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The big read – Infrastructure investment

Infrastructure: from investment backwater to a $1tn asset class

Early movers profited from unloved assets, but higher interest rates and more competition mean windfalls will become harder to achieve

By Antoine Gara in New York – March 25 2024

The turbulent years that followed the global financial crisis were not an ideal time for Michael Dorrell and Trent Vichie to be seeding a new infrastructure fund.

Potential investors were reluctant to back new funds and they had little appetite for deals that offered less lucrative returns than large buyouts. At many points, it seemed the end was nigh for their nascent venture.

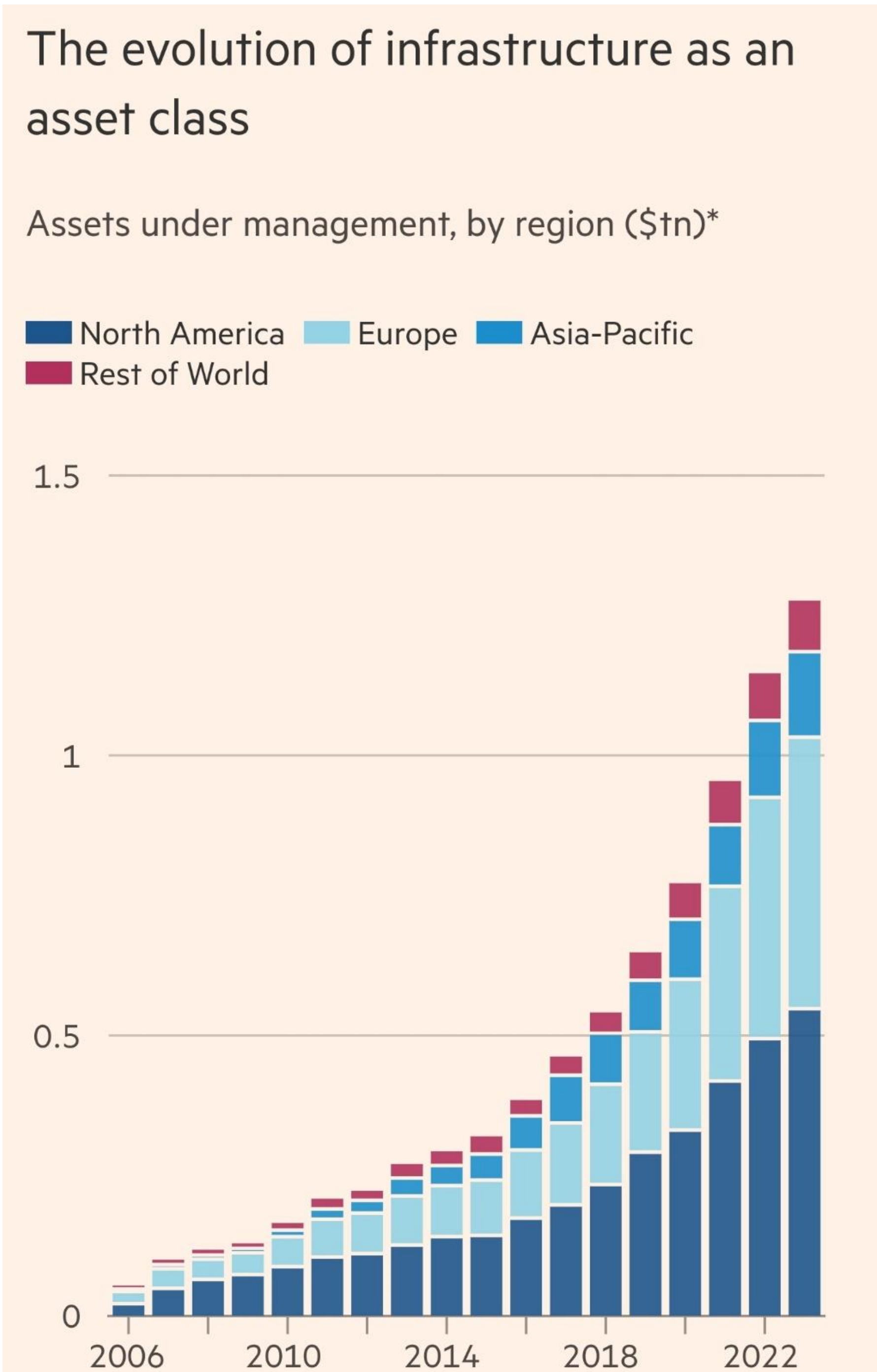
A dozen years later Stonepeak, the New York-based infrastructure-dedicated investment group they created, is a colossus in the private investment world, with $60bn under management.

