KEYNOTE INTERVIEW

Land of opportunities

Bipartisan support for reviving America's ageing infrastructure is unleashing exciting opportunities for private investors, says Rob Collins, 3i's managing partner for North American infrastructure

3i is focused on assets with core infrastructure characteristics where the firm can see opportunities to apply its value-added strategy in order to optimise performance of those assets, while protecting downside risk. Rob Collins, managing partner and head of North American infrastructure, explains what makes the sector so attractive.

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Q What makes North American infrastructure an interesting investment proposition?
Unfortunately, the US has under-invested in its infrastructure for a number of years. That has created a wealth of opportunities for private infrastructure capital to help improve everything from the purity of drinking water to enhancing digital networks, transportation systems and supply-chain logistics, all whilst stimulating the domestic economy and improving quality of life for Americans everywhere.

Q What infrastructure sectors do you invest in?
We have a cross-border infrastructure team made up of 40 infrastructure investment colleagues across both the US and Europe with a broad range of experience across all infrastructure sectors, including digital infrastructure, transportation, environmental services, leasing and the energy transition. We leverage the track record of both our North American and European teams to back management teams and invest in companies across all of these sectors. Essentially, we are translating our European experience and best practice into a successor strategy in North America.

Q Are there other advantages that your

European origins bring when it comes to investing in the US?

We benefit greatly from the experience of our European infrastructure team members. We second colleagues from Europe to work on North American investment opportunities and we work alongside the European team on European opportunities. We have a joint asset management function and we share best practices from both sides of the pond on a weekly basis and in a more concentrated manner every month.

Q How do you expect infrastructure to fare in a high-inflation environment and how can you ensure your portfolio assets remain resilient?

Infrastructure, as an asset class, is largely inflation-resistant. The majority of infrastructure contracts and pricing agreements have inflation protection built into them and many investors look at infrastructure as a natural hedge. When you look at real assets as an investment category, I would certainly say that infrastructure stands out as the place to be in an environment where we are seeing 20-year inflationary highs around the globe.

We are very focused on optimising the capital structure of all our assets and ensuring we are using leverage conservatively. I think it is clear that those assets that were conservatively leveraged through the pandemic fared better than those where leverage was used more aggressively. I also believe it is essential to match the right management teams with the right assets, and to provide the correct governance to maximise the operating capabilities of the company.

Q How do you define core infrastructure and what types of opportunity do you deem to be particularly attractive?

In the run up to the pandemic, there were many in the infrastructure industry who defined core infrastructure as airports, seaports, toll roads and contracted pipelines. But we all saw the downside case related to those sectors during protracted covid lockdowns. When we think about core infrastructure now, we look closely at the asset's underlying characteristics.

We consider whether a business provides an essential service and whether it has highly durable cashflows and sustainable margins. We also look for strong barriers to entry – a moat around the business that prevents others from entering the space.

Q What would be an example of an asset that fits that less traditional definition of core infrastructure and how did that asset fare through the pandemic?

A good example would be Smarte Carte, which is the sole provider of baggage carts in 125 locations, including 49 of America's top 50 airports. Our rationale for investing in that business back in 2017 included its market leadership position across multiple product segments – it owns and manages lockers and other consumer-rental equipment in amusement parks, fitness clubs and ski resorts, in addition to baggage carts at airports. Our investment thesis was also based on increasing international travel.

Of course, the pandemic dramatically impacted international travel volumes but because of its underlying core characteristics, Smarte Carte has performed remarkably well regardless. In fact, because its revenues are diversified across multiple airports and geographies, rather than being concentrated in a single location, it is actually generating higher EBITDA today than it was in 2019. That is an example of a business that has proved incredibly resilient through one of the worst economic storms that the airline industry has ever seen.

