IFM Investors

The infrastructure opportunity

Part 2 Making the most of infrastructure allocation

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At a glance

- Tapping into the full potential of unlisted infrastructure calls for disciplined acquisitions, considered portfolio construction and active asset management
- To maximise the benefits of unlisted infrastructure for our clients, IFM focuses on:
  - Buying well and holding for the long-term
  - Strategic portfolio construction
  - Active long-term management and
  - Enhanced risk management and control

Unlisted infrastructure has proven its resilience to market cycles and volatility over time. Part One of this paper, '*The infrastructure opportunity: the role of unlisted infrastructure in long-term resilient portfolios*', explains how an optimal unlisted infrastructure strategy leverages the inherent characteristics of infrastructure – including performance through economic cycles, long-term, predictable revenue streams and a differentiated risk/return profile – and helps investors achieve diversified, low-correlation, risk-adjusted returns over the long term.

Tapping into the full potential of unlisted infrastructure calls for disciplined acquisitions, considered portfolio construction and active asset management. These approaches must align with the attributes of different infrastructure assets and be driven by a long-term investment thesis.

Our focus on investing long-term pension capital aligns closely with the long life of infrastructure assets. This longer time horizon suits the objectives of our clients, for whom we have developed durable, long-term strategies and structures for portfolio and asset management.

To maximise the benefits of unlisted infrastructure, we focus on buying well and holding for the long term, strategic portfolio construction, active management over time and enhanced risk control.

Buying well: assessing and acquiring high-quality assets

Buying well is crucial to making the most of the infrastructure opportunity. As we seek to invest in assets that fit with our strategy, we look for a series of distinct characteristics that are inherent to infrastructure, as well as those that an experienced manager can influence or control (Figure 1).

These characteristics are fundamental to the quality of an investment and the overall infrastructure strategy. Understanding and pricing these risks, among many others, is a core part of IFM's rigorous investment process – one that we have developed and refined over 30 years of investing in this sector.

Constructing an all-weather portfolio: strategic diversification

Unlisted infrastructure is an effective total portfolio diversifier. To maximise its benefits, we focus on intra-portfolio diversification, taking a multi-dimensional approach that emphasises revenue streams, asset type, sector/subsector and geography.

Targeting infrastructure asset allocation by sector or sub-sector alone, for example, does not fully consider the range of asset types and variation in revenue streams that can be found within a particular sector or sub-sector.

Our proprietary InFRAME portfolio construction system enables us to analyse the diverse underlying revenue streams that drive the performance of infrastructure assets, providing us with deep, granular insights into infrastructure portfolio characteristics.

The InFRAME system recognises the complexity of infrastructure assets, as well as their multiple sources of income and distinct risk characteristics, organising these into key revenue categories and types (Figure 2).

FIGURE 1

CHARACTERISTICS THAT HELP DEFINE THE QUALITY OF AN INVESTMENT

Key inherent characteristics

- Essential Services
- High barriers to entry
- Stable cashflows with inflation protection
- Long-term concessions or contracts
- Performance through economic cycles

Key characteristics a manager can influence

- Strong legal protections
- Governance rights and control
- Prudent capital structures
- Aligned shareholders
- Social licence to operate

The InFRAME system then plots revenue categories and types according to volume risk and price risk. Understanding and profiling the risk parameters of individual assets and how these interact at a consolidated level is critical to the task of building resilient portfolios. Importantly, assets in the same sector or sub-sector can have different sources of revenue.

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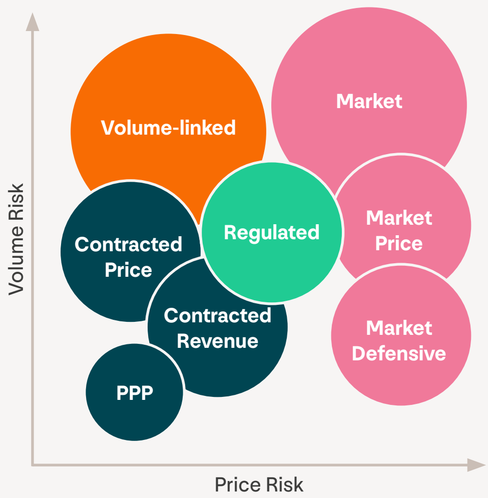
FIGURE 2

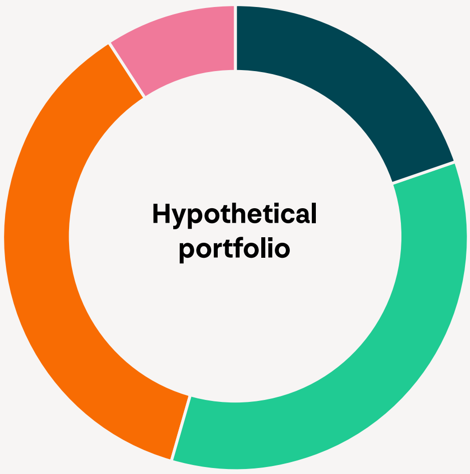
Building a portfolio - understanding diverse sources of infrastructure revenue and risks

8 revenue types – grouped into 4 main categories:

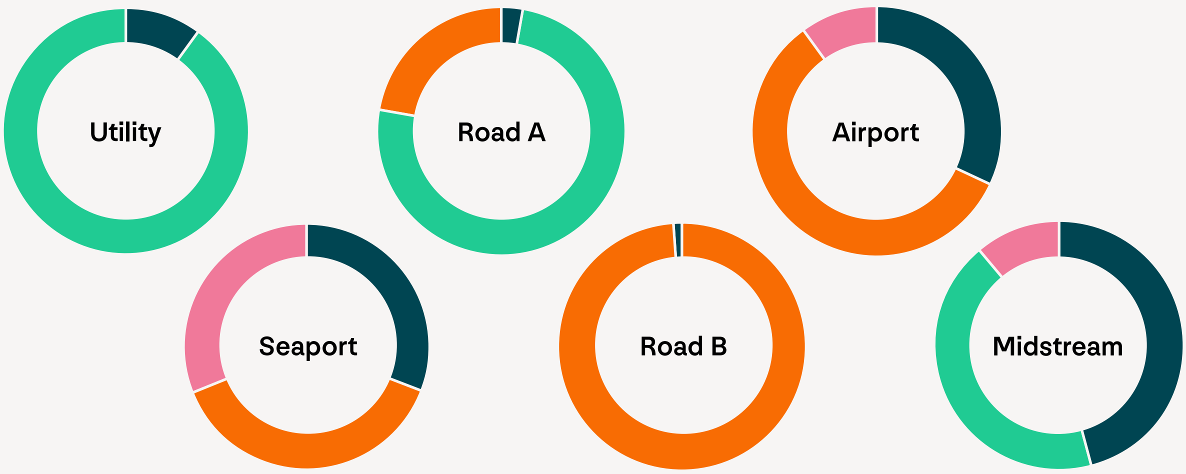
Contracted Regulated Volume-linked Market-related

Revenue stream framework





Assets and revenue streams



Source: IFM Investors

Creating long-term value through active asset management

Long-term active asset management is one of the hallmarks of our infrastructure investment strategy. We invest in assets with long-term concessions, some up to 99 years, and into perpetuity.

Our specialist asset management team drives long-term value by actively engaging with portfolio company management, governments and other stakeholders to manage risks and enhance value. Through well-planned and managed capital expenditure, we continuously upgrade and optimise portfolio assets over time, including by increasing operational capacity and efficiency, building climate resilience and creating social and economic value. See a case study of our active asset management approach on page 5. In the five years to 2025, we expect that over US$4.5 billion will be invested in major projects across our portfolio.

An opportunistic approach to divestment

Building long-term, robust portfolios also means recognising opportunities to create value or de-risk through selective divestments. Before considering a divestment, we aim to de-risk portfolio companies and demonstrate how our asset management capabilities have changed their risk profiles through our value-add initiatives.

Enhanced risk management and control

Investing directly in private assets allows for a deeper understanding of risks compared to listed markets. If the investment is large enough, it may also provide some control and management of risks, as well as the ability to influence strategic outcomes.

This deeper insight and control, in turn, enable more accurate pricing of assets and opportunities to capture upsides. We typically invest where we have strong governance rights, enabling the active asset management approach outlined above. Through representation on portfolio company boards and specific initiatives, we aim to exercise our influence to manage and reduce risks and generate value.

Unlisted infrastructure's role in long-term, resilient portfolios

Equity investors and asset allocators face challenging times, with existing portfolio construction approaches under stress due to global economic challenges and megatrends that continue to play out.

Against this backdrop, infrastructure offers an attractive opportunity for investors to improve the robustness of their portfolios and risk adjusted returns. This asset class demonstrates a differentiated risk/return profile and portfolio resilience through various economic cycles and environments.

For investors aiming to deliver positive long-term outcomes, a well-structured portfolio of high-quality unlisted infrastructure assets, actively managed over time, can further enhance these outcomes by providing enhanced diversification, governance and risk management.

Unlock more infrastructure expertise.

To learn more about how we seek to build robust portfolios that are resilient to the long-term effects of market shocks and volatility, read our companion paper, *The infrastructure opportunity - The role of infrastructure in long-term resilient portfolio*

Case study: Building investor value at Indiana Toll Road

The 157-mile Indiana Toll Road (ITR) is a critical part of the U.S. freight network. IFM invested in the ITR Concession Company (ITRCC), which operates the ITR, in 2015 and currently manages an approximate 70% ownership stake.[1] Our investment in ITRCC exemplifies our approach to active asset management focusing on long-term value-creation.

Investing in value creation
Capital improvements were a focus in the first three years following our acquisition, with over US$300 million invested in road improvements and travel plazas to enhance safety and amenity. This proactive management helped to strengthen our relationships with governments and key stakeholders, including with the Indiana Finance Authority (IFA). In 2018, ITRCC shareholders agreed to pay the IFA US$1 billion over two years and committed an added US$50 million to further improve road safety and amenities for heavy vehicle customers, in exchange for a one-time 35% increase in heavy vehicle tolls.

De-risking
In addition to capital expenditure programs and stakeholder relationship building, IFM has also focused on de-risking the debt profile of ITRCC through a series of successful refinancings. We have worked closely with ITRCC's board and management teams to drive social and sustainability initiatives, particularly in relation to worker and customer safety, workforce diversity and emissions reductions. With strong links to US inflation and GDP, coupled with the toll road's position as an essential part of the US industrial sector, ITRCC's revenues have consistently increased over time, demonstrating resilience through several economic cycles. This, combined with IFM's successful active asset management outcomes, makes the investment an example of how well-managed core infrastructure can play an important role in investor portfolios.

[1] As at 30 June 2024

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