Infrastructure's mid-market: well-positioned for the post-pandemic recovery?

In their quest for dependable, long-term income, investors have increased allocations to infrastructure assets. This has fuelled competition for large-sized deals. By contrast, the mid-market remains less crowded and, at the same time, the number of opportunities continues to grow.

Since the last economic crisis in 2008, the infrastructure asset class has attracted strong interest from investors, with both the amount raised by funds and the total number of funds significantly increasing year-on-year. The growth in popularity of the asset class can be attributed primarily to infrastructure's much-touted characteristics, among them the potential for steady yield, low volatility, downside protection and inflation protection. In addition, the prolonged period of low interest rates has forced asset managers to consider alternatives to fixed income, including infrastructure investments.

Despite the Covid-19 crisis, global fundraising for unlisted infrastructure funds has remained strong, with approximately €71 billion (bn) raised in 2020. And, in spite of a slow start to fundraising in 2020, the last couple of quarters saw a return to pre-pandemic levels. It's unsurprising that infrastructure has continued to attract substantial attention in the current market environment, as investors look for stable, sustainable, long-term yield with downside protection.

The growth in popularity of infrastructure has led to a steady increase in the presence of large sovereign wealth funds and public pension managers, especially across Europe. These investors have driven the increase in the average unlisted infrastructure fund-size raised - from $750 million in 2017 to $1.6 bn in 2019. Furthermore, these investors have relatively large capital allocations to the infrastructure asset class, and often a low cost of capital.

Repositioning within the infrastructure market

Research shows that the increased presence of large investors in the infrastructure market has led to greater competition for large-cap transactions. This has not been fully replicated in the lower-middle-market, in part due to the fact that these investors are looking to deploy their large capital allocations - which is more easily achieved through large deals.

In addition to these large direct investors, capital continues to flow into infrastructure funds within the asset class. This has encouraged many players to move up in scale, or to diversify their strategies in order to capture a larger share of the market. This shift has left the mid-market less crowded. And, at the same time, the number of opportunities to invest continues to expand.

The mid-market continues to provide ample scope to find value across a broad spectrum of opportunities. There are more transactions in the mid-market, with less competition, typically enabling investors to deploy their capital at lower more attractive prices.

Discovering value in the mid-market

There has been an abundance of small-to-mid-market opportunities, despite the initial slowdown experienced across the global economy. This activity is mainly driven by companies or municipalities looking to sell their non-core assets so as to improve their liquidity.

The large-cap market is fast becoming saturated, with the main differentiator between investors simply their cost of capital. By contrast, due to its fragmented nature, the mid-market offers more prospects with greater return potential, and at more reasonable multiples. Furthermore, the mid-market typically offers more opportunities for managers to implement operational improvements and to deliver environmental, social and governance ('ESG') benefits to society, while at the same time targeting sensible and appropriate financial returns for investors.

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Central European Renewables Investments

Central European Renewables Investments is an example of one of our mid-market infrastructure assets. It comprises 384.5MW of ground-mounted solar photovoltaic farms spread across six operational portfolios. A further two portfolios are currently under construction.

Image source: Aberdeen Standard Investments

Loimua Oy

Another of our assets is Loimua Oy, which owns and operates 640MW of heat-production capacity and 16 district heating networks across Central and Southern Finland. Loimua produces district heating, and sells and distributes district heating and natural gas in Häme, Central Finland, Northern Ostrobothnia and Heinola.

Image source: Aberdeen Standard Investments

Outlook for the mid-market

The infrastructure market is still relatively nascent, especially when compared to private equity and real estate and is expected to l continue to grow and develop over the coming years. We expect to see infrastructure attract further capital as investors look for attractive returns with robust yield and downside protection.

As the full extent of the pandemic is realised, we remain confident that deal flow will stay strong and plentiful in the mid-market as corporates and small companies seek solutions to improve their liquidity situations. This, coupled with many managers moving up the deal-size spectrum, will afford further opportunities to invest in attractive mid-market businesses.

The examples shown are for illustrative purposes only. This article is not a recommendation to invest. The value of an investment can go down as well as up, and you may get less back than you invested.

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