stanley's Investment Banking Division where she pursued real estate investments. She has a BA and MA in modern languages from Oxford University. Kathryn is based in San Francisco.

Important Disclosure

The views and opinions expressed herein by Andrea Echberg and Kathryn Leaf are their own views as of the date of the publication, and may change in response to changing circumstances and market conditions.

Under no circumstances should these views and opinions in this article be construed by any reader as investment, securities, legal, or tax advice. The information contained herein should not be deemed as a recommendation to purchase or sell any securities or investments.

No representation or warranty, express or implied, is made or can be given with respect to the accuracy or completeness of the information in this article. In general, alternative investments such as private equity involve a high degree of risk, including potential loss of principal invested, are highly illiquid, can charge higher fees than other investments, and typically do not grow at an even rate of return and may decline in value.

Information, opinions, or commentary concerning the financial markets, economic conditions, or other topical subject matter were prepared, written, or created prior to posting this article on this Site and do not reflect current, up-to-date, market or economic conditions. Pantheon disclaims any responsibility to update such information, opinions, or commentary.

In addition, past performance is not indicative of future results, future results are not guaranteed, and loss of principal may occur. This article may include "forward-looking statements". All projections, forecasts or related statements or expressions of opinion are forward-looking statements. Although the interviewees believe that the expectations reflected in such forward-looking statements are reasonable, they can give no assurance that such expectations will prove to be correct, and such forward-looking statements should not be regarded as a guarantee, prediction or definitive statement of fact or probability.