Companies it controls transport about 10 per cent of the world's seaborne natural gas, own over 120,000 kilometres of fibre networks and produce enough renewable electricity to power 200,000 households.

The group recently drew a $2bn investment from a minority investor that valued it at nearly $15bn, according to people briefed on the matter. Dorrell, the Australian-born dealmaker who fought to keep Stonepeak alive in its early days as its chief executive, is now a billionaire.

Stonepeak's speedy rise has surprised many on Wall Street, but it is a story shared by a small circle of dealmakers who entered infrastructure investment in the US in the early 2000s.
Adebayo Ogunlesi, for example, who in his days as a top Credit Suisse banker often sat opposite Dorrell and Vichie during negotiations, created Global Infrastructure Partners with the support of the Swiss bank in 2006.

After building up a portfolio of over $100bn, this year Ogunlesi agreed to sell to BlackRock for $12.5bn in a cash-and-shares deal that will make him and his partners the second-largest shareholders of the world's largest asset manager.



Source: Prequin Pro * 2023 = to Jun (*ex secondaries and fund of funds)

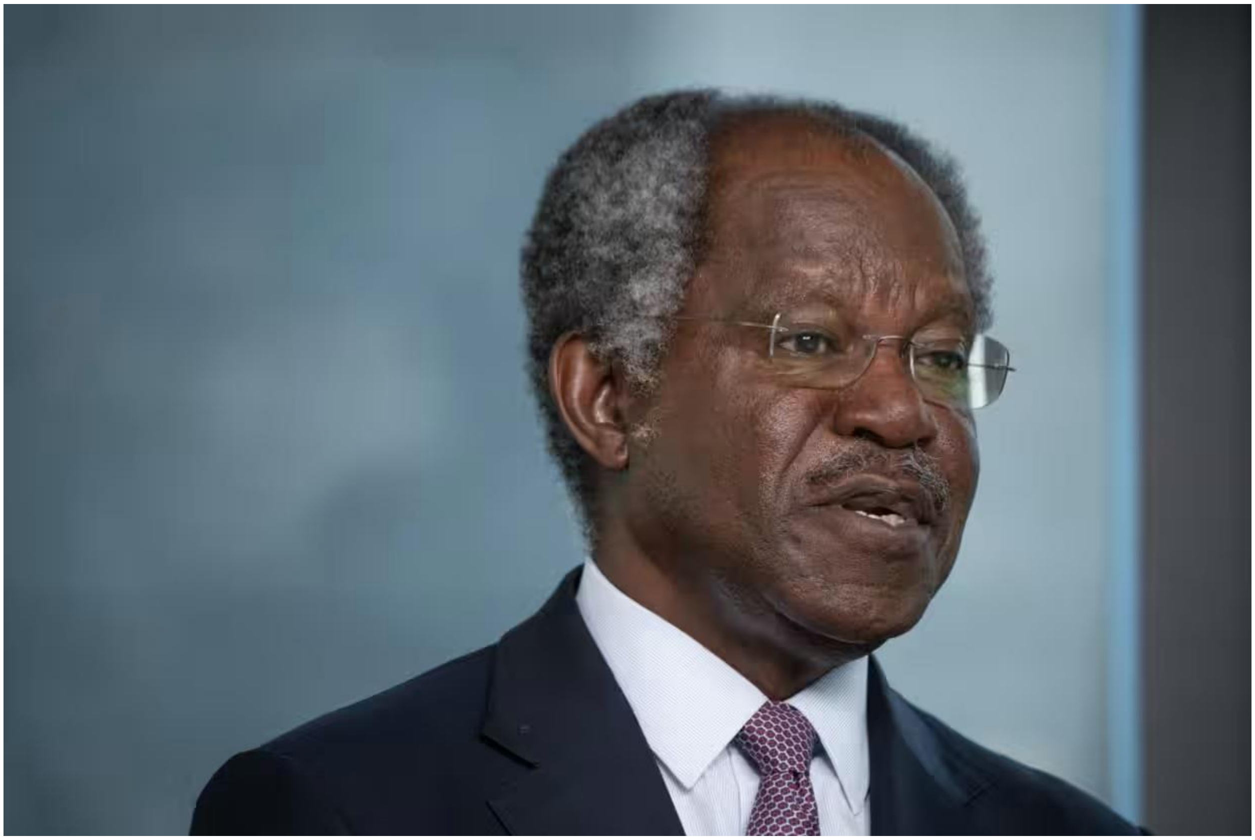
In the early days, Ogunlesi, Dorrell and Vichie and others bid against each other for mundane assets like toll road concessions and parking meter networks. The deals often carried high levels of debt and many quickly soured during the financial crisis.

