Generating alpha returns in energy infrastructure

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Actis invests globally in critical, sustainable infrastructure, not only because we view it as our mission to transform infrastructure for a better tomorrow but, above all, because we know that our investment approach, and experience investing in critical infrastructure in more than 35 countries over the last 20 years, delivers competitive, alpha returns. There are many reasons for this, including that infrastructure is one of the fastest growing sectors in private markets, but also because Actis specifically invests behind three global megatrends spurring the global economy: decarbonisation and the energy transition, digitalisation, and deglobalisation and supply chain re-allocation.

Not all parts of the world will benefit equally from these transformative megatrends but in the growth markets where Actis invests, notably in Latin America, Asia, the Middle East and Africa, these trends are accentuated. This is perhaps most notably the case for the energy transition, which represents both a challenge as well as an enormous investment opportunity. The growth markets Actis focuses on represent about 80 per cent of the global population but only get about a third of the world's infrastructure investments, with two-thirds typically allocated to North America and Western Europe.

While this is a stark market inefficiency, it means Actis faces less competition for its investments, allowing the firm to pick and choose the best investments with the strongest risk-return ratios. This is precisely what Actis has been doing for 20 years, most notably in the energy sector, where the firm has built and invested in 28 energy generation businesses and invested in 5 transmission and distribution businesses.

The vast energy transition opportunity

Decarbonisation and the energy transition represent a truly significant investment opportunity. McKinsey & Company estimate that a colossal US$275 trillion will need to be spent on physical assets between 2021 and 2050 as part of the net zero transition, with energy assets a significant part of this equation.

This requirement for investment comes not only from the need to decarbonise and electrify existing thermal energy systems, but also build-out entirely new energy systems to meet the growing demand for power amid population growth, economic development and digitalisation. Add to this the fact that new energy transmission and distribution systems will also be required and the scale of the transition becomes evident. And this is precisely why Actis invests in the sectors and markets it does.

The markets Actis invests in benefit from tailwinds such as strong demographic and economic growth that mean they have very strong demand for energy. These are also markets blessed with natural resources ideal for renewable energy generation, such as strong winds and solar irradiance, allowing for more efficient energy generation. Renewables are now cost competitive in all the markets Actis operates in, even when taking intermittency into account, and are high in demand.

While a majority of Actis' energy infrastructure investments are in renewables, the firm also invests in other forms of generation, such as natural gas which has a key role to play as a transition fuel to provide a baseload for industrial customers in certain markets as an alternative to coal, as well as transmission assets. By investing in the right assets, in the right markets, Actis can generate alpha returns for investors.

Risk mitigation: a central part of the Actis investment thesis

A key part of how Actis seeks to generate these high returns for investors is through a series of measures focused on both value enhancement and risk mitigation. Actis' investment strategy is based on a core infrastructure proposition, focused on long term contracted cashflows, traditional non recourse project finance, structured risk mitigation through project agreements and capital preservation through downside protection. It is by delivering this core infrastructure focus in growth markets, with its expertise in navigating complexity and building trusted stakeholder partnerships, that Actis looks to generate superior investment returns.

Our risk mitigation investment approach is encapsulated by the measures in our HILDAH acronym – with hard currency, inflation-linked, local debt, diversified, macro-risk analysed and hedged investments.

Using hard currency, usually the US Dollar but also Euro or Yen, is a big part of how we manage risk across our global investments, with more than 50 per cent of our investments covered by hard currency. We also use large, local currency markets in Brazil, India and South Africa, and mitigate risk through inflation protection measures, for example in Brazil 100 per cent of our tariff matches inflation every year.

The firm also underwrites depreciation into all investments with local currency exposure, further reducing risk, and sometimes also hedges. Over the course of fund cycles though local currencies tend to balance out and using local currencies can bring benefits, such as enabling local debt financing. Having a diversified set of investments, encompassing different markets as well as infrastructure sub-sectors is also key.

Sustainability: further managing risk while enhancing value

Our responsible investment approach, focused on investing in sustainable sectors and creating sustainability leaders is also vital for risk management. Actis portfolio companies are set up to have the highest standards on governance, which significantly reduces risk exposure because non-transparent or questionable actors simply do not engage with Actis investments, either as investors, partners or in management teams.

But Actis' approach to sustainability is about far more than mitigating risk – it actively enhances the value of our investments. The firm ensures that portfolio companies operate sustainably, with their own sustainability directors leading platform sustainability strategies, overseen by board-level ESG committees on which sit members of the Actis sustainability team. This approach means that Actis platforms drive positive social and environmental impact in the communities in which they operate, helping secure buy-in and a "license to operate" from the local community.

The sustainability excellence of Actis platforms is often cited at exit as a motivating factor for acquirers and their valuation of Actis' businesses. A prime example of this is Sprng Energy, a renewable energy platform in India that was sold to Shell and where the platform's best-in-class ESG standards were cited by Shell as key to the deal and its valuation.

Actis: a global leader in sustainable infrastructure

It is for the reasons laid out above – Actis' unique approach to sustainable infrastructure investing, with a strong reputation for unlocking global opportunities in growth markets, for building and operating assets efficiently, and for mitigating risk while enhancing investment value that so many institutional investors choose to trust Actis.

Many allocators in alternative assets understand the high degree of expertise and experience that Actis brings to bear in sectors like energy. The firm has a long track record of generating alpha returns for investors and follows a tried and tested investment methodology to continue to deliver for investors.

Achieving Actis' track record is not easy and there is a reason Actis has had success. It is thanks to an active, control investor proposition with a hands-on approach and a builder-operator mindset with sustainability at its core that the firm succeeds.

This is the recipe for success when investing in infrastructure and the energy transition.

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