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What May Be Ahead For PE Infrastructure Investment In Asia

By **Scott Jalowayski and James Jackson** (June 6, 2019, 4:32 PM EDT)

Infrastructure has been an important focus of private equity sponsors in Asia for some time. Despite some softening in global and Asian infrastructure deal volumes in 2018 and the first part of 2019, both fundraising targets and long-term investment prospects remain strong for Asian infrastructure focused private equity sponsors. This article examines the current landscape of private equity investment in infrastructure in Asia, explores the macroeconomic and other factors contributing to the robust outlook going forward, and briefly spotlights the renewable energy infrastructure space given its especially strong growth prospects.

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Trends in Infrastructure Fundraising and Deal Activity

Infrastructure fundraising globally totalled $90 billion in 2018, exceeding the record-setting $75 billion raised in 2017.[1] Although Asia-focused funds represent a small portion of overall fundraising and funds in the market — $4.1 billion raised in 2018,[2] and $11 billion aggregate capital targeted by funds in the market as of April 2019[3] — this belies the true amount of dry powder available for the region given the global mandate of many infrastructure funds.

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Global Infrastructure Partners and I Squared Capital are two examples of this phenomenon. Global Infrastructure Partners closed its third fund in early 2017 with a record $15.8 billion in total commitments and I Squared Capital closed its second fund at $6.5 billion in June 2018. Although both funds are global in scope, each has shown a strong interest in Asian infrastructure assets. GIP completed its $5 billion acquisition of Singapore-based Equis Energy in January 2018, the largest renewable energy generation acquisition ever. In October 2017, ISQ completed its HK$14.5 billion acquisition of Hutchison Global Communications, a Hong Kong-based fixed-line telecommunications business.

Another interesting trend is the establishment of investment platforms by private equity funds and other asset managers. A hybrid of a joint venture and a fund vehicle, platforms are typically established by asset managers in connection with the acquisition of a specific infrastructure asset, but contemplate a series of acquisitions in the same infrastructure vertical. There are several advantages to establishing such a platform.

One is that an asset manager can partner with a local player to take advantage of its expertise and local deal sourcing and management capability. Another advantage in Asia is the existence of specialized implementing regulations facilitating the establishment of such platforms, such as the infrastructure investment trust, or InvIT, legislation in India.

Such regulations enable operators and developers to monetize assets by segregating operations and infrastructure/assets, and can enable financial investors such as PE sponsors and other asset managers to deploy capital efficiently and create exit opportunities such as listing such trusts on public markets. One recent example of this trend is the Canadian Pension Plan Investment Board's announcement of its intent to establish India's first renewable energy focused InvIT, together with Piramal Enterprises. This platform would reportedly invest up to $600 million in operating renewable energy assets in India.

The long-term performance of the broader Asian infrastructure investment market demonstrates that the deals mentioned above are not outliers. Although both deal number and volume fell in 2017 and 2018 alongside the faltering of global infrastructure deal making, compared to the peaks reached in 2016, the mid- and long-term prospects for Asian infrastructure remain strong, underpinned by the fast-growing regional economies, expansion of middle class and continued urbanization. The final close of the Macquarie Asia Infrastructure Fund II at its hard cap of $3.3 billion in April 2018 — with over half of that amount already committed to Asian investments — and KKR's recently announced target of up to $2 billion for its proposed Asian infrastructure fund show that investors and sponsors remain confident in the region's prospects going forward.

The diversity of investors in the infrastructure space in Asia is also a testament to the popularity of this asset class. Investors buying Asian infrastructure assets are not limited to dedicated Asian infrastructure focused PE funds. Global infrastructure funds and conventional PE funds all have their fair shares of investment in the asset class.

For example, Brookfield Infrastructure Partners, a Canada based publicly traded limited partnership that focuses on global infrastructure assets has acquired telecommunication tower assets in India.[4] In addition, the New York-based The Rohatyn Group, a general purpose fund with a particular focus on emerging markets, has recently enlarged its existing infrastructure assets in Asia by acquiring the JP Morgan Asian Infrastructure & Related Resources Opportunity platform and its India-based investment team to pursue further opportunities.[5]

The Upside and Challenges of Asian Infrastructure Investing

What is behind the long-term growth in infrastructure investment globally and in Asia? Investment in infrastructure offers certain unique value propositions. Infrastructure assets are less susceptible to major economic cycles and short-term fluctuations. Thus, the performance of infrastructure investments is less correlated with other asset classes, thereby reducing the risk profile and volatility of a portfolio that has a healthy infrastructure allocation. Infrastructure assets also tend to offer steady income streams.

These characteristics are attractive to institutional investors, particularly pension funds and insurance companies that have annuity-like liabilities.[6] Public and private pension funds and insurance companies account for 35% of the total investor pool in 2018.[7] This is also borne out by the commitments to recently formed infrastructure funds, which are typically weighted toward pension funds and insurers.