“Infrastructure investment came to the US in the early 2000s and it was dominated by a handful of people who were mostly project finance, utilities and municipal bankers,” says one senior industry executive. “They saw it as a trend and capitalised by making big early bets around the crisis. Many of the people who didn’t get washed out became billionaires.”

Today’s infrastructure market is more crowded. The success of entities such as Stonepeak and GIP, along with a decade of rock-bottom borrowing costs, prompted asset managers like BlackRock, CVC and General Atlantic to enter the fray by acquiring large infrastructure managers. A further wave of deals is brewing, according to bankers and private equity executives.

Once an investment backwater, infrastructure became a favoured area for pension funds looking for yield and protection against market volatility. Infrastructure assets under management worldwide have soared beyond $1tn, more than six times their level in 2008, according to data provider Preqin.

The increased competition for assets has led big players to widen their definition of infrastructure; it now includes assets such as gas export facilities, the transmission masts that mobile phone networks are increasingly selling, or the data centres that will provide the computing power needed for artificial intelligence projects.



Adebayo Ogunlesi this year agreed to sell Global Infrastructure Partners to Blackrock for $12.5bn in a cash and share deal © Victor J. Blue / Bloomberg

Their business is starting to face more scrutiny; politicians and consumers in some countries are starting to ask how desirable it is to have pieces of infrastructure key to the public realm owned by highly indebted and secretive private companies.

As asset prices and interest rates rise, windfalls have become harder to achieve. "There is always tension on how far you can push the frontier and what is infrastructure," says Hamilton James, the former vice-chair of Blackstone Group, which initially backed Stonepeak.

