KEYNOTE INTERVIEW

North America's 'Goldilocks moment'

Contracted infrastructure opportunities in the mid-market are ripe for investment, says Northleaf's Jared Waldron

The North American mid-market infrastructure landscape is incredibly varied, with a wide range of investable opportunities of different sizes to be found across its subsectors.

Northleaf Capital Partners, a global private markets investment firm with $26 billion of commitments across private equity, private credit and infrastructure, knows this territory and its particular investment opportunity set well. In infrastructure specifically, it manages some $7 billion of assets, with a focus on core-plus contracted infrastructure in the mid-market.

For Northleaf's infrastructure platform, this means businesses with enterprise values in the $300 million to $500 million range, with the firm typically investing $200 million to $300 million into individual opportunities.

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After all, as managing director Jared Waldron explains, this is a segment that offers attractive relative value and the opportunity to build a diversified portfolio.

Q What makes the mid-market attractive?

Focusing on the mid-market gives us a great chance to find opportunities outside of competitive auction environments. It also opens up a significant amount of space between the size of opportunities we are looking at versus what the larger investors prefer.

If you think about some of the large-cap strategies investing into $1 billion-plus businesses, the vast majority of the time the vendor will engage a sell-side adviser to run a competitive auction. The investor who ends up winning is going to pay top dollar relative to the dynamic we aim for in the mid-market, where a bilateral process allows for value creation throughout the diligence process.

There is a far better balance in the mid-market in terms of the number of opportunities to pursue compared to the amount of capital pursuing them.

Q Why is North America particularly attractive?

First of all, I would say that there is a competitive advantage here too. There aren't many core-plus infrastructure managers operating in North America that have more than a decade of track record; rather, it's mostly groups that have evolved from being traditional energy investors to more recently focusing on the energy transition. Few managers can bring core-plus expertise to bear in the mid-market either, so those that can have far more opportunities to themselves.

Beyond that, you have to benchmark the opportunities available in North America versus other global markets. In the three main sectors we focus on – the energy transition, communications infrastructure and transport – the region has distinct advantages.

If you take something like decarbonisation, for instance, there is no question that the US has achieved a huge relative advantage thanks to the Inflation Reduction Act. It has accelerated investment into a number of subsectors within the energy transition, including traditional renewables, energy storage, green hydrogen and electric vehicle charging, to name a few.

Similarly, in terms of exploiting the rollout of artificial intelligence and demand for high-performance computing, US corporates are leading the way when it comes to capturing that generational opportunity to invest in data centres and the associated supporting infrastructure.

On rural broadband, the government has created a number of programmes – including the Rural Digital Opportunity Fund (RDOF) and the Broadband Equity, Access, and Deployment (BEAD) programme – to support the buildout of high-speed broadband connectivity to rural markets.

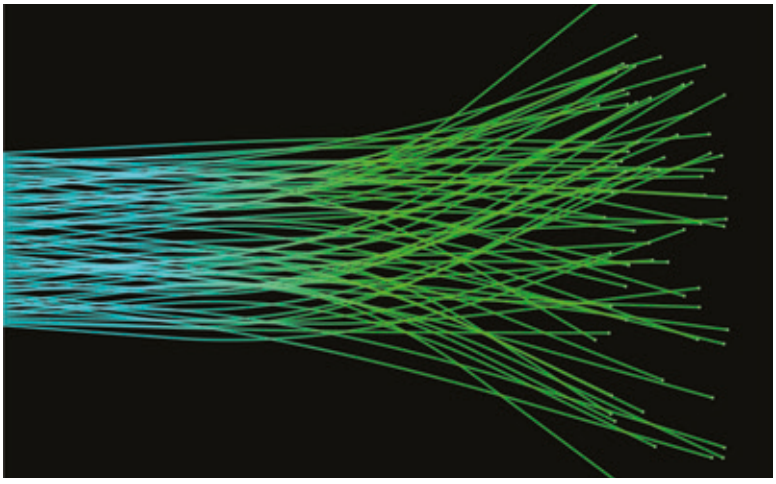
These dynamics are driving the scale of the opportunities in the mid-market sector in North America.

Q What is happening in the rural fibre space?

Rural fibre has a great background in the US. The RDOF and BEAD programmes are providing subsidies to network operators to reach the most remote population groups within America and to build networks for that 5 percent of forgotten users.

So, you're getting a subsidised capital investment to support a buildout that is otherwise uneconomic, sometimes worth as much as 50 percent of the capital expenditure. If you are the group that builds the network, it gives you a real barrier to entry. And once you have achieved customer penetration, you have a large, diversified portfolio of customer contracts.

