KEYNOTE INTERVIEW

A new era in infrastructure debt

Unprecedented returns have opened the market to a whole new set of investors, says Infranity's Gilles Lengaigne

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Infrastructure debt has been a net winner from this high interest rate, high inflation environment. The absolute returns now on offer, as a result of increased rates and margins, means the asset class is proving a compelling option for insurance companies, pension funds, sovereign wealth funds and private investors that may have historically opted to focus on public market strategies, according to Gilles Lengaigne, managing partner at Paris-based investment firm Infranity, part of Generali Investments.

The energy and digital transition investment themes continue to deliver attractive opportunities. However, the massive capital at stake and complexity of these sectors means it is becoming increasingly important for infrastructure debt managers to have large financing capabilities and sizeable teams with domain expertise. This will prove a critical differentiator when it comes to sourcing deals, as well as astute investment decision making.

Q Why does infrastructure debt represent an attractive investment strategy in the current economic environment?

This is a highly opportune time to be investing in infrastructure debt – the risk-return proposition is extremely strong. Not only are rates high, but margins have increased and, contrary to certain other private debt strategies which can be more cyclical, infrastructure offers a stable investment thesis and resilient credit story in a volatile economic environment.

While we have seen a marked slowdown in investor allocations to alternatives more broadly over the past 12 months, there have been two segments that have fared relatively well: one is infrastructure and the other private debt. Private infrastructure debt, a field that sits at the crossroads of those two market segments, therefore has been well positioned when it comes to attracting LP capital in an otherwise difficult fundraising market.

Indeed, as infrastructure debt returns are at an all-time high, both due to a rate increase and the margins that lenders have been able to capture, several institutional investors have now opened up their alternatives bucket to infrastructure debt. Historically, the absolute returns available have simply been too low for many pension funds and sovereign wealth funds to consider, but that is no longer the case. We are also seeing private wealth investors, many of whom have previously focused exclusively on equity products, now looking at infrastructure debt for the first time.

Q What areas are you focusing on within the infrastructure debt space?

At Infranity, we focus solely on infrastructure, and currently have three strategies in the market. First is our historical senior investment grade risk/return. This approach is optimised for LPs looking to capture a high illiquidity premium against listed fixed income and offering a very efficient capital treatment. Particularly appealing to insurance companies, it caters well to our investor base, and in particular our main shareholder Generali, which provides significant seed capital in our products.

Since 2020, we run an enhanced return strategy targeting sub-investment grade credit with a defensive profile underpinned by secured cashflows. This can offer strong relative value, as well as very attractive absolute high single-digit returns, to those new types of investors that are looking for a robust absolute return.

Finally, another area of emphasis for us is the core-plus equity investment sector, which sits in an area that is generating very attractive investment opportunities right now in a re-rated environment. Prices are now taking this new interest rate environment into account. The strong thematic megatrends like the energy transition and digital transition that underpin these assets remain completely intact, although valuations have moderated, making this a great time to be deploying capital.

Q What is the level of dealflow that you are seeing today, given a less active M&A market?

The first half of 2023 was certainly softer than usual, but we saw a significant acceleration in dealflow in the second half of the year. To put that in perspective, we invested around €2.5 billion across all our strategies throughout the year, in line with historical averages, but it was definitely more back-ended than usual.

This was driven by a combination of market dynamics and investment discipline. We anticipated that pricing would become more attractive in the second half of the year, factoring in the interest rate increases we have experienced. Looking ahead to 2024, we see strong dealflow in line with what we saw towards the end of 2023. Some transactions that were put on hold are now being brought back to market, so we expect to see significant activity as that backlog clears.

Q Which sectors or investment themes offer the most interesting

Q How do you see the infrastructure debt market evolving going forward?

We believe there are several trends that are going to shape the infrastructure debt market going forward. The first is consolidation. Being backed by such a large investor as Generali, we are well positioned in this new landscape as we continue to grow.

The second significant trend, we believe, will be increased specialisation. To be successful, infrastructure debt managers will need to develop deep sectoral expertise within their investment teams. We have grown our headcount by about 15 professionals per annum in recent years and expect that to continue going forward.

opportunities today, and what is driving that?

Two very strong convictions underpinned Infranity's sectoral approach since our inception. The first is the green transition, encompassing energy, mobility and the circular economy. In that space, we have mobilised significant capital to support renewable energy developers in accelerating delivery on their pipeline of projects. This is a fragmented market made up of a lot of mid-cap companies that are playing an important role in meeting European renewables targets.

In the green transportation space, we have primarily focused on the rail sector, investing significantly in rolling stock companies and financing the expansion of fleets with electric locomotives. We also have strong conviction around the need for renewable heat, which we see as key to the decarbonisation of our economies, as well as waste recycling.

Alongside the green transition, we are also focused on digital infrastructure. We initially targeted fibre and towers, where we like the stability of cashflows on offer, but we are now increasingly investing in data centres as well. We have developed significant expertise within our investment team in this space when it comes to pursuing and structuring these opportunities, and we are particularly targeting the hyperscaler market.

It is our belief that migration to the cloud, which has been the primary driver of growth over recent years, will continue to fuel the sector. But the advent of AI will result in significant additional demand resulting in a very strong growth trajectory for the industry.

Nonetheless, it is very important to balance this with adequate sustainability ambitions including energy efficiency, eliminating or controlling water consumption and sourcing green energy. We have partnered with platforms that have a clear path to net zero in what is clearly an energy intensive sector.

> *"Migration to the cloud will continue to fuel the sector [and] AI will result in significant additional demand, resulting in a very strong growth trajectory for the industry"*

Q How do you incorporate sustainability into your investment processes more broadly?

Our sustainability approach begins with product design, which is a joint effort between our investment, sustainability and investor relations teams. It is also reflected in our portfolio construction, in terms of the sectors that we focus on to meet our ESG targets. The investment team benefits from a dedicated sustainability team which provides expertise to support our due diligence capabilities, and also informs the decision making of our investment committees.

To put this in perspective, we manage Article 8 and 9 funds, around 70 percent of our assets qualify as sustainable investments under the new SFDR framework, and we seek to align our portfolios with a below two degrees trajectory, which gives us a solid basis to support our net-zero commitment. We committed to the Net Zero Asset Managers Initiative last year, marking a continuation of efforts to ensure our portfolio is aligned with this critical ambition.

Q What does an infrastructure debt investor need in order to be successful in the current environment?

Significant sectoral expertise, particularly in the complex fields of the energy and digital transition, is extremely important when it comes to both accessing opportunities and the quality of the investments ultimately realised, leading us to develop one of Europe's largest and most diverse infrastructure debt teams.

We have deployed a lot of capital in the renewable energy space, backing developers as they grow their pipelines with projects at different stages of maturity. In that situation, it is vital to be able to design highly structured financing that facilitates scaling their business while providing the right level of protection for creditors. It is also important to be able to execute on a bilateral basis to bring a complete solution to the deal. This requires size in addition to expertise.

Meanwhile, digital infrastructure is clearly a complex segment with significant geographical variations. For example, the fibre market in France is very different to the fibre market in Germany. It is essential to have a thorough understanding of the different frameworks and to be able to adapt structures to specific markets. ■