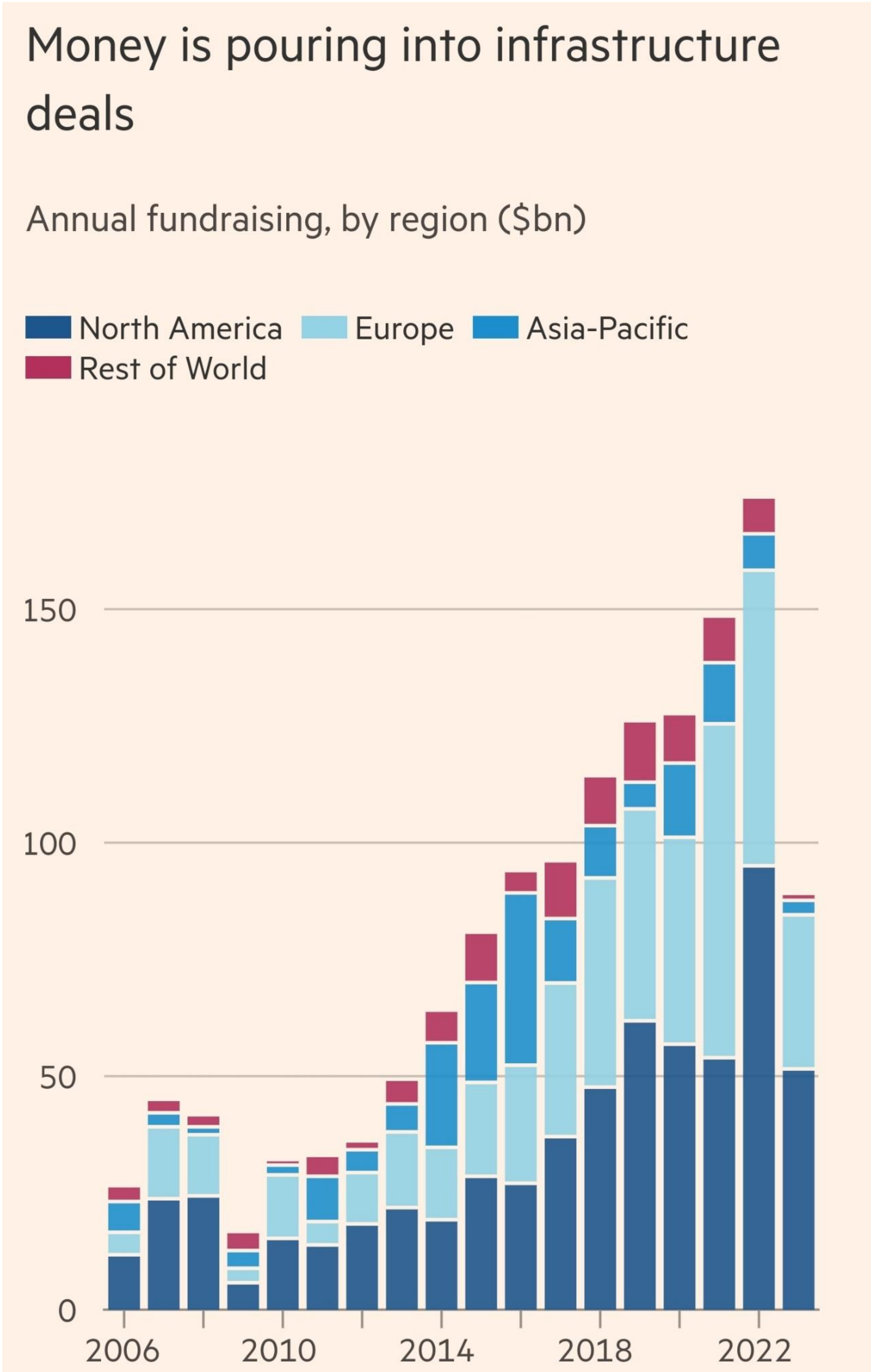
"My guess is we are in a part of the cycle where returns will be lower. Rising rates and high stock prices make it harder to do interesting deals and there is a lot of capital chasing after investments."

Dorrell and Vichie, both native Australians, were sent by Macquarie to the US in 2000 to replicate the Sydney-based infrastructure group's past successes in the world's largest economy.

During the 1980s and 1990s, Macquarie underwrote a wave of privatisations across Australia, Europe and Canada, countries where governments were

looking to sell state monopolies such as utilities, airports and toll roads. It then began investing directly in the businesses that were being privatised.
But translating that strategy to the US was initially challenging. Federal and state governments were less likely to sell assets, fearing a political backlash. The existence of large municipal debt markets, which carried tax advantages for domestic investors and generated funding for public bodies, meant there was less financial incentive to privatise.

Dorrell and Vichie soon wondered whether they should just return to Australia. “Infrastructure wasn’t even a backwater in the US. It didn’t exist,” says Dorrell. “We almost didn’t bother.”



Source: Prequin Pro

But the duo came to realise that many other pieces of infrastructure, like communications networks, pipelines and logistics assets, were owned privately and often neglected and undervalued on corporate balance sheets.

“We quickly worked out that the sectors available in the US have dwarfed the other asset classes,” says Dorrell. “Over time you started to realise that the US was different, and different in a good way. It makes it the most interesting infrastructure market in the world.”

