Infrastructure Debt

Newsletter Q2 2023

Overview

- Total global deal value for Q1 2023 amounted to USD 193.6 bn with a deal count of 624. This means that infrastructure markets contracted markedly compared to the previous year, with the number of closed deals almost 30% reduced and almost USD 100bn less in transaction volume.
- Even though macroeconomic pressures have now started to ease in some areas, geopolitical stress factors, uncertainty and sustained supply chain issues continue to have a muting effect and lenders remain cautious and very selective. In the near-term, activity is expected to remain subdued, but it is expected that transaction activity will increase later in the year. However, this will depend on a continuing improvement in market stability and potential central bank activity.
- The energy sector accounted for almost half of total market share in Q1 2023, as several large-scale LNG transactions boosted the sectors' value.
- The most notable deal of the first quarter was an acquisition of a 60% stake in National Grid Gas (NGG) by Macquarie Asset Management and British Columbia Investment Management Corporation at a USD 9.9bn valuation.
- The leverage ratio for Q1 2023 stands at 60% (Capital markets: 10%, Loans: 90%) with USD 116.7 bn of the total deal value financed by debt, compared to a leverage ratio of 49% and USD 137.4 bn respectively, in Q1 2022.

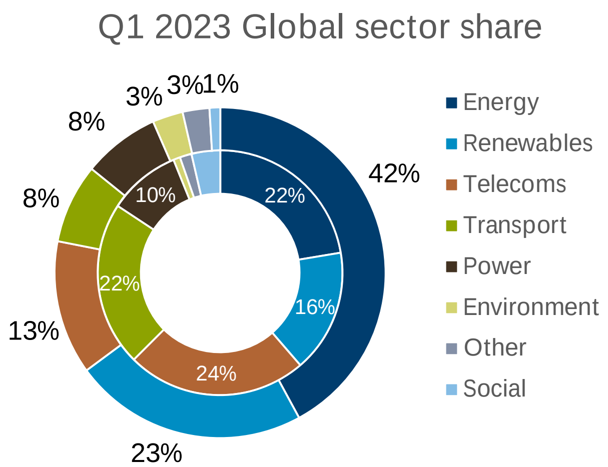

Figure 1: Sector Share Q1[1]
Outer Circle Q1 2023; Inner Circle Q1 2022

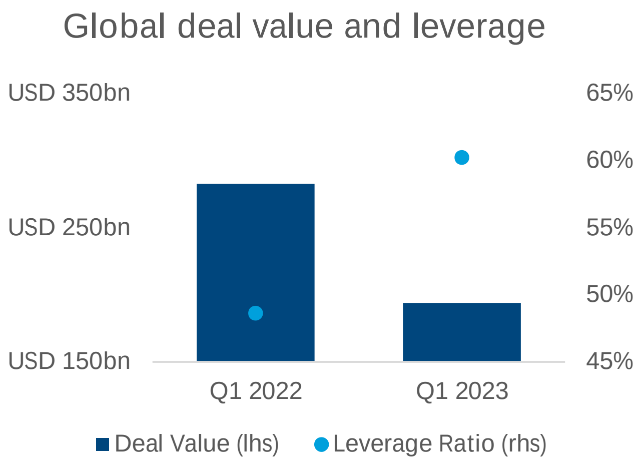

Figure 2: Global Deal Value[1]

[1] Source of data: Inframation June 2023: [Global | Inframation Deals - Infrastructure Data & Research (inframationnews.com)]

Infrastructure Debt – Activity in detail

According to Inframation data, the value of global infrastructure deals stood at USD 193.6 bn at the end of the first quarter of 2023, down from USD 282.6 bn during the same period one year ago. The decline in deal value is due to a general decrease in deals. Overall, deal value declined by 31.5% and the deal count by 28.5%. Sector wise, energy had the highest market share (42.1%) with total transactions of USD 81.1bn which is an increase of 29.3% compared to the same period one year ago. Renewables took second stage with a market share of 22.9% (+6.6% YoY) and a total deal volume of USD 44.2 bn. Debt markets have contracted in a YoY comparison, with debt value totalling USD 116.7bn for Q1 2023. Bank financing continued to be the main source of debt financing, making up 90.1% of total debt value, while the share of debt issued via capital markets dropped to 9.9%. Overall, the leverage ratio for global infrastructure transactions increased significantly to 60.2% in Q1 2023, up from 48.6% in Q1 2022.

The **European market** recorded 313 deals with a total value of USD 73,3bn in Q1 2023 compared to 392 deals (-20.2%) and total deal value of USD 85.6bn (-14.4%) in Q1 2022. Deal financing was mainly sourced through classic lending, amounting to USD 49,4 bn (99% of total debt) while capital market activity decreased immensely, amounting to a total of only USD 0.2bn in the first quarter (<1% of total debt value), vs. EUR 5.0bn last year. On average, the leverage ratio for European infrastructure deals stood at 67.4% (+22.5% YoY).

The most notable European deals of the first quarter were the acquisition of a 60% stake in Natural Grid Gas by Macquarie Asset Management and British Columbia Investment Management Corporation (BCI) at a USD 9.9 bn valuation. The acquisition also reflects the rapid increase in market share of the energy sector to 37.3% (+28% YoY). This was followed by telecommunication with a market share of 25.1% and renewables with 17.9%.

The **North American market** recorded 165 deals with a total transaction value of USD 73.5bn in Q1 2023 compared to 202 deals (-18.3%) and a transaction value of USD 66.7bn (+10.2%) in Q1 2022, which is a strong performance in terms of transaction value while the number of deals decreased. The transactions were financed with USD 34.2bn in debt resulting in a slight reduction of the average leverage ratio to 46,5%. Most of the debt financing was provided via bank loans (87.8%), while DCM accounted for 12.2% of total debt volume.

Among the notable American deals in the first quarter 2023 were the project financing of Port Arthur LNG by Sempra Infrastructure Partners for USD 9.8bn and the acquisition of South Jersey Industries by JP Morgan's Infrastructure Investments for USD 8.1bn. The ten largest deals' share of the overall value is 63%.

With regards to sector distribution, energy had by far the largest share with 56.9% after 32.0% in Q1 2022, followed by renewables with 24.2% (YoY: +6.6%) and transport with 6.6% (Q1 2022: 9.9%). Thus, the three largest contributors account for 88% of the overall value and sector distribution is very volatile under current market conditions.

The **Australasian market** recorded 70 transactions with a total value of USD 28.2bn compared to 151 deals and a total deal value of USD 83,7bn (-66.3%) in Q1 2022. The average leverage ratio stood at 63.7% during the first quarter 2023, while debt was almost exclusively raised via bank loans (99% of total debt). Debt Capital Markets activity was very low in the region, with only USD 230m raised via capital markets (YoY: -85%)

The Australasian development was strongly influenced by its largest deals with just two deals, the refinancing of the Oyu Tolgoi Copper and Gold Mine in Mongolia for USD 4.4bn and the project finance of New Ethylene Project for USD 4.0 bn, accounting for almost 30% of overall deal value.

The largest Australian/New Zealand sectors were renewables, which increased strongly to 74.7% market share from 3.3% in Q1 2023 and transportation, which decreased to 18.7% from 47.3%. Together, these two account for almost 94% of the overall Australian market.

In Asia, energy had the largest sector share with 24.8% (Q1 2022: 6.7%). Commodities took the second spot with 23.9%, a 24% increase mostly resulting from copper and gold mine refinancings. Renewables take the third place with 17.2% (Q1 2022 38.2%). Therefore, the three largest sectors accounted for 66%.

"Spotlight": Diversification of Sustainable Investment Strategies - The case for Private Infrastructure Debt

Investors who are seeking to diversify their environmental, social, and governance (ESG) strategies are increasingly turning their attention to private debt as a compelling and attractive alternative asset class. While ESG-themed fixed-income asset classes such as Green, Social, and Sustainability-linked bonds have become an established and sizeable market for investors with an ESG focus, private debt is emerging as a viable option due to its unique advantages that align with the ESG goals of institutional investors without compromising on their return expectations. In the global private infrastructure debt market with a total size of USD 995bn, there exist a multitude of attractive opportunities that grant investors access to a broad range of sustainable themes, including but not limited to climate change mitigation, social inclusion, circular economy, and biodiversity preservation.

This spotlight explores why private debt stands out as viable alternative for ESG investors by underscoring the key aspects and considerations that make the case for the asset class:

SFDR - Ensuring Transparency and Accountability for Private Debt Investments:

The Sustainable Finance Disclosure Regulation (SFDR) plays an indispensable role in establishing a framework that fosters transparency and accountability within the realm of sustainable investing. Within the European Union (EU), the SFDR imposes binding and standardized requirements on investment firms and asset managers to disclose how ESG considerations and risks are integrated into their investment decisions, portfolio management and monitoring of the investments. By mandating such disclosure and monitoring requirements, this ensures that institutional investors have unrestricted access to comprehensive information concerning the sustainability risk management protocols employed by asset managers. In contrast, while voluntary guidelines like the green bond principles exist, they do not provide the same level of regulatory oversight as the SFDR. Consequently, the SFDR establishes a more robust and homogeneous market standard for private debt investments, offering institutional investors confidence and comparability in assessing the environmental and social impact of their portfolios.

Customizable Structures for Sustainability Objectives:

Private debt investments, particularly in sustainable infrastructure projects, can be structured to meet specific sustainability objectives. Institutional investors can collaborate with their investment managers to design customized strategies aligned with their ESG goals. This flexibility enables investors to focus on targeted sustainability themes such as climate change mitigation, social inclusion, circular economy, and biodiversity. By tailoring their investment approach, institutional investors can achieve greater diversification and broaden their impact across a range of sustainable projects.

Immediate Impact through Sustainable Infrastructure Projects:

Investing in sustainable infrastructure projects through private debt allows institutional investors to make an immediate impact aligned with their sustainability strategies. By providing financing and support specific initiatives, investors actively contribute to the development of critical projects addressing environmental and social challenges. Private debt investments offer institutional investors an opportunity to play a direct role in driving positive change and advancing sustainable practices.

Closer Connection to Underlying Infrastructure Assets:

Private debt investments provide institutional investors with a closer connection to underlying infrastructure assets. The customizable structures, longer tenors, and direct lending approach associated with private debt enable investors to have a tangible connection to the assets they finance. This direct involvement enhances the ability to demonstrate a concrete investment track record and showcase the sustainable investing footprint. The transparency and traceability of private debt investments strengthen the link between investors and the sustainable projects they support.

Attractive Risk-Returns Potential:

Private infrastructure debt typically provides investors with the potential for superior returns when compared to publicly traded ESG bonds. The higher return can be attributed to the longer tenors as well as the illiquidity and complexity of the underlying assets. Institutional investors who prioritize portfolio diversification can capitalize on the enticing risk-adjusted returns by incorporating private infrastructure debt into their investment mix. The synergy between elevated returns and a clear commitment to ESG principles within sustainable infrastructure projects makes private debt an attractive choice for investors in pursuit of optimal risk-return profiles.

Flexibility in Risk Profile and Financing Structure:

Private debt offers institutional investors greater flexibility in managing risk profiles and financing structures. With options such as senior, mezzanine, junior, and holdco debt, investors can tailor their exposure to align with their risk appetite and return expectations. Senior debt provides a lower-risk profile with priority repayment rights, while mezzanine and junior debt carry higher risk but potentially higher returns. The availability of diverse debt products allows institutional investors to optimize their portfolios and align with their risk preferences.

Reduced market volatility and low correlation with other asset classes:

Private infrastructure debt investments are typically not subject to the same market volatility factors (interest rates, inflation, and credit ratings) as liquid fixed income asset classes. Investors may therefore benefit from a robust investment and reduced exposure to short-term market fluctuations with less correlation with other fixed income asset classes.

Inflation hedge, pricing power and link to GDP growth:

Infrastructure debt typically performs strong in a high inflation environment, due to the pricing power or inflation indexation of the underlying assets and thus the ability to pass higher costs to off-takers. This protects the real value of the debt and provides a hedge against inflation risk. Private infrastructure debt is typically also linked to GDP growth, as infrastructure spending is a key driver of economic development and productivity. Therefore, private infrastructure debt is a resilient and attractive asset class that can offer inflation protection, stable income and growth potential to investors.

Conclusion

Private debt presents institutional investors with a compelling alternative asset class for diversifying their ESG investment strategies. With the SFDR ensuring transparency and accountability, private debt offers customizable structures, immediate impact through sustainable projects, a broad range of sustainable themes, closer connections to underlying assets, higher potential returns, flexibility in risk profiles and financing structures as well as robust inflation protection.

PRIME CAPITAL

About Prime Capital's Private Debt Team

Our infrastructure debt team, which has been active in the infrastructure debt market for many years, has executed transactions of more than EUR 1.2bn. The Private Debt Team also invests in Commercial Real Estate, Transport Debt and Corporate Lending. We expect significant further asset growth in these areas, while providing satisfactory risk adjusted returns to our largely institutional investors. Prime Capital's Private Debt Team manages more than EUR 2bn across asset classes for institutional investors.

Further information about Prime Capital AG can be found at www.primecapital-ag.com

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Prime Capital Infrastructure Debt Expertise

> Advice and support for infrastructure direct investments, portfolio strategy and sector allocation

> Managed accounts and funds with investment expertise in various jurisdictions and markets

> Unique "multi-channel sourcing" with access to transactions via direct lending, bank and advisor sourcing on the basis of longstanding relationships to market leading sponsors, equity funds and project finance banks

> Investments in senior and junior debt

numbers, (ii) the company you work for and your position, (iii) identification and background information we may collect about you as part of our business acceptance procedures, (iv) technical information such as information from your visits to our website or relating to the event invitations, updates, marketing material, and other communication we send to you electronically, (v) your communication preferences regarding marketing materials or (vi) any other personal information you provide to us during your relationship with us, such as dietary requirements, any physical disability and your views and comments.

They ways in which we collect personal information about you may include the following: (i) in the course of our business acceptance procedures, (ii) through your general use of our website. In particular, we collect personal information about you if you complete forms on our website and if you send emails to firm personnel, (iii) through your responses to our emails asking that you confirm and update information we maintain about you, or that you provide your consent for us to communicate with you, or (iv) through information you may provide to representatives of our firm at conferences or similar events.