At the same time, the competition is weak. You are often up against very slow DSL-type services offering only 25 megabytes. Nor does satellite offer real competition in this market. The speed of light is the fastest we can move data, and that is what fibre offers. I think there are also clear advantages when you look at some of the reliability features of fibre versus satellite, whether in inclement weather or otherwise. So people are only choosing satellite where fibre isn't available.



Q Which aspects of the energy transition are most attractive?

As a result of the Inflation Reduction Act, we are seeing a number of subsectors maturing to a point where they have revenue frameworks that align with our focus on contracted infrastructure.

For instance, with the new tax incentives, we are now seeing a migration of developers to opportunities where they can contract away some of the risks associated with different energy transition investments. This, along with a general maturation of the market, is bringing the same stability to those investments that is characteristic of the traditional contracted infrastructure we seek.

A good example would be EV charging. When reviewing the many opportunities out there, for a long time it felt like we were being asked to build out the equivalent of the next gas station network in the EV charging landscape. That didn't suit our risk profile as a core-plus manager.

We had to think differently. For instance, we own a parking garage in Chicago that is now the largest EV charging hub in the Midwest. In that case, we co-created a revenue model that aligns with our contracted

infrastructure mandate, having shifted utilisation risk to a diversified group of corporate customers under long-term agreements. That leaves them with most of the utilisation risk and provides us with the type of contracted, downside-protected returns we are looking for.

Q Do any other parts of the energy transition have similar characteristics?

Yes, the sub-metering opportunities are particularly attractive. In Canada, for instance, housing affordability challenges and the tailwind of high levels of immigration have led to a multi-decade period of significant multi-residential condo development. Historically, individual condo units didn't have sub-meters, and a building's bulk meter was allocated to owners by square footage, so owners were not exactly incentivised to conserve energy. The introduction of sub-meters can drive down energy usage by as much as 30 or even 40 percent.

As with our EV charging business, we partnered with an entrepreneur via a bilateral process, and again the contractual element that we favour was present. We will fund the costs associated with the installation of the meters and then enter into 10- to 15-year contracts with the condo boards to provide the electricity service. A fixed, inflation-linked administration fee goes on every monthly invoice, and that's what we retain. That makes this an investment with very steady, inflation-linked contracted revenue streams.

Q Are there similar opportunities in communications infrastructure?

Yes indeed, especially where investors are building new data centres to create capacity for AI and high-performance computing.

As I said, this is a once-in-a-generation investment opportunity. Investors can partner with the major technology companies, such as Google, Amazon, Meta and others. These are groups that are investing very heavily into this activity, and from a contractual perspective they have very strong credit ratings. In the world of contracted infrastructure, having counterparties with strong credit ratings is a key element.

> *"The US has achieved a huge relative advantage thanks to the Inflation Reduction Act"*

We typically get involved in a data centre once a contract is in place and the facility has been built. We focus on the energy sources as part of our due diligence, as well as from an ESG perspective, to make sure we are comfortable with where the data centre is sourcing its energy from. In some cases, we are having data centres co-locate with our renewable energy assets. So, instead of selling power into the grid, we are actually selling power to an on-site customer, particularly in states such as Texas.

We have also executed on a roll-up strategy to build a large, diversified portfolio of data centres by acquiring individual facilities at around $10 million to $50 million in value. These typically wouldn't attract the kind of valuation multiples a larger site would, but they often come with both recontracting and expansion opportunities that allow us to pull further value levers.

Q What are the opportunities in transport?

Transport is a more well-trodden sector, so it is important to think outside the box when seeking relative value here.

Generally speaking, we seek to identify asset leasing opportunities with a complex service wrapper around them – so we're looking at businesses that provide services to transport assets and companies.

For example, instead of trying to own the Class 1 railway, which is much larger than what we are able to invest in, we look instead at the businesses that lease the equipment or provide contracted operations and maintenance. That's a business model that creates stickiness, with underlying revenue and contracts that are evergreen, with inflation linkage.

Apart from rail, we are also looking at services being offered to airports and seaports. It's amazing how many opportunities protected by strong contracts exist in the mid-market segment. You end up finding a diverse set of opportunities that are often in very niche areas.

Q How would you describe the current macro environment, and how does it affect future opportunities in the mid-market sector?

There are challenges. It is true that in this higher interest rate environment we are seeing revaluations, and the opportunities for exits are more moderated. We hear time and time again from investors that DPI is the new IRR.

But overall, I would say we are in a bit of a Goldilocks moment from an investing perspective. For the developers and industrial businesses that we usually partner with, it's harder to access capital. That means more opportunities and dealflow being created. And thanks to those recent tight conditions, sellers have slightly more sensible value expectations.

Overall, I think this is a very attractive time for mid-market specialists, and the future is bright. ■