No love lost

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Infrastructure funds can be a lifeline for port finance, but the feeling is not reciprocated. Barry Parker reports

In the port sector, infrastructure assets have come into their own over the past ten years.

Infrastructure Rising, a 2015 report by BlackRock, which manages in excess of $4tr of equity and debt for large institutions and governments, proclaimed that infrastructure is an asset class in its own right.

Demand for infrastructure spending worldwide exceeds the amount of funding available from governments - the traditional provider of public works and a catch-all category that includes port facilities, equipment and road/rail links.

One important pathway for private equity to come into transactions is through funds, where investors, usually large institutions, purchase a slice in a bigger money pool. The funds may be listed on exchanges enabling individual investors to participate, but most are private funds, typically "closed end"- with a finite time horizon that dictates unwinding of investments as per a set timeline, which may, or may not be, optimal in terms of market cycles. Funds may have three to four years from the time of the final close to invest in portfolio assets.

The fund life is typically 10 years but can have one or more one year extension. So, a hypothetical fund which had its "final close" in 2005 might have still been investing in 2008, and if it extended- multiple times, then it might not be winding down until 2018.

Exit strategies

Prophetically, the BlackRock authors cited opportunities "… in the unwinding of distressed transport deals put together pre-crisis" and a search of maritime assets held by funds that closed during the heyday of 2005-2007 may reveal targets for transacting, though not all would be distress situations.

As a fund such as Highstar III (originally part of AIG but now part of the Oaktree Capital family) winds down, it must sell its holdings in order to realise its return. These holdings, in this fund's case, include Ports America, which should put context around market rumblings that Yildirim Holding AS, the large Turkish conglomerate and major investor in carrier CMA CGM, has its eye on acquiring this market leading stevedore.

When a fund sells onward, it may be through a sale to another fund as in the case of the recently announced sale by Deutsche Bank's RREEF Infrastructure Fund of its Port Elizabeth holding to Macquarie, which is now raising money for another infrastructure vehicle. Alternatively, the new owner might be a strategic buyer, for example RREEF's sale of its Prince Rupert holding to DP World. DP World's recent pronouncements of possible acquisitions in North America, might signal an interest in a deal of this type.

When deals are reported, the ratio is sometimes expressed in terms of Enterprise Value (an "overall value" concept) and/or EBITDA (a "cash flow" concept). Travis Hemphill, a director in the Dallas office of KPMG Corporate Finance's Infrastructure Advisory Group notes that a number of recent transactions closed in the 15x-25x ratio range. This EV/EBITDA ratio can vary quite substantially (10x-35x) based on the asset's unique characteristics, such as geographical focus, growth prospects, expansion opportunities, competitive positioning, cargo served and the current financial market conditions.

Seeking opportunities

Currently, brownfield assets with significant expansion opportunities are seeing the highest multiples, while greenfield assets and brownfield assets in developed markets are seeing multiples on the lower end of the range.

Mr Hemphill explains to Port Strategy that funds most likely to have interest in a brownfield port would be pension funds, sovereign wealth funds and infrastructure funds, who partner with the former participants to provide operating expertise or pursue transactions at the smaller to middle portion of the market.

Facilities already built, and actually in operation - depending on the deal - are less risky. Tom Carr, head of Real Asset Products at Preqin, explains: "Shipping can be quite useful from a fund's point of view because much of the risk and cost is offset to third parties. In many cases the fund will acquire an asset such as a terminal or fleet of ships, and then immediately lease them out to an operating company. The cost of insurance or management of the asset is passed on to the operator, and the fund can offset most of the related overhead while receiving regular lease payments.

“This also serves to fix the rate of return, meaning that the fund is protected from a lot of the downside risk associated with the ebb and flow of global demand. Overall, it’s a pretty stable, low risk investment, provided the fund can find a customer.”

When it comes to greenfield container facilities, Mr Hemphill identifies the big terminal operators, who bring operating expertise and container shipping connections, as the most likely investors. He points out the EV/EBITDA ratios aren’t as applicable for greenfield transactions since they don’t usually have disclosed EBITDA projections, take multiple years before the cash flows are stabilised and the ratio isn’t as useful for comparison.

Preqin’s Mr Carr says: “The majority of assets are being bought at the secondary stage, partly because this enables a fund to limit the amount of risk, and means they can immediately begin making money from the asset via rent, tolls, or leasing. Given that, the profile of many of these investments fall more in line with what might be seen in other transport or logistics sectors, such as bridges or roads.”

A matter of time

Another dissuader for funds to invest in early stage projects is the timing aspect - where the time horizons may not match those of closed end funds. Mr Carr says: “It is true that the initial outlay and long wait that would be required to build assets from the greenfield stage may be much longer than 10 years allows – however, especially given the recent slump in global shipping demand, these are increasingly less likely to be the kind of assets or projects that will attract closed-end private capital fund managers.”

In the non-container sectors, Mr Hemphill notes that large brownfield projects can attract interest from the same pension, sovereign and infrastructure funds, but could also appeal to corporations (sector or cargo focused) that could provide value by connecting the facility to their existing global supply chain.

One direction for infrastructure funds is a public listing. Consider Fortress: the now publicly quoted Fortress Transportation and Infrastructure Investors LLC (which was listed on the New York Stock Exchange in May 2015) has been looking to develop Repauno, a one-time ammunition factory, near Philadelphia, into a port that might figure in the automobile logistics and petroleum and chemical businesses. Fortress has also indicated that it’s studying an existing oil products terminal on the Ohio River. Unlike closed end funds, a listed structure is not constrained by a set ending date; Fortress has used this as a selling point.

So what next for the port sector, which finds itself in the midst of a sea change as governments are looking for exits? BlackRock offers sage advice in its report, suggesting that the best way to navigate the expanding infrastructure landscape is to “find the fast rivers”.
“By fast rivers, we mean sectors or geographies that are experiencing fundamental change or growth that results in increased opportunity and deal flow for investors.”

A DROP IN THE OCEAN

Preqin, provider of data on alternative assets, conducts regular surveys of investors and maintains a comprehensive database.

In its January 2016 monthly Infrastructure Spotlight, Andrew Moylin, head of Real Asset Products, said: “While the demand for private capital in the infrastructure space will only increase over time due to the significant gaps in government budgets to actively replace ageing infrastructure or finance new projects, investors are concerned that capital committed now may not deliver the strong, stable returns to which they have become accustomed.”

Management consultant McKinsey calculated in its January 2016 report, Financing Change that private investment accounts for up to half of total infrastructure spending, amounting to $1tr to $1.5tr a year. Sixty-five percent to 75% of that comes from corporate actors, and the rest from institutional investors, such as private equity and pension funds. “Private institutional investors could fill up to half the financing gap,” it said.

Preqin’s Mr Moylin says: “The demand for infrastructure and the increased availability of debt financing, together with more investors looking to make direct investments and the high levels of dry powder available to fund managers, has led to increased competition for infrastructure assets, pushing up pricing.”

For now, though, overall deal making by funds has slowed. The consultant cites $349bn of infrastructure assets acquired by funds in 2015, down from $444bn in 2014. Ports comprise a small fraction of infrastructure deals.

Preqin’s data provided to Port Strategy shows that seaport and shipping focused fundraising accounted for 2.3% of infrastructure deals done during 2010-mid 2016, accounting for an aggregate $45.3bn over the six-year period.

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