While these same advantages generally hold true for Asian infrastructure assets, there are unique advantages as well as challenges to be aware of. As fundraising and deal activity remain robust across North America and Europe, increased competition has driven up infrastructure asset prices. However, assets located in Asia — in particular the emerging markets — have attractive risk-adjusted returns and offer significant potential upside to investors disillusioned by increased valuations in the developed world. According to investor interviews conducted by Preqin in November 2018, among all the emerging markets, 34% of investors view India and 27% of investors view China as presenting the best opportunities for investments in infrastructure.

Investment in Asian infrastructure projects also presents significant risks and challenges. Uncertainties in the legal and regulatory environment abound. Investors often face questions as basic as whether they can enforce their contractual rights against local partners and sovereign entities in an underdeveloped legal environment.

To mitigate the risks, PE investors need to retain legal counsel with both international deal making experience and local expertise and deploy on-the-ground deal execution and management teams to conduct sufficient due diligence. In certain markets, maintaining close working relationships with relevant regulatory authorities and government-backed partners is also an important ingredient for success.

The Outlook for the Asian Infrastructure Market

A positive economic outlook in Asia may well mean a projected sustained demand for infrastructure projects. According to a United Nations survey, Asia's developing economies are projected to record an overall annual growth rate of 5% and 5.1% in 2019 and 2020, respectively.[8] Ample evidence suggests a significant relationship between economic growth and infrastructure investment, with such investments generating long-term economic benefits in a nation's output, growth and productivity.[9]

At the same time, a significant infrastructure investment gap in Asia needs to be filled. The Asian Development Bank estimated an infrastructure financing deficit of $459 billion per year for the next decade, due to massive under-spending on infrastructure projected for the period. Private capital can play an important role in bridging the investment gap. Thus, the long-term outlook for PE infrastructure investment in Asia is very positive against the favorable economic backdrop and substantial demand for private capital.

The Case for Renewable Energy in Asia

One sector in particular stands out in the Asian market for PE infrastructure investment — renewable energy.[10] The ongoing transformation of the world's energy infrastructure necessitates a significant contribution from the private sector, and private equity investment has been an integral piece of that financing puzzle. The reported aggregate global renewable energy deal value has increased from $25.5 billion in 2008 to $83.6 billion in 2018.[11] This represents a compound annual growth rate of 12.6%, outpacing the overall growth of value of all infrastructure deals by 5.8%. Renewable energy accounted for 57% of the number of completed infrastructure deals globally in 2018.[12]

The growth opportunities in Asia are even more pronounced. According to a report published in March 2019 by the International Renewable Energy Agency, Asia accounted for 61% of total new renewable generating capacity in 2018.[13] This increase is at least partially attributable to a decade of active development and deal-making by private equity funds in Asia. Asia renewable energy deals accounted for 10.2% of the global renewable energy reported deal value and this number has grown to 16.1% in 2018.

Recent notable Asian renewable energy deals include the NT$180 billion investment in Taiwan Strait Wind Assets by Copenhagen Infrastructure II and Copenhagen Infrastructure III, BlackRock's pending acquisition of a 115MW Taiwan solar portfolio announced in May 2019, and the Equis Energy and InvIT transactions mentioned above. Greater government focus on promoting renewable energy investments to combat climate change and lowered costs of renewable energy technology, among other things, contribute to the increased investor interest in the area.[14]

The supply and demand dynamics outlined above portend a positive outlook for private equity investment in Asian infrastructure assets for the rest of 2019 and beyond. On the supply side, global infrastructure fundraising could be on track for another record year in 2019 based on indications and data to date, and there is an increasing amount of dry powder available exclusively for Asian infrastructure. In terms of demand for capital, the Asian region is home to many high-growth economies that have a large infrastructure funding gap. Sponsors are gearing up to deploy their capital in the region and fill that funding gap, and this bodes well for the Asian infrastructure transaction volume in the coming years.

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[1] 2019 Preqin Global Infrastructure Report.

[2] 2019 Preqin Global Infrastructure Report.

[3] Preqin Quarterly Update Q1 2019.

[4] Asia Private Equity Review, April 2018.

[5] Asia Private Equity Review, July 2018.

[6] Asian Development Bank Institute, ADBI Working Paper 555.

[7] 2019 Preqin Global Infrastructure Report.

[8] United Nations, Economic and Social Survey of Asia and the Pacific.

[9] International Journal of Financial Studies, Capital Markets, Infrastructure Investment and Growth in

the Asia Pacific Region.

[10] Although “energy” and “infrastructure” are often separate categories for statistical purposes, energy infrastructure projects — including renewables — are often included in the infrastructure category and such projects are squarely within the mandate of the typical infrastructure fund.

[11] 2019 Preqin Global Infrastructure Report Data Pack.

[12] 2019 Preqin Global Infrastructure Report.

[13]International Renewable Energy Agency, Renewable Capacity Highlight.

[14] PwC, Investing in the ASEAN Infrastructure Asset Class.