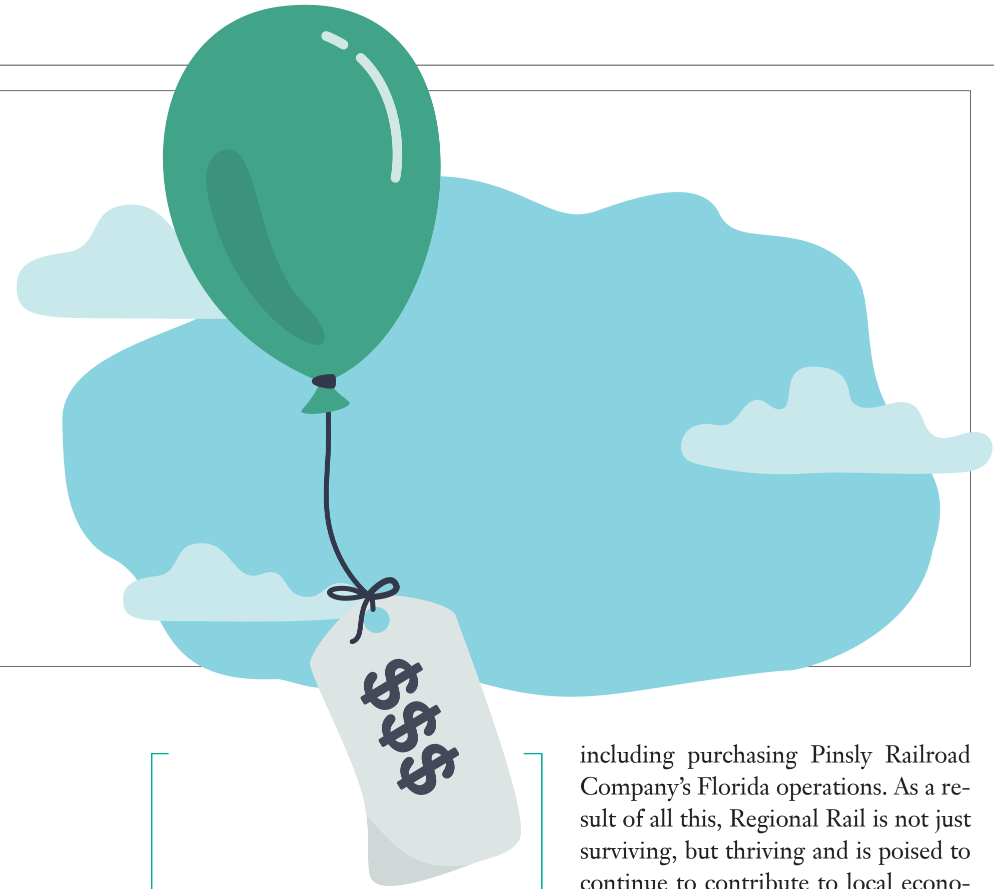
Q Are there any other assets in your US infrastructure portfolio that have proved to be covid winners?

We invested in a business called Regional Rail in 2019. Regional Rail provides freight transportation, car storage and transloading services in New York, Pennsylvania and Delaware. It serves over 70 customers across a diversified set of end-user markets including heating, fuel blending, agriculture, chemicals and metals, while its subsidiary Diamondback Signal, provides rail-cross installation and maintenance services to over 100 short-line rail customers in 20 states. Critically, no one customer represents more than 6 percent of overall revenues.

This is a business with high barriers to entry and a premium geography at the centre of a densely populated corridor within the New York, Philadelphia, Baltimore and Washington DC metro areas. Freight revenue is largely generated from local consumption tied to these attractive end markets.

Meanwhile, what we saw with this asset as the economy slowed through the pandemic, was that the business earned at least as much revenue from car storage as it did from moving rail cars. That diversification once again paid off.

Furthermore, the company was awarded essential service status by local and state governments, and so was able to operate seamlessly throughout the covid period. We have also managed to complete a couple of tuck-in acquisitions to increase economies of scale,



including purchasing Pinsly Railroad Company's Florida operations. As a result of all this, Regional Rail is not just surviving, but thriving and is poised to continue to contribute to local economies.

Q Is that a sector that has also benefited from a growing focus on environmental sustainability?

Absolutely. Short line rail is much more fuel efficient than trucking; the fuel required to haul one railcar is the same as the fuel required to power four trucks.

There is therefore a significant emissions reduction advantage to transition from road to rail. The use of short line rail also reduces the need for road repairs and congestion meaning there is a public benefit to growing the industry.

Q What is your approach to ESG in the infrastructure context, more broadly?

ESG is critical to our investment strategy across all asset classes. It has been part of our DNA as a firm since 2004, when we first started publishing our annual sustainability report.

We later invested in the largest ESG consultant in Europe, SLR, which we went on to own for a decade. ESG is embedded in the fabric of the firm and has really helped us create strong investment outcomes over the years.

One example of an investment we have made recently that is having a hugely positive ESG impact is EC Waste, the largest vertically integrated provider of solid waste services in Puerto Rico, which we backed in November last year. The company provides waste services to over 80,000 residential, commercial and industrial customers and operates four US EPA permitted disposal sites, ensuring all of Puerto Rico is served in an environmentally responsible and sustainable manner. EC Waste also manages two transfer stations, runs the island's largest regulated, solid waste collections network and hosts what will be Puerto Rico's largest renewable natural gas collection project.

We always look for assets that have a large moat around them in terms of barriers to entry and there is no greater moat than the Caribbean Sea surrounded by the Atlantic Ocean. A waste disposal business that is helping the 3.3 million people of Puerto Rico, improving the quality of the island's drinking water and shutting down illegal landfills, is an example of infrastructure investment that really makes a difference to lives, whilst also generating attractive returns for our investors.

Q What is your outlook for US infrastructure going forward?

There is bipartisan support in congress for rebuilding the country's infrastructure and private capital has a major role to play in this process. I think there will be huge opportunities across all sectors of infrastructure in the years ahead and we are excited to be playing our part. ■

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