A small number of deals sparked investors’ interest. In 1999, the provincial government of Ontario sold a lease on 407 ETR, a toll road around Toronto, for about $3bn — a price that in Dorrell’s eyes wildly undervalued the highway. Macquarie quickly became a large investor and by 2019, 407 ETR was valued at around $30bn. “It is arguably the most successful infrastructure asset ever,” says Dorrell.

In 1999, the provincial government of Ontario sold a lease on Highway 407, a toll road around Toronto, for about $3bn. By 2019 it was valued at around $30bn © Steve Russel/Toronto/Getty Images

Canadian pension funds and those in Europe and Australia began pouring money into infrastructure and US municipalities started to sell assets such as the Chicago Skyway Bridge, acquired by Macquarie and Cintra for $1.8bn in 2004. Before long, large investment banks including Goldman Sachs, Credit Suisse, Citigroup, Morgan Stanley and Deutsche Bank were building their own dedicated investment teams.

But the 2007-08 financial crisis brought the boom to an abrupt end and left many institutions nursing big losses. "The early deals were all levered to the gills," says one senior executive involved with many transactions, who estimated some were priced at between 40 and 60 times annual operating cash flow. "They weren't bad assets. They were a story of too much leverage and not enough time," he adds. "It was the ultimate winner's curse."

It was around this time that Dorrell and Vichie were headhunted by US investment group Blackstone to build an internal infrastructure investment unit inside the world's largest private equity group.

But after failing to make much headway, their unit was quietly spun out in 2011. They used their savings to rent Manhattan office space for their venture, Stonepeak, and scoured the US for investment from large pension funds and endowments. The response was lukewarm.

By the summer of 2012 they were racing to secure $250mn of investment in the fledgling Stonepeak that would help them land a $400mn cornerstone commitment from a large US teachers' pension fund.

Their best hope was a Washington state pension fund, but one Friday near the end of summer, it notified Stonepeak that it was putting its potential investment on hold. Both Dorrell and Vichie feared it was the end. "I have never been so nervous in my life," says Dorrell.

The fund changed its mind the following Monday and ultimately invested $250mn, setting Stonepeak on the way to raising over $1bn for its first fund. "The investment put us in business," says Dorrell. Vichie retired from the company in 2021 to pursue other projects.

The Chicago Skyway Bridge was acquired by Macquarie and Cintra for $1.8bn in 2004, but the deal subsequently soured © Henryk Sadura / Alamy

Stonepeak, along with rivals like GIP and Canadian asset manager Brookfield, would soon have investors flocking to their doors as the era of low or even negative interest rates forced asset managers to look for returns from unlisted investments.

Another beneficiary was Sadek Wahba, an Egyptian-born banker who began his career as an economist at the World Bank before building up Morgan Stanley's internal infrastructure unit.

That entity, spun out of the US bank in 2012 and now called iSquared Capital, manages nearly $40bn in assets. Antin Infrastructure, one of Europe's most valuable listed asset private investment groups, followed a similar path after being seeded inside BNP Paribas.

The growth of private infrastructure groups bore similarities to previous structural changes in finance that gave rise to the private equity and credit markets that now manage assets of over $14.5tn.

“Your structure doesn’t matter until it does. It can really save your capital”

Michael Dorrell, Stonepeak chief executive

The now expansive buyout and private credit industries were also pioneered by small teams of former bankers from groups like Bear Stearns, Lehman Brothers and Drexel Burnham Lambert, who devised new financial structures and underwriting techniques for corporate assets.

GIP, Stonepeak and iSquared helped to push the infrastructure industry away from auctions of government-owned assets and towards a strategy that more closely resembles that of private equity. Last year, iSquared agreed to acquire UK-based bus and train operator Arriva from Deutsche Bahn.

Dorrell and Vichie even recreated the culture they had observed inside Blackstone, recruiting dealmakers from private equity and hedge funds with expertise in restructuring financially distressed assets.

Jack Howell, one of Dorrell’s early recruits, is now co-president alongside Luke Taylor, another Macquarie veteran. Under Howell’s direction, Stonepeak invested heavily in the US pipeline sector in the early days of the shale gas revolution but embedded financial protections such as enhanced seniority for its equity investments.

