

RPM—44 | New frontiers in infrastructure

Michael Venne: In a lot of ways, infrastructure is something we tend to take for granted, and we really don't think about it until it isn't working. Potholes and road closures. Plane and ferry delays. Internet and power outages. The stability is what people count on every day to carry on with their lives, and it's also what infrastructure investors count on when they decide to invest in the asset class. Hence why some regard it as boring.

But there are some really interesting things happening in infra that turn “boringness” on its head. A confluence of trends is making this perhaps the most interesting time to invest in infrastructure.

1. First, the energy transition which will reshape how power is generated, transmitted, stored and used.
2. Second, an inexorable demand for data and storage.
3. And third, modernizing cities around the world.

Yet despite all this newness, we're going to hear why infrastructure is going to remain well, infrastructure and why it's important for investors to be ahead of the curve. In other words, infrastructures frontiers might be changing, but the value it can add to a portfolio and the reasons to invest in it are not.

Joining me today to discuss the trends that are redefining infrastructure and the ways investors can best position themselves to capitalize on them is Simon Beer, a Toronto-based partner on our Infrastructure and real assets team.

Simon, welcome to *RPM*!

Simon Beer: Thanks, Michael, and it's great to be here with you at *RPM* to discuss what we're seeing in infrastructure. It's a pretty exciting time. And I think one of the key things that I thought about as you were talking through that introduction was that infrastructure has always been a vital tool to support our way of living. You can remember sort of Roman roads being built, Victorian era sewers being built in the UK, and the railways that supported the development of the West in the US.

Obviously, as we continue to see investment opportunities in traditional infrastructure-like assets, and we see those continuing everywhere in the world. What we're also seeing is new investment opportunities that service the modern essentials of society today. And those can be telecoms, data centers, the support every phone, computer and iPad that's connected to the internet and our addiction to being connected. And while there's a lot of growth, the demand doesn't look to be slowing down anytime soon across the wide spectrum of infrastructure investment opportunities. With energy transition being a key driver to opening up new investment opportunities across the world. And it's really exciting for us and the entire sort of private markets universe in these in these areas.

MV: Yeah, certainly. And you've touched on a couple of things that we want to discuss today. Data being one of them. Glad you went there. Is there like what's happening in data that's going to affect the investment landscape? Is this something new or is it a continuation of the vector it's already been on?

SB: Thanks for the question, Michael. I think it's one of the things that we get asked quite a few times a week, if not every day. And maybe I'll just sort of focus on data centers.

They've been a key investment focus in the infrastructure and real assets area for many years. And the key reason behind that is that they support an essential part of our society today in terms of access to information and our connected world.

A good way I've been thinking about this is imagine how much more you use the internet today than you did 20 years ago. And just remember 20 years ago less than 30% of the world had access to a mobile phone and most of those mobile phones didn't have a data connection even ten years ago. Usage of data on mobile communication devices was a small fraction of what it is today. So, with that growth and the underlying demand that needs the infrastructure behind it, just imagine where we're going to be in 5- or 10-years' time. And that to me is the really exciting part of where we see the future for data and telecommunications.

It's not without its challenges. As with everything, but for data centers, where we see some key challenges, as well as opportunities for investors to think about and potentially make better returns—they cover in a number of different areas, but for starters, there's the growth of artificial intelligence and the impact that a different setting of computing requirements that are needed to support AI will have on the data center universe. And how operators are going to change and support that going forward.

The recontacting risk and opportunity of existing data centers, as customers pursue different strategies and move to a net zero approach, is a real confluence of two trends about data and sustainable energy. Because all of the major data providers Meta, Apple, Google, etc. have all focused on being net zero, and to achieve that, they need to have their data centers powered in a net zero way, which also creates a challenge for the grid. There's not a data center manager alive that can guarantee access to the grid, and it becomes a really big challenge for new developments, which we're watching closely across all of the different investors and investments we've made.

All of these factors that have kind of just gone through, and there are many, many more are going to have a direct impact on data center operators and impact investment decision making, especially when you remember that all of those data centers need to be powered somehow. And we think it's an exciting time, (a) to think about where to invest, but (b) also to kind of carefully consider who to invest with and where.

MV: So that segues quite nicely into another the next topic that I wanted to address. And that's the energy transition. As we discuss in the white paper that we just released on this very subject, you know, to borrow a term that you used in your previous response, you know, the energy

transition is very much a confluence of smaller micro changes that are driving a bigger macro goal. There's a lot to unpack here. How do you define the energy transition, both in terms of its macro objectives and its underlying micro parts?

SB: Thanks for the question, Michael. I think it's a really interesting one and something we get asked all the time. And I think the reason we get asked all the time is because it means different things to different people. Because of that, I think it might make sense to sort of take a step back. And the way I've always thought about this challenge has been that energy's been an essential component to human development, and it's critical to the functioning of our society. And the fact of the matter is that a significant part of our energy over the last hundred years has come from fossil fuels, which in the most part have been cheap and abundant. For a variety of reasons the world wants to move away from fossil fuels. But in addition to that challenge, we're also faced with an ever increasing demand for energy as well, meaning that we not only have to replace the sources of energy we have traditionally relied on, but we also need to support an additional 50% increase, according to the IEA, over the coming decades and genuinely to achieve that goal, the way we produce, distribute and consume energy will need to change, and that creates a number of opportunities for investors across the spectrum, whether it be new hydrogen developments, better energy-saving devices, or an increase in electricity and the requisite infrastructure to support that. All of it is something that is absolutely at the forefront of our thinking when it comes to energy transition, and it covers a wide variety of potential opportunities, all of which we think are kind of exciting to look at and offer interesting risk return for investors.

