

## KEYNOTE INTERVIEW

# Diversification under the spotlight



*With heightened macroeconomic and geopolitical volatility, diversifying risk exposure is more important than ever, says Northleaf's **Jamie Storrow***

Infrastructure investors have long grappled with the dilemma of whether to adopt diversified or targeted strategies. While diversification may seem to be a common-sense approach, it also places heightened demands on the skillsets of managers.

Jamie Storrow, managing director and co-head of infrastructure at Northleaf Capital Partners, says that maintaining diversification across geographies and subsectors is particularly important in the current environment. And while volatility brings risks, he highlights how it can also provide managers with openings to make opportunistic investments.

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### **Q Which subsectors are today most attractive for mid-market infrastructure?**

The mid-market is active across a number of sectors. Fortunately for mid-market investors, there are many small assets – for example in power generation, communications networks and regional toll roads.

The energy transition is an area that we believe continues to have a big future. It's clear that decarbonisation and electrification is where the world

is headed, even if there's been a recent pullback. Within this sector, we look at renewable power and batteries, as well as different types of assets supporting energy efficiency, such as sub-metering and contracted electric vehicle charging.

This sector also includes opportunities such as installing geo-exchange heating and cooling systems, and energy-efficient lighting or electric boilers to retrofit buildings to reduce their carbon footprint. It continues to grow in breadth and offer attractive, contracted revenue opportunities.

Communications is another appealing subsector. This segment is a

## Q How are geopolitical and macroeconomic trends affecting the importance of diversification?

Geopolitical issues, government policy, interest rates, inflation and tariffs are always material considerations, and they are factored into our investment analysis. The US, in particular, has recently been highlighting many of those risk factors concurrently. With certain risks, we position our funds to be protective and with others, we position ourselves to be opportunistic.

On the protective side, projects or single-purpose companies that operate in one country typically have very limited or no exposure to cross-border elements, either through revenue or equipment sourcing or different types of inputs coming from other countries. In the current environment, this approach is highly protective and helps to minimise cross-border risk.

The unpredictable policy environment, particularly in the US, is also creating many investment opportunities with under-capitalised or distressed industrials and developers. Right now, the turbulence in the US, the higher interest rate environment and the inflationary impact on some types of equipment have led to a number of really interesting investment opportunities – good

assets owned by companies facing financial challenges.

The One Big Beautiful Bill Act has also completely altered the landscape for many wind and solar companies. Currently, we're seeing some really interesting opportunities because there's balance sheet distress in some of the owners of these assets, but not in the assets themselves. Compared to past years, at our investment target size, in the \$100 million-\$300 million range, there isn't as much capital for renewables.



bit more straightforward, and includes towers, fibre and data centres. Data centres, in particular, need an incredible amount of capital and we see adjacent opportunities around the support needs of data centres, particularly electricity production.

Transport is another sector of focus, although this area has been a little quieter in the mid-market recently. We currently have investments in ports, ferries and roads. From a revenue perspective, our preference is for contracted revenue, which can be difficult to find in transportation where there's often a lot of volume-linked revenue. However, transport can add attractive diversification at the fund level, with those different growth and revenue drivers, and can offer strong inflation linkage as well.

The mid-market provides significant opportunity in other types of

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contracted infrastructure assets as well. Often our investments in this space include small leasing companies or contracted equipment companies. These companies don't necessarily fit neatly into other sectors, but that in itself creates opportunities if you're willing to be open-minded about the definition of “infrastructure” and the protected nature of certain investments. You often see strong revenue retention, inflation linkage and highly protected market characteristics.

## Q Why is diversification important for a mid-market infra strategy?

We look at a number of criteria with respect to diversification – geographic, sector, subsector, different types of physical equipment, different counterparties and differences in cross-border exposure. Some investors are looking

for their funds to provide a level of diversification, and they can choose to invest in a fund which is seeking diversification at a number of levels, or they can invest in several purely specialised funds and build diversification via multiple fund exposures. With the growth in the infrastructure fund manager landscape, there are sector focused funds, geographic focused as well as large- or mid-cap funds.

We aim to not be overly exposed to any particular thematic, counterparty or equipment type. As we add investments to a fund, we spend quite a bit of time measuring whether the opportunity is accretive from a diversification perspective across a whole series of metrics. That's partly about making sure we're not doubling down on any exposures that we think aren't going to be additive to the overall portfolio.

More recently, we've seen some diversified managers that didn't appropriately diversify across subsectors or got overtly caught up in specific thematics. For example, the urban fibre sector has presented challenges, some of the regulated assets haven't performed well, and renewable power development has been difficult in some jurisdictions. So, depending on where you were positioned, you might be overexposed to some of those thematics and paying the price today.

### **Q How can managers maintain expertise in a range of different sectors and markets?**

It's all about appropriate staffing. In each region that we operate, we have sector heads responsible for energy transition, communications, transportation and other types of contracted assets. These individuals position us to make acquisitions across those

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underlying sectors and seek out developers and industrial companies that we might be able to work with outside of auctions. We also work a lot with dedicated operating partners who are industrial experts that help us source, do due diligence and manage investments. So, while we manage diversified funds, we have individuals dedicated to different sectors across the regions where we invest. In our opinion, this is crucial to a diversified strategy.

### **Q What are the main challenges that lie ahead?**

In all of the countries we cover, including the US, we think it's important to minimise our exposure to government policy. The current era is really reinforcing the need to review the risks around cross-border exposures, and it's not just because of tariffs – it can also relate to supply chain issues and avoiding inflated prices; we try to source locally where we can.

In addition, it's been more challenging to predict volume-related activities given changing macroeconomic forecasts. We've been cautious regarding new investments that have volume-linked revenues or that are highly GDP-linked, particularly after this latest round of government policy change.

Despite the recent turbulence, the US continues to provide significant opportunities. We're looking for investments that don't have significant government linkage or cross-border risk, as best as we can. The US is a large and very fragmented country, which helps from an investment sourcing perspective. The US is also host to many smaller industrial companies and developers, often with undercapitalised balance sheets, which is where we aim to spot new opportunities and build proprietary dealflow. ■