That helped it avoid losses during the sector’s cyclical downturns. “Your structure doesn’t matter until it does,” says Dorrell. “It can really save your capital.” According to pension fund documents published publicly this past January, the group has not yet realised a loss on any of its deals.

Ogunlesi’s GIP has arguably been an even greater success, attracting over $100bn in assets using a strategy of making incremental changes to large businesses to improve their profitability and valuations before selling them on.

At London City airport, GIP reworked the take-off and landing schedules to allow for an increase flight numbers, eventually selling its 75 percent stake at a huge profit © Jason Alden / Bloomberg

At London City airport, GIP reworked the take-off and landing schedules to allow for an increase in flight numbers, eventually selling its 75 per cent stake at a huge profit. At Gatwick, another London airport, it more than halved the time taken for security screening — allowing passengers to spend more time and money in the retail and catering outlets that pay revenue-based rents to the airport.

There have been misfires along the way. GIP acquired UK waste management company Biffa in early 2008, only to see the financial crisis expose its vulnerability to competition and economic downturns. It salvaged just $93mn of its $600mn investment.

Stonepeak put $3.6bn of equity — its single largest cheque — into Astound Broadband in 2021, but the New York company wilted under intense competition from larger broadband operators. Profits evaporated and rating agencies cut its debt ratings, raising the cost of its borrowings.

The diversification into investment areas previously dominated by private equity and real estate trusts, such as fibre networks, cellular towers and data centres, could bring more blow-ups. The sharp rise in interest rates is also putting pressure on many deals done in 2020 and 2021, say industry executives.

“So much capital had been chasing wind and solar energy it became heavily mispriced,” says Dorrell. “The music stopped and there has been real distress.” Stonepeak has looked to capitalise on that; last month, it agreed to take a 50 per cent stake in a package of US wind energy projects from Danish renewables group Ørsted.

Data centres have been another area of almost unbridled optimism as investors gush over prospects for artificial intelligence. But some deals have already soured; Canada’s Brookfield Infrastructure Partners has been forced to inject more equity into Evoque, a data centre business it bought from AT&T in 2019 whose revenues have since declined. Evoque itself recently acquired a private equity owned rival out of bankruptcy.

Last week short seller Hindenberg warned that so-called hyperscalers such as Amazon, Google and Meta were changing the dynamics of the industry and stripping pricing power from smaller operators. It has also accused Equinix, a listed data centre operator, of manipulating the accounting treatment of capital spending to flatter its profitability. Equinix says it is investigating the claims.

“The data investment theme to me feels super, super toppy and the thing everyone is chasing,” says one infrastructure executive. “People are making huge commitments and huge bets.”

Some early privatisation efforts have also backfired after being overloaded with debt. Water utilities privatised by the UK in the 1990s were taken off the stock market by infrastructure investors in a series of deals during the mid-2000s.

But many of these heavily indebted operators have attracted public and political opprobrium for delivering poor customer service, polluting waterways and failing to invest in new assets — all while showering their overseas owners with dividends.

"If you pay too much for the assets, the regulator will lower the regulated return," says one infrastructure executive. "If the deal goes wrong, it goes wrong really quickly."

"You are going to see a huge amount of investment activity going forward"

Adebayo Ogunlesi, GIP chief executive

When GIP and Stonepeak began they had few competitors, but large private equity groups Blackstone, KKR, EQT and Brookfield have built increasingly deep pockets of capital to invest in the sector. Ogunlesi believes trillions of dollars will still need to be invested in infrastructure, for instance, to reshore manufacturing supply chains, build modern digital networks and secure traditional and renewable energy supplies.

Furthermore, he says large public companies will struggle to deliver the revenue growth that investors demand and will look to release capital for investment in faster-growing niches by selling infrastructure assets or forming joint ventures with specialist investors. GIP's investment portfolio now includes partnerships with many of the world's largest companies, including Abu Dhabi's state oil producer Adnoc, Shell, TotalEnergies and Vodafone.

Ogunlesi says the infrastructure boom has much further to run. "You are going to see a huge amount of investment activity going forward."

But he also acknowledges that in the current economic and geopolitical environment, managers "are going to have to work much harder to earn their keep than they've had to do in the past".