MV: How is the combination of these trends affecting the investment landscape? I guess what I mean by that is how much how much larger is it getting in terms of fundraising? How much more diverse in terms of the number of general partners and their practice areas. And, you know, I know this is something that we touched on in the paper, but, you know, it's also changing, you know, the perception of infrastructure and the spectrum of risk return profiles. How are all these things changing?

SB: Again, thanks for the question. It's again, one thing that gets asked of our team quite a bit around the world.

Again, if I start off with the macro conditions here, the investment landscape continues to grow exponentially, and it's really a testament to investors' demand for and focus on energy transition. Again, if you look at where the world needs to spend to achieve that and support the increased demand, we're talking about trillions of dollars to support this transition. And private markets have been focused on fundraising to support that transition in a variety of different ways. We actively monitor over 100 energy transition managers, which, by the way, have developed over the last several years from a lot lower base. The vast majority of those are all in market, and they're raising different sized funds, ranging from 200 million to 20 billion across the full risk spectrum of opportunities, whether that be turning high polluting energy developers into green developers or traditional solar developments, or energy efficient demand management approaches. The risk spectrum that we're seeing covers everything, which means there's a lot of opportunities to invest.

But it's a crowded market, and finding the right manager is critical.

I think the other thing to remember on this is that the world's biggest managers are deploying expert teams to focus on this trend and see it as critical to their development as well. So we see this massive market increase really focus on things that are essential to public life, and it means that investment opportunities are there for investors across that risk spectrum, which we get very excited about.

MV: And so, some investors will be keener than others to invest in these trends earlier. What's at stake if an investor chooses to wait and see?

SB: Another great question there, so thanks for that.

Look, again, as we've seen historically, the opportunity to achieve attractive risk adjusted returns for capital is helped by investing at the right time. For that, I don't think there can be any debate, but I think the kind of thinking around now is this the right time? And when you look at the growth of opportunities for most investors, the right time looks to be now.

Now some will want to look at kind of higher returning, more risky assets and opportunities, and others will look at more stable operating assets. But again, the plethora of opportunities that cross that risk spectrum is available right now. And what we see is that there isn't the kind of challenge of a limited supply in the market. So, no matter where you want to play in the risk spectrum, we think there are opportunities which can be pursued and achieve appropriate returns for the risk involved.

MV: So, whether you want to target core risk, core returns or value add and opportunistic, there's something for everyone it sounds like.

SB: Exactly. And it's a particular focus because it's a growing market. And what we've seen historically. And you can think about investors that looked at solar investments 10 or 15 years ago, more and more capital is going to be needed in this sector. So, we think there's going to be more and more opportunities to achieve good returns.

MV: There's a lot of "newness" on the horizon. And yet it seems like, you know, we believe the fundamental reasons to invest in infrastructure will remain intact. Talking about uncorrelated returns. Predictable cash yields or cash flows, among other things. But as the investment landscape, you know, I guess expands. I mean, what's the one thing you tell investors who question this assumption?

SB: Again, I think that's a difficult question, because there are so many different opportunities that investors can look at. But the way I think of it is that there's a fundamental increase in society's need for sustainable energy, and that's gathered pace over the last 20 years or so. And the key thing that demand is not slowing down but speeding up. And you can sort of see that in the requirements for electric cars. The data centers we were discussing earlier, the movement away, whether it be legislated or personal demand driven of different sources of heating. Meaning genuinely the demand for clean, reliable energy keeps increasing. And for me at least, the

opportunities for investors to make good decisions that service that needs and potentially deliver upside on a risk adjusted basis are there to be found.

And what we've seen over the past several years has been infrastructure investments, actually delivering what they promised in terms of predictable yields, solid cash flows that could be kind of directed in whatever way an investor wants. And those trends seem to be really focused on energy transition going forward, which again, I think sort of reinforces the attractiveness of this sector.

MV: I guess, to that, I would add that, you know, there's a lot of data and evidence coming out now that infrastructure as a whole has delivered on its promise to protect against Inflation. You know, there was a lot of doubt about that -- that we've been in a inflationary period for a number of years. There's a lot of data to suggest that, yes, infrastructure has made good on what people assumed it could offer.

SB: Absolutely. Maybe a funny story here, but one of my colleagues, um, tells a good story about when he decided to focus on infrastructure. He thought about it, on the fact that ten years ago, post the financial crisis, there was a desire to kind of have inflation protection and infrastructure was going to deliver that. And it was really set for growth in an inflation world.

Clearly, we had ten years of ultra-low inflation and ultra-low interest rates. And then when that change came, as you mentioned, infrastructure did exactly what it was supposed to do ten years ago, kept its kind of value, saw inflation increases being able to be passed through and achieved for investors what it was always supposed to do. And that, as you say, reinforces the kind of criteria of where people have seen from an asset class in terms of that risk adjusted return basis. But it's something we can see continuing across all of the things that have been described as new infrastructure sectors, when in reality they're just the same infrastructure requirements that support society's essential services.

MV: And gladly, for our colleague, you know, he was eventually proven right.

SB: Absolutely.

MV: Simon, this has been excellent. Thanks, as always. A pleasure to talk to you and I hope to see you again soon.

SB: Great stuff Michael. Thanks for your time as well and really appreciate having the opportunity to discuss a topic that's pretty close to my heart.

MV: That does it for this episode of *RPM*. For more insights on the energy transition, as well as the rest of StepStone's thought Leadership library. Head to stepstonegroup.com. *RPM* is available wherever you listen to podcasts.