

Ports as an Infrastructure Investment

Nicola Palmer, Partner, Arcus Infrastructure Partners



Nicola Palmer, Partner at Arcus Infrastructure Partners, a European investment fund with two billion Euros under investment and two port investments, has told Port Finance International about an infrastructure investor's perspective of port investments.

"Hockeystick projections," says Ms Palmer, "instil fear in the minds of infrastructure investors." So, if dramatically increasing projections is not what investors are after, what do they look for when it comes to choosing suitable infrastructure targets?

Ms Palmer explains that Arcus' key attribute of a solid infrastructure investment is a stable long-term cash flow that matches the low volatility and long-term liabilities in the respective pension fund.

Typical infrastructure investments for pension funds are therefore low-risk, stable assets such as regulated utilities. Ports, on the other hand, do not immediately fit into this category. Some even deny ports to be infrastructure altogether.

However, according to Ms Palmer, ports may still have what it needs to be a stable infrastructure investment as they can offer many of the attributes that are essential for infrastructure investment.

Every investor needs to assess the risk of

the potential asset as a fundamental part of the decision-making process. Pension funds in particular look for low volatility infrastructure investments as they have stable long-term obligations to meet. Arcus thus strives to minimise the gross domestic product (GDP) exposure of its investments.

Another aim for the more conservative infrastructure investor is to hedge against the risk that inflation will undermine the performance of their infrastructure investments and Arcus therefore prefers its assets to be Retail Price Index (RPI) linked.

"Investors, particularly pension funds are also particularly interested in tangible assets, because," says Ms Palmer, "they can understand where the return is coming from."

Further typically sought after attributes are a combination of high yield and growth, which is particularly interesting in the current low interest rate environment. Other attributes include diversification, low operational complexity and downside protection.

Ms Palmer points out that, while ports might not be as low risk as some investors would prefer, in reality, most infrastructure investments carry a certain risk. That even investments that were thought to be very safe, such as government securities, are not immune to trouble as has been shown clearly in the recent sovereign debt crisis.

Infrastructure investors are now wary of infrastructure investments backed by contracts with government or regulated utilities in those jurisdictions impacted by the sovereign debt crisis where previously government backed infrastructure assets would have been perceived as the highest quality infrastructure investments.

"Ports are," says Ms Palmer, "no different from other infrastructure investments in that they are exposed to risk and need to be managed."

Having established ports as potentially attractive infrastructure investments Ms Palmer stresses that it is crucial to look at the type of port an investor is investing in and specifies a number of characteristics that Arcus seeks in its assets. A stable market, competitive position in the supply chain, diversity of customers, a deep water port and multimodal capability are strong properties for a port, as are long-term contracts, high operating margins

"Some ports have what it needs to be a profitable infrastructure investment"

and a significant investment by customers in local facilities. "Premium assets," Ms Palmer notes "are operating ports that have a port rental income or conservancy associated with them."

Weak port properties, on the other hand, are small size, concentrated customers, a poor competitive position, short term contracts, variability in revenue, lower operating margins and poor customer investment in local facilities.

Concluding that ports are, even post crisis, an attractive infrastructure investment, Ms Palmer illustrates that, investors are still prepared to pay comparatively high EBITDA multiples (~12x compared to pre-crisis ~14x) for port investments, if they feel their criteria are matched.

Having established that ports have the potential to be profitable infrastructure investments, Ms Palmer highlights that, in order to maximise the value of the investment, active management of the asset is essential.

Arcus focuses on three crucial areas: Management Excellence, Strategy and Operations and Finance and Reporting.

"As shareholders," says Ms Palmer, "it is very important that we get our business plan right on the way in." In order to balance the fund's portfolio, Arcus strives to co-invest with other investors. This approach calls for good communication and alignment on the business plan amongst the co-investors.

Other key attributes of management excellence are a board and senior leadership team that understand

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and effectively support the business plan. Arcus further incentivises the management team to deliver the shareholder's objectives through long term performance schemes.

With regards to strategy and operations, Arcus takes an active role in setting up strategy working groups and cooperating with the management team to deliver the business plan by combining sound industry expertise with occasional Arcus secondments.

The third area Arcus focuses on is finance and reporting, which has become even more imperative during the recession. In order to combat the current financial situation, Arcus is involved in all aspects such as refinancing, treasury hedging, reporting and tax issues.

Ms Palmer also comments on financing port

investments, which has proved difficult during the recession. "Pre-crisis," says Ms Palmer "was a wonderful time for the financing of port investments."

However, cheap and plentiful bank debt and the readiness of banks to lend to the port sector and to port investors have soured during the recession. Reduced liquidity and a generally weaker economic outlook have resulted in more conservative bank debt financing.

Nevertheless, Ms Palmer emphasises that "infrastructure investments are still very attractive for lenders and lending is still very much available for this sector."

The quantum of bank debt has reduced to match investment grade parameters equivalent to quantum available in the bond or US private placement markets. Since these markets offer longer tenors

and better pricing for longer tenors than bank debt and long-term debt is what infrastructure investors seek to match the duration of the investment, these financing options have become increasingly attractive for infrastructure investors in the current market.

Bank debt is however still important as it provides more flexibility on the way into an initial investment, but for the long-term Arcus looks at alternatives to supplement bank debt. Ultimately, investors will strive to refinance their original finance models by a mixture between bank debt and long-term bonds or other equivalent markets such as the US private placement market.

In conclusion, Ms Palmer recommends ports as having a strong potential for infrastructure investment as long as the asset is managed well and the port has stable investment parameters including strong cash flows, a diversified customer base and optimally rental or conservancy income.

"Bonds have become more interesting, but bank